

Electronics Line 3000 Announces Results for the Year 2009

(Results shown in U.S Dollars)

Petach Tikvah, Israel (March 17, 2010) – Electronics Line 3000, a global leader in electronic security with remote management solutions, achieved in the last quarter of 2009 an operating profit of \$98,000 and positive cash flow from operating activities .Nevertheless, the Company has decided to take a conservative business and financial approach due to internal and external challenges.

General

We hereby submit the Directors' Report for the year ended December 31, 2009 (the “Reported Year”) and the respective 2008 year.

Corporate Description and Business Environment

The Company engages in the design, development, production, marketing and sale of electronic security with remote management solutions and complementary products for the mass residential and small commercial markets. These solutions can be monitored and enable remote management of the premises for security, automation, and video applications.

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

General Results Review

The Company is facing internal and external challenges due to the recent developments in the global economy. These global economic developments have affected the Company, its customers and suppliers and introduced new challenges for the Company’s 2009 performance and results.

The Company’s U.S. subsidiary (“ELUSA”) has been undergoing a transition phase, severely influencing the Company’s results for 2008 and the current period of 2009, as well as the U.S subsidiary’s cash and cash-flow situation. The Company has been taking necessary measures to address this issue and prevent further losses. As part of these measures, during Q2 2009, ELUSA entered into an agreement with a local U.S.-based service provider to spin out ELUSA's non-core products, such as the DVRs and CCTV.

In light of the global situation, the Company has been implementing a rolling efficiency plan since December 1 2008, which mainly influenced results from the second quarter of 2009 onwards.

The Company’s revenues in the Reported Year amounted to \$26.4 million, compared to revenues of \$36.4 million for 2008. The Company’s 2009 reduction in sales is mainly a result of the U.S. subsidiary’s performance and the devaluation of the British Pound against the U.S. Dollar plus a slowdown in sales of some of the Company’s customers in other regions.

Revenues (In 000's)	2009	2008
IL	17,846	22,180
UK	7,153	8,718
USA	1,391	5,518
Total	26,390	36,416

The gross margins for the Reported Year amounted to 35%, compared to a gross margin of 36% in the comparable year.

The gross profit in the Reported Year amounted to \$9.3 million, compared to \$13.1 million for the fiscal year of 2008.

Research and development costs and know-how amounted to \$1.9 million compared to \$3.6 million for 2008. The reduction in Research and Development costs is mainly due to the efficiency plan implemented since December 2008 and the completion of several R&D projects from 2008. Nevertheless, the Company is focusing on developing new products and services that will help the Company to remain an innovation leader in its markets. \$ 392,306 of these new costs for developing future products were capitalized by the end of the year.

Sales and marketing expenses amounted to \$4.8 million during the Reported Year and \$7.4 million for 2008. The reduction is mainly driven by the efficiency plan that was implemented and the spin off of the non core activity in the U.S. operation. The Company continues to develop and expand its marketing and sales capabilities with a focus on strategic customers while, at the same time, providing more marketing and technical support to existing customers due to the tough economic situation in certain countries.

General and administrative expenses amounted to \$2.7 million during the Reported Year and to \$3.3 million for 2008.

The Company's operating loss was \$114,000 during the Reported Year, compared to an operating loss of \$1.2 million for 2008.

Net financing and other net expenses, amounted to \$704,000 during the Reported Year, compared to \$1.0 million for 2008.

Part of these costs, as well as payments in NIS to local suppliers, have been hedged against the U.S. Dollar. Nevertheless, the influence of the strengthening of all currencies against the U.S. Dollar negatively influenced operating loss.

Loss before taxes on income amounted to \$818,000 during the Reported Year, compared to a \$2.2 million loss for 2008.

Tax expense was \$68,000 during the Reported Year, compared to \$704,000 for 2008. .

The Company ended the Reported Year with a net loss of \$886,000, compared to a \$2.9 million loss for 2008.

Move from Prime Standard to General Standard

Following the Board resolution dated February 8, 2009 to move from the Prime Standard to the General Standard, the Deutsche Bourse has announced Electronics Line 3000's revocation from the Prime Standard on March 17, 2009.

The revocation does not affect the admission to the regulated market (General Standard). It had the objective of reducing the costs and the administration efforts associated with the listing and took effect

three months after the announcement of the revocation by the executive of the German Stock Exchange on the internet at www.deutsche-boerse.com. ; i.e., on June 18 2009.

On June 18 2009, all Electronics Line 3000 shares were traded on the General Standard for the first time.

The Company's Financial Position

The Company's cash and cash equivalents on December 31, 2009 (hereinafter: "the Reported Date") were \$2.2 million, compared to \$2.3 million on December 31, 2008.

The Company's trade receivables on the Reported Date were \$3.9 million, compared to \$6.5 million on December 31, 2008.

The Company's prepaid expenses, other accounts receivables, advance payments to suppliers and income tax receivables on the Reported Date were \$1.3 million, compared to \$1.4 million on December 31, 2008.

The Company's inventories on the Reported Date were \$5.9 million, compared to \$6.6 million on December 31, 2008.

Net investment in non-current assets, less amortization, on the Reported Date amounted to \$5.8 million, and a \$4.7 million investment on December 31, 2008, was comprised of the following:

- Net investment in property, plant and equipment, less amortization, was \$5.2 million on the Reported Date, compared to \$4.4 million on December 31, 2008. During the second quarter of 2009, Electronics Line 3000's UK subsidiary, finalized the acquisition of new commercial property which will serve as the Company's hub for all European activities. The acquisition was financed by UK loans, all of which will be returned within 20 years at most.
- Deferred taxes were \$215,000 on the Reported Date and on December 31, 2008.
- Security deposits were \$74,000 on the Reported Date, compared to \$86,000 on December 31, 2008.
- Net investment in research and development for products that have been proven to be technologically feasible, but have not yet been released, was \$392,000 in the Reported Period.

The short-term credit balance from banks and others on the Reported Date was \$5.7 million, compared to \$8.1 million on December 31, 2008.

The Company's trade payables as on Reported Date and on December 31, 2008 were \$4.1 million.

Other current liabilities, accrued expenses and income tax payable were \$2.5 million, the same as on December 31, 2008.

Long-term loans were \$1.2 million on the Reported Date, compared to \$77,000 on December 31, 2008.

Financial Ratios

	December 31, 2009	December 31, 2008
Current Ratio	1.1	1.1
Quick Ratio	0.6	0.7

Cash Flow

During the Reported Year, net cash provided by operating activities was \$3.4 million, compared to \$1.8 million provided during the entire year of 2008. Most of the increase in cash provided by operating activities is derived from the decrease in trade receivables.

During the Reported Year, the Company directed \$2.0 million towards investment activities, compared to \$365,000 during the entire year of 2008. As elaborated above, the increase is mainly due to the acquisition of commercial property.

During the Reported Year, cash used in financing activities amounted to \$1.6 million, compared to \$2.1 million that was used in financing activities during the fiscal year of 2008. Loans of \$1.6 million were taken in order to finance the commercial property that was acquired in the UK. During the period, the Company repaid \$2.3 million of principal for the combined loans.

Financing Sources

Shareholders' equity as of December 31, 2009 amounted to \$5.3 million, a ratio of 27.7% to the total balance sheet, compared to \$5.9 million and 27.5%, respectively, as of December 31, 2008.

On December 31, 2009, short and long term credit from banks and other creditors designated for financing working capital and investments in fixed assets and rental property was \$13.5 million, compared to a credit balance of \$14.8 million on December 31, 2008.

Statutory declaration

We assure to the best of our knowledge that the consolidated financial statements provide a presentation of the Company financial position and results from operations that corresponds to the actual conditions, in accordance with applicable accounting standards, and that the Company management report presents the course of business, including the business results and situation of the Company, in a way that corresponds to the actual conditions and describes the material risks and opportunities of the Company's expected future development.

Amir Hayek
President & CEO

Bob Marbut
Chairman of the Board

Petach Tikva, March 17, 2010

ELECTRONICS LINE 3000 LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2009

U.S. DOLLARS IN THOUSANDS

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INDEPENDENT AUDITORS' REPORT**To the Shareholders of****ELECTRONICS LINE 3000 LTD.**

We have audited the accompanying consolidated financial statements of Electronics Line 3000 Ltd. and its subsidiaries ("the Group"), which comprise the consolidated balance sheets as of December 31, 2009 and 2008, and the consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the years then ended, and a summary of significant accounting policies and other explanatory notes.

We did not audit the financial statements of certain subsidiaries, whose assets constitute approximately 34% and 30% of total consolidated assets as of December 31, 2009 and 2008, respectively, and whose revenues constitute approximately 33% and 39% of total consolidated revenues for the years then ended, respectively. The financial statements of those companies were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those companies, is based on the reports of the other auditors.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audits in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained, together with the reports of the other auditors, are sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements give a true and fair view of the financial position of the Group as of December 31, 2009 and 2008, and of its financial performance and its cash flows for each of the years then ended, in accordance with International Financial Reporting Standards.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	Note	December 31,	
		2009	2008
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	3	2,245	2,297
Trade receivables	4	3,898	6,529
Income tax receivable		246	291
Prepaid expenses		572	691
Advances to suppliers		126	112
Other accounts receivable	5	388	331
Inventories	6	5,890	6,552
<u>Total current assets</u>		<u>13,365</u>	<u>16,803</u>
NON-CURRENT ASSETS:			
Property, plant and equipment:	7		
Cost		16,006	14,664
Less - accumulated depreciation		10,838	10,258
		5,168	4,406
Intangible assets	8	392	-
Deferred taxes	14e	215	215
Security deposits		74	86
<u>Total non current assets</u>		<u>5,849</u>	<u>4,707</u>
<u>Total assets</u>		<u>19,214</u>	<u>21,510</u>
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Short-term credit from banks and others	9	5,704	8,141
Trade payables	10	4,091	4,096
Accrued expenses		453	518
Income tax payable		62	98
Other current liabilities	11	1,971	1,888
<u>Total current liabilities</u>		<u>12,281</u>	<u>14,741</u>
LONG-TERM LIABILITIES:			
Bank loans	12	1,214	77
Employee benefit liabilities	13	395	776
<u>Total long-term liabilities</u>		<u>1,609</u>	<u>853</u>
EQUITY:			
Share capital	16	10,933	10,933
Additional paid-in capital		6,621	6,610
Foreign currency translation reserve		1,588	1,300
Hedge reserves		10	15
Accumulated deficit		(13,828)	(12,942)
<u>Total equity</u>		<u>5,324</u>	<u>5,916</u>
<u>Total liabilities and equity</u>		<u>19,214</u>	<u>21,510</u>

The accompanying notes are an integral part of the consolidated financial statements.

March 17, 2010

Date of approval of the
financial statements

Bob Marbut
Chairman of the
Board of Directors

Amir Hayek
President and CEO

Shirly Gavriely
VP Finance

CONSOLIDATED STATEMENTS OF INCOME

U.S. dollars in thousands, except per share data

	Note	Year ended December 31,	
		2009	2008
Revenues	18	26,391	36,435
Cost of revenues	19	17,130	23,366
Gross profit		9,261	13,069
Operating costs and expenses:			
Research and development	20	1,856	3,608
Selling and marketing	21	4,849	7,403
General and administrative	22	2,670	3,262
<u>Total operating costs and expenses</u>		9,375	14,273
Operating loss		(114)	(1,204)
Financial income	23a	2,371	3,773
Financial expenses	23b	(3,067)	(4,816)
Other income (expenses)		(8)	2
Loss before taxes on income		(818)	(2,245)
Taxes on income	14b	68	704
Net loss		(886)	(2,949)
Net loss per share (basic and diluted)	24	(0.09)	(0.29)

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

U.S. dollars in thousands

	Year ended December 31,	
	2009	2008
Net loss	(886)	(2,949)
Other comprehensive income (loss):		
Exchange differences of translation of foreign operations	288	(891)
Net gain (loss) on cash flow hedges	(5)	15
Total other comprehensive income (loss)	283	(876)
Total comprehensive loss	<u>(603)</u>	<u>(3,825)</u>

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

U.S. dollars in thousands

	<u>Share capital</u>	<u>Additional paid-in capital</u>	<u>Foreign currency translatio n reserve</u>	<u>Hedge reserves</u>	<u>Accumulated deficit</u>	<u>Total equity</u>
Balance as of January 1, 2008	10,933	6,535	2,191	-	(9,993)	9,666
Total comprehensive loss	-	-	(891)	15	(2,949)	(3,825)
Cost of share-based payments	-	75	-	-	-	75
Balance as of December 31, 2008	10,933	6,610	1,300	15	(12,942)	5,916
Total comprehensive loss	-	-	288	(5)	(886)	(603)
Cost of share-based payments	-	11	-	-	-	11
Balance as of December 31, 2009	<u>10,933</u>	<u>6,621</u>	<u>1,588</u>	<u>10</u>	<u>(13,828)</u>	<u>5,324</u>

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,	
	2009	2008
<u>Cash flows from operating activities:</u>		
Loss before taxes on income	(818)	(2,245)
Adjustments for:		
Depreciation and amortization	816	896
Loss on sale of property, plant and equipment	8	-
Increase (decrease) in employee benefit liabilities, net	(381)	164
Cost of share-based payments	11	75
Financial expenses, net	694	1,043
	<u>330</u>	<u>(67)</u>
Operating cash flows before working capital changes:		
Decrease in trade receivables	2,843	1,039
Decrease (increase) in prepaid expenses and other accounts receivable	124	(77)
Decrease in inventories	840	1,407
Decrease (increase) in security deposits	12	(1)
Decrease in trade payables	(175)	(5)
Increase (decrease) in accrued expenses	(65)	235
Increase in other current liabilities	86	231
	<u>3,665</u>	<u>2,829</u>
Cash provided by operations	3,995	2,762
Interest received	-	11
Interest paid	(430)	(630)
Income taxes received	-	132
Income taxes paid	(122)	(431)
	<u>3,443</u>	<u>1,844</u>
Net cash provided by operating activities		
<u>Cash flows from investing activities:</u>		
Investment in intangible assets	(392)	-
Acquisition of property, plant and equipment	(1,599)	(381)
Proceeds from sale of equipment	7	16
	<u>(1,984)</u>	<u>(365)</u>
Net cash used in investing activities		
<u>Cash flows from financing activities:</u>		
Decrease in short-term bank credit, net	(795)	(472)
Receipt of long-term loans from banks and others	1,568	-
Repayment of long-term loans from banks	(2,332)	(1,642)
	<u>(1,559)</u>	<u>(2,114)</u>
Net cash used in financing activities		
<u>Effect of exchange differences on cash and cash equivalents of foreign operations</u>		
	48	(196)
Decrease in cash and cash equivalents	(52)	(831)
Cash and cash equivalents at beginning of year	2,297	3,128
Cash and cash equivalents at end of year	<u>2,245</u>	<u>2,297</u>

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 1:- GENERAL**

- a. Electronics Line 3000 Ltd. ("the Company") was incorporated in Israel in December 2002 for the purpose of absorbing the assets and activities of Metis Capital Ltd. ("Metis") (formerly: Electronics Line (E.L.) Ltd.). The Company's shares are publicly traded on the Prime Standard, a market operated by the Frankfurt Stock Exchange.
- b. Following the Board resolution, dated February 8, 2009, to move from the Prime Standard to the General Standard, the Deutsche Bourse announced the Company's revocation from the Prime Standard on March 17, 2009.

On June 18, 2009, all of the Company's shares began trading on the General Standard for the first time.

- c. The Company and its subsidiaries ("the Group") are engaged in the design, development, production, marketing and sale of electronic security with remote management solutions, and complementary products for the mass residential and small commercial markets. These solutions can be monitored and enable remote management of the premises for security, and automation and video application. The registered office of the Group is located at 2 Granit Street, Petach Tikva, Israel.
- d. Definitions:

In these financial statements:

The Company	- Electronics Line 3000 Ltd.
The Group	- The Company and its investees, as detailed in the accompanying appendix.
Subsidiaries	- Companies that are controlled by the Company (as defined in IAS 27) and whose accounts are consolidated with those of the Company.
Investees	- Subsidiaries.
Related parties	- As defined in IAS 24.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of presentation of the financial statements:

The Company's financial statements have been prepared on a cost basis, except for derivatives and certain financial instruments that have been measured at fair value.

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These Standards comprise:

1. International Financial Reporting Standards (IFRS).
2. International Accounting Standards (IAS).
3. Interpretations issued by the IFRIC and by the SIC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The accounting policies have been consistently applied in the financial statements for all periods presented, except as described below.

Changes in accounting policies in view of the adoption of new standards:

IAS 1 (Revised) - Presentation of Financial Statements:

Pursuant to a revision to IAS 1 (Revised), an additional separate statement, "statement of comprehensive income", may be presented and display net income taken from the statement of income and all items carried in the reported period to equity that do not result from transactions with the shareholders in their capacity as shareholders (other comprehensive income (loss) and the tax effect of these items carried to equity, allocated between the Company and the minority interests. Alternatively, the items of other comprehensive income may be displayed along with the items of the statement of income in a single statement entitled "statement of comprehensive income" which replaces the statement of income, allocated between the Company and the minority interests. Items carried to equity resulting from transactions with the shareholders in their capacity as shareholders will be disclosed in the statement of changes in equity as will the summary line carried forward from the statement of comprehensive income, allocated between the Company and the minority interests.

The Company elected to present a separate statement. The revision was adopted on January 1, 2009 with a retrospective restatement of comparative figures.

IFRS 8 - Operating Segments:

IFRS 8 deals with operating segments and replaces IAS 14. According to the Standard, the Company adopted a "management approach" in reporting on the financial performance of the operating segments. The segment information is the information that is internally used by management in order to assess its performance and allocate resources to the operating segments.

The Company adopted the provisions of IFRS 8 on January 1, 2009 with a retrospective restatement of comparative figures.

The adoption of the Standard did not have any material effect on the presentation of segment information.

IFRS 2 - Share-based Payment:

Pursuant to an amendment to IFRS 2, the definition of vesting terms will only include service conditions and performance conditions and the cancellation of a grant that includes non-vesting conditions by the Company or the counterparty will be accounted for by way of acceleration of vesting and not by forfeiture. Conditions that are other than service and performance conditions will be viewed as non-vesting conditions and must therefore be taken into account when estimating the fair value of the instrument granted.

This amendment was adopted on January 1, 2009 with a retrospective restatement of comparative figures. The initial adoption of the Standard did not have any material effect on the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)***IAS 20 - Government Grants:*

Pursuant to an amendment to IAS 20, interest-free loans or loans with a below-market rate of interest received by a company from the State will be accounted for upon initial recognition and in subsequent periods pursuant to the provisions of IAS 39, "Financial Instruments: Recognition and Measurement". Accordingly, the loans will be initially measured at fair value and discounted at market interest. The difference between the loan amount received and the fair value will be accounted for thereafter as a Government grant according to the provisions of the Standard.

The amendment was adopted as a prospective change from January 1, 2009 for grants received after that date.

IFRS 7 - Financial Instruments: Disclosures:

The amendment to IFRS 7 requires additional disclosures about fair value measurement and liquidity risk. According to the amendment, additional disclosures should be made, among others, as to the source of inputs used in making the measurements, using a three level fair value hierarchy for all financial instruments recognized at fair value. In addition, a reconciliation between the beginning and ending balance for Level 3 fair value measurements is required (source of inputs that is not based on market data), as well as disclosure of significant transfers between levels in the fair value hierarchy.

The amendment was adopted as a prospective change from the financial statements for the year beginning January 1, 2009 (there is no need to provide comparative information).

- b. Significant accounting judgments, estimates and assumptions used in the preparation of the financial statements:

Estimates and assumptions:

The preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the adoption of the accounting policies and the reported amounts of assets, liabilities, revenues and expenses. The basis of the estimates and assumptions is reviewed regularly. The changes in accounting estimates are reported in the period of the change in estimate.

The key assumptions made in the financial statements concerning uncertainties at the balance sheet date and the critical estimates computed by the Group that may cause a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

- Deferred tax assets:

Deferred tax assets are recognized for unused carryforward tax losses and temporary differences to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies. Further details are given in Note 14.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- Pensions and other post-employment benefits:

The liability in respect of post-employment defined benefit plans is determined using actuarial valuations. The actuarial valuation involves making assumptions about, among others, discount rates, expected rates of return on assets, future salary increases and mortality rates. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Further details are given in Note 13.

- Development costs:

Development costs are capitalized in accordance with the Group's accounting policy. In determining the amounts to be capitalized, management makes assumptions regarding the expected cash generation of the asset for which development is made, discount rate and the expected period of benefits. Further details are given in Note 8.

- c. Consolidated financial statements:

The consolidated financial statements comprise the financial statements of companies that are controlled by the Company (subsidiaries). Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity. The effect of potential voting rights that are exercisable at the balance sheet date are considered when assessing whether an entity has control. The consolidation of the financial statements commences on the date on which control is obtained and ends when such control ceases.

Significant intragroup balances and transactions and gains or losses resulting from intragroup transactions are eliminated in full in the consolidated financial statements.

The financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods. The accounting policy in the financial statements of the subsidiaries was applied consistently and uniformly with the policy applied in the financial statements of the Company.

- d. Functional currency and foreign currency:

- 1. Functional currency and presentation currency:

The presentation currency of the financial statements is the U.S. dollar.

The functional currency, which is the currency that best reflects the economic environment in which the Company operates and conducts its transactions, is separately determined for each Group entity, including an associate presented using equity accounting, and is used to measure its financial position and operating results. The functional currency of the Company is the U.S. dollar.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The financial statements of a subsidiary have been translated from the functional currency (GBP) to the presentation currency (U.S. dollar), in accordance with the following:

- a) Assets and liabilities for each balance sheet presented (including comparative data) are translated at the closing rate at the date of that balance sheet. Goodwill and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation are treated as assets and liabilities of the foreign operation and are translated at the closing rate at the date of that balance sheet.
- b) Income and expenses for each period presented in the statement of income (including comparative data) are translated at average exchange rates for the presented periods; however, if exchange rates fluctuate significantly, income and expenses are translated at the exchange rates at the date of the transactions.
- c) Share capital, capital reserves and other changes in capital are translated at the exchange rate prevailing at the date of incurrence.
- d) Retained earnings are translated based on the opening balance translated at the exchange rate at that date and other relevant transactions (such as dividend) during the period are translated as described in b) and c) above.
- e) All resulting translation differences are recognized as a separate component of other comprehensive income (loss) in equity "foreign currency translation reserve".

On a total or partial disposal of a foreign operation, the relevant part of the other comprehensive income (loss) is recognized in the statement of income.

Intragroup loans for which settlement is neither planned nor likely to occur in the foreseeable future are, in substance, a part of the investment in that foreign operation and are accounted for as part of the investment and the exchange differences arising on these loans (net of their tax effect) are recognized in the same component of equity as discussed in e) above.

Exchange differences in respect of a financial instrument in foreign currency that constitutes a net investment hedge are recorded, net of tax effect, in other comprehensive income (loss) in a hedge reserve. On disposal of the net investment, these translation differences are recognized in the statement of income.

2. Transactions, assets and liabilities in foreign currency:

Transactions denominated in foreign currency (other than the functional currency) are recorded on initial recognition at the exchange rate at the date of the transaction. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at each balance sheet date into the functional currency at the exchange rate at that date. Exchange differences, other than those capitalized to qualifying assets or carried to equity in hedging transactions, are recognized in the statement of income. Non-monetary assets and liabilities measured at cost are translated at the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

currency and measured at fair value are translated into the functional currency using the exchange rate prevailing at the date when the fair value was determined.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

3. Index-linked monetary items:

Monetary assets and liabilities linked to the changes in the Israeli Consumer Price Index ("Israeli CPI") are adjusted at the relevant index at each balance sheet date according to the terms of the agreement. Linkage differences arising from the adjustment, as above, other than those capitalized to qualifying assets or carried to equity in hedge transactions, are recognized in the statement of income.

Following are data about the representative exchange rate of the U.S. dollar in relation to the New Israeli Shekel ("NIS"), Euro and the GBP:

<u>As of</u>	<u>Exchange rate of NIS 1</u>	<u>Exchange rate of €1</u>	<u>Exchange rate of £ 1</u>
		\$	
December 31, 2009	0.26	1.44	1.62
December 31, 2008	0.26	1.39	1.45
<u>Change during the year ended</u>	%	%	%
December 31, 2009	-	3.5	11.6
December 31, 2008	-	(5.4)	(28.9)

e. Cash equivalents:

Cash equivalents are considered as highly liquid investments, including unrestricted short-term bank deposits with an original maturity of three months or less from the date of acquisition or with a maturity of more than three months, however, they are repayable on demand without penalty and form part of the Group's cash management.

f. Allowance for doubtful accounts:

The allowance for doubtful accounts is determined in respect of specific debts whose collection, in the opinion of the Company's management, is doubtful. The Company also recognizes a provision for groups of customers that are collectively assessed for impairment based on their credit risk characteristics. Impaired debts are derecognized when they are assessed as uncollectible.

g. Inventories:

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises costs of purchase and costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated selling costs.

Cost of inventories is assigned as follows:

Raw and auxiliary materials - using the weighted average cost method.

Work in progress and finished products - cost of direct materials and labor and a proportion of manufacturing overheads, based on normal operating capacity but excluding borrowing costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company periodically evaluates the condition and age of inventories and makes provisions for slow moving inventories accordingly.

If in a particular period production is not at normal capacity, the cost of inventories does not include additional fixed overheads in excess of those allocated based on normal capacity. Such unallocated overheads are recognized as an expense in the statement of income in the period in which they are incurred. Furthermore, cost of inventories does not include abnormal amounts of materials, labor or other costs resulting from inefficiency.

h. Financial instruments:

Financial assets:

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs, except for investments at fair value through profit or loss in respect of which transaction costs are carried to the statement of income.

After initial recognition, the accounting treatment of investments in financial assets is based on their classification into one of the following four categories:

- financial assets at fair value through profit or loss;
- held-to-maturity investments;
- loans and receivables; and
- available-for-sale financial assets.

1. Financial assets at fair value through profit or loss:

The Group has financial assets at fair value through profit or loss comprising financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term, if they form part of a portfolio of identified financial instruments that are managed together to earn short-term profits or if they are derivatives not designated as hedging instruments. Gains or losses on investments held for trading are recognized in the statement of income when incurred.

Embedded derivatives are separated from the host contract and accounted for separately if: (a) the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the combined instrument is not measured at fair value through profit or loss.

Derivatives, including separated embedded derivatives, are classified as held for trading unless they are designated as effective hedging instruments. In the event of a financial instrument that contains one or more embedded derivatives, the entire combined instrument shall be designated upon initial recognition as a financial asset at fair value through profit or loss.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group first becomes party to the contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

2. Loans and receivables:

The Group has loans and receivables that are financial assets (non-derivative) with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans are measured based on their terms at amortized cost using the effective interest method taking into account also directly attributable transaction costs. Short-term borrowings (such as granting loans to customers and other receivables) are measured based on their terms, normally at nominal value. Gains and losses are recognized in the statement of income when the loans and receivables are derecognized or impaired, as well as through the systematic amortization process. As for recognition of interest income, see q below.

3. Fair value:

The fair value of investments that are actively traded in organized financial markets is determined by reference to market prices on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow or other valuation models.

4. Offsetting financial instruments:

Financial assets and financial liabilities are offset and the net amount is presented in the balance sheet if there is a legally enforceable right to set off the recognized amounts and there is an intention either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Financial liabilities:

1. Financial liabilities measured at amortized cost:

Loans and borrowings are initially recognized at fair value less directly attributable transaction costs (such as loan raising costs). After initial recognition, loans, including debentures, are measured based on their terms at amortized cost using the effective interest method taking into account directly attributable transaction costs. Short-term borrowings (such as loans from suppliers and other payables) are measured based on their terms, normally at nominal value. Gains and losses are recognized in the statement of income when the financial liability is derecognized as well as through the systematic amortization process.

2. Financial liabilities at fair value through profit or loss:

Financial liabilities at fair value through profit or loss include financial liabilities classified as held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Financial liabilities are classified as held for trading if they are acquired for the purpose of settling in the near term. Gains or losses on liabilities held for trading are recognized in the statement of income.

Derivatives, including separated embedded derivatives, are classified as held for trading unless they are designated as effective hedging instruments. In the event of a financial instrument that contains one or more embedded derivatives, the entire combined instrument shall be designated upon initial recognition as a financial liability at fair value through profit or loss.

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group first becomes party to the contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

*Derecognition of financial instruments:**Financial assets:*

A financial asset is derecognized when the contractual rights to the cash flows from the financial asset expire or the company has transferred its contractual rights to receive cash flows from the financial asset or assumes an obligation to pay the cash flows in full without material delay to a third party and has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A transaction involving factoring of accounts receivable and / or credit card vouchers is derecognized when the abovementioned conditions are met.

If the Company transfers its rights to receive cash flows from an asset and neither transfers nor retains substantially all the risks and rewards of the asset nor transfers control of the asset, a new asset is recognized to the extent of the Company's continuing involvement in the asset. When continuing involvement takes the form of guaranteeing the transferred asset, the extent of the continuing involvement is the lower of the original carrying amount of the asset and the maximum amount of consideration received that the Company could be required to repay.

Financial liabilities:

A financial liability is derecognized when it is extinguished, i.e. when the obligation is discharged or cancelled or expires. A financial liability is extinguished when the debtor (the Group):

- discharges the liability by paying in cash, other financial assets, goods or services; or
- is legally released from the liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Where an existing financial liability is exchanged with another liability from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is accounted for as an extinguishment of the original liability and the recognition of a new liability. The difference between the carrying amount of the above liabilities is recognized in the statement of income. If the exchange or modification is immaterial, it is accounted for as a change in the terms of the original liability and no gain or loss is recognized from the exchange.

Impairment of financial assets:

The Group assesses at each balance sheet date whether there is any objective evidence that the following financial asset or group of financial assets is impaired.

Financial assets carried at amortized cost:

There is objective evidence of impairment of debt instruments, loans and receivables and held-to-maturity investments measured at amortized cost as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulty and default in interest or principal payments. The amount of the loss carried to the statement of income is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). If the financial asset has a variable interest rate, the discount rate is the current effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account (see allowance for doubtful accounts above). In a subsequent period, the amount of the impairment loss is reversed if the recovery of the asset can be related objectively to an event occurring after the impairment was recognized. The amount of the reversal, as above, is credited to the statement of income up to the amount of any previous impairment.

i. Derivative financial instruments held for hedging:

Sometimes the Group enters into contracts with derivative financial instruments such as forward currency contracts (forward) in respect of foreign currency and interest rate swaps (IRS) to hedge its risks associated with foreign exchange rates and interest rate fluctuations. Such derivative financial instruments are initially recognized at fair value. After initial recognition, the derivatives are measured at fair value. Derivatives are carried in the balance sheet as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in the fair values of derivatives that do not qualify for hedge accounting are carried directly to the statement of income.

For the purpose of hedge accounting, hedges are classified as:

- fair value hedges when hedging the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (except for foreign currency risk); or
- cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecast transaction or the foreign currency risk in an unrecognized firm commitment; or

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)*Cash flow hedges:*

The effective portion of the gain or loss on the hedging instrument is recognized directly in equity as other comprehensive income (loss), while any ineffective portion is recognized immediately in the statement of income.

Amounts recognized as other comprehensive income (loss) are transferred to the statement of income when the hedged transaction affects profit or loss, such as when the hedged income or expense is recognized or when a forecast sale occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, this cost also includes the associated other comprehensive income (loss) transferred from equity in the same period during which the asset or liability are recognized.

If the forecast transaction or firm commitment is no longer expected to occur, amounts previously recognized in equity are transferred to the statement of income. If the hedging instrument expires or is sold, terminated or exercised, or if its designation as a hedge is revoked, amounts previously recognized in equity remain in equity until the forecast transaction or firm commitment occurs.

j. Fixed assets:

Items of fixed assets are measured at cost with the addition of direct acquisition costs, less accumulated depreciation, less accumulated impairment losses and less related investment grants and excluding day-to-day servicing expenses. Cost includes spare parts and auxiliary equipment that can be used only in connection with the machinery and equipment.

The cost of an item of fixed asset comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which the item is located, any obligation which the Company incurs either when the item is acquired or as a consequence of having used the item during a particular period.

The cost of self-constructed assets includes the cost of materials, direct labor and borrowing costs as well as any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Depreciation is calculated on a straight-line basis over the useful life of the assets at annual rates as follows:

	<u>%</u>	<u>Mainly %</u>
Buildings	2	
Machinery and equipment	10 - 15	10
Motor vehicles	15	
Office furniture and equipment	6 - 33	33
Leasehold improvements	see below	

Leasehold improvements are depreciated on a straight-line basis over the shorter of the lease term (including the extension option held by the Group and intended to be exercised) and the expected life of the improvement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

A part of a fixed asset with a cost that is significant in relation to the total cost of the item is depreciated separately using the component method. Depreciation is calculated on a straight-line basis at annual rates that are adequate for the depreciation of the assets over the term of their expected useful life.

The useful life, depreciation method and residual value of an asset are reviewed at least each year-end and the changes are accounted for as a prospective change in accounting estimate. As for testing the impairment of fixed assets, see 1 below.

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. An asset is derecognized on disposal or when no further economic benefits are expected from its use. The gain or loss arising from the derecognition of the asset (determined as the difference between the net disposal proceeds and the carrying amount in the financial statements) is included in the statement of income when the asset is derecognized.

k. Intangible assets:

Separately acquired intangible assets are measured on initial recognition at cost with the addition of costs directly attributable to the acquisition. Intangible assets acquired in a business combination are included at the fair value at the acquisition date. After initial recognition, intangible assets are carried at their cost less any accumulated amortization and any accumulated impairment losses. Expenditures relating to internally generated intangible assets, excluding capitalized development costs, are recognized in the statement of income when incurred.

According to management's assessment, intangible assets have a finite useful life. The assets are amortized over their useful life using the straight-line method and reviewed for impairment whenever there is an indication that the asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for as prospective changes in accounting estimates. The amortization charge on intangible assets with finite useful lives is recognized in the statement of income.

Gains or losses arising from the derecognition of an intangible asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the statement of income.

Research and development expenses:

Research expenses are recognized in the statement of income when incurred. An intangible asset arising from a development project or from the development of an internal project is recognized if the Company can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale; the Company's intention to complete the intangible asset and use or sell it; the Company's ability to use or sell the intangible asset; how the intangible asset will generate future economic benefits; the availability of adequate technical, financial and other resources to complete the intangible asset; and the Company's ability to measure reliably the expenditure attributable to the intangible asset during its development.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The asset is measured at cost and presented less any accumulated amortization and less, if appropriate, any accumulated impairment losses. Amortization of the asset begins when development is complete and the asset is available for use. As for the testing of impairment, see 1 below.

1. Impairment of non-financial assets:

The Company evaluates the need to record an impairment of the carrying amount of non-financial assets whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of fair value less costs of sale and value in use. In measuring value in use, the expected future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the statement of income.

An impairment loss of an asset, other than goodwill, is reversed only if there have been changes in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. Reversal of an impairment loss, as above, shall not be increased above the lower of the carrying amount that would have been determined (less depreciation or amortization) had no impairment loss been recognized for the asset in prior years and its recoverable amount. The impairment loss of an asset presented at cost is carried to the statement of income. A reversal of that impairment loss is also recognized in the statement of income.

The impairment test of capitalized development costs is performed annually, on December 31, or more frequently if events or changes in circumstances indicate that there is impairment.

m. Government grants:

Government grants are recognized where there is reasonable assurance that the grant will be received and the Company will comply with the attached conditions. Where the Government investment grants relate to assets such as fixed assets, they are presented as a deduction from the carrying amount of the asset.

Government grants from the Office of the Chief Scientist in Israel for supporting research and development activities that contain a liability to pay royalties to the State depending on future sales from development are recognized upon receipt as a liability as long as there are expected future economic benefits from the research activity that lead to sales entitling the State to royalties. If the royalty payments for the grant do not bear market rates of interest, the liability is measured at fair value discounted at the market rate of interest existent when the grant was received. The difference between amount of the grant and the fair value of the liability is accounted for as a Government grant and, accordingly, recognized as a reduction from research and development expenses. Amounts paid as royalties are recognized as settlement of liability. When no economic benefits are probable, the receipts from the grant are deducted from the relevant research and development expenses. In such event, the royalty liability is accounted for as a contingent liability pursuant to IAS 37 until the date on which the liability is recognized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

At each balance sheet date, the Company evaluates whether there is reasonable assurance that the liability, in whole or in part, will not be settled (since the Company will not be required to pay royalties) based on the best estimate of future sales, if any, and if so, the appropriate liability is derecognized and a gain is recognized with a corresponding reduction of research and development expenses. If the estimate of future sales indicates that there is no such reasonable assurance, the appropriate liability reflecting the anticipated royalty payments is recognized with a corresponding charge to research and development expenses.

n. Taxes on income:

Taxes on income in the statement of income comprise current and deferred taxes. The tax results in respect of current or deferred taxes are carried to the statement of income except to the extent that the tax arises from items which are recognized directly in equity. In such cases, the tax effect is also carried to the relevant item in equity.

1. Current taxes:

The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date as well as adjustments required in connection with the tax liability in respect of previous years.

2. Deferred taxes:

Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes. Deferred taxes are carried directly to equity if the tax relates to items that are taken to equity.

Deferred tax balances are measured at the tax rates that are expected to apply to the period when the taxes are taken to the statement of income or to equity, based on tax laws that have been enacted or substantively enacted by the balance sheet date. The amount for deferred taxes in the statement of income represents the changes in said balances during the reported period, excluding changes attributable to items carried directly to equity.

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is not probable that they will be utilized. Simultaneously, temporary differences (such as carryforward losses) for which deferred tax assets have not been recognized are reassessed and deferred tax assets are recognized to the extent that their recoverability has become probable. Any resulting reduction or reversal is recognized in the item taxes on income.

Taxes that would apply in the event of the sale of investments in investees have not been taken into account in computing the deferred taxes, as long as the sale of the investments in investees is not expected in the foreseeable future. Also, deferred taxes that would apply in the event of distribution of earnings by investees as dividend have not been taken into account in computing the deferred taxes, since the distribution of dividend does not involve an additional tax liability or since it is the Company's policy not to initiate distribution of dividend that triggers an additional tax liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Deferred tax assets and deferred tax liabilities are presented in the balance sheet as non-current assets and non-current liabilities, respectively. Deferred taxes are offset if there is a legally enforceable right to set off a current tax asset against a current tax liability and the deferred taxes relate to the same taxpayer and the same taxation authority.

o. Share-based payment transactions:

The Company's employees are entitled to remuneration in the form of share-based payment transactions as consideration for equity instruments and certain employees are entitled to cash-settled benefits based on the increase in the Company's share price.

Equity-settled transactions:

The cost of equity-settled transactions with employees is measured at the fair value of the equity instruments granted at grant date. The fair value is determined using a standard pricing model, additional details are given in Note 16. As for other service providers, the cost of the transactions is measured at fair value of the goods or services received as consideration for equity instruments. In cases where the fair value of the goods or services received as consideration of equity instruments cannot be measured, they will be measured by reference to the fair value of the equity instruments granted.

The cost of equity-settled transactions is recognized in the statement of income, together with a corresponding increase in equity, during the period which the performance and/or service conditions are to be satisfied, ending on the date on which the relevant employees become fully entitled to the award ("the vesting period"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the statement of income represents the movement in cumulative expense recognized at the end of that reported period.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether the market condition is satisfied, provided that all other vesting conditions (service and/or performance) are satisfied.

If the Company modifies the conditions on which equity-instruments were granted, an additional expense is recognized for any modification that increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee at the modification date.

If a grant of an equity instrument is cancelled, it is accounted for as if it had vested on the cancellation date, and any expense not yet recognized for the grant is recognized immediately. However, if a new grant replaces the cancelled grant and is identified as a replacement grant on the grant date, the cancelled and new grants are accounted for as a modification of the original grant, as described in the previous paragraph.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

p. Employee benefit liabilities:

The plans are normally financed by contributions to insurance companies and classified as defined contribution plans or as defined benefit plans.

The Group has defined contribution plans pursuant to Section 14 to the Severance Pay Law under which the Group pays fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods. Contributions in the defined contribution plan in respect of severance pay or compensation are recognized as an expense when contributed simultaneously with receiving the employee's services and no additional provision is required in the financial statements.

The Group also operates a defined benefit plan in respect of severance pay pursuant to the Severance Pay Law. According to the Law, employees are entitled to severance pay upon dismissal or retirement. The liability for termination of employee-employer relation is measured using the projected unit credit method. The actuarial assumptions include future salary increases and rates of employee turnover based on the estimated timing of payment. The amounts are presented based on discounted expected future cash flows using a discount rate on Government bonds with maturity that matches the estimated term of the benefit payments.

The Company makes current deposits in respect of its liabilities to pay compensation to certain of its employees in pension funds and insurance companies ("the plan assets"). Plan assets comprise assets held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the Group's own creditors and can not be returned directly to the Group.

The liability for employee benefits presented in the balance sheet presents the present value of the defined benefit obligation less the fair value of the plan assets, less past service costs and any unrecognized actuarial gains and losses.

Actuarial gains and losses are recognized in the statement of income in the period in which they occur.

q. Revenue recognition:

Revenues are recognized in the statement of income when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Revenues are measured at the fair value of the consideration received less any trade discounts, volume rebates and returns.

Revenues from credit sales transactions that include a financing element are recorded at present value such that the difference between the fair value of the consideration had credit not been provided and the nominal amount of the consideration is recognized in the statement of income as Finance income using the effective interest method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Specific criteria for revenue recognition for the following types of revenues:

Revenues from the sale of goods:

Revenues from the sale of goods are recognized when all the significant risks and rewards of ownership of the goods have passed to the buyer and the seller no longer retains continuing managerial involvement. The delivery date is usually the date on which ownership passes.

r. Cost of revenues and supplier discounts:

Cost of sales includes expenses for loss, storage and conveyance of inventories to the end point of sale. Cost of sales also includes impairment provisions in respect of inventories, inventory write offs and provisions for slow-moving inventories.

Discounts are deducted from cost of purchase when the conditions entitling to those discounts are satisfied. Certain of the discounts in respect of that portion of the purchases that are added to closing inventories are attributed to inventories and the balance reduces the cost of sales.

s. Finance income and expenses:

Finance income comprise interest income on amounts invested (including available-for-sale financial assets), revenues from dividend, gains from sale of financial assets classified as available-for-sale, changes in fair value of financial assets at fair value through profit or loss, exchange gains and gains on hedges recognized in the statement of income. Interest income is recognized as it accrues using the effective interest method. Revenues from dividend are recognized when the Group's right to receive the payment is established. If the dividend is received on traded shares, the Group's recognizes revenues from dividend on the ex-date.

Changes in fair value of financial assets at fair value through profit or loss contain also interest income and revenues from dividend.

Finance costs comprise interest expenses on borrowings, changes in the time value of provisions, reductions in the fair value of financial assets at fair value through profit or loss, impairment losses of financial assets and losses on hedges recognized in profit or loss. Borrowing costs that are not capitalized to qualifying assets are recognized in the statement of income using the effective interest method.

Gains and losses on exchange differences are reported on a net basis.

t. Operating segments:

An operating segment is a component of the Group that meets the following three criteria:

1. is engaged in business activities from which it may earn revenues and incur expenses, including revenues and expenses relating to intragroup transactions;
2. whose operating results are regularly reviewed by the Group's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and
3. for which separate financial information is available.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

u. Earnings (loss) per share:

Earnings per share are calculated by dividing the net income attributable to equity holders of the parent by the weighted number of Ordinary shares outstanding during the period. Basic earnings per share only include shares that were actually outstanding during the period. Potential Ordinary shares (convertible securities such as convertible debentures, warrants and employee options) are only included in the computation of diluted earnings per share when their conversion decreases earnings per share or increases loss per share from continuing operations. Further, potential Ordinary shares that are converted during the period are included in diluted earnings per share only until the conversion date and from that date in basic earnings per share. The Company's share of earnings of investees is included based on the earnings per share of the investees multiplied by the number of shares held by the Company.

v. Provisions:

A provision in accordance with IAS 37 is recognized when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are measured according to the estimated future cash flows discounted using a pre-tax interest rate that reflects the market assessments of the time value of money and, where appropriate, those risks specific to the liability.

w. Advertising expenses:

Expenses incurred from advertising, marketing or promotional activities, such as production of catalogues and promotional pamphlets, are recognized as an expense when the Group has the right of access to the advertising goods or when the Group receives those services.

x. Standards issued but not yet applied:

IFRS 3 Business Combinations (Revised) and *IAS 27 Consolidated and Separate Financial Statements (Amended)*

IFRS 3 (Revised) introduces significant changes in the accounting for business combinations occurring after initial adoption. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs and future reported results.

IAS 27 (Amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes by *IFRS 3 (Revised)* and *IAS 27 (Amended)* will affect future acquisitions or loss of control of subsidiaries and transactions with non-controlling interests.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Standard will be effective starting January 1, 2010 and will be applied prospectively.

IFRS 9 - Financial Instruments:

In November 2009, the IASB issued IFRS 9, "Financial Instruments", which represents the first phase of a project to replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 focuses mainly on the classification and measurement of financial assets and it applies to all financial assets within the scope of IAS 39.

According to IFRS 9, upon initial recognition, all the financial assets (including hybrid contracts with financial asset hosts) will be measured at fair value. In subsequent periods, debt instruments can be measured at amortized cost if both of the following conditions are met:

- the asset is held within a business model whose objective is to hold assets in order to collect the contractual cash flows.
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Subsequent measurement of all other debt instruments and financial assets will be at fair value.

Financial assets that are equity instruments will be measured in subsequent periods at fair value and the changes will be recognized in the statement of income or in other comprehensive income (loss), in accordance with the election of the accounting policy on an instrument-by-instrument basis. Nevertheless, if the equity instruments are held for trading, they must be measured at fair value through profit or loss. This election is final and irrevocable. When an entity changes its business model for managing financial assets it shall reclassify all affected financial assets. In all other circumstances, reclassification of financial instruments is not permitted.

The Standard will be effective starting January 1, 2013. Earlier application is permitted. Early adoption will be made with a retrospective restatement of comparative figures, subject to the reliefs set out in the Standard.

The Company is evaluating the possible effect of the adoption of the new Standard on the consolidated financial statements but is presently unable to assess such effect, if any.

IAS 1 - Presentation of Financial Statements:

The amendment to IAS 1 deals with current or non-current classification of the liability component of a convertible instrument. Pursuant to the amendment, terms of a liability that can, at the option of the counterparty, be settled by the issue of the entity's equity instruments do not affect its classification as current or non-current. The amendment will be prospectively adopted starting from the financial statements for periods beginning on January 1, 2010. Earlier application is permitted.

The Company believes that the effect of the amendment on the financial statements is not expected to be material.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)***IAS 32 - Financial Instruments: Presentation - Classification of Rights Issues:*

The amendment to IAS 32 determines that rights, options or share options to acquire a fixed number of the entity's equity instruments for a fixed amount of any currency are classified as equity instruments if the entity offers the rights, options or share options pro rata to all of its existing owners of the same class of its non-derivative equity instruments.

IAS 36 - Impairment of Assets:

The amendment to IAS 36 defines the required accounting unit to which goodwill will be allocated for impairment testing of goodwill. Pursuant to the amendment, the largest unit permitted for impairment testing of goodwill acquired in a business combination is an operating segment as defined in IFRS 8, "Operating Segments" before the aggregation for reporting purposes. The amendment will be prospectively adopted starting from the financial statements for periods beginning on January 1, 2010. Earlier application is permitted.

The Company believes that the effect of the amendment on the financial statements is not expected to be material.

IAS 38 - Intangible Assets:

Pursuant to an amendment to IAS 38, expenses incurred for advertising, marketing or promotional activities will be recognized as an expense when the company has the right of access to the advertising goods or when the company receives those services. For these purposes, the activities also include production of catalogs and promotional pamphlets. Also, IAS 38 is amended to allow the unit of production amortization method for all intangible assets even if it results in a lower amount of accumulated amortization than under the straight-line method.

The amendment was adopted retrospectively from January 1, 2009. The initial adoption of the Standard did not have any material effect on the consolidated financial statements.

NOTE 3:- CASH AND CASH EQUIVALENTS

	December 31,	
	2009	2008
U.S. dollars	1,018	1,582
Euros	241	106
GBP	489	353
NIS	497	256
	<u>2,245</u>	<u>2,297</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 4:- TRADE RECEIVABLES

- a. Composition:

	December 31,	
	2009	2008
Open accounts	4,271	6,826
Checks receivable	62	163
	<u>4,333</u>	<u>6,989</u>
Less - allowance for doubtful accounts	435	460
	<u>3,898</u>	<u>6,529</u>

Trade receivables are non-interest bearing and are generally for 60-90 day terms.

- b. As at December 31, 2009, trade receivables with nominal value of \$ 435 (2008: \$ 460) were impaired and fully provided for. Movements in the allowance for doubtful accounts were as follows:

	Individually impaired
At January 1, 2008	388
Charge for the year	110
Exchange rate adjustments	<u>(38)</u>
At December 31, 2008	460
Charge for the year	(30)
Exchange rate adjustment	<u>5</u>
At December 31, 2009	<u>435</u>

- c. As at December 31, the ageing analysis of trade receivables is as follows:

	Neither past due nor impaired	Past due but not impaired				Total
		< 30 days	30 – 60 days	60 – 90 days	90 day	
2009	1,757	794	338	184	825	3,898
2008	3,720	1,361	567	602	279	6,529

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 5:- OTHER ACCOUNTS RECEIVABLE

	December 31,	
	2009	2008
Government authorities	245	148
Other receivables	148	183
	388	331

NOTE 6:- INVENTORIES

	December 31,	
	2009	2008
Finished products	2,922	3,366
Work in progress	411	588
Raw and auxiliary materials	2,557	2,598
	5,890	6,552

The amounts of write-down of inventories recognized as an expense in 2009 and 2008 are \$ 624 and \$ 521, respectively.

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT

	Building	Installations and leasehold improvements	Machinery and equipment	Motor vehicles	Office furniture and equipment	Total
Cost:						
Balance as of January 1, 2008	-	5,901	4,948	210	3,338	14,397
Acquisitions during the year	-	45	89	41	206	381
Disposals during the year	-	-	-	(67)	-	(67)
Currency translation differences	-	(9)	(5)	(10)	(23)	(47)
	-	5,937	5,032	174	3,521	14,664
Balance as of December 31, 2008	-	5,937	5,032	174	3,521	14,664
Acquisitions during the year	1,467	27	84	-	21	1,599
Disposals during the year	-	(52)	(170)	-	(37)	(259)
Currency translation differences	(11)	3	-	3	7	2
	1,456	5,915	4,946	177	3,512	16,006
Balance as of December 31, 2009	1,456	5,915	4,946	177	3,512	16,006
Accumulated depreciation:						
Balance as of January 1, 2008	-	2,825	3,610	96	2,910	9,441
Provision during the year	-	402	332	25	137	896
Disposals during the year	-	-	-	(51)	-	(51)
Currency translation differences	-	(9)	-	(5)	(14)	(28)
	-	3,218	3,942	65	3,033	10,258
Balance as of December 31, 2008	-	3,218	3,942	65	3,033	10,258
Provision during the year	8	370	308	24	106	816
Disposals during the year	-	(1)	(215)	-	(28)	(244)
Currency translation differences	-	3	-	-	5	8
	8	3,590	4,035	89	3,116	10,838
Balance as of December 31, 2009	8	3,590	4,035	89	3,116	10,838
Depreciated cost as of December 31, 2009	1,448	2,325	911	88	396	5,168
Depreciated cost as of	-	2,719	1,090	109	488	4,406

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

December 31, 2008



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 8:- INTANGIBLE ASSETS

Internal development costs of software and production files that have been capitalized are composed as follows:

	December 31,	
	2009	2008
Cost:		
As of January 1	-	-
Additions	392	-
As of December 31	<u>392</u>	<u>-</u>

The intangible assets are under development as of December 31, 2009, and are expected to be available for use in 2010.

NOTE 9:- SHORT-TERM CREDIT FROM BANKS AND OTHERS

a. Composition:

	Annual interest rate % *)	December 31,	
		2009	2008
Overdrafts:			
NIS		-	69
Short-term loans:			
NIS	5.2	317	434
U.S. dollars **)	3.43	944	1,290
		<u>1,261</u>	<u>1,793</u>
Reclassified from long-term loans ***)		2,168	4,252
Current maturities of long-term loans (see Note 12)		<u>2,275</u>	<u>2,096</u>
		<u>5,704</u>	<u>8,141</u>

*) Weighted average annual interest rate as of December 31, 2009. The effective interest rate is equal to the average interest rate.

**) Includes shareholders' loan of \$ 140 at December 31, 2009 and 2008. The loan does not bear interest since June 2006.

***) Breach of financial covenants - see Note 17b(3).

b. Liens:

The Company recorded a floating charge (a non-specific lien on all assets of the Company on which there is no previous specific lien) on the Company's assets in favor of three of the Company's banks.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 10:- TRADE PAYABLES

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Open accounts	3,515	3,494
Checks payable	576	602
	<u>4,091</u>	<u>4,096</u>

Trade payables are non-interest bearing and generally have terms of 60-90 days.

NOTE 11:- OTHER CURRENT LIABILITIES

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Accrued salaries and related expenses	1,838	1,698
Government authorities	95	98
Others	38	92
	<u>1,971</u>	<u>1,888</u>

NOTE 12:- BANK LOANS

a. Composition:

	<u>Average interest rate ⁽¹⁾ %</u>	<u>December 31,</u>	
		<u>2009</u>	<u>2008</u>
U.S. dollars	LIBOR + 1.6 ⁽²⁾	600	1,000
U.S. dollars	LIBOR + 1.74 ⁽³⁾	3,652	5,339
GBP (c)	UK base rates + 1.98 ⁽⁴⁾	1,327	-
NIS	6.75	78	86
		<u>5,657</u>	<u>6,425</u>
Less - current maturities		<u>2,275</u>	<u>2,096</u>
		3,382	4,329
Reclassified to current liabilities ⁽⁵⁾		<u>(2,168)</u>	<u>(4,252)</u>
		<u>1,214</u>	<u>77</u>

(1) As of December 31, 2009. The effective interest rate is equal to the average interest rate.

(2) As of December 31, 2009, six months LIBOR is 0.43 (2008 – 1.75).

(3) As of December 31, 2009, three months LIBOR is 0.25 (2008 – 1.42).

(4) As of December 31, 2009, UK base rate is 0.5.

(5) See Note 17b(3).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 12:- BANK LOANS (Cont.)**

- b. As described in Note 17b(3), the Company is not in compliance with loan covenants, and therefore, the banks can demand repayment of these loans at any time. According to their original contractual terms, the long-term loans are repayable in future years, as follows:

	December 31,	
	2009	2008
First year	2,275	2,096
Second year	1,397	2,098
Third year	997	1,299
Fourth year	86	900
Fifth year	902	32

- c. The bank loan is secured by a fixed and floating charge over the Company's building in England.

NOTE 13:- EMPLOYEE BENEFIT LIABILITIES

- a. The amount included in the balance sheet arising from obligations in respect of the defined benefit plan for severance pay is comprised as follows:

	December 31,	
	2009	2008
Present value of funded obligation	2,070	2,232
Fair value of plan assets	1,675	1,456
	<u>395</u>	<u>776</u>

- b. The principal actuarial assumptions used are as follows:

	December 31,	
	2009	2008
Discount rate	4.7%	4.7%
Future salary increase	5%	5%

NOTE 14:- TAXES ON INCOME

- a. Income taxes applicable in Israel:

1. Measurement of results for tax purposes under the Israeli Income Tax (Inflationary Adjustments) Law, 1985:

Income Tax (Inflationary Adjustments) Law, 1985:

According to the law, until 2007, the results for tax purposes were adjusted for the changes in the Israeli CPI.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 14:- TAXES ON INCOME (Cont.)**

In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Since 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. Adjustments relating to capital gains such as for sale of property (betterment) and securities continue to apply until disposal. Since 2008, the amendment to the law includes, among others, the cancellation of the inflationary additions and deductions and the additional deduction for depreciation.

2. Tax benefits under the Israeli Law for The Encouragement of Industry (Taxes), 1969:

The Company is an "industrial company" as defined by the Israeli Law for the Encouragement of Industry (Taxes), 1969 and, as such, is entitled to certain tax benefits, primarily accelerated depreciation and the right to claim public offering expenses as a deduction for tax purposes.

3. Tax benefits under the Israeli Law for The Encouragement of Capital Investments, 1959:

Metis was accorded the status of an Approved Enterprise under the Israeli Law for Encouragement of Capital Investments, 1959. On December 31, 2002 (see Note 1), the benefits deriving from this status were transferred to the Company. These benefits include an exemption from income taxes on income from the Approved Enterprise for a period of four years beginning with the first year in which it reports taxable income (started in 2000) and a reduced tax rate of 25% for the following three years (starting 2004).

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above law, regulations published thereunder, and the instruments of approval for the specific investments in "Approved Enterprise". In the event of failure to comply with these conditions, the benefits may be canceled, and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2009, management believes that the Company is meeting all of the aforementioned conditions.

In the event of distribution of a dividend from tax exempt income, as described above, the Company will be required to pay income tax at a rate of 15% and the dividend will be subject to 15% tax withholding. The Company's policy is to reinvest its tax-exempt earnings and not to distribute such earnings as dividends. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate.

A recent amendment to the Law, which was officially published effective as of April 1, 2005 ("the Amendment") has changed certain provisions of the Law. As a result of the Amendment, a company is no longer obligated to implement an "Approved Enterprise" status in order to receive the tax benefits previously available under the alternative benefits provisions, and therefore there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

out by the Amendment. A company is also granted a right to approach the Israeli Tax Authorities for a pre-ruling regarding their eligibility for benefits under the Amendment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 14:- TAXES ON INCOME (Cont.)**

- b. Income tax expense included in the statements of income:

	Year ended December 31,	
	2009	2008
Current taxes	60	131
Deferred taxes	-	573
Taxes in respect of previous years	8	-
	<u>68</u>	<u>704</u>

- c. Tax computation:

The difference between income tax expense on profit before taxes computed at regular tax rates and income tax expense in the consolidated statement of operations is explained as follows:

	Year ended December 31,	
	2009	2008
Loss before taxes on income	<u>(818)</u>	<u>(2,245)</u>
Tax benefit computed at statutory tax rate of 26% (2008 - 27%)	<u>(213)</u>	<u>(606)</u>
Increase (decrease) in tax due to:		
Different tax rates	-	(76)
Non-deductible expenses	49	57
Losses and other items for which deferred taxes were not provided	227	808
Taxes in respect of previous years	8	-
Reversal of deferred tax assets	-	511
Differences in the basis of measurement (U.S.\$/GBP - CPI) *)	<u>(3)</u>	<u>10</u>
	<u>68</u>	<u>704</u>

*) The amount represents the difference resulting from the basis of measurement for income tax purposes in Israel (calculated based on the New Israeli Shekel linked to the Israeli Consumer Price Index) and the measurement currency of the Company (the U.S. dollars).

- d. Tax assessments:

Final tax assessments:

The Company received final tax assessments through 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 14:- TAXES ON INCOME (Cont.)**

e. Deferred taxes:

Deferred tax assets are computed at an average tax rate of approximately 25% for 2009 and 2008.

The Group recorded deferred tax assets, principally for tax loss carryforwards and also for other temporary differences, as of December 31, 2009 and 2008 in the amount of \$ 215 (see Note 14f). The deferred tax assets were recorded based on the Group's management best estimation of realization of these losses and temporary differences in the foreseeable future.

f. Changes in deferred taxes:

	Year ended December 31,	
	2009	2008
Balance at the beginning of the year	215	788
Change during the year	-	(573)
Balance at the end of the year	<u>215</u>	<u>215</u>

g. Tax rates applicable to the income of the Group companies:

- The rate of the Israeli corporate tax is as follows: 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 - 25%. Tax at a reduced rate of 25% applies on capital gains arising after January 1, 2003, instead of the regular tax rate. In July 2009, the "Knesset" (Israeli Parliament) passed the Law for Economic Efficiency (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among others, an additional gradual reduction in the rates of the Israeli corporate tax and real capital gains tax starting 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 - 22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

The effect of the abovementioned change on the financial statements is immaterial.

- The principal tax rates applicable to the subsidiaries whose place of incorporation is outside Israel are:

A company incorporated in the U.S. - weighted tax at the rate of 38.63% (Federal tax, State tax and City tax of the city where the company operates).

Company incorporated in England - tax at the rate of 24.3%.

h. Carryforward losses for tax purposes:

The Group's carryforward losses for tax purposes as of December 31, 2009 and 2008 amount to approximately \$ 14,327 and \$ 11,570, respectively. With respect to tax losses carryforward of approximately \$ 13,527 and \$ 10,743, no deferred tax asset was recognized as of December 31, 2009 and 2008, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 15:- COMMITMENTS AND CONTINGENT LIABILITIES**

a. Royalties:

1. The Company is obligated to pay royalties of 2% -3.5% of the revenues from products in the development of which the Chief Scientist participated. The royalties are limited to the amount of the grant received, linked to the U.S dollar. Total grants received as of December 31, 2009 and 2008 amounted to approximately \$ 1,670 and the balance of contingent royalties amounts to approximately \$ 1,238.
2. Under the conditions of an agreement for participation by the Bi-National Fund for Research and Development (BIRD) in joint R&D programs between the Group and a U.S. company, BIRD granted grants to the Group. In consideration for this grant, BIRD is entitled to royalties of between 2.5% and 5% of the gross sales of products resulting from this research, up to the amount of the grant, linked to the U.S dollar. Thereafter, BIRD will be entitled to royalties of 2.5% of sales up to an additional amount equaling half of the grant received. On January 1, 2003, the benefits and the obligations deriving from this agreement were transferred to the Company from Metis. The grants received by the Company and the balance of contingent royalties as of December 31, 2009 and 2008 amounted to approximately \$ 340.

It was also agreed with BIRD that should one of the companies register a patent on a product developed, the Group will also pay royalties to BIRD at the rate of 1.5% of the gross sales of the product resulting from the research, for the duration of the patent.

b. Operating leases:

The Company entered into agreements with Metis to lease the plant and office building until 2021 and 2024, respectively. The Company has an option to cancel the leases in 2011 and 2014, respectively. The rent is linked to the higher of the change in Israel's CPI or the exchange rate of the NIS in relation to the U.S. dollar. Certain of the leases have escalation clauses.

Total lease expenses amounted to \$ 1,376 and \$ 1,400 for 2009 and 2008, respectively.

The foreign subsidiaries rent their facilities under various operating lease agreements, which expire on various dates, the latest of which is in 2010.

Future minimum lease payments in years subsequent to December 31, under non-cancelable operating lease are as follows:

	<u>2009</u>	<u>2008</u>
First year	939	1,453
Second through fifth years	1,820	3,403
Thereafter	-	50
Total	<u>2,759</u>	<u>4,906</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 16:- EQUITY**

- a. The share capital is composed as follows:

	<u>December 31, 2009</u>		<u>December 31, 2008</u>	
	<u>Authorized</u>	<u>Issued and outstanding</u>	<u>Authorized</u>	<u>Issued and outstanding</u>
	<u>Number of shares</u>			
Ordinary shares of NIS 5 par value each	<u>50,000,000</u>	<u>10,162,848</u>	<u>50,000,000</u>	<u>10,162,848</u>

The authorized share capital of the Company is NIS 250,000,000 comprised of 50,000,000 authorized Ordinary shares, par value NIS 5 each.

- b. Stock Option Plan:

On June 8, 2005, the Company's Board of Directors adopted a share option plan according to which up to 290,735 options exercisable into Ordinary shares of the Company may be granted to officers, directors, employees and consultants of the Group.

On August 8, 2005, the Company's Board of Directors granted 102,500 options (including 15,000 options to the former Managing Director). The options granted expire 10 years after the date of grant and vest over a period ending in December 2008. The exercise price of the options granted is €2.297 (\$ 2.844 on date of grant). The exercise price of the options was based on the average market price of the Company's shares for a period of 30 days prior to the grant. The options were granted under section 102 of the Israeli Income Tax Ordinance.

The weighted average fair value of options granted by the Company in August 2005 is \$ 2 per share, which was estimated based on the following data and assumptions:

Share price - €2.77 (\$ 3.43); exercise price - €2.297 (\$ 2.84); expected volatility - 94%; risk-free interest rate - 2%; expected dividends - 0% and expected average life of options - 2.5 years.

Compensation costs in respect of these options, in accordance with IFRS 2, "Share-Based Payment", were recorded commencing in the third quarter of 2005.

In November 2005, 22,500 options were granted to the President and CEO. The options granted expire 10 years after the date of grant and vest over a period ending in November 2009. The exercise price of the options granted is €4.043 (\$ 4.757 on date of grant).

The weighted average fair value of options granted by the Company in November 2005 is \$ 1.74 per share. Compensation costs in respect of these options, in accordance with IFRS 2 were recorded commencing in the fourth quarter of 2005.

On May 9, 2006, the Company's Board of Directors ("BOD") resolved to accelerate the vesting of 21,875 options granted in August 2005 such that these options vest immediately.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 16:- EQUITY (Cont.)

In addition, on May 9, 2006, the BOD resolved to increase the number of shares available for option grants under the June 2005 share option plan up to 500,000 options. On that date, the BOD granted 125,183 options (including 41,561 options to the CEO) at an exercise price of €5.19 (\$ 6.59 on date of grant). The options vest over a period ending in December 2009 and expire 10 years after date of grant.

Furthermore, the BOD granted an additional 97,692 options (including 35,939 options to the CEO) at an exercise price of €5.19 (\$ 6.59 on date of grant). These options vest on December 31, 2011, unless vesting is accelerated upon achievement of targeted share market prices in the range of between €7 and €15.

The weighted average fair value of options granted by the Company in May 2006, in the amount of \$ 3.04, was estimated by applying the Binomial Model for option pricing based on the following data and assumptions (weighted average): share price - \$ 6.48; exercise price - \$ 6.59; expected volatility - 58.2% (based on historical values); risk-free interest rate - 3.78% and expected dividends - 0%.

In November and December 2006, the BOD granted 30,000 options and 20,000 options, respectively. The options were granted mainly to officers and employees, which began to work for the Company in 2007. The options vest over a period ending in January 2011 will expire 10 years after the date of grant. The exercise price of the options granted is €5.19 (\$ 4.2 at date of grant). The weighted average fair value of options granted by the Company in November and December 2006 are \$ 1.17 and \$ 1.22 per share, respectively, compensation cost in respect to these options, in accordance with IFRS 2 was recorded commencing January 2007.

On June 28, 2007, the Board of Directors granted 30,000 options. The options granted expire 10 years after the date of grant and vest over a period ending in June 2011. The exercise price of the options granted is €5.19 (\$ 6.99 on date of grant). The weighted average fair value of options is \$ 1.24 per share.

Total cost of share-based payments amounted to \$ 11 and \$ 75 for 2009 and 2008, respectively.

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the years:

	Year ended December 31,			
	2009		2008	
	Number	WAEP (U.S.\$)	Number	WAEP (U.S.\$)
Outstanding at beginning of year	233,908	6.18	248,908	6.23
Granted during the year	-	-	-	-
Forfeited during the year	(20,000)	6.99	(15,000)	6.99
Exercised during the year	-	-	-	-
Outstanding at end of year	<u>213,908</u>	<u>6.18</u>	<u>233,908</u>	<u>6.18</u>
Exercisable at end of year	<u>199,214</u>	<u>4.19</u>	<u>107,930</u>	<u>3.61</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 17:- FINANCIAL INSTRUMENTS**

- a. The financial assets and financial liabilities in the balance sheet are classified by groups of financial instruments pursuant to IAS 39:

	December 31,	
	2009	2008
Financial assets:		
Financial assets at fair value through profit or loss:		
Designated as such upon initial recognition	<u>31</u>	<u>39</u>
Loans and receivables	<u>6,746</u>	<u>9,409</u>
Financial liabilities:		
Financial liabilities measured at amortized cost	<u>12,244</u>	<u>14,738</u>

- b. Financial risks factors:

The Group's activities expose it to various financial risks such as market risk (foreign currency risk and interest rate risk), credit risk and liquidity risk. The Group's comprehensive risk management plan focuses on activities that reduce to a minimum any possible adverse effects on the Group's financial performance. The Group utilizes derivatives in order to hedge certain exposures to risks.

A unit specifically set up for this purpose ("the risk management unit") oversees the management of these risks in accordance with the policies approved by the Board. The risk management unit identifies, measures and manages financial risks in collaboration with the Group's operating units. The Board establishes documented objectives for the overall risk management activities as well as specific policies with respect to certain exposures to risks such as currency risk, interest rate risk, credit risk, the use of derivative financial instruments and non-derivative financial instruments and the investments of excess liquid positions.

1. Market risks:

- a) Foreign currency risk:

The Group is subject to foreign exchange risk as it operates and has sales in different countries worldwide. Group management regularly monitors its foreign exchange risk and attempts to limit such risks by making adequate decisions regarding cash and credit positions.

As of December 31, 2009 and 2008, the Company's monetary liabilities in NIS exceeded monetary assets by \$ 2,017 and \$ 4,337, respectively.

As of December 31, 2009 and 2008, the Company's monetary assets in Euro exceeded monetary assets by \$ 1,093 and \$ 792, respectively.

As of December 31, 2009 and 2008, the Company's monetary assets in GBP exceeded monetary assets by \$ 278 and \$ 1,564, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data**

NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)

b) Interest rate risk:

The Group is exposed to the risk of changes in the market interest rates on long-term loans with floating interest rates. The Group's policy is to manage the finance costs relating to the interest by having a balance between fixed and variable rate long-term loans.

2. Credit risk:

The Group has no significant concentrations of credit risk. The Group has a policy to ensure collection through sales of its products to wholesalers with an appropriate credit history and through retail sales in cash or by credit card.

Credit risk may arise from the exposure of holding several financial instruments with a single entity or from entering into transactions with several groups of debtors with similar economic characteristics whose ability to discharge their obligations will be similarly affected by changes in economic or other conditions. Factors that have the potential of creating concentrations of risks consist of the nature of the debtors' activities, such as their business sector, the geographical area of their operations and the financial strength of groups of borrowers.

The Company regularly monitors the credit extended to its customers and requires collateral as security for these receivables. The Company provides an allowance for doubtful accounts based on the factors that affect the credit risk of certain customers, past experience and other information.

The Company maintains cash and cash equivalents, and long-term investments and other financial instruments in various financial institutions. These financial institutions are located in different geographical areas around the world. The Company's policy is to diversify its investments among the various institutions. According to the Company's policy, the relative credit stability of the various financial institutions is evaluated on a regular basis.

As of December 31, 2009, cash and cash equivalents totaled \$ 2,245.

3. Liquidity risk:

The Group monitors its risk to a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of both its financial investments and financial assets and projected cash flows from operations.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank overdrafts and bank loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)**

The Company has financial covenants with its three principal banks which include certain customary financial covenants that the Company is required to fulfill, including the ratio of shareholders' equity to total assets, certain profitability level, cash balances and other balance sheet ratios. As of December 31, 2009 and 2008, the Company did not meet a specific ratio and, accordingly, long-term loans in an amount of \$ 2,168 (2008 - \$ 4,252) were reclassified to current liabilities (see Note 9). To date, the banks have not demanded early repayment, and the Company's management believes that the banks will continue not to demand early repayment in the future. The Group's exposure to liquidity risk is limited.

The maturities of the financial liabilities of the Group are for one year, except for the bank loans. The long-term loans are repayable in future years based on contractual undiscounted payments (including interest), as follows:

	December 31,	
	2009	2008
First year	2,528	2,479
Second year	1,520	2,338
Third year	1,050	1,048
Fourth year	101	939
Fifth year	1,124	27

c. Fair value:

The carrying amount of cash and cash equivalents, short-term investments, trade receivables, other accounts receivable, short-term loans granted, credit from banks and others, trade payables and other accounts payable approximate their fair value.

d. Classification of financial instruments by fair value hierarchy:

The financial instruments presented in the balance sheet at fair value are with similar characteristics using the following fair value hierarchy which is determined based on observable market data (valuation techniques which use inputs that are not based on observable market data).

Financial assets measured at fair value:

	December 31,	
	2009	2008
Financial assets at fair value through profit or loss:		
Derivatives - hedged	23	6
Derivatives - non-hedged	8	33
	<u>31</u>	<u>39</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)

- e. Derivatives and hedging:

Derivatives not designated as hedging instruments:

The Group has forward foreign currency contracts to manage some of its transactions exposure to fluctuations in exchange rates. These forward foreign currency contracts are not designated as cash flow, fair value or net investment hedges and are entered into for periods consistent with the periods of currency transaction exposure. Such derivatives do not qualify for hedge accounting.

Cash flow hedges:

As of December 31, 2009 and 2008, the Group held forward foreign currency contracts designated as hedges of expected future salaries to be paid in NIS, for which the Company has highly probable forecasted transactions. The forward foreign currency contracts are being used to hedge currency risk of the firm commitments.

	December 31,			
	2009		2008	
	Asset	Liability	Asset	Liability
	NIS in thousands			
Fair value of forward foreign currency contracts	31	-	39	-

The critical terms of the forward foreign currency contracts have been negotiated to match the terms of the commitments.

The cash flow hedges of the expected future salary payments in 2010 were assessed to be highly effective and as of December 31, 2009 other comprehensive loss of \$ 5, relating to the hedging instruments were included in equity.

	Year ended December 31,	
	2009	2008
Sensitivity test to changes in the NIS exchange rate:		
Gain (loss) from the change:		
Increase of 5% in the NIS rate	(101)	(217)
Decrease of 5% in the NIS rate	101	217
Sensitivity test to changes in the Euro exchange rate:		
Gain (loss) from the change:		
Increase of 5% in the Euro rate	55	40
Decrease of 5% in the Euro rate	(55)	(40)
Sensitivity test to changes in the GBP exchange rate:		
Gain (loss) from the change:		
Increase of 5% in the GBP rate	14	78
Decrease of 5% in the GBP rate	(14)	(78)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 18:- REVENUES

	Year ended December 31,	
	2009	2008
Foreign:		
Europe	21,516	25,113
United States	1,550	5,581
Other countries	3,170	5,584
	<u>26,236</u>	<u>36,278</u>
Domestic - Israel	155	157
	<u>26,391</u>	<u>36,435</u>
Includes sales to one major customer	<u>4,440</u>	<u>4,506</u>

NOTE 19:- COST OF REVENUES

	Year ended December 31,	
	2009	2008
Purchases and changes in raw and auxiliary materials	11,844	15,879
Labor	2,473	3,464
Manufacturing and other expenses	1,535	1,507
Depreciation and amortization (including write-down of inventories)	657	713
	<u>16,509</u>	<u>21,563</u>
Changes in finished products and work-in-progress inventories	621	1,803
	<u>17,130</u>	<u>23,366</u>

NOTE 20:- RESEARCH AND DEVELOPMENT EXPENSES

Salaries and related expenses	835	1,959
Other	1,021	1,649
	<u>1,856</u>	<u>3,608</u>

NOTE 21:- SELLING AND MARKETING EXPENSES

Salaries and related expenses	2,724	4,583
Commissions	102	92
Advertising	304	344
Foreign travel and transportation	709	860
Rent	411	553
Other	599	971
	<u>4,849</u>	<u>7,403</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 22:- GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31,	
	2009	2008
Salaries and related expenses	938	1,378
Management and consulting fees	200	206
Provision for doubtful accounts and bad debts	371	241
Depreciation	159	182
Other	1,002	1,255
	<u>2,670</u>	<u>3,262</u>

NOTE 23:- FINANCIAL INCOME AND EXPENSES

	Year ended December 31,	
	2009	2008
a. Financial income:		
Foreign exchange differences	2,371	3,707
Other	-	66
	<u>2,371</u>	<u>3,773</u>
b. Financial expenses:		
Bank borrowings, net	(439)	(655)
Foreign exchange differences	(2,338)	(3,996)
Other	(290)	(165)
	<u>(3,067)</u>	<u>(4,816)</u>

NOTE 24:- LOSS PER SHARE

The following reflects the net loss and share data used in the basic and diluted loss per share computations:

	Year ended December 31,	
	2009	2008
Loss attributable to Ordinary shares for basic and diluted loss per share	(886)	(2,949)
Weighted average number of Ordinary shares for basic loss per share	10,162,848	10,162,848
Effect of dilution:		
Share options	-	-
Adjusted weighted average number of Ordinary shares for diluted loss per share	<u>10,162,848</u>	<u>10,162,848</u>

In the calculation of the diluted loss per share for the year ended December 31, 2009 and 2008, all share options were not taken into account because of the anti-dilutive effect.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 25:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

- a. Balances with related parties:

	December 31,	
	2009	2008
Short-term credit (Note 9a)	140	140

- b. Transactions with related parties:

Since March 1, 2003, Mr. Bob Marbut, who is the Chairman of the Board of Directors and an indirect controlling shareholder of the Company, has been acting as CEO and president of a subsidiary in the United States ("STG"). The employment contract was for a period of one year, but is automatically renewable for additional one year periods, unless one of the parties makes prior notice of cancellation. In consideration for his services, Mr. Marbut is entitled to an annual salary of \$ 350.

On May 14, 2007, the Company's shareholders approved Mr. Marbut's decision to waive \$ 150 of his agreed salary in favor of Mr. Ron Chaimovsky, a director of the Company. On May 15, 2007, the Company signed an agreement with Mr. Chaimovsky. According to the agreement, Mr. Chaimovsky will provide management and consultation services to the Company. In consideration for his services, Mr. Chaimovsky is entitled to an annual salary of \$ 150.

On June 16, 2009, Mr. Marbut decided to waive \$ 50 of his salary.
In 2009, Mr. Marbut's and Mr. Chaimovsky's annual salary was \$ 150 each.

- c. Compensation of key management personnel of the Group:

	Year ended December 31,	
	2009	2008
Short-term employee benefits	1,742	2,193
Share-based payments	11	36
Severance pay	-	34
	<u>1,753</u>	<u>2,263</u>

NOTE 26:- OPERATING SEGMENTS

The Group operates in one business segment of electronic security with remote management solutions and complementary products.

The Group operates in two principal geographic segments: the United States and Europe.

Management monitors the operating results of its geographical units separately for the purpose of making decision about resource allocation and performance assessment. Segment performance is evaluated based on segment profit. Group financing (including corporate, research and development expenses, finance costs and finance income) and income taxes are managed on a group basis and are not allocated to operating segments.

Segment assets do not include deferred taxes and loans to associates, as these assets are managed on a group basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 26:- OPERATING SEGMENTS (Cont.)**

Segment liabilities do not include deferred taxes, current tax liability and loans, as these liabilities are managed on a group basis.

Capital expenditures consist of additions to fixed assets and intangible assets.

The following tables present revenue and profit information, and certain asset and liability information regarding geographic segments:

a. Revenues:

	Year ended December 31,	
	2009	2008
Sales to external customers:		
Europe	21,516	25,087
United States	1,550	5,581
Other countries	3,325	5,741
	<u>26,391</u>	<u>36,409</u>
Intersegment sales:		
Europe	1,761	2,061
United States	110	318
	<u>1,871</u>	<u>2,379</u>
Total revenues	28,262	38,788
Adjustments	(1,871)	(2,353)
Total revenues in financial statements	<u><u>26,391</u></u>	<u><u>36,435</u></u>

b. Segments results:

Sales less directly attributable and allocable expenses:		
Europe	3,914	4,630
United States	(757)	(891)
Other countries	432	734
	<u>3,589</u>	<u>4,473</u>
Adjustments	255	201
	<u>3,844</u>	<u>4,674</u>
Unallocated expenses	<u>(3,958)</u>	<u>(5,878)</u>
Operating income (loss)	(114)	(1,204)
Financial income	2,371	3,773
Financial expenses	(3,067)	(4,816)
Other income (expenses), net	(8)	2
Taxes on income	<u>(68)</u>	<u>(704)</u>
Net loss	<u><u>(886)</u></u>	<u><u>(2,949)</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 26:- OPERATING SEGMENTS (Cont.)

c. Segment assets:

	December 31,	
	2009	2008
Europe	6,847	6,301
United States	1,005	2,443
Other countries	601	1,818
	8,453	10,562
Adjustments	(39)	(34)
Unallocated assets	10,800	10,982
Total assets	<u>19,214</u>	<u>21,510</u>

d. Segment liabilities:

Europe	2,635	1,240
United States	6,474	6,881
	9,109	8,121
Adjustments	(6,536)	(6,656)
Unallocated liabilities	11,317	14,129
Total liabilities	<u>13,890</u>	<u>15,594</u>

e. Tangible fixed assets:

1. Capital expenditure:

Europe	1,490	50
United States	2	7
	<u>1,492</u>	<u>57</u>

2. Depreciation:

Europe	29	23
United States	16	17
	<u>45</u>	<u>40</u>

SCHEDULE OF ACTIVE INVESTEE COMPANIES

<u>Entity</u>	<u>Place of incorporation</u>
Electronics Line (UK) Ltd.	United Kingdom
Electronics Line USA Inc.	United States
Sectec Global Inc.	United States

All of the investees are wholly-owned subsidiaries held directly by the Company for all reported periods.

The Annual Report's Management Discussion And Analysis (the "Report")

1. BUSINESS OVERVIEW AND IMPORTANT TRENDS IN THE INDUSTRY
 - 1) Business Overview
 - 2) Market Information
 - 3) Business Strategy
2. RESEARCH AND DEVELOPMENT, PATENTS AND TRADEMARKS
3. OPERATING AND FINANCIAL REVIEW for 2009
4. Additional information
5. Risk Report
6. Outlook

Market Overview and Operational Activities

BUSINESS OVERVIEW AND IMPORTANT TRENDS IN THE INDUSTRY

The Company engages in the design, development, production, marketing and sale of security with remote management solutions as well as complementary products for the mass residential and small commercial markets. The Company's solutions include both wireless and wired security platforms including intrusion prevention, hazard detection including fire and water leaks, medical monitoring, home automation, video event capture and remote video look-in. These solutions can be monitored by a third party or by the end user and enable remote management via WAP and Web user interfaces to interactively manage the premises for security and automation, video and other applications. All these are provided using multiple communications protocols including PSTN, GSM, TCP/IP and GPRS.

The Company was incorporated as a private company limited by shares on December 19, 2002 with the Israeli Registrar of Companies in accordance with the laws of the State of Israel and started its activities on January 1, 2003.

Although in its current corporate form, the Company has existed for almost six years, Metis Capital Ltd. ("hereinafter "Metis") previously Electronics line (E.L.) Ltd, which transferred the business to the Company has existed in one form or another for over 25 years. Thus the Company has much more experience and familiarity with the security market, the technologies serving this market, its customers and competitors than would be apparent based on the period of its corporate existence.

The Company has a strong technological foundation and believes it is one of the leading companies in the field of integration of advanced communication methodologies with security systems for residential and small commercial users. While the majority of security system manufacturers focus primarily on PSTN and GSM (public switched telephony network, which is a telephone system based upon copper wires that carry analogue voice signals) narrow band telephone communication, the Company has also developed a platform that is compatible with GPRS cellular communications and high speed broadband Ethernet communications, in addition to traditional PSTN and GSM communications.

The Company's customers include leading security monitoring companies, service providers and distributors throughout the world. The Company supports its global customer base from its headquarters in Israel and its subsidiaries in the United States and the U.K. The Company further enhances its presence by using a network of distributors in various countries. The Company sells through both traditional security channels – monitoring companies and distributors – and non-traditional channels – including utility companies, cable companies, and non-security distributors.

The Company has a presence, and believes it is well positioned in important markets around the world, in particular Northern and Western Europe and consistently strengthens its position in additional regions in Latin America, APAC and more. The Company's brand is associated with high quality products and solutions.

The Company is a customer-centric organization and continuously endeavors to work with its customers to understand the market needs and to introduce new solutions to the market. The Company provides its customers with features for maximum convenience – including wireless detectors, wireless communicators, advanced management tools such as remote programming software and remote firmware updates. For the end user, the Company provides solutions that are designed to be easy to use and attractive and also have enhanced functionality, including a 45kg pet-immune motion detector, remote connectivity capabilities and home automation applications.

The Company has its own manufacturing facility and employs a multi-skilled R&D team that performs engineering, development and quality assurance testing. The Company believes this combination provides it with the flexibility and capabilities that are important in a market driven company to respond to customer demands.

Products and Product Families

The Company's latest, stylish solution launched is the *iConnect* product line which offers residential security, safety, connectivity and control with interactive remote management applications. These enable users to control and be connected to their homes, anywhere, anytime. Sophisticated remote management capabilities are attained using advanced communications based on PSTN, GSM, Ethernet, and a newly implemented GPRS platform.

An additional product line, CommPact is about to be introduced to the market during the first half of 2010. This product line presents all main security capabilities based on the *iConnect* technology, in a compact packaging and at cost effective market price.

Additional prominent product families are the *infinite* and the *infinite Prime* product lines, which enable using phone line, cellular and internet for communication between the premises, monitoring station and end-user. The *infinite Prime* product line includes a couple of options for the international market including a hybrid solution, and an Ethernet communications solution. *infinite Prime* was introduced to the market in August 2005, and includes an updated version of the *infinite* product with advanced end user and service provider features to enable voice communication, enhanced two-way connectivity and remote management, as well as a design that simplifies installation.

The Company's wireless family of products includes equipment located at the premises (such as a home or small business) – a control panel and peripherals such as motion detectors, door/window magnets, glass break detectors, water leak detectors and smoke and fire detectors. In addition, the Company sells equipment that is centrally located - such as a monitoring station – and this includes a receiver and other software used to monitoring signals from the home and to connect into the premises remotely.

The Company also sells fully wired security solutions – the Summit and Penta control panels and wired detectors as the secondary product family. These are used for similar solutions as the wireless product lines, but they are wired and target more traditional security customers.

Industry Information

Market Size

The global residential security market is estimated to be U.S.\$6.9 Billion in 2009,. Currently, the penetration of monitored residential burglar alarm systems is approximately 20% in the U.S. and 5% across Europe, and even lower in Asia. The U.S. market alone installs more than one million new residential systems per year.

Market Structure

The main players in the security market are: (1) the manufacturers of systems, (2) integrators, service providers, distributors and installers of systems who are responsible for reselling and/or installing the systems at end-user sites, and (3) alarm monitoring service companies that are responsible for monitoring the protected areas through monitoring centers and informing the local police or private security companies or other authorities of activations received by the systems.

Market Trends

The growth in the residential market is attributable to several factors: (1) the expected general growth in crime, (2) increase in the standard of living, and (3) a reduction in prices of security solutions. These factors all contribute to a growth in demand for security with remote management solutions.

In addition, the increasing availability of broadband and GPRS, encourage growth in the residential market. The trend appears to be that more and more end-users will be looking to be connected with their home or office. As part of this trend, end-users will be looking to obtain information valuable to them, such as if a child has arrived home from school, to look in on the nanny, remotely manage appliances, check the status of an alarm system or oversee operations within a store.

The Company is leveraging the opportunity to develop the channels seeking for security with remote management solutions. As a direct result of new technology which is digital/IP-based, the Company is able to integrate its technology and bundle the security with remote management solutions with service providers' other offerings (security providers, as well as cable companies, utility companies and telecommunication companies). This increases the number of distribution channels and provides the Company with a larger target market. The Company endeavors to work with service providers with established reputations and large customer bases, which enables the Company to benefit from their reputations. The Company offers multiple business models to service providers in order to maximize the Company's revenues from these customers.

The Company believes that both the service providers and the end users benefit from the Company's relationships with service providers. The service providers are able to increase their revenue base by offering the Company's solutions, and the end users are able to receive more value for the existing broadband or other platforms in their home or office.

Trend from Wired to Wireless Solutions

The Company focuses its marketing and sales efforts on its product family of wireless products and solutions. In the past, security systems were standard wired systems – these took days to install and lots of drilling and resultant damage in the homes and commercial installation sites. In addition, these systems were difficult for an end user to use and provided only the basic functionality of monitoring of intruders. Today, wireless solutions can be installed in less than two hours, with minimal drilling in the walls. The detectors may use encrypted RF (radio frequency) to communicate back to the control panel thus eliminating the need to run wires throughout the home. In addition, these solutions have easy-to-use interfaces including one button arming and disarming. This decrease in installation time reduces the overall cost of a system. As a result of this increase in functionality and the decrease in costs, the Company believes that there is and will continue to be a greater demand for wireless solutions in the foreseeable future. None the less the Company also offers a wide range of wired products, while the *infinite Prime* and iConnect also support existing wired installations.

Increased Functionality of Wireless Security Solutions

Today's security solutions integrate new technologies. They offer advanced functionality, including home automation – the ability to manage lights and appliances from the control panel, two-way connectivity and interactive medical monitoring and fire detection. A user can receive notifications from the system through a website, via email or an SMS message from a cell phone or other personal data accessories (PDA's). For example, a customer may send a web command or SMS to turn on the lights in a home, arm the security system, operate electrical appliances (air conditioning or hot water boiler) or receive an email about an emergency in the home.

Insurance Cost Savings

In some jurisdictions, a form of security system is mandatory in order to obtain property insurance. In addition, if a property owner has a professionally installed monitored solution, the property owner may be eligible for an insurance premium reduction. As a result, payments of the monthly service fees are often offset, in whole or in part, by the reduction in insurance premiums and do not constitute a new or significant financial burden on the customer.

Demand to Always be Connected to the Home or Office

The Company believes users have an increasing desire to be connected to their homes and offices, wherever they are. With cell phones and broadband access becoming ever more popular and available, people are more aware of the benefits of always being connected to their homes or offices. New security with remote management solutions integrates innovative communications such as GSM/GPRS (cell phone) and Ethernet (internet). These types of communications enable an end user to proactively receive information about the status of the home (e.g., if a child arrived home from school or if an elderly parent got out of bed in the morning).

New Companies Distributing Security with Remote Management Solutions

Professional security systems have principally been sold through traditional security monitoring and distribution companies. Today, many new players, such as value added resellers, in addition to service providers, are looking for additional solutions to add to their product portfolio in order to increase their revenue per customer; therefore, the availability of the solutions to the end customers is expanding.

Market Structure

The main players in the security with remote management market are: (1) the manufacturers of systems, (2) integrators, service providers, distributors and installers of systems who are responsible for reselling and/or installing the systems at end-user sites, and (3) alarm monitoring service companies that are responsible for monitoring the protected areas through monitoring centers and informing the local police or private security companies or other authorities of activations received by the systems

Industry Standards

Industry Standards

Industry standards create a barrier to entry into the industry and into specific countries, as they are costly and time consuming to obtain. As in other industries, alarm manufacturers are expected to conform to ISO 9001:2000 quality standards.

The Company received confirmation from the Israeli Institute of Standards that the Company's production facilities in Israel comply with the requirements of the Israeli and International Standard ISO 9001:2008. This approval is valid through **December 29 2012**

Certain of the Company's products **are approved** international **institutes**, including:

Standard	Country	Nature of Products
VDS	Germany	Security and Functionality
CE	European Union	RTTE & LVD Directive
EN50131	European standard for Alarm system	Functionality
F&P	Denmark	Security and Functionality
UL	USA	Security and Functionality
FCC	USA	Communication Interruptions
ACTA	USA	Telecom
CCC	China	Security and Functionality
NCP	Holland	Security and Functionality
INCERT	Belgium	Security and Functionality
F&G	Norway	Security and Functionality

Business Strategy

The Company engages in the design, development, production, marketing and sales of security and control solutions with remote management applications for the mass residential and small commercial markets.

The Company's vision is to be a leading global provider of wireless security with remote management solutions for the mass residential and small commercial markets.

Key elements of the Company's growth strategy include:

- Focusing on non-traditional marketing and distribution channels, such as value added resellers, Telcos and IT companies and others to develop new markets for security with remote management solutions.
- Continuing to position the Company's wireless products as an innovative quality solution that reduces operating expenses for the service provider and increases functionality and control for the end user.
- Developing and strengthening relationships with key target customers in order to sell to their customers the wireless security with remote management solutions.
- Providing a full range of market solutions – from standard, low cost solutions to high end, advanced solutions
- Increasing services which are available as part of the Company's platform for remote management solutions, including advanced video capabilities, remote management applications and more.
- Leveraging wireless technology and various platforms to develop new solutions.
- Invest in both short-term and long-term R&D in order to improve product design and lower production costs.

- Continuously evaluate the Company's organizational structure and make changes as needed to maximize efficiency, sales and profitability.

Trends and Developments

The following are several characteristics, trends and developments, which are currently affecting or are likely to affect the operations of the Company in the future:

Developments in Markets or Changes in Customer Needs

As technologies converge, end user demands for solutions may evolve and new companies may enter the market to provide competitive or complementary solutions to the Company's offerings. The Company intends to continue to focus on developing new solutions to meet the customers' needs. In addition, the Company intends to develop new channels to reach end users in both the residential and commercial markets, with a particular focus on markets where it has been successful in the past.

Customers

General

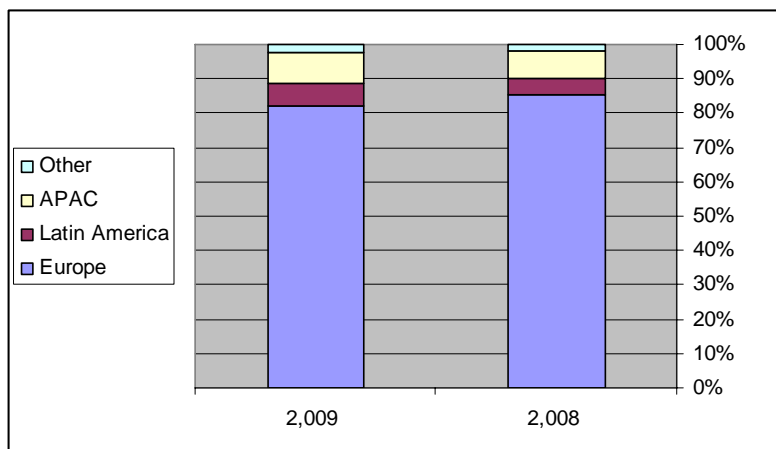
The Company's current customers include monitoring companies, distributors, value added resellers, security providers and service providers in Europe, Latin America, APAC and other parts of the world. Approximately 99% of the products that are produced by the Company are exported from Israel, where they are manufactured.

Key Customers of the Company include:

- Four security service providers.
- Four value-added resellers

The Company's only field of activity is the design, development, production, marketing and sale of security with remote management solutions as well as complementary products for the mass residential and commercial markets.

The following is the distribution of the revenues of the Company according to geographical regions. The figures include sale's distribution from the Company's headquarters:



Service Providers/Monitoring Companies

The Company sells its products to large providers with strong marketing organizations that have a large customer base. These service providers, in turn, sell and install the Company's solutions at the end user's location. In addition, these service providers take responsibility for monitoring of emergency events, technical support and maintenance of the solutions.

Distributors and Value added resellers

The Company also sells to local distributors who buy the product from the Company and re-sell the products to installers who take responsibility for the sales, installation and maintenance of the Company's solutions. The Company focuses only value-added resellers that can also be responsible for marketing and advertising activities, as well as approaching service providers.

Marketing and Sales

The Company sells its products and solutions directly through its own sales force and the sale forces of its subsidiaries, as well as indirectly through local distributors. The Company has an established customer base with which it works either on an order-by-order basis or via yearly forecasts with regular purchase orders.

The Company's sales and marketing headquarters are located in Israel. In addition, the Company has local and regional direct sales offices through its subsidiaries in the UK and USA.

The Company has indirect sales channels through local distributors. The Company engages only with selected distributors chosen for their proven ability to act as effective marketers in their territories. The Company works on both exclusive and non-exclusive bases with its local distributors. In exclusive relationships, the Company typically imposes minimum annual purchase requirements on the distributors. Should a distributor fail to meet these annual minimum purchase requirements, the Company may choose to terminate the distributor's exclusivity or distribution agreement.

In several countries, there is more than one distributor, and different distributors may sell different models of the Company's products. Such distributors purchase the products from the Company and re-sell them to end users.

The Company utilizes a variety of marketing programs to support its sales efforts and to promote its products and systems including seminars, print advertising, trade shows, speaking engagements, public relations activities, web site advertising and more. The sales and marketing department also performs product demonstrations and prepares product literature, including product presentation materials, brochures, data sheets and materials that are relevant to the area of interest of a specific customer.

The Company markets products under its own brand names and also under private labels for selected large customers.

From its office in Israel and through its subsidiaries, the Company provides global customer support. The customer care team consists of trained professionals who use advanced computer and communications systems to respond to the technical needs of the Company's customers.

The Company provides customer support to its customers, but not to the end users of the systems. To minimize overall service calls and increase customer satisfaction, the Company's products and services are specifically designed with remote diagnostic and management tools that enable the customer to troubleshoot and maintain the system. In addition, this capability enables the Company to provide customers with real-time support if they are experiencing trouble while at an end user's premises.

Competition

The market for security with remote management solutions is an established yet growing industry. The market is global in nature, yet it has national customizations. The players in the security with remote management

market include manufacturers of systems, service providers, distributors, installers and the monitoring stations. The main manufacturers of systems include large global entities such as Tyco, a worldwide leader in fire protection and electronic security; General Electric, a global conglomerate with a security group providing wired and wireless intrusion products and fire protection components; Honeywell, a global conglomerate; and Bosch, a global conglomerate with a security division focused on large scale electronic security systems. Smaller players include Visonic, Rokonet and Crow –Israeli companies selling intrusion products.

Manufacturing Capability

The Company manufactures its own products from its facility in Petach Tikva, Israel. The Company maintains two independent robotic production lines with a combined capacity of 15 million components per month when operated with three shifts. The Company also has additional machines for sub-assembly. As of the date of this Report, the Company, on average, utilizes approximately 70% of its manufacturing capability. The Company, to the extent necessary, also transfers a part of the production to sub-contractors.

Raw Materials and Suppliers

The Company's raw materials are mainly electronic, metal and plastic components, such as microchips, control panel covers and motion detector covers. Most of the raw materials have several alternative vendors, thus minimizing the Company's dependence on a single vendor. For select raw materials, which are in shorter supply or require longer lead times, the Company undertakes to maintain appropriate inventories to meet the demands of manufacturing. A delay in the supply of, or shortage of, raw materials could impede or delay the production of the Company's products and the Company may be unable to find alternative suppliers.

The Company purchases raw materials from a large number of suppliers.

The Company has written agreements with many of the vendors that it orders from on a regular basis. For vendors that the Company orders from on a one-time basis, the Company submits a purchase order to these vendors as needed.

For some particular component the Company currently uses a single supplier. The lead-time for these components is relatively long. The Company cannot assure its continued supply from this particular supplier but is of the opinion that, if needed, it could find an alternative supplier for these same components within a reasonable period of time. The Company is currently investigating a second source for these components.

In addition, the Company purchases machinery and equipment from third parties both in Israel and overseas.

Raw Materials Inventory Policy

The policy of the Company is to maintain approximately three months of raw materials inventory. The entire raw materials and work in process inventory is maintained by the Company in Israel.

The Company will endeavor to take advantage of opportunities and or market conditions to increase the volume of raw materials purchasing in order to realize cost savings to the Company.

Finished Goods Inventory Policy

As a rule, the Company's policy is to manufacture products according to orders ("build to order") and not for inventory. The Company therefore does not maintain extensive inventories of its finished goods. The majority of finished goods inventory that the Company has is held by its subsidiaries.

Description of Company Policy of Warranty

The Company limits its liability for product warranty as follows:

- Most of the products sold by the Company have a 24-month warranty from the date of shipment to the customer against defects in material or workmanship, although some have a 36-month warranty.
- Batteries and software are not covered under the Company's warranty.
- The Company repairs or replaces products found to be defective in material or workmanship. The cost of fulfilling its warranty obligations includes labor required to repair the defect, material cost and return shipping and insurance costs.
- A product, even though defective, will not be covered by the Company's warranty if the product is altered, tampered with or improperly repaired or serviced by anyone other than the Company or an entity or individual approved by the Company in writing.
- Other than intentional misconduct, the Company further limits its liability by placing a maximum limit on the amount for which it can be held liable in the event of a claim for loss or damage due to a product defect, such limit being the price of the alleged defective product.
- The Company disclaims all other warranties, other than those explicitly set forth in its written agreement including, but not limited to, the warranty of merchantability or fitness for a particular purpose.

The Company's product warranty is a part of the Company's standard sales agreement. Because the Company conducts business in many countries, the enforceability of the product warranty may be governed by different countries laws.

Regulatory Provisions

In each country in which it does business, the Company is subject to the applicable statutes and provisions in relation to its business. These include provisions on technical safety and environmental protection, provisions concerning the reporting, registration, labeling and handling of products, labor law provisions, and industrial and occupational safety provisions. The Company's products comply with the safety standard requirements of the European Union and are entitled to be marked as "CE". Most of the Company's products also meet the safety standards set by the UL (Underwriters Laboratories), including the *infinite* product line which is in the process of obtaining UL approval, and the communication standards set by the FCC (Federal Communications Commission) in the United States.

Insurance

The Company and its subsidiaries have group insurance (property damage and business interruption insurance) insuring them against the physical loss or damage, including total destruction or partial damage of their plants and other property and loss resulting from interruption to operations as a result of such physical loss or damage. In addition, the Company and its subsidiaries have insurance protection under group insurance, including environmental insurance caused by an accidental occurrence and product liability insurance policies, as well as other property and liability policies. Directors' and Officers' insurance is in place on a group basis to protect all office holders, including the members of the Company's governing bodies and including all subsidiaries. In the Company's opinion, the sums insured and limits of liability under all policies provide adequate insurance protection in line with industry standards.

RESEARCH AND DEVELOPMENT, PATENTS AND TRADEMARKS

Research and Development

The Company considers R&D to be an essential part of its operating discipline and strategy. The Company intends to continue to invest substantial resources in R&D.

The Company conducts surveys of both its customers and the end user to solicit feedback on its products and services. In addition, the Company monitors the market, industry trends and its competitors to anticipate future functionality requirements and to develop new products and services that meet the needs of both its customers and their end users.

The R&D team is 40 people strong and is comprised of both employees and outsourced professionals with multi-disciplinary qualifications in electronics, assimilation of systems, physics, optics and software development. In addition, the Company utilizes sub-contractors from time to time to complement its in-house skills. The R&D team has developed numerous products including, the leading *infinite* wireless platform, and currently has several other product offerings in various stages of development.

The know-how and technology developed by the Company is used solely for the Company's products and services. The Company does not engage in the sale or licensing of its know-how.

The Chief Scientist

Certain products are developed using financing, in part, provided by the Chief Scientist of the Israel Ministry of Industry and Trade (the "Chief Scientist"), which is responsible for implementing the Israeli government's policy regarding the support and encouragement of industrial research and development within Israel.

In order to repay the amount of grants received from the Chief Scientist and in accordance with the letters of approval originally issued to Metis in 1998 and earlier, the Company pays royalties to the Chief Scientist at the rate of 2% - 3.5% of sales for those products that were developed in part or in whole with funds from the Chief Scientist. The total royalties paid shall not exceed the amounts of the grant as linked to the U.S dollar. As of the date of this Report, the Company (and earlier Metis) received grants totaling approximately U.S.\$ 1.67 million of which a total of U.S.\$ 425,000 has already been refunded to the Chief Scientist.

The participation of the Chief Scientist in R&D expenses is conditioned on the fact that the R&D efforts are undertaken in Israel, unless the Chief Scientist approves another arrangement. A separate agreement is required from the Chief Scientist to transfer technologies outside of Israel, which were developed with governmental funding. These restrictions do not apply to the export for sale of products that were developed with the Chief Scientist's funds. The Company is also required to notify the Chief Scientist of any change of 25% or more in the shares of the Company and/or a change in the means of control: (1) Voting rights in meetings of the Company; (2) the right to appoint officers to the Company; and (3) the right to participate in profits of the Company. Furthermore, according to the letter of approval, any transferring of control to a foreign resident or to a foreign company requires the advanced written approval of the Research Committee of the Chief Scientist office.

R&D Agreement

Intangible Assets

Patents

As of the date of this Report, the Company has four registered and two pending patents.

The following is a list of patents, registered in favor of the Company and/or its subsidiaries or patents to which the Company and/or its subsidiaries has an exclusive right of use thereof as of December 31, 2009

The Patent	The Country of Registration	Status		Expiration Date
Burglary infra red detector and methods	Israel (127407) United States (6,642,846)	Registered Registered	Fee due 6-Dec-08 Fee due 4-Jul-11	Dec 6, 2018 Dec 6, 2019
Methods of practical implementation and sorting, mainly of a Doppler effect detector and burglary detector systems	Israel (127438) United States (6,509,835)	Registered Registered	Fee due 7-Dec-08 Fee due 21-Jul-10	Dec 7, 2018 Dec 6, 2019
A system and method for the detection of moving objects during burglary.	Israel (130398) United States (6,348863)	Registered Registered	Fee due 9-Jun-09 Fee due 19-Aug-09	Jun 9, 2019 Aug 8, 2020
Method and apparatus for detecting moving objects, particularly intrusions	United States (CIP) (6,774,791)	Registered	Fee due 10-Feb-12	Jun 5, 2021
System for remote secured operation, monitoring and control of security	United States (11/433,954)	Pending	Awaiting office action	May 15, 2026
Remote configuration of security – oriented devises	United States (11/603,906)	Pending	Awaiting office action	Nov 24, 2026

The Company shall be able to continue with its ongoing operations and business notwithstanding the expiration or invalidity of any of the patents listed above.

Trademarks

EL-UK registered the trade name of “*infinite*” on March 20, 2003.

The Company has filed for the following trademarks or service marks:

- Electronics Line with logo - Madrid Protocol Countries (includes USA), China, Turkey, Norway, the Russian Federation and Bulgaria
- *infinite* – Madrid Protocol Countries (includes USA), China, Turkey, Norway, and the Russian Federation
- *infinite* Triangle Logo - Madrid Protocol Countries (includes USA), China, Turkey, Norway, and the Russian Federation
- E.L. - China
- SecTecGLOBAL – USA (SecTec Global, Inc. is a wholly owned subsidiary of the Company)
- iConnect logo –In Israel, China, European union, United States, Chile

Domain Names

The Company has the following internet domain names:

- ELECTRONICS-LINE.EU
- electronics-line.com
- electronics-line.co.il
- electronics-line.in
- elecline.com
- electronics-line.co.uk
- el3000.com.cn
- elgoldkeeper.com
- sectecpartners.com
- sectechpartners.com
- sectec-partners.com
- infinitebroadband.net
- espuk.com
- sectecglobal.com
- sectecusa.com
- sectecus.com
- sectecglobal.net
- sectecglobal.org
- argglobal.com
- El-usa.com

OPERATING AND FINANCIAL REVIEW for 2009

General

We hereby submit the Directors' Report for the year ended December 31, 2009 (the "Reported Year") and the respective 2008 year.

Corporate Description and Business Environment

The Company engages in the design, development, production, marketing and sale of electronic security with remote management solutions and complementary products for the mass residential and small commercial markets. These solutions can be monitored and enable remote management of the premises for security, automation, and video applications.

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

General Results Review

The Company is facing internal and external challenges due to the recent developments in the global economy. These global economic developments have affected the Company, its customers and suppliers and introduced new challenges for the Company's 2009 performance and results.

The Company's U.S. subsidiary ("ELUSA") has been undergoing a transition phase, severely influencing the Company's results for 2008 and the current period of 2009, as well as the U.S. subsidiary's cash and cash-flow situation. The Company has been taking necessary measures to address this issue and prevent further losses. As part of these measures, during Q2 2009, ELUSA entered into an agreement with a local U.S.-based service provider to spin out ELUSA's non-core products, such as the DVRs and CCTV.

In light of the global situation, the Company has been implementing a rolling efficiency plan since December 1 2008, which mainly influenced results from the second quarter of 2009 onwards.

The Company's revenues in the Reported Year amounted to \$26.4 million, compared to revenues of \$36.4 million for 2008. The Company's 2009 reduction in sales is mainly a result of the U.S. subsidiary's performance and the devaluation of the British Pound against the U.S. Dollar plus a slowdown in sales of some of the Company's customers in other regions.

Revenues (In 000's)	2009	2008
IL	17,846	22,180
UK	7,153	8,718
USA	1,391	5,518
Total	26,390	36,416

The gross margins for the Reported Year amounted to 35%, compared to a gross margin of 36% in the comparable year.

The gross profit in the Reported Year amounted to \$9.3 million, compared to \$13.1 million for the fiscal year of 2008.

Research and development costs and know-how amounted to \$1.9 million compared to \$3.6 million for 2008. The reduction in Research and Development costs is mainly due to the efficiency plan implemented since December 2008 and the completion of several R&D projects from 2008. Nevertheless, the Company is focusing on developing new products and services that will help the Company to remain an innovation leader in its markets. \$ 392,306 of these new costs for developing future products was capitalized by the end of the year.

Sales and marketing expenses amounted to \$4.8 million during the Reported Year and \$7.4 million for 2008. The reduction is mainly driven by the efficiency plan that was implemented and the spin off of the non core activity in the U.S. operation. The Company continues to develop and expand its marketing and sales capabilities with a focus on strategic customers while, at the same time, providing more marketing and technical support to existing customers due to the tough economic situation in certain countries.

General and administrative expenses amounted to \$2.7 million during the Reported Year and to \$3.3 million for 2008.

The Company's operating loss was \$114,000 during the Reported Year, compared to an operating loss of \$1.2 million for 2008.

Net financing and other net expenses net, amounted to \$704,000 during the Reported Year, compared to \$1.0 million for 2008.

Part of these costs, as well as payments in NIS to local suppliers have, has been hedged against the U.S. Dollar. Nevertheless, the influence of the strengthening of most currencies against the U.S. Dollar negatively influenced operating loss.

Loss before taxes on income amounted to \$818,000 during the Reported Year, compared to a \$2.2 million loss for 2008.

Tax expense was \$68,000 during the Reported Year, compared to \$704,000 for 2008. .

The Company ended the Reported Year with a net loss of \$886,000, compared to a \$2.9 million loss for 2008.

Move from Prime Standard to General Standard

Following the Board resolution dated February 8, 2009 to move from the Prime Standard to the General Standard, the Deutsche Bourse has announced Electronics Line 3000's revocation from the Prime Standard on March 17, 2009.

The revocation does not affect the admission to the regulated market (General Standard). It had the objective of reducing the costs and the administration efforts associated with the listing and took effect three months after the announcement of the revocation by the executive of the German Stock Exchange on the internet at www.deutsche-boerse.com. ; i.e., on June 18 2009.

On June 18 2009, all Electronics Line 3000 shares were traded on the General Standard for the first time.

The Company's Financial Position

The Company's cash and cash equivalents on December 31, 2009 (hereinafter: "the Reported Date") were \$2.2 million, compared to \$2.3 million on December 31, 2008.

The Company's trade receivables on the Reported Date were \$3.9 million, compared to \$6.5 million on December 31, 2008.

The Company's prepaid expenses, other accounts receivables, advance payments to suppliers and income tax receivables on the Reported Date were \$1.3 million, compared to \$1.4 million on December 31, 2008.

The Company's inventories on the Reported Date were \$5.9 million, compared to \$6.6 million on December 31, 2008.

Net investment in non-current assets, less amortization, on the Reported Date amounted to \$5.8 million, and a \$4.7 million investment on December 31, 2008, was comprised of the following:

- Net investment in property, plant and equipment, less amortization, was \$5.2 million on the Reported Date, compared to \$4.4 million on December 31, 2008. During the second quarter of 2009, Electronics Line 3000's UK subsidiary, finalized the acquisition of new commercial property which will serve as the Company's hub for all European activities. The acquisition was financed by UK loans, all of which will be returned within 20 years at most.
- Deferred taxes were \$215,000 on the Reported Date and on December 31, 2008.
- Security deposits were \$74,000 on the Reported Date, compared to \$86,000 on December 31, 2008.
- Net investment in research and development for products that have been proven to be technologically feasible, but have not yet been released, was \$392,000 in the Reported Period.

The short-term credit balance from banks and others on the Reported Date was \$5.7 million, compared to \$8.1 million on December 31, 2008.

The Company's trade payables as on Reported Date and on December 31, 2008 were \$4.1 million.

Other current liabilities, accrued expenses and income tax payable were \$2.5 million, the same as on December 31, 2008.

Long-term loans were \$1.2 million on the Reported Date, compared to \$77,000 on December 31, 2008.

Financial Ratios

	December 31, 2009	December 31, 2008
Current Ratio	1.1	1.1
Quick Ratio	0.6	0.7

Cash Flow

During the Reported Year, net cash provided by operating activities was \$3.4 million, compared to \$1.8 million provided during the entire year of 2008. Most of the increase in cash provided by operating activities is derived from the decrease in trade receivables.

During the Reported Year, the Company directed \$2.0 million towards investment activities, compared to \$365,000 during the entire year of 2008. As elaborated above, the increase is mainly due to the acquisition of commercial property.

During the Reported Year, cash used in financing activities amounted to \$1.6 million, compared to \$2.1 million that was used in financing activities during the fiscal year of 2008. Loans of \$1.6 million were taken in order to finance the commercial property that was acquired in the UK. During the period, the Company repaid \$2.3 million of principal for the combined loans.

Financing Sources

Shareholders' equity as of December 31, 2009 amounted to \$5.3 million, a ratio of 27.7% to the total balance sheet, compared to \$5.9 million and 27.5%, respectively, as of December 31, 2008.

On December 31, 2009, short and long term credit from banks and other creditors designated for financing working capital and investments in fixed assets and rental property was \$13.5 million, compared to a credit balance of \$14.8 million on December 31, 2008.

General Israeli Tax Law Information

Measurement of results for tax purposes under the Israeli Income Tax (Inflationary Adjustments) Law, 1985:

Income Tax (Inflationary Adjustments) Law, 1985:

According to the law, until 2007, the results for tax purposes were adjusted for the changes in the Israeli CPI.

In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Since 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. Adjustments relating to capital gains such as for sale of property (betterment) and securities continue to apply until disposal. Since 2008, the amendment to the law includes, among others, the cancellation of the inflationary additions and deductions and the additional deduction for depreciation.

Tax benefits under the Israeli Law for The Encouragement of Industry (Taxes), 1969:

The Company is an "industrial company" as defined by the Israeli Law for the Encouragement of Industry (Taxes), 1969 and, as such, is entitled to certain tax benefits, primarily accelerated depreciation and the right to claim public offering expenses as a deduction for tax purposes.

Tax benefits under the Israeli Law for The Encouragement of Capital Investments, 1959:

Metis was accorded the status of an Approved Enterprise under the Israeli Law for Encouragement of Capital Investments, 1959. On December 31, 2002 (see Note 1), the benefits deriving from this status were transferred to the Company. These benefits include an exemption from income taxes on income from the Approved Enterprise for a period of four years beginning with the first year in which it reports taxable income (started in 2000) and a reduced tax rate of 25% for the following three years (starting 2004).

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above law, regulations published thereunder, and the instruments of approval for the specific investments in "Approved Enterprise". In the event of failure to comply with these conditions, the benefits may be canceled, and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2009, management believes that the Company is meeting all of the aforementioned conditions.

In the event of distribution of a dividend from tax exempt income, as described above, the Company will be required to pay income tax at a rate of 15% and the dividend will be subject to 15% tax withholding. The Company's policy is to reinvest its tax-exempt earnings and not to distribute such earnings as dividends. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate.

A recent amendment to the Law, which was officially published effective as of April 1, 2005 ("The Amendment") has changed certain provisions of the Law. As a result of the Amendment, a company is no longer obligated to implement an "Approved Enterprise" status in order to receive the tax benefits previously available under the alternative benefits provisions, and therefore there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authorities for a pre-ruling regarding their eligibility for benefits under the Amendment.

Approved Enterprise Status

The Offices of the Israeli Chief Scientist

The Company is obligated to pay royalties of 2% -3.5% of the revenues from products in the development of which the Chief Scientist participated. The royalties are limited to the amount of the grant received, linked to the U.S dollar. Total grants received as of December 31, 2009 and 2008 amounted to approximately \$ 1,670 and the balance of contingent royalties amounts to approximately \$ 1,238 and \$ 1,238, respectively

Under the conditions of an agreement for participation by the Bi-National Fund for Research and Development (BIRD) in joint R&D programs between the Group and a U.S. company, BIRD granted grants to the Group. In consideration for this grant, BIRD is entitled to royalties of between 2.5% and 5% of the gross sales of products resulting from this research, up to the amount of the grant, linked to the U.S dollar. Thereafter, BIRD will be entitled to royalties of 2.5% of sales up to an additional amount equaling half of the grant received. On January

1, 2003, the benefits and the obligations deriving from this agreement were transferred to the Company from Metis. The grants received by the Company and the balance of contingent royalties as of December 31, 2008 and 2007 amounted to approximately \$ 340.

It was also agreed with BIRD that should one of the companies register a patent on a product developed, the Group will also pay royalties to BIRD at the rate of 1.5% of the gross sales of the product resulting from the research, for the duration of the patent.

The benefits under the Encouragement of Capital Investments Law are conditional upon compliance with conditions set out in that law and in the Letters of Approval in accordance with which the investments were made in the approved enterprises. Non-compliance with the conditions may lead to a cancellation of the benefits, in whole or in part, and to the repayment of the amounts of the benefits with interest. In the opinion of the management of the Company, the Company is in compliance with the aforesaid conditions.

A dividend that is distributed from the income of an approved plant is liable for tax at a rate of 15% by the recipient thereof, including by a company that is resident in Israel (unless its recipient is entitled under an international convention to a lower rate of tax). If a dividend is distributed from exempt income from an approved enterprise, the Company, although previously exempt, will be liable for tax, which it received an exemption from paying, on the amount of the grossed-up dividend which will be distributed, and this is in addition to the tax at the rate of 15% that is payable when the dividend is distributed.

The Company believes that its Approved Enterprises currently operate in compliance with all applicable conditions and criteria, but there can be no assurance that it will remain in compliance in the future.

Additional information/additional balance

No event has occurred since December 31, 2009 which may have a major impact on the company's activities.

Risk report

Risks related to the Company

Dependence on Sub-contractors

The Company depends on sub-contractors who perform research and development services, quality assurance testing and prepare production files on its behalf. In the event that the relationship with any of the sub-contractors is terminated, the Company may incur a delay in developing new products and in producing and supplying its products until such time as the Company is able to locate and establish a relationship with alternative sub-contractor(s) or alternatively, perform such work in-house. Additional time would be needed before such new sub-contractor(s) or internal personnel could render effective development services and prepare production files previously provided by the original sub-contractor(s). This time delay could affect the Company's ability to launch new products or introduce new versions of products in a timely manner which could adversely affect the Company's market share. In addition, any arrangement with a new sub-contractor or a decision to perform any such work in-house may increase the Company's costs and affect its gross margins.

The Dependence on Integrators, Service Providers, Distributors and Installers of Systems

Currently, the Company does not typically sell its solutions to end users. The Company's traditional customers are integrators, service providers, distributors and installers of systems. Therefore, the Company is dependent, and has little control over, the customers who are, in fact, third-party installers of the Company's products. The Company has virtually no contact with end users of the product. The Customers are responsible, for the most part, for the sale, installation and technical support of the Company's products with the end user. Due to this extended channel of distribution, the business results of the Company could be significantly harmed through changes in the business conditions of the Customers which are beyond the ability of the Company to control. Installation and/or service problems could arise that might affect the sale of products to end users and because the Company does not perform the installation or service of its Products at the end user facility, it might be difficult for the Company to positively impact or resolve such issues between the Customer and the end user. Furthermore, the Company may not be able to preserve its current relationships or to develop new relationships with different Customers. Any such change in its relationships with Customers is liable to significantly harm the business affairs of the Company, affect the Company's sales and its financial condition and business results.

Dependence on Key Customers

The Company's sales to its largest four customers accounted for approximately 30.1% of its total revenues in 2009 and approximately 29.5% of its total revenues during 2008. The Company does not have long-term purchase contracts with its customers, and sales arrangements with some of these customers do not have minimum purchase requirements. The Company cannot assure that these major customers or any other customer will continue to purchase its products at all or in the same volumes or on the same terms as they have in the past. Their failure to do so may significantly reduce the Company's revenues.

Delay or Discontinuation of the Supply of Raw Materials

Currently, the Company receives sales forecasts from part of its customers. Based on these sales forecasts and incoming orders, the Company purchases raw materials needed for production. The Company generally maintains a sufficient inventory of long-lead time items in order to meet its production schedule. The Company does purchase several components from a sole source supplier. This makes the Company dependent on a single supplier. In the event the sole source supplier ceases to supply the Company or materially raises its price, or the Company incurs substantial delay in delivery, the Company may need to seek a new supplier for these components. The search process can be time consuming, costly, and could potentially delay production until the new suppliers components are tested and approved.

There may be a delay in supply of, or a shortage of, raw materials or component(s) that could impede or delay the production of the Company's products, particularly with respect to raw materials supplied by a sole source supplier. The Company may be unable to quickly locate alternative sources for needed components at reasonable prices and at the time needed to meet the Company's production cycle. In the event of i) a delay in supply, or ii) shortage of raw materials, customers may cancel their orders or turn to the Company's competitors to fill their orders. In addition, in the event the Company is compelled to find new sources of supply, this could cause delay in shipments of its products, which could increase its costs in order to meet the Company's commitments to its customers.

The Company may choose to maintain inventories of certain components that exceed what is necessary for the short term in order to have a small buffer stock to compensate for shortages or cessation in the supply of components. In such event, the Company will incur additional costs to maintain this excess inventory, which could affect its gross margins.

Changes in Rates of Exchange

At certain points in time, the financial statements can be exposed to fluctuations created due to the fact that some of the financial balances are linked to different currencies other than the U.S. dollar as opposed to the financial statements of the Company, which are denominated in U.S. dollars. In the event of depreciation in the U.S. dollar vis-à-vis other currencies, the Company will incur additional financial expenses, which would have a negative impact on the Company's operations and its financial condition. The Company endeavors to mitigate its exposure to such currency fluctuations by entering into transactions in different currencies with customers and suppliers.

In addition, the Company is exposed to exchange rate fluctuations between the U.S. dollar and other currencies, which may negatively affect its earnings. A substantial majority of the Company's revenues are denominated in U.S. dollars; however, a significant portion of the expenses associated with the Company's Israeli operations, including personnel, are incurred in NIS. The Company cannot predict any future trends in the exchange rates of the NIS against the U.S. dollar. In addition, exchange rate fluctuations in currency exchange rates in countries other than Israel where the Company operates may also negatively affect the Company's earnings. These currencies currently include the Euro and the British Pound.

The Company has established certain hedging policies to protect itself against the impact of currency fluctuations going forward.

Intellectual Property

The Company's ability to protect its proprietary technology is critical to the Company's future. The Company relies on a combination of patent, copyright, trademark and trade secret laws in order to protect its intellectual property rights. The Company currently has been issued four patents and has filed an additional provisional patent.

The process of seeking patent protection can be long, expensive and sometimes unsuccessful. Therefore, the Company has chosen to file for protection of its intellectual property in certain selected markets, although not in all markets in which the Company sells its products. There can be no assurance that the Company's pending or future patent applications will result in patents being issued or that the Company's existing patents or any future patents which may be granted will provide meaningful protection or commercial advantages to the Company. A patent only affords partial protection to intellectual property as much depends on the climate of enforcement within the country granting the patent. In addition, any issued patent may be challenged, invalidated or legally (or illegally) circumvented by third parties, and the Company cannot be certain that its patents will be upheld as valid, be enforceable or prevent the development of competitive products. Moreover, the Company sells and markets its products in some countries; e.g., China, with potentially weak enforcement of intellectual property rights. If competitors are able to develop, manufacture and sell products that directly compete with the Company's products, the Company's sales and gross margins could be adversely affected.

In addition, competitors could purchase one of the Company's systems and attempt to replicate some or all of the competitive advantages the Company derives from its development efforts or design around the Company's protected proprietary technology or develop their own competitive technologies that fall outside of the Company's protected intellectual property rights. If the Company's intellectual property is not adequately protected against use by competitors and other third parties, its competitive position could be eroded and its business could be adversely affected.

In addition to the risks of third-party infringement of the Company's intellectual property, there is also the risk that the Company may inadvertently and innocently infringe on the intellectual property of a third party, which would expose the Company to possible patent infringement claims which are often lengthy and costly disputes. The Company may be required to obtain licenses from third parties or otherwise redesign its products so as not to utilize such intellectual property, which may be uneconomical or otherwise impossible.

Risks Pertaining to Product Liability and Product Warranty

The products developed by the Company may contain latent defects that may only be discovered after the products have been installed and are in use. Such defects could cause a reduction in the satisfaction of customers, harm the reputation of the Company or the need to introduce costly changes to the product. In addition, the Company could be exposed to potential product liability claims. This could involve significant costs to the Company. Although the Company has a Corporate General Liability insurance policy, this policy does not cover costs the Company may incur to change the product, and there is no guarantee that the Company's insurance policy will fully cover any and all types of claims pertaining to product liability or afford coverage to the full extent of such claims that may be filed against the Company.

The Company provides a limited product warranty for the use and operation of its products, many of which also contain components manufactured by third parties. In effect, the Company is warranting components which it does not manufacture. This could give rise to a situation whereby the Company provides a more extensive warranty on these third party components than the Company receives from such third party manufacturers, thus creating some warranty exposure for the Company.

Marketing and Product Risk

The Company spends significant time and money to understand the needs of the market; however, the Company may misjudge market needs. The Company may design products and solutions that do not meet market demands or are not priced correctly or are not delivered to the market in a timely manner. For example, the Company may develop complementary products for its security solution with remote management capability that the market determines is not necessary. In case this event happens, the Company's costs would increase without a corresponding increase in revenues. This may have a negative impact on the Company's operations and its financial condition.

International Markets

The Company sells its products globally, primarily in Western Europe, the United States and Asia. As a result of operating internationally, the Company may face the following risks due to its international operations, any one of which may affect sales or the Company's profitability:

- Changes in governmental requirements and regulations and differences in various country's requirements;
- Difficulty in collecting accounts receivables;
- Differences in customs in each country;
- Differences in taxation in different countries;
- Political and/or economic instability;
- Disruption in trade caused by civil disturbances and/or war;
- Local labor strikes that affect the Company's ability to sell or deliver products in a particular country;
- and

- Weakening economies in target markets.

Additional financing.

In order to operate the business, we may need to obtain additional surety bonds, maintain working capital, or make significant capital expenditures. In order to do any of those things, we may need to obtain additional capital. Therefore, our ability to operate and grow is dependent upon, and may be limited by, among other things, the availability of financing arrangements. If we are not able to obtain the additional capital necessary to pursue new projects or maintain our operations, we may not be able to grow as quickly as we plan. In addition, even if we are able to obtain additional financing, the additional financing may not be on terms which are favorable to us and could hamper our profitability. In addition our customers are experiencing a slowdown in sales and are stretching their payables and this, in turn, affects our sales and cash flow

Risks Related to the Industry

Changes in Prices of Raw Materials

The raw materials of the Company (mainly electronic, metal and plastic components) are purchased from various suppliers throughout the world. The capacity, supply and demand for such raw materials is subject to cyclical forces and market factors as well and may fluctuate significantly and, as a result, the Company may have limited ability to control its costs in securing raw materials. In addition, prices of raw materials may be subject to fluctuation. The Company cannot assure that it will be able to pass on to customers the increased costs associated with the procurement of raw materials. To the extent that increases in costs of raw materials cannot be passed on to customers or there is a delay in passing on the increased costs to customers, the Company is likely to absorb the increase in the cost of raw materials which may materially reduce its margin of profitability.

Delay or Discontinuation of the Supply of Raw Materials

Currently, the Company receives sales forecasts from the majority of its customers. Based on these sales forecasts and incoming orders, the Company purchases raw materials needed for production. The Company generally maintains a sufficient inventory of long lead-time items in order to meet its production schedule. The Company does purchase several components from a sole source supplier. This makes the Company dependent on a single supplier. In the event the sole source supplier ceases to supply the Company or materially raises its price, or the Company incurs substantial delay in delivery, the Company may need to seek a new supplier for these components. The search process can be time consuming, costly, and could potentially delay production until the new suppliers components are tested and approved.

There may be a delay in supply of, or a shortage of, raw materials or component(s) that could impede or delay the production of the Company's products, particularly with respect to raw materials supplied by a sole source supplier. The Company may be unable to quickly locate alternative sources for needed components at reasonable prices and at the time needed to meet the Company's production cycle. In the event of (1) a delay in supply, or (2) shortage of raw materials, customers may cancel their orders or turn to the Company's competitors to fill their orders. In addition, in the event the Company is compelled to find new sources of supply, this could cause delay in shipments of its products, which could increase its costs in order to meet the Company's commitments to its customers.

The Company may choose to maintain inventories of certain components that exceed what is necessary for the short term in order to have a small buffer stock to compensate for shortages or cessation in the supply of components. In such event, the Company will incur additional costs to maintain this excess inventory, which could affect its gross margins.

Competition and Pressure to Develop New Products

The Company participates in a competitive market environment. Competition, whether direct or indirect, may adversely affect the income and profits of the Company through pressure exerted on prices, the loss of market share or other factors. Some of the Company's current and potential competitors are large companies or conglomerates that have vast resources (including abilities in the fields of finance, technology, production, marketing and distribution), including, for example, General Electric, Tyco, Bosch and Honeywell. The Company may not be able to position its solutions as distinct from those of its competitors or be able to invest the same amount of resources in order to penetrate the market or successfully develop and introduce new products at the same pace of its competitors. These large competitors may also be able to respond quickly to the Company's marketing or technological initiatives due to their vast resources, which would materially affect the Company's competitive position and its ability to increase its sales.

In addition, new competitors, such as service providers, utility companies, cable companies, and non-security distributors, may enter into the competitive market in which the Company operates.

The Company's products deal with evolving technology. The Company must continually invest in product development in order to stay on the cutting edge of technology in its market and secure its market position. The Company's sales may be affected by newer technologies offered by competitors that are not available from the Company.

Risks Related to Israel

Dependence on Governmental Programs and Tax Benefits

Pursuant to the *Encouragement of Capital Investments Law, 1959*, the Company is obligated to continuously fulfill certain requirements, including the receipt of additional approvals for the execution of certain investments in fixed assets, employing a certain number of employees and maintaining a certain level of exports from its total sales. The Company has received a formal approval which indicates that it has met all necessary terms and requirements with respect to its current approved plans. However, if the Company fails to meet such requirements, the benefits may be cancelled and the Company may be required to return to the State of Israel taxes and other receipts, plus interests tied to the Israeli consumer price index.

In connection with the private placement in July 2005, the Company on November 6, 2005, obtained approval of the private placement from the Investment Center of the Ministry of Industry, Trade and Employment of the State of Israel which is the branch of the Ministry which implements and coordinates the *Encouragement of Capital Investments Law, 1959* (the "Investment Center"). In addition, the Company has taken steps to obtain approval of the sale of New Shares and the Over-allotment Shares contemplated in this Report by the Investment Center of the Ministry of Industry and Trade. In the event the Investment Center does not approve the sale of shares contemplated by this Report, the Company may be required to return all benefits that it has received from the Investment Center.

Any changes or reductions of certain programs and tax benefits that currently benefit the Company, especially those available as a result of the Company's "Approved Enterprise" status, would increase the Company's tax rate up from 31% to the full rate of taxation applicable to companies in Israel, which is currently 34%, which would adversely affect the Company's profitability.

Chief Scientist

Certain of the Company's products are developed using financing, in part, provided by the Chief Scientist of the Israel Ministry of Industry and Trade (the "Chief Scientist"), who is responsible for implementing the Israeli government's policy regarding the support and encouragement of industrial research and development.

The participation of the Chief Scientist in R&D expenses is based on certain conditions, unless the Chief Scientist approves a different arrangement (see page 26). In the event the Company does not comply with the terms of the Chief Scientist grants, the Company may be required to return the grants, which may have a material adverse effect on the Company.

Security, Political and Economic Instability in Israel

The principal offices of the Company are located in Israel. Accordingly, security, political and economic conditions in Israel may directly affect the Company's business. Over the past several decades, a number of armed conflicts have occurred between Israel and its neighbors. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect the Company's operations. Since October 2000, terrorist violence in Israel increased significantly, primarily in the West Bank and Gaza Strip. Thus far in 2005, there has been a noticeable decline in terrorist activity. Israel's recent unilateral withdrawal from the Gaza Strip has stimulated the local economy and opened potential contacts with countries which had no previous diplomatic contact with Israel. However, the ongoing hostilities and violence, future armed conflicts, political developments in other countries in the region or continued or increased terrorism could disrupt the Company's operations or make conducting the Company's operations in Israel more difficult. Any of these factors could have the effect of increasing the Company's costs, adversely affecting the Company's financial results and the expansion of the Company's business and delaying deliveries to Customers.

Furthermore, several countries continue to restrict business with Israel, in general, and with Israeli companies, in particular, which may limit the Company's ability to make sales to these countries. These boycotts and embargos may have an adverse impact on the operations, financial condition or the further expansion of the Company's business.

Reserve Military Service in Israel

Unless exempted, all male, adult Israeli citizens that served in the Israeli armed forces and meet certain age restrictions are obligated to perform annual military duty for a period of several weeks. Additionally, they can be called to active duty at any time under emergency circumstances. Should the hostilities in the region escalate, some of the Company's employees could be called to active military duty possibly resulting in interruptions in the Company's business and operations. Any disruption to the Company's operations could harm its business.

Labor Strikes

During 2008, a general strike at Israel's ports caused a shortage of raw materials and also resulted in a delay in the Company's shipments to customers, resulting in increased operating costs. Although earlier this year a privatization of the Israeli sea ports was instituted, a further strike or labor disruption at Israel's ports may still have an adverse effect on the Company's business.

Global Risks

The volatility and disruption of the capital and credit markets and adverse changes in the economy may negatively impact our ability to access financing, and to generate revenues and earnings.

The capital and credit markets have been experiencing extreme volatility and disruption for more than 12 months. In the third and fourth quarters of 2008, such volatility and disruption have reached unprecedented levels. The markets have exerted downward pressure on availability of liquidity and credit capacity for many issuers, including us.

While we intend to finance our operations with existing cash, cash flow from operations and borrowing under our existing senior credit facility, we may require additional financing to support our continued growth. However, due to the existing uncertainty in the capital and credit markets, access to capital may be limited on terms acceptable to us, or unavailable. Our customers may also come under greater budgetary pressure as a result of economic and financial market conditions, which could negatively impact our cash revenues and earnings.

Outlook

Future Projections

Going forward, the Company expects an increase in revenues from its strategic markets, in particular, Northern and Western Europe, Latin America and China. In these locations, the Company intends to address non-traditional marketing channels, in addition to the traditional security channels. Non-traditional marketing channels include utility companies, cable providers, telcos and other service providers.

The Company plans to focus on its new iConnect product line that will support a wide range of solutions and services that the Company offers to its customers. The Company believes that the new solution will be well received in the market place.

The Company is undergoing a strategic transition, becoming a provider of integrated security and control solutions while developing a strong value proposition for large-scale business partners. The Company will continue this shift from working with traditional security distribution channels to a new focus on prominent service providers and value-added resellers.

Among its goals, the Company will also continue its efforts to obtain and maintain international standard approvals for its products.