

ELECTRONICS LINE 3000 LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2005

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 balance sheets of Electronics Line 3000 Ltd. ("the Company") and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, whose assets constitute approximately 24% and 41% of total consolidated assets as of December 31, 2005 and 2004, respectively, and whose revenues constitute approximately 39% and 52% of total consolidated revenues for the years then ended. Those statements were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those companies, is based solely on the reports of the other auditors.

We conducted our audits in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above give a true and fair view of the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004, and of the consolidated results of their operations and their cash flows for the years then ended, in accordance with International Financial Reporting Standards.

Tel-Aviv, Israel
March 7, 2006**KOST FORER GABBAY & KASIERER**
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	Note	December 31,	
		2004	2005
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	3	6,658	8,188
Trade receivables	4	6,668	8,979
Income tax receivable		1,565	122
Prepaid expenses and other receivables	5	861	1,135
Inventories	6	6,789	6,822
<u>Total</u> current assets		22,541	25,246
NON CURRENT ASSETS:			
Property, plant and equipment:	7		
Cost		14,594	13,961
Less - accumulated depreciation		7,663	7,894
		6,931	6,067
Intangible assets, net	8	5,432	5,365
Deferred taxes	14d	1,683	1,228
Security deposits		106	107
<u>Total</u> non current assets		14,152	12,767
<u>Total</u> assets		36,693	38,013
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Short-term credit from banks and others	9	21,738	13,559
Trade payables	10	4,859	5,610
Accrued expenses		589	507
Income tax payable		79	39
Other current liabilities	11	1,953	3,032
<u>Total</u> current liabilities		29,218	22,747
LONG-TERM LIABILITIES:			
Accrued severance pay, net	12	446	473
Loan from shareholders	13	502	-
<u>Total</u> long-term liabilities		948	473
EQUITY:			
Share capital	16	9,359	10,895
Additional paid-in capital		1,317	6,126
Foreign currency translation reserve		1,871	1,871
Accumulated deficit		(6,020)	(4,099)
<u>Total</u> equity		6,527	14,793
<u>Total</u> liabilities and equity		36,693	38,013

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

March 7, 2006

Date of approval of the
consolidated financial
statements

Bob Marbut
Chairman of the
Board of Directors

Amir Hayek
President and CEO

Amir Blumenfeld
CFO

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Note	Year ended December 31,	
		2004	2005
Revenues	18	34,760	45,391
Cost of revenues	19	<u>23,431</u>	<u>27,874</u>
Gross profit		<u>11,329</u>	<u>17,517</u>
Operating costs and expenses:			
Research and development	20	1,559	1,786
Selling and marketing	21	8,868	8,689
General and administrative	22	<u>4,677</u>	<u>4,532</u>
<u>Total</u> operating costs and expenses		<u>15,104</u>	<u>15,007</u>
Operating profit (loss)		(3,775)	2,510
Financial income (expenses), net	23	(795)	275
Other income (expenses), net		<u>(92)</u>	<u>201</u>
Profit (loss) before taxes on income		(4,662)	2,986
Taxes on income (income tax benefit)	14b	<u>(421)</u>	<u>1,065</u>
Net profit (loss)		<u>(4,241)</u>	<u>1,921</u>
Net earnings (loss) per share (basic and diluted)	25	<u>(0.58)</u>	<u>0.21</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 translation reserve</u>	<u>Accumulated deficit</u>	<u>Total equity</u>	<u>Total recognized income (expense)</u>
Balance as of January 1, 2004	6,172	1,317	1,319	(1,779)	7,029	
Issuance of shares in consideration for the conversion of a loan from shareholders	3,187	-	-	-	3,187	-
Currency translation differences	-	-	552	-	552	552
Net loss	-	-	-	(4,241)	(4,241)	(4,241)
Balance as of December 31, 2004	9,359	1,317	1,871	(6,020)	6,527	<u>(3,689)</u>
Issuance of shares, net of issuance costs	1,536	4,688	-	-	6,224	-
Cost of share-based payments	-	121	-	-	121	-
Net profit	-	-	-	1,921	1,921	1,921
Balance as of December 31, 2005	<u>10,895</u>	<u>6,126</u>	<u>1,871</u>	<u>(4,099)</u>	<u>14,793</u>	<u>1,921</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,	
	2004	2005
<u>Cash flows from operating activities:</u>		
Profit (loss) before taxes on income	(4,662)	2,986
Adjustments for:		
Depreciation and amortization	1,763	1,718
Loss (gain) on sale of property, plant and equipment	-	(6)
Increase (decrease) in accrued severance pay	(16)	27
Cost of share-based payments	-	121
Financial expenses (income), net	795	(275)
Operating cash flows before working capital changes	(2,120)	4,571
Decrease (increase) in trade receivables	2,568	(2,311)
Decrease (increase) in prepaid expenses and other receivables	130	(274)
Decrease (increase) in inventories	437	(33)
Decrease (increase) in security deposits	10	(1)
Increase in trade payables	32	751
Increase (decrease) in accrued expenses	52	(82)
Increase in other current liabilities	377	1,079
	3,606	(871)
Cash provided by operations	1,486	3,700
Interest received	43	94
Interest paid	(714)	(1,076)
Income taxes received	-	1,165
Income taxes paid	(498)	(98)
Net cash provided by operating activities	317	3,785
<u>Cash flows from investing activities:</u>		
Acquisition of intangible assets	(1,009)	(645)
Acquisition of property, plant and equipment	(559)	(292)
Proceeds from sale of equipment	43	156
Net cash used in investing activities	(1,525)	(781)
<u>Cash flows from financing activities:</u>		
Proceeds from issuance of shares, net of issuance costs	-	5,968
Receipt of loans from shareholders	1,000	-
Increase (decrease) in short-term bank credit, net	1,669	(7,442)
Net cash provided by (used in) financing activities	2,669	(1,474)
<u>Effect of exchange rate changes on cash and cash equivalents</u>	517	-
Increase in cash and cash equivalents	1,978	1,530
Cash and cash equivalents at beginning of year	4,680	6,658
Cash and cash equivalents at end of year	6,658	8,188
<u>Significant non-cash transactions:</u>		
Issuance of shares in consideration for loan from shareholders	3,187	-

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.). On January 1, 2003, the assets and operations of Metis (including related liabilities), were transferred to the Company. These included the development, production, selling and marketing activities of Metis ("the technological activities"). The technological activities were acquired at their carrying values in Metis by the Company in consideration for, among others, the issuance of the Company's shares to Metis in accordance with Section 104A of the Israeli Income Tax Ordinance.

As of December 31, 2003, all of the Company's shares were held by Metis.

On June 24, 2004, Metis effected an in-kind distribution of approximately 84% of the share capital of the Company to the shareholders of Metis. On June 28, 2004, the Company's shares were listed on the stock exchange in Germany (Regulated Unofficial Market of the Frankfurt Stock Exchange). Subsequent to effecting the in-kind distribution, Metis held approximately 16% of the share capital of the Company. On October 6, 2004, Metis effected a supplementary in-kind distribution of the remaining 16% of the share capital of the Company to the shareholders of Metis and ceased to hold the Company's shares.

On November 1, 2004, a shareholder in the Company ("Argyle") transferred all of its holdings in Metis' shares in exchange for the entire holdings (28.23%) of the Krubiner Group in the Company's shares. Subsequent to the exchange, Argyle's holdings in the Company increased to 43.23%.

See Note 16b regarding additional issuances of shares during the reported periods and the admission of the Company's shares for trade on the Prime Standard of the Frankfurt Stock Exchange. Subsequent to the aforementioned share issuances, Argyle's holdings in the Company decreased to 40.9%.

- b. 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.
- c. The preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions by the Company's management. Management is not presently aware of any significant uncertainty in applying these estimates, which might result in a material change in the carrying amounts of assets and liabilities within the next financial year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), on the historical cost basis. The significant accounting policies followed in the preparation of these consolidated financial statements, on a consistent basis, except as described in a. and q. below, are:

a. Functional and presentation currency:

Until December 31, 2004, the functional currency of the Group was the Euro. In the beginning of 2005, the Group reevaluated the factors used in determining its functional currency, including the currency in which the Group's sales and its costs are denominated and settled. Based on this reevaluation, the Group concluded that the U.S. dollar presently reflects the primary economic environment in which the Group operates, and therefore, the U.S. dollar is the Group's functional currency. In accordance with IAS 21, "The Effects of Change in Foreign Exchange Rates", the change in functional currency from the Euro to the U.S. dollar is accounted for prospectively. Accordingly, assets and liabilities in the balance sheet at December 31, 2004, were translated from the Euro to U.S. dollar at the exchange rate in effect as of December 31, 2004.

Due to the change in the functional currency, the Group has selected the U.S. dollar as the presentation currency for all reported periods. Accordingly, the financial statements of the Group for comparative periods in which the functional currency was the Euro have been translated from the Euro to the presentation currency in accordance with the principles set forth in IAS 21, as follows:

Assets and liabilities of the Group are translated into U.S. dollars at the closing rate at the date of each balance sheet. Issued capital, additional paid-in capital and other reserves are translated into U.S. dollars using the exchange rate on the date of the transaction. Income and expenses are translated at average monthly exchange rates. Translation differences resulting from the translation are recognized as a separate component of equity ("foreign currency translation reserve").

Foreign currency transactions:

Transactions in foreign currencies are translated at the exchange rates prevailing at the dates of the individual transactions. At the end of the accounting period, the unsettled balances of foreign currency receivables and liabilities are translated at the exchange rates prevailing at the period-end. Foreign exchange gains and losses resulting from the translation are included as a net amount under financial income and expenses, net.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

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</u> <u>of U.S. \$ 1</u>	<u>Exchange rate</u> <u>of U.S. \$ 1</u>	<u>Exchange rate</u> <u>of U.S. \$ 1</u>
	<u>NIS</u>	<u>€</u>	<u>GBP</u>
December 31, 2005	4.60	0.85	0.58
December 31, 2004	4.31	0.79	0.52
December 31, 2003	4.38	0.79	0.56
<u>Change during the year ended</u>	<u>%</u>	<u>%</u>	<u>%</u>
December 31, 2005	6.8	15.3	11.8
December 31, 2004	(1.6)	(7.4)	(7.0)

b. Consolidation of the financial statements:

The financial statements of the Company have been consolidated with those of its wholly-owned and controlled subsidiaries. Control is normally evidenced when the Company owns, either directly or indirectly, more than 50% of the voting rights of a company's share capital and is able to govern the financial and operating policies of an enterprise so as to benefit from its activities. Inter-company transactions and balances, including profits from inter-company transactions not yet realized outside the Group, have been eliminated upon consolidation.

A schedule of investee companies has been included in the Appendix.

c. Cash and cash equivalents:

Cash includes cash on hand and cash with banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value.

d. Allowance for doubtful accounts:

The allowance for doubtful accounts is computed for specific accounts, the collectibility of which is doubtful.

e. Inventories:

Inventories are valued at the lower of cost and net realizable value, after provision for obsolete items. Net realizable value is the selling price in the ordinary course of business, less the costs of completion, marketing and distribution costs, necessary to bring the sale to closure. Cost is determined primarily on the basis of weighted average cost. For processed inventories, cost includes the applicable allocation of fixed and variable overhead costs based on a normal operating capacity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Property, plant and equipment:

Property, plant and equipment are presented at cost less accumulated depreciation. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the statement of operations. The initial cost of property, plant and equipment comprises its purchase price, non-refundable purchase taxes, and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property, plant and equipment. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets.

The annual depreciation rates are as follows:

	%
Installations and leasehold improvements	Shorter of the lease term or useful life
Machinery and equipment	10 - 15 (primarily 10)
Motor vehicles	15
Office furniture and equipment	6 - 33

g. Intangible assets:

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost, less any accumulated amortization.

Intangible assets include software and production files development costs. Intangible assets are amortized using the straight-line method over their estimated useful lives (6-10 years).

h. Accounting for leases:

Operating lease - leases of assets under which substantially all risks and rewards of ownership are effectively retained by the lessor are classified as operating leases.

The Group as lessee - lease payments under an operating lease are recognized as an expense on a straight-line basis over the lease term.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Research and development costs:

Expenditures for research are recognized as an expense when incurred. Expenditures on development are charged against income in the period incurred except for product development costs, which comply with all of the following criteria:

- the product is clearly defined and costs are separately identified and measured reliably;
- the technical feasibility of the product is demonstrated;
- the product will be sold or used;
- the product will generate future economic benefits because a potential market exists for the product;
- adequate technical, financial and other resources required for completion of the product are available.

Capitalization of costs commences when the above criteria are first met. Expenditures recognized as an expense in previous accounting periods are not re-instated.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use, and otherwise when events or changes in circumstances indicate that the carrying value may not be recoverable.

j. Revenue recognition:

Revenue is recognized upon delivery when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

k. Deferred income taxes:

1. The Group provides for deferred income taxes using the liability method of accounting. Under the liability method, deferred taxes are recognized for temporary differences between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred taxes are measured based on enacted tax rates that will be in effect in the year in which the differences are expected to reverse. Deferred tax assets in respect of carryforward losses and other temporary deductible differences are recognized to the extent that it is probable that they will be utilized.
2. Taxes that would apply in the event of the distribution of earnings by investees as dividends have not been taken into account in computing deferred taxes, when the distribution of dividend does not involve an additional tax liability or when the Company is able to control the distribution of dividends that will cause additional tax liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Impairment of assets:

Financial instruments (see Note 17c) are reviewed for impairment at each balance sheet date. Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in income.

The recoverable amount is the higher of an asset's net selling price and value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction less the costs of disposal while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if this is not possible, for the cash-generating unit to which the asset belongs.

Reversal of impairment losses recognized in prior years is recorded when there is an indication that the impairment losses recognized for the asset no longer exist or have decreased. The reversal is recorded in income. However, the increased carrying amount of an asset due to a reversal of an impairment loss is recognized to the extent it does not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for that asset in prior years.

m. Royalty-bearing grants:

Royalty-bearing grants for funding of approved research projects are recognized at their fair value where there is a reasonable assurance that the grant will be received and all stipulated conditions will be complied with. Such grants are recorded as a liability when repayment is probable. If repayment is not probable, the grants are deducted from the related expenses.

n. Borrowing costs:

Borrowing costs are generally expensed as incurred.

o. Earnings (loss) per share:

Basic earnings per share is computed using the weighted average number of shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of shares outstanding during the period plus the dilutive effect of convertible securities outstanding during the period.

p. Contingencies:

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefit is remote.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

q. Share-based payment transactions:

On 1 January 2005, the Company adopted IFRS 2, "Share-Based Payment". IFRS 2 requires an expense to be recognized where the Company buys goods or services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions"). The main impact of IFRS 2 on the Company is the expensing of employees' and directors' share options (equity-settled transactions).

The cost of equity settled transactions is measured by reference to the fair value at the date at which they were granted. The fair value is determined by using an option-pricing model.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date the options vest. The cumulative expense, recognized at each reporting date until the vesting date, reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. No expense is recognized for amounts that do not ultimately vest.

The effect of the adoption of IFRS 2 on the year ended 31 December 2005, was an increase in employee benefits expense and a decrease in profit in the amount of U.S.\$ 121 thousand, with a corresponding increase in equity (additional paid-in capital).

NOTE 3:- CASH AND CASH EQUIVALENTS

	December 31,	
	2004	2005
Euros	3,275	3,781
U.S. dollars	1,876	3,326
GBP	1,503	1,078
NIS	4	3
	<u>6,658</u>	<u>8,188</u>

NOTE 4:- TRADE RECEIVABLES

Open accounts	7,545	9,830
Checks receivable	195	212
	<u>7,740</u>	<u>10,042</u>
Less - allowance for doubtful accounts	1,072	1,063
	<u>6,668</u>	<u>8,979</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 5:- PREPAID EXPENSES AND OTHER RECEIVABLES

	December 31,	
	2004	2005
Government authorities	363	446
Advances to suppliers	236	99
Prepaid expenses	142	206
Other receivables	120	384
	<u>861</u>	<u>1,135</u>

NOTE 6:- INVENTORIES

Finished products	4,206	4,497
Work in process	687	599
Raw and auxiliary materials	1,896	1,726
	<u>6,789</u>	<u>6,822</u>

The amount of write-down of inventories recognized as an expense in 2005 is U.S.\$ 1,101.

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT

	Installations and leasehold improvements	Machinery and equipment	Motor vehicles	Office furniture and equipment	Total
Cost:					
Balance as of January 1, 2004	5,366	4,613	234	2,881	13,094
Acquisitions during the year	113	107	148	191	559
Disposals during the year	-	(45)	(89)	(9)	(143)
Currency translation differences	439	374	23	248	1,084
Balance as of December 31, 2004	5,918	5,049	316	3,311	14,594
Acquisitions during the year	15	89	78	110	292
Disposals during the year	(245)	(322)	(225)	(133)	(925)
Balance as of December 31, 2005	5,688	4,816	169	3,288	13,961
Accumulated depreciation:					
Balance as of January 1, 2004	1,277	2,789	102	1,710	5,878
Acquisitions during the year	313	322	87	577	1,299
Disposals during the year	-	(45)	(46)	(9)	(100)
Currency translation differences	133	249	13	191	586
Balance as of December 31, 2004	1,723	3,315	156	2,469	7,663
Provision during the year	340	332	37	297	1,006
Disposals during the year	(245)	(322)	(86)	(122)	(775)
Balance as of December 31, 2005	1,818	3,325	107	2,644	7,894
Depreciated cost as of December 31, 2005	<u>3,870</u>	<u>1,491</u>	<u>62</u>	<u>644</u>	<u>6,067</u>
Depreciated cost as of December 31, 2004	<u>4,195</u>	<u>1,734</u>	<u>160</u>	<u>842</u>	<u>6,931</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 8:- INTANGIBLE ASSETS

Software and production files development costs:

	<u>2004</u>	<u>2005</u>
Cost:		
As of January 1	5,248	6,774
Additions	1,009	645
Currency translation differences	517	-
As of December 31	<u>6,774</u>	<u>7,419</u>
Accumulated amortization:		
As of January 1	770	1,342
Provision	464	712
Currency translation differences	108	-
As of December 31	<u>1,342</u>	<u>2,054</u>
Amortized cost as of December 31	<u><u>5,432</u></u>	<u><u>5,365</u></u>

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

a. Composition:

	Annual interest rate % *)	December 31,	
		<u>2004</u>	<u>2005</u>
Overdrafts:			
U.S. dollars	5.8	-	2,948
GBP	6.2	-	1,635
Euros	3.9	-	13
NIS	7.1	6,697	200
Short-term loans:			
Euros		11,488	-
U.S. dollars **)	5.7	<u>3,553</u>	<u>8,763</u>
		<u>21,738</u>	<u>13,559</u>

*) Weighted average annual interest rate as of December 31, 2005.

**) Includes shareholders' loan of U.S.\$ 1,028 and U.S.\$ 502 at December 31, 2005 and 2004, respectively (see Note 13b).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 9:- SHORT-TERM CREDIT FROM BANKS AND OTHERS (Cont.)**

b. Liens and financial covenants:

In September 2005, 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 Group's banks. Due to the recording of the floating charge, one of the Group's banks (Bank A) canceled its request for compliance with any financial covenants. As of December 31, 2005, the Company's balance of short-term credit from Bank A is U.S.\$ 3,619.

In September 2005, the Company approved new financial covenants in respect of credit from Bank B. The Company and Bank B reached an understanding as to certain customary financial covenants that the Company will have 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, 2005, the Company is meeting these financial covenants. The Company's balance of short-term credit from Bank B is U.S.\$ 4,661 as of December 31, 2005.

NOTE 10:- TRADE PAYABLES

	December 31,	
	2004	2005
Open accounts	4,068	4,543
Checks payable	791	1,067
	<u>4,859</u>	<u>5,610</u>

NOTE 11:- OTHER CURRENT LIABILITIES

	December 31,	
	2004	2005
Government authorities	235	196
Accrued salaries and related expenses	647	1,118
Due to Metis (see Note 15c(3))	1,061	1,630
Others	10	88
	<u>1,953</u>	<u>3,032</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 12:- ACCRUED SEVERANCE PAY, NET**

The Company's obligation for severance pay for its employees in Israel is covered by regular payments to insurance companies, pension funds and severance pay funds and by the accrual on the balance sheet. The Company's liability is calculated, on the basis of the latest salary, according to law and labor agreements. Accumulated amounts with the insurance companies and pension funds are not under the control or administration of the Company, and accordingly, neither those amounts nor the corresponding liability are reflected in the consolidated financial statements.

	December 31,	
	2004	2005
Accrued severance pay	465	481
Less - deposits with severance pay fund	19	8
	<u>446</u>	<u>473</u>

The amounts deposited with the severance pay fund include profits accumulated to the balance sheet date and may be withdrawn only after fulfillment of the obligations under the Severance Pay Law and labor agreements.

NOTE 13:- LOAN FROM SHAREHOLDERS

- a. On December 31, 2003, the Company entered into a loan agreement with Metis. Pursuant to the loan agreement, Metis provided a loan to the Company in the amount of NIS 14.3 million (U.S.\$ 3,267).

In May 2004, the Company and Metis entered into a revised agreement to the loan agreement, according to which, following the publication of the Expose and shortly before effecting the distribution in kind and listing of the Company's shares for trade on the Regulated Unofficial Market of the Frankfurt Stock Exchange ("RUM"), the loan will be converted into share capital. On June 21, 2004, the Company issued to Metis 2,861,699 Ordinary shares in consideration for the conversion of the loan in the amount of U.S.\$ 3,187.

- b. On November 18, 2004, Argyle provided the Company with two intermediate-term loans each in the amount of U.S.\$ 500. The first loan was due for repayment in October 2005 and the second loan is to be repaid in October 2006. The loans bear interest at an annual rate of 2.5%, which is payable on the maturity dates.

As of the date of approval of the financial statements, Argyle has agreed to postpone the repayment date of the first loan to a date which will later be determined.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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:

Under the Income Tax (Inflationary Adjustments) Law, 1985, the Company's results for tax purposes are measured in accordance with the changes in the Israeli CPI. The following are the changes in the CPI:

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2005</u>
CPI	1.2%	2.4%

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 January 1, 2003 (see Note 1a), 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, 2005, 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 14:- TAXES ON INCOME (Cont.)

- b. Income tax expense (benefit) included in the statements of operations:

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2005</u>
Current taxes	1	354
Deferred taxes	(497)	711
Taxes in respect of previous years	75	-
	<u>(421)</u>	<u>1,065</u>

- c. Tax computation:

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

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2005</u>
Profit (loss) before taxes on income	<u>(4,662)</u>	<u>2,986</u>
Tax expense (benefit) computed at statutory tax rate of 34% (2004 - 35%)	(1,632)	1,015
Increase (decrease) in tax due to:		
Different tax rates	73	(133)
Non-deductible expenses	34	72
Losses and other items for which deferred taxes were not provided	911	302
Utilization of carryforward losses for which deferred taxes were not recorded in prior years	-	(231)
Taxes with respect to previous years	75	-
Differences in the basis of measurement (U.S.\$/EURO - CPI) *)	118	40
	<u>(421)</u>	<u>1,065</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.\$ in 2005 and the Euro in 2004). For changes in the CPI, see a. above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 14:- TAXES ON INCOME (Cont.)

d. Deferred taxes:

Deferred tax assets (liabilities) are computed at an average tax rate of approximately 29%, and are computed in respect of the following:

	December 31,	
	2004	2005
Property, plant and equipment	(311)	(265)
Inventories	109	100
Intangible assets	(276)	(146)
Tax loss carryforward	1,629	377
Research and development expenses	-	476
Employee benefit liabilities	216	201
Doubtful accounts	316	304
Other temporary differences in recognition of income and expenses	-	181
Net deferred tax asset	<u>1,683</u>	<u>1,228</u>

e. Changes in deferred taxes:

	Year ended December 31,	
	2004	2005
Balance at the beginning of the year	1,054	1,683
Transferred from Metis	-	-
Recognized in income	497	(711)
Credited directly to equity	-	256
Currency translation differences	132	-
Balance at the end of the year	<u>1,683</u>	<u>1,228</u>

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

1. The Company:

Until December 31, 2003, the regular tax rate applicable to income (not entitled to benefits due to "approved enterprise", as described above) was 36%. In June 2004, an amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 was passed by the "Knesset" (Israeli parliament) and on July 25, 2005, another law was passed, the amendment to the Income Tax Ordinance (No. 147) 2005, according to which the corporate tax rate is to be progressively reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 and thereafter - 25%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 14:- TAXES ON INCOME (Cont.)**

2. Foreign subsidiaries:

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

U.S. - 33%.

United Kingdom - 19% - 30%.

France - 34%.

g. Carryforward losses for tax purposes:

The Group's carryforward losses for tax purposes as of December 31, 2005 amounts to approximately U.S.\$ 3,123 (all of it is attributable to the U.S. subsidiaries). With respect to tax loss carryforwards of approximately U.S.\$ 2,281, no deferred tax asset was recognized as of December 31, 2005.

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, 2005 amounted to approximately U.S.\$ 1,670 and the balance of contingent royalties amounts to approximately U.S.\$ 1,249.
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. The grants received by the Company and the balance of contingent royalties as of December 31, 2005 amounted to approximately U.S.\$ 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 buildings until 2011 and 2014, respectively. Annual rent - U.S.\$ 845. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 15:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

The foreign subsidiaries rent their facilities under various operating lease agreements, which expire on various dates, the latest of which is in 2009.

Future minimum lease payments in years subsequent to December 31, 2005 under non-cancelable operating lease are as follows:

First year	1,200
Second through fifth years	3,872
Thereafter	<u>1,709</u>
Total	<u><u>6,781</u></u>

c. Contingent liabilities:

1. On November 24, 2003, a former employee of Metis filed an action against Metis in the Kfar Saba, Israel Magistrates Court for personal injury allegedly caused to him as a result of his employment with Metis. The amount of this lawsuit is limited to the amount of the jurisdiction of the Magistrates Court (NIS 2.5 million (U.S.\$ 550), as of the date of filing the claim). The Company is liable for all of the consequences of any legal proceeding filed against Metis after the acquisition of the technological activities. The claim is covered by the Company's insurance policies and therefore no provision has been made for this claim in the financial statements of the Company.

2. Potential claim against EL-USA:

On September 21, 2005, the wholly-owned U.S. subsidiary ("EL-USA") received a letter from the attorneys of Kodicom Australia PTY. Limited ("Kodicom"), regarding a contract dispute and alleged breach of a certain Distribution Agreement entered into between Kodicom and EL-USA on April 11, 2002 ("the Agreement"). EL-USA's counsel has responded to Kodicom's letter stating that EL-USA did not breach the Agreement and in fact, has several counter-claims against Kodicom concerning its performance pursuant to the Agreement. On January 18, 2006, EL-USA filed a complaint against Kodicom in the United States District of Colorado Court ("the action").

On January 31, 2006, EL-USA and Kodicom entered into a settlement agreement, according to which EL-USA paid Kodicom U.S. \$ 15 and dismissed the action and EL-USA and Kodicom released and discharged each other from any claims.

3. Claims related to Metis:

Pursuant to an agreement between the Company and Metis that became effective on June 1, 2004, Metis provides the Company with consulting services in the field of alarm systems, for a fee of U.S.\$ 900 per year. In addition, the Company bears Metis' expenses in connection with providing the consulting services up to U.S.\$ 250 per year. The agreement is in effect for a period of four years, with an automatic annual option renewal. The Company has not paid Metis any consulting fees since July 1, 2004. In a letter to the Company dated March 6, 2005, Metis demanded that the Company pay the consulting fees pursuant to the terms of the consulting agreement. In a response letter dated March 13, 2005, the Company rejected Metis' monetary demands. The Company has recorded an accrual in its financial statements of U.S.\$ 1,350, which represents the entire unpaid amount.

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

The Company has serious concerns as to the validity and thus, the enforceability of the consulting agreement. At the Company's demand, the dispute was referred to arbitration on September 21, 2005, and an arbitrator has already been appointed by mutual agreement of the parties. Metis served the Company with its statement of claim on October 17, 2005. Since negotiations are in progress between the parties to settle the dispute, the Company has not yet filed a statement of defense and a counterclaim.

4. Patent infringement claim:

On June 30, 2005, the Company received a letter from Fresnel Technologies Inc. ("Fresnel") in which Fresnel alleged that the Company was infringing one of its U.S. patents and demanded that the Company pay a royalty of U.S. 20 cents for each passive infra-red detector sold by the Company in the U.S. during the last six years. The Company, through its patent counsel, denied the patent claim as well as the demand for compensation based on sales. On December 15, 2005, Fresnel served the Company and EL-USA a Complaint in the United States District Court for the Northern District of Texas regarding this issue. The Company has engaged patent counsel in the United States and is in the process of preparing its response to the Complaint. The Company believes it has several affirmative defenses to Fresnel's claims and the validity of Fresnel's patent. The Company is presently unable to predict the ultimate outcome of this Complaint. However, Company management believes that the potential exposure to the Company under this claim is immaterial, and therefore, the Company has made no accrual with regard thereto in its financial statements.

NOTE 16:- SHARE CAPITAL

- a. The share capital is composed as follows:

	December 31,	
	2004	2005
	Number of shares	
Authorized:		
Ordinary shares of NIS 5 par value each *)	<u>12,000,000</u>	<u>**) 50,000,000</u>
Issued and fully paid:		
Ordinary shares of NIS 5 par value each *)	<u>8,709,265</u>	<u>10,130,191</u>

*) On June 21, 2004, the Company effected a share consolidation such that every 5 Ordinary shares of NIS 1 par value each became 1 Ordinary share of NIS 5 par value. Share and per share data in these financial statements have been retrospectively adjusted for all periods presented to reflect this share consolidation.

***) On October 2, 2005, the shareholders of the Company resolved to increase the Company's authorized share capital, by an additional NIS 190,000,000. Following such increase, 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 16:- SHARE CAPITAL (Cont.)**

b. Issuance of shares:

1. On June 21, 2004, the Company issued to Metis 2,861,699 Ordinary shares in consideration for the conversion of the loan which Metis granted to the Company (see Note 13a).
2. On June 28, 2004, the Company's shares were listed on the Regulated Unofficial Market of the Frankfurt Stock Exchange.
3. On July 10, 2005, the Company's Board of Directors resolved to approve a private placement of 500,000 Ordinary shares in consideration of € 2 per share (a total of U.S.\$ 1,190, before issuance expenses in the amount of U.S.\$ 127). The shares were issued on July 11, 2005.
4. On December 12, 2005, the Company's shares were admitted for trade on the Prime Standard, a market operated by the Frankfurt Stock Exchange.

Concurrently, the Company also completed a public offering of 920,926 Ordinary shares, at a price per share of € 5.3. The proceeds of the public offering were approximately U.S.\$ 5,716, before issuance expenses in the amount of U.S.\$ 811.

c. 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 (U.S.\$ 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 U.S.\$ 2 per share, which was estimated based on the following data and assumptions:

Share price - € 2.77 (U.S.\$ 3.43); exercise price - € 2.297 (U.S.\$ 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 new 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 (U.S.\$ 4.757 on date of grant).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands, except share and per share data****NOTE 16:- SHARE CAPITAL (Cont.)**

The weighted average fair value of options granted by the Company in November 2005 is U.S.\$ 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.

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

	Year ended December 31, 2005	
	Number	WAEP (U.S.\$)
Outstanding at the beginning of the year	-	-
Granted during the year	<u>125,000</u>	3.09
Outstanding at the end of the year	<u>125,000</u>	<u>3.09</u>
Exercisable at the end of the year	<u>36,875</u>	<u>2.72</u>

NOTE 17:- FINANCIAL INSTRUMENTS

a. Credit risks:

Cash and cash equivalents as of December 31, 2005 are deposited with large banks in Israel. Accordingly, management does not anticipate losses on liquid assets arising from credit risks.

The Group's customers are dispersed over a number of countries, mainly developed countries. The Group customarily receives bank guarantees in respect of customers with high credit risk. In respect of certain other customers, the Group insures the receivables through foreign trade risk insurance. Management regularly monitors trade receivables and includes provisions in the consolidated financial statements, which, in its opinion, are adequate to cover doubtful accounts. In light of the above, the exposure to credit risks in connection with trade receivables is limited.

b. Foreign currency exposure:

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, 2005, the Group's monetary liabilities in NIS exceeded monetary assets by U.S.\$ 3,957.

As of December 31, 2005, monetary assets in currencies other than the U.S.\$ and the NIS exceeded monetary liabilities in the amount of U.S.\$ 5,167 (all current).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)**

- c. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, prepaid expenses and other receivables, credit from banks and others, trade payables and other current liabilities approximate their fair value due to the short-term maturity of such instruments.

NOTE 18:- REVENUES

	Year ended December 31,	
	2004	2005
Foreign:		
Europe	20,768	31,663
United States	9,629	9,545
Other countries	3,652	3,773
	<u>34,049</u>	<u>44,981</u>
Domestic - Israel	711	410
	<u>34,760</u>	<u>45,391</u>
Includes sales to one major customer	<u>2,877</u>	<u>11,619</u>

NOTE 19:- COST OF REVENUES

	Year ended December 31,	
	2004	2005
Purchases and changes in raw and auxiliary materials	17,833	22,191
Labor	2,867	3,062
Manufacturing and other expenses	1,378	1,445
Depreciation and amortization	1,119	1,379
	<u>23,197</u>	<u>28,077</u>
Changes in finished products and work-in-process inventories	234	(203)
	<u>23,431</u>	<u>27,874</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 20:- RESEARCH AND DEVELOPMENT EXPENSES

	Year ended December 31,	
	2004	2005
Salaries and related expenses	1,164	1,141
Other	395	645
	<u>1,559</u>	<u>1,786</u>

NOTE 21:- SELLING AND MARKETING EXPENSES

	Year ended December 31,	
	2004	2005
Salaries and related expenses	4,673	4,445
Commissions	157	44
Advertising	37	440
Foreign travel and transportation	1,443	1,574
Rent	534	550
Other	2,024	1,636
	<u>8,868</u>	<u>8,689</u>

NOTE 22:- GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31,	
	2004	2005
Salaries and related expenses	619	897
Management and consulting fees	1,440	915
Provision for bad debts and doubtful accounts	460	782
Depreciation	644	339
Other	1,514	1,599
	<u>4,677</u>	<u>4,532</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 23:- FINANCIAL INCOME (EXPENSES), NET

	Year ended December 31,	
	2004	2005
Income (expenses) with respect to:		
Bank borrowings, net	(1,180)	(1,226)
Short-term deposits	57	93
Foreign exchange differences, net	324	1,404
Other, net	4	4
	<u>(795)</u>	<u>275</u>

NOTE 24:- DEPRECIATION AND AMORTIZATION EXPENSE

	Year ended December 31,	
	2004	2005
Property, plant and equipment:		
Cost of revenues	655	667
General and administrative expenses	644	339
	<u>1,299</u>	<u>1,006</u>
Intangible assets:		
Cost of revenues	464	712
	<u>1,763</u>	<u>1,718</u>

NOTE 25:- NET EARNINGS (LOSS) PER SHARE

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

	Year ended December 31,	
	2004	2005
Net profit (loss) attributable to Ordinary shares for basic and diluted earnings (loss) per share	<u>(4,241)</u>	<u>1,921</u>
Weighted average number of Ordinary shares for basic earnings (loss) per share	7,278,416	9,008,175
Effect of dilution:		
Share options	<u>-</u>	<u>30,782</u>
Adjusted weighted average number of Ordinary shares for diluted earnings (loss) per share	<u>7,278,416</u>	<u>9,038,957</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 26:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

a. Balances with related parties:

	December 31,	
	2004	2005
Current liabilities:		
Short-term credit from banks and others	502	1,028
Non-current liabilities:		
Loan from shareholders	502	-

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 U.S.\$ 350.

Mr. Marbut has decided to waive his salary for 2005, and, accordingly, no salary expense for Mr. Marbut is included in the financial statements for the year ended December 31, 2005.

- On November 1, 2004, subsequent to the distributions in kind and the change in shareholders, as described in Note 1a, Metis ceased to be a related party of the Company. Accordingly, the data below for 2004 relates to the ten months ended October 31, 2004.

	Ten months ended October 31, 2004
Cost of revenues - rent	478
Research and development costs - rent	122
Selling and marketing expenses - rent	50
General and administrative expenses - rent	46
General and administrative expenses - management and consulting services	1,428

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 26:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)**

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

	Year ended December 31,	
	2004	2005
Short-term employee benefits	1,497	1,158
Share-based payments	-	91
Termination benefits	54	95
	<u>1,551</u>	<u>1,344</u>

NOTE 27:- INVESTMENT IN SUBSIDIARIES

On September 5, 2005, a wholly-owned French subsidiary ("Sectec") signed an agreement, effective October 1, 2005, with a French company providing for the transfer of its business activities and operations (distribution of electronic security products), including certain assets and all of the liabilities and the commitments of Sectec in consideration of € 200 thousand (U.S.\$ 250). Together with the agreement to transfer the business of Sectec, the Company entered into a distribution agreement with the acquirer.

The Group recorded a gain of approximately U.S.\$ 200 upon the consummation of the sale.

NOTE 28:- GEOGRAPHIC SEGMENTS

- a. General:

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

The Group companies operate in two principal geographic segments according to IAS 14: the United States and Europe.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 28:- GEOGRAPHIC SEGMENTS (Cont.)

b. The following data are presented in accordance with IAS 14:

1. Revenues:

	Year ended December 31,	
	2004	2005
Sales to external customers:		
Europe	20,768	31,663
United States	9,629	9,545
Other countries	4,363	4,183
	<u>34,760</u>	<u>45,391</u>
Intersegment sales:		
Europe	3,410	2,643
United States	1,271	959
	<u>4,681</u>	<u>3,602</u>
Total revenues	39,441	48,993
Adjustments	<u>(4,681)</u>	<u>(3,602)</u>
Total revenues in financial statements	<u><u>34,760</u></u>	<u><u>45,391</u></u>

2. Segments results:

	Year ended December 31,	
	2004	2005
Sales less directly attributable and allocable expenses:		
Europe	1,518	7,234
United States	(391)	(25)
Other countries	(367)	758
	<u>760</u>	<u>7,967</u>
Adjustments	<u>372</u>	<u>(239)</u>
	<u>1,132</u>	<u>7,728</u>
Unallocated expenses	<u>(4,907)</u>	<u>(5,218)</u>
Operating profit (loss)	(3,775)	2,510
Financial income (expenses), net	(795)	275
Other income (expenses), net	(92)	201
Income taxes	<u>(421)</u>	<u>1,065</u>
Net profit (loss)	<u><u>(4,241)</u></u>	<u><u>1,921</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 28:- GEOGRAPHIC SEGMENTS (Cont.)

3.	Segment assets:		
		December 31,	
		2004	2005
		<hr/>	<hr/>
	Europe	7,130	10,004
	United States	4,784	4,455
	Other countries	1,511	973
		<hr/>	<hr/>
		13,425	15,432
	Adjustments	(295)	(202)
	Unallocated assets	23,563	22,783
		<hr/>	<hr/>
	Total assets	<u>36,693</u>	<u>38,013</u>
4.	Segment liabilities:		
	Europe	9,283	2,852
	United States	5,472	6,159
		<hr/>	<hr/>
		14,755	9,011
	Adjustments	(12,310)	(7,179)
	Unallocated liabilities	27,721	21,388
		<hr/>	<hr/>
	Total liabilities	<u>30,166</u>	<u>23,220</u>
5.	Tangible fixed assets:		
	a) Capital expenditure:		
		Year ended December 31,	
		2004	2005
		<hr/>	<hr/>
	Europe	166	111
	United States	35	17
		<hr/>	<hr/>
		201	128
		<hr/>	<hr/>
	b) Depreciation:		
	Europe	65	55
	United States	47	30
		<hr/>	<hr/>
		112	85
		<hr/>	<hr/>

APPENDIX TO CONSOLIDATED FINANCIAL STATEMENTS

SCHEDULE OF ACTIVE INVESTEE COMPANIES

<u>Entity</u>	<u>Place of incorporation</u>
Sectec S.A.R.L. (*)	France
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 of the Company.

(*) Held directly by the Company.

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