

C.M.T. MEDICAL TECHNOLOGIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2008

IN U.S. DOLLARS

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INDEPENDENT AUDITORS' REPORT
To the Shareholders of
C.M.T. MEDICAL TECHNOLOGIES LTD.

We have audited the accompanying financial statements of C.M.T. Medical Technologies Ltd. and its subsidiaries ("the Group"), which comprise the consolidated balance sheets as of December 31, 2008 and 2007 and the consolidated statements of income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the two years in the period ended December 31, 2008, and a summary of significant accounting policies and other explanatory notes.

We did not audit the financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), of a subsidiary, whose assets constitute approximately 17% and 21% of total consolidated assets as of December 31, 2008 and 2007, respectively, and whose revenues constitute approximately 15% and 16% of total consolidated revenues for the years ended December 31, 2008 and 2007, respectively, after the reconciliation of those financial statements from U.S. GAAP to International Financial Reporting Standards, which we have audited. The financial statements of this subsidiary were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for that company, is based on the reports of the other auditors.

Also, we did not audit the financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") of an associate, the investment in which, at equity, amounted to \$ 670 thousand and \$ 1,138 thousand as of December 31, 2007 and 2008, respectively, and the Company's equity in its loss amounted to \$ 790 thousand and \$ 414 thousand, for the years ended December 31, 2008 and 2007, respectively, after the reconciliation of those financial statements from U.S. GAAP to International Financial Reporting Standards, which we have audited. The financial statements of this company were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for that company, 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 audit 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 and 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 audit 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, 2008 and 2007, and of its financial performance and its cash flows for each of the two years in the period ended December 31, 2008, in accordance with International Financial Reporting Standards.

Tel-Aviv, Israel
May 19, 2009

Kost Forer Gabbay and Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2007	2008
	U.S. dollars in thousands	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents (Note 3)	1,718	6,727
Short-term deposits (Notes 4)	11,678	2,871
Trade receivables (Note 5)	3,378	2,415
Other current assets (Note 6)	1,243	904
Inventories (Note 7)	1,815	2,377
Total current assets	19,832	15,294
NON-CURRENT ASSETS:		
Deferred taxes (Note 21i)	877	1,158
Long-term investments (Note 8)	955	4,188
Interest in a joint venture (Note 9)	1,138	670
Long-term receivables (Note 10)	240	243
Property and equipment, net (Note 11)	672	634
Total non-current assets	3,881	6,893
Total assets	23,714	22,187

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

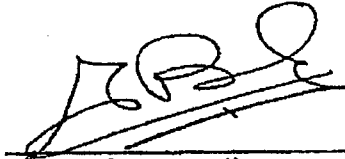
**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS

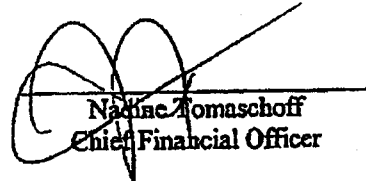
	December 31,	
	2007	2008
	U.S. dollars in thousands	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Trade payables (Note 12)	2,414	3,277
Provisions (Note 13)	66	48
Income tax payables	376	344
Other current liabilities (Note 14)	1,556	2,569
Total current liabilities	4,412	6,238
NON-CURRENT LIABILITIES:		
Government grants (Note 16)	1,732	2,184
Employee benefit liability (Note 15)	426	561
Total non-current liabilities	2,158	2,745
EQUITY: (Note 20)		
Share capital	1,080	1,080
Premium	7,351	7,351
Share-based payments reserve	2,172	2,338
Retained earnings	7,234	3,618
Treasury shares	(693)	(1,183)
Total equity	17,144	13,204
Total liabilities and equity	23,714	22,187

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

May 19, 2009
Date of approval of the
financial statements



Jacques Belin
Chairman of the Board
of Directors



Nadine Tomaschoff
Chief Financial Officer

**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF INCOME

	Year ended	
	December 31,	
	2007	2008
	U.S. dollars in thousands	
Revenues from sale of products	21,885	19,822
Revenues from construction contracts	500	1,300
Total revenues	22,385	21,122
Cost of revenues from sale of products	11,291	12,868
Cost of revenues from construction contracts	170	550
Total cost of revenues (Note 22a)	11,461	13,417
Gross profit	10,924	7,705
Operating expenses:		
Research and development costs (Note 22b)	5,603	5,910
Selling and marketing (Note 22c)	2,610	2,198
General and administrative (Note 22d)	3,604	2,968
Total operating costs and expenses	11,817	11,076
Other expenses, net	(5)	(24)
Loss from operations	(898)	(3,395)
Financial income (Note 22e)	726	511
Financial expenses (Note 22f)	(306)	(164)
Share of losses of a joint venture	(414)	(790)
Loss before income taxes	(892)	(3,838)
Income taxes (Note 21)	159	281
Loss for the year from continuing operations	(733)	(3,557)
Loss from discontinued operations	(890)	(59)
Loss for the year	(1,623)	(3,616)
Basic and diluted loss per share from continuing operations (Note 20g)	<u>(0.19)</u>	<u>(0.94)</u>
Basic and diluted loss per share for the year (Note 20g)	<u>(0.42)</u>	<u>(0.95)</u>

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

**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Number of shares	Share capital	Premium	Share-based payments reserve	Retained earnings	Treasury shares	Total equity
	U.S. dollars in thousands						
Balance as of January 1, 2007	3,893,462	1,079	7,084	1,409	9,662	(283)	18,951
Purchase of treasury shares	(38,689)	-	-	-	-	(410)	(410)
Proceeds from exercise of stock options	3,000	1	267	-	-	-	268
Cash dividend	-	-	-	-	(805)	-	(805)
Cost of share-based payments	-	-	-	763	-	-	763
Net profit	-	-	-	-	(1,623)	-	(1,623)
Balance as of December 31, 2007	3,857,773	1,080	7,351	2,172	7,234	(693)	17,144
Purchase of treasury shares	(114,965)	-	-	-	-	(490)	(490)
Cost of share-based payments	-	-	-	166	-	-	166
Net loss	-	-	-	-	(3,616)	-	(3,616)
Balance as of December 31, 2008	<u>3,742,808</u>	<u>1,080</u>	<u>7,351</u>	<u>2,338</u>	<u>3,618</u>	<u>(1,183)</u>	<u>13,204</u>

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

**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
<u>Cash flows from operating activities:</u>		
Loss from continuing operations	(733)	(3,557)
Loss from discontinued operations	(890)	(59)
Loss	(1,623)	(3,616)
Adjustments for:		
Depreciation	200	211
Impairment of goodwill *)	200	-
Inventory write-off *)	231	11
Accrued severance pay, net	(89)	135
Impairment of property and equipment *)	46	-
Loss from sale of property and equipment	5	-
Share of loss of a joint venture	414	790
Exchange differences	(21)	(3)
Accrued interest on Government grants	38	77
Increase in deferred taxes, net	(280)	(281)
Cost of share-based payments	763	166
Operating cash flows before working capital changes	(1,507)	1,106
Movement in government grants	(46)	-
Decrease in trade receivables	1,262	963
Decrease in income tax receivable	508	-
Decrease in other current assets	115	339
Decrease (increase) in inventories	44	(562)
Increase in balance with joint venture	-	(322)
Increase (decrease) in trade payables	(1,093)	863
Decrease in provision for warranty	(18)	18
Increase (decrease) in income tax payables	376	(32)
Increase (decrease) in other current liabilities	(78)	1,013
Changes in working capital	1,070	2,244
Net cash flows provided by operating activities	954	(266)
<u>Cash flows from investing activities:</u>		
Investment in a joint venture	(1,550)	-
Proceeds from sale of property and equipment	11	-
Purchase of property and equipment	(83)	(173)
Purchase of long-term investments	-	(3,245)
Purchase and realization of short and long-term deposits	677	8,807
Net cash flows used in investing activities	(945)	5,389

*) Relates to the discontinued operations.

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

**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
<u>Cash flows from financing activities:</u>		
Proceeds from Government grants	800	375
Proceeds from exercise of stock options	268	-
Purchase of treasury shares	(410)	(490)
Cash dividend	(805)	-
	(147)	(115)
Net cash flows used in financing activities	(147)	(115)
Increase (decrease) in cash and cash equivalents from continuing operations	(138)	5,009
Cash and cash equivalents at beginning of year	1,856	1,718
Cash and cash equivalents at end of year	1,718	6,727
 (a) <u>Supplemental disclosure of cash flows activities:</u>		
Cash paid during the year for:		
Taxes (operating activities)	66	109
Cash received during the year from:		
Interest (operating activities)	502	621
Taxes (operating activities)	883	230

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL

- a. C.M.T. Medical Technologies Ltd. ("CMT" or "the Company"), an Israeli corporation, is an industrial company. C.M.T. develops, manufactures and markets digital image processing systems for X-ray equipment.
- b. C.M.T. Medical Technologies Inc. ("CMT Inc."), a wholly - owned subsidiary of C.M.T. markets the Company's products and purchases materials in the United States.
- c. The Company currently sells its products to two main customers. The Company expects these customers to account for a substantial percentage of the Company's revenues in the coming years. Should these customers cease trading with the Company, its results of operations could be adversely affected.

For the years ended December 31, 2008 and 2007, these customers accounted for 80% and 72% of the Company's consolidated revenues, respectively.

- d. On December 16, 2008, Thales, a publicly traded company in France, and the Board of directors of the Company entered into a letter agreement whereby Thales agreed to file a cash tender offer for all the shares of the Company at a price per share of €5.65. On December 17, 2008, Thales filed the offer pursuant to section III of book II and specifically articles 232-1 et seq. of the AMF General Regulations. On March 24, 2009, Thales announced it purchased 94.25% of the Company's shares.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of preparation:

The consolidated financial statements of C.M.T. have been prepared on a historical cost basis. The consolidated financial statements are presented in U.S. dollars, and all values are rounded to the nearest thousand, except when otherwise indicated.

- b. Statement of compliance:

The consolidated financial statements of CMT and all of its subsidiaries ("the Group") have been prepared in accordance with International Financial Reporting Standards (IFRS).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Changes in accounting policies:

The accounting policies adopted are consistent with those of the previous financial year.

d. Significant accounting estimates and assumptions:

The preparation of the Group's consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Estimates and assumptions:

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Development costs:

Research costs 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.

The asset is measured at cost and presented less any accumulated amortization and any accumulated impairment losses. Amortization of the asset begins when development is complete and the asset is available for use. It is amortized over the period of expected future sales. During the development period in which the asset is not yet in use and the amortization period has not yet begun, it is tested for impairment at each year-end.

The Company cannot yet demonstrate technical feasibility of completing the intangible asset so that it will be available to use or sell the asset.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Cost of share-based payments:

The cost of share based payment is determined using the binomial valuation model. The valuation involves making assumptions about expected life of the options and termination rate. Further details are given in Note 20.

Deferred tax assets:

The Company and its subsidiaries did not record deferred tax assets amounting to approximately \$ 1,950 thousand as of December 31, 2008 in respect of loss carryforward as it is uncertain whether there will be taxable income in the future.

e. **Functional and presentation currency:**

The majority of the Group's sales are made outside Israel in U.S. dollars, and a substantial portion of Group's costs is incurred in U.S. dollars or linked thereto. Accordingly, the Company has determined the U.S. dollar to be the currency of the primary economic environment of each company in the Group and, thus, the functional and presentation currency.

Transactions and balances denominated in U.S. dollars are presented at their original amounts. Monetary assets and liabilities denominated in non-dollar currencies are translated at the exchange rate prevailing at the balance sheet date. Transactions in non-dollar currencies are recorded at the exchange rate prevailing at the date of transaction. All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the income statement as financial income or expenses, as appropriate.

f. **Scope of consolidation:**

The scope of consolidation is established according to principles of IAS 27, "Consolidated and Separate Financial Statements". The following companies are consolidated as of the balance sheet date:

Subsidiaries	Country of incorporation	Equity interest %
C.M.T. Medical Technologies Inc.	U.S.A.	100
Medibell Medical Vision Technologies Ltd.	Israel	100
C&T Medical Solutions Ltd.	Israel	62
C&T Medical Solutions Limited Partnership	Israel	61.38

See also Note 1b, c and d.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

g. Basis of consolidation:

The consolidated financial statements include the financial statements of C.M.T. Medical Technologies Ltd. ("the parent company") and its subsidiaries after the elimination of all intercompany transactions and balances.

Subsidiaries are consolidated from the date the parent obtains control until such time as control ceases. Acquisitions of subsidiaries are accounted for using the purchase method of accounting. The financial statements of subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

h. Cash and cash equivalents:

Cash and short term deposits in the balance sheet comprise cash at banks and on hand and short term deposits with an original maturity of three months or less.

i. Short-term deposits:

The Company classified deposits with original maturities of more than three months and less than one year as short-term deposits. The short-term deposits are presented at cost, including accrued interest.

j. 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.

k. 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.

Costs incurred in bringing each product to its present location and condition are accounted for as follows:

- | | |
|-------------------------------------|--|
| Raw materials | - at cost of purchase using the first-in, first-out method; |
| Finished goods and work in progress | - on the basis of weighted average costs which take into account materials, labor and other direct and indirect manufacturing costs. |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

1. Financial instruments:

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.

Financial assets at fair value through profit or loss:

Derivatives are classified as held for trading, unless they are designated as effective hedging instruments.

Held-to-maturity investments:

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Group has the positive intention and ability to hold it to maturity. After initial measurement held-to-maturity investments are measured at amortized cost using the effective interest method. This method uses an effective interest rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset. Gains and losses are recognized in the consolidated income statement when the investments are derecognized or impaired, as well as through the amortization process.

Derecognition of financial instruments:

Financial assets:

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Financial liabilities:

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

m. Interest in a joint ventures:

The Group has an interest in a joint venture which is a jointly controlled entity, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The Company recognizes its interest in the joint venture using the equity method. Under the equity method, the investment in the joint venture is carried in the balance sheet at cost plus post acquisition changes in the Group's share at net assets of the joint venture. The income statement reflects the share of the results of operations of the joint venture. Where there has been a change recognized directly in the equity of the joint venture, the Group recognizes its share of any changes and discloses this, when applicable, in the statement of changes in equity. Unrealized gains and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture.

The share of profit of the joint venture is shown on the face of the income statement. This loss is attributable to equity holders of the joint venture.

The financial statements of the joint venture are prepared for the same reporting period as of the Company. Adjustments are made where necessary to bring the accounting policies into line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognize an additional impairment loss on the Group's investment in its joint venture. The Group determines at each balance sheet date whether there is any objective evidence that the investment in the joint venture is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the joint venture and its carrying value and recognizes the amount in the income statement.

n. Long-term investments:

Long-term investments are comprised of bank deposits with maturities of more than one year. Bank deposits are presented at their amortized cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Property, plant and equipment

Plant and equipment is stated at cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the cost of replacing part of the plant and equipment. Likewise, when a major inspection is performed its cost is recognized in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in the income statement as incurred.

Depreciation is calculated on a straight-line basis over the useful life of the asset as follows:

	%
Equipment	20 - 33 (mainly 20)
Office furniture and equipment	6 - 15 (mainly 15)
Motor vehicles	15
Leasehold improvements (not exceeding the leasehold period)	10 - 20 (mainly 20)

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognizing of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognized.

The assets residual values, useful lives and methods of depreciation are reviewed at each financial year end, and adjusted prospectively if appropriate.

The carrying value of property and equipment is reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying value exceeds the estimated recoverable amount, the assets are written down to the recoverable amount. The recoverable amount of property and equipment is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the income statement.

p. Revenue recognition:

Revenues from sales of products are recognized when the significant risks and rewards of ownership of the products have passed to the buyer (usually on dispatch of the goods) and the amount of revenue can be measured reliably.

Revenues from interest are recognized as the interest accrues (taking into account the effective yield on the asset).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from construction contracts:

Revenues from construction contracts are recognized on the percentage of completion basis provided that the revenues are fixed or can be reasonably estimated, collection is probable, costs related to performing the work are determinable or can be reasonably determined, there is no substantial uncertainty regarding the ability of the Company to complete the contract and to meet the contractual terms, and the percentage of completion can be reasonably estimated. The percentage of completion is determined based on the ratio of actual cost to total estimated cost. As for contracts in which a loss is anticipated, a provision is recorded for the full amount of the expected loss.

q. Research and development costs:

Research costs are expensed as incurred. Development expenditure on an individual project is recognized as an intangible asset when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the asset and the ability to measure reliably the expenditure during development.

Development costs are capitalized in accordance with the accounting policy mentioned above. Initial capitalization of costs is based on management's judgment that technological and economical feasibility is confirmed, usually when a product-development project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalized, management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

The Company has several projects in the research phase and two projects in the development phase. The Company did not capitalize development costs since the Company cannot yet demonstrate technical feasibility of completing the intangible asset so that it will be available to use or sell the asset. In addition, the Company is not able to evaluate the expenditure until the intangible asset will be available for use, or the sale of the asset.

r. Warranty costs:

The Group recognizes a provision for warranty (up to one year) for sale of its products, based on past experience of the level of repairs and returns. Warranty is limited to malfunctions as defined by the Group and does not include warranty for damages incurred by the customer. Assumptions used to calculate the provision are based on current sales levels and current information available about returns based on the two-year warranty period for all products sold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. 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.

Government grants from the Office of the Chief Scientist in Israel for funding research and development activities that include a liability to pay royalties to the State depending on future sales from development are recognized upon receipt as a liability if an outflow of economic benefits from the research activity has become probable and leads to sales entitling the State to royalties. Amounts paid as royalties are recognized as settlement of liability. When no such economic benefits are probable, the receipts from the grant are deducted from research and development costs in the statement of income. 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 once all the above conditions are met.

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 in the statement of income. If in a later period, the estimated future sales indicate that there is no such reasonable assurance, the appropriate liability reflecting the anticipated royalty payments is recognized concurrently with research and development cost in the statement of income.

t. Taxes:

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, except in a limited number of exceptions. 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.

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 dividends have not been taken into account in computing the deferred taxes, since the distribution of dividends does not involve an additional tax liability or since it is the Company's policy not to initiate distribution of dividends that triggers an additional tax liability.

Deferred tax assets and deferred tax liabilities are presented in the balance sheet as non-current assets and long-term 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Current taxes:

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Current income tax relating to items recognized directly in equity is recognized in equity and not in the income statement.

u. Employee benefit liabilities:

The Group has several employee benefit plans:

1. Short-term employee benefits:

Short-term employee benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

2. Benefits after the completion of employment:

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

The Company 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 presented by the projected unit credit method. The actuarial assumptions comprise 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").

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

3. Termination and voluntary retirement benefits:

Employee termination benefits are carried as an expense when the Company has committed, without realistic possibility of withdrawal, to terminate employees before the normal retirement date according to a detailed formal plan. Benefits to employees in respect of voluntary retirement are carried when the Group has offered the employees a plan that encourages voluntary redundancy, it is expected that the offer will be accepted and the number of respondents can be reliably measured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

v. Loss per share:

Loss per share are calculated by dividing the loss attributable to equity holders of the parent by the weighted number of Ordinary shares outstanding during the period. Basic loss 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 loss per share when their conversion increases loss per share from continuing operations. Furthermore, potential Ordinary shares that are converted during the period are included in diluted loss per share only until the conversion date and from that date in basic loss per share. The investor's share of loss of an investee is included based on the loss per share of the investee multiplied by the number of shares held by the investor.

w. Treasury shares:

Company shares held by the Company are recognized at cost and deducted from equity. Gains or losses on purchase, sale, issue or cancellation of treasury shares are recognized directly in equity.

x. Leases:

Leases where the Group as a lessee retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

y. Share based payment transactions:

Employees (including senior executives) of the Company receive remuneration in the form of share-based payment transactions, whereby employees render services as a consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The fair value is determined by an external appraiser using a binomial model. Further details are given in Note 20c.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). 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 Company's best estimate of the number of equity instruments that will ultimately vest. The income statement charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that period. No expense is recognized for awards that do not ultimately vest.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense if the terms had not been modified. In addition, an expense is recognized for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

z. Trade receivables:

Trade receivables, which generally have 30 day terms and bear no interest, are recognized and carried at the original invoice amount less an allowance for any uncollectible amount. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

aa. Standards issued but not yet effective:

IAS 1 Revised Presentation of Financial Statements:

The revised Standard was issued in September 2007 and becomes effective for financial years beginning on or after 1 January 2009. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income:

it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group is still evaluating whether it will have one or two statements.

IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation

These amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for financial years beginning on or after 1 January 2009. The revisions provide a limited scope exception for puttable instruments to be classified as equity if they fulfil a number of specified features. The amendments to the standards will have no impact on the financial position or performance of the Group, as the Group has not issued such instruments.

NOTE 3:- CASH AND CASH EQUIVALENTS

	Weighted average annual interest rate		December 31,	
	2007	2008	2007	2008
	%		U.S. dollars in thousands	
Cash			1,465	3,104
Deposits in banks	4.07	0.31	391	3,623
			<u>1,856</u>	<u>6,727</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4:- SHORT-TERM DEPOSITS

Short-term deposits in U.S. dollars are made for varying periods of between three months and one year, depending on the immediate cash requirements of the Group and earn interest at the respective short-term deposits rates.

Short-term effective annual interest rates were 5% and 2% in 2007 and 2008, respectively.

NOTE 5:- TRADE RECEIVABLES

	December 31,	
	2007	2008
	NIS in thousands	
Open accounts	3,594	2,592
Less - allowance for doubtful accounts	216	177
Trade receivables, net	3,378	2,415

Trade receivables are non-interest bearing. They are generally on 30-60 credit day terms.

As of December 31, 2008, trade receivables at nominal value of approximately \$ 177,000 (2007: \$ 216,000) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows:

	Individually impaired U.S. dollars in thousands
As of January 1, 2007	182
Charge for the year	34
As of December 31, 2007	216
Released during the year	(39)
As of December 31, 2008	177

The balances of trade receivables, net as of December 31, 2008 and 2007 represent amounts neither past due nor impaired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6:- OTHER CURRENT ASSETS

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Government authorities	240	264
Loans to employees (1)	99	35
Prepaid expenses	178	122
Interest receivable	289	75
Other receivables	437	408
	1,243	904

(1) The loans are in NIS and bear interest at the rate of 4% which is linked to the Consumer Price Index in Israel.

NOTE 7:- INVENTORIES

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Raw materials and components	884	1,403
Work-in-progress	447	422
Finished products	484	552
	1,815	2,377

The amount of the write-down of inventories recognized as an expense was \$ 11 thousand (2007 - \$ 244) and related to discontinued operations.

NOTE 8:- LONG-TERM INVESTMENTS

In 2008 the Company invested in several debentures which are traded overseas. The debentures bear interest rates between 3.625% - 6.125% are held to maturity between January 2010 - February 2011.

In 2007, the balance is comprised of long-term deposits in banks totaling \$ 955 thousand, with an effective interest rate of 5.29%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9:- INTEREST IN A JOINT VENTURE

On December 18, 2007, the Company and Tower Semiconductors Ltd. ("Tower") established C&T Medical Solutions Limited Partnership ("C&T LP"). C&T LP will design and develop a detector to be used for medical applications. In addition, the Company and Tower established a company called C&T Medical Solutions Ltd. ("C&T"), which will be the general partner in C&T LP. CMT holds 62% in C&T and Tower holds 38% in C&T. The Company holds 61.38% in C&T LP, Tower holds 37.62% in C&T LP and C&T holds 1% in C&T LP. As of the balance sheet date the Company and Tower invested \$ 1,550,000 and \$ 950,000, respectively.

The following table illustrates summarized financial information of the Company interest in the joint venture:

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Share in joint venture's balance sheet:		
Current assets	2,204	658
Current liabilities	(1,068)	(310)
Net assets	1,136	348
Intercompany balance	2	322
	1,138	670
Share in joint venture's revenue and profit:		
Revenues	-	-
Loss	414	790

See also Note 1d.

NOTE 10:- LONG-TERM RECEIVABLES

In 2004, the Company deposited NIS 945 thousand (\$ 249 thousand) with the income tax authorities in Israel, to secure an obligation in that amount in respect of a dispute regarding employee tax related to the former CEO and CFO. Further details are given in Note 18c. The Company is of the opinion that this amount will be refunded or collected.

**C.M.T. MEDICAL TECHNOLOGIES LTD.
AND ITS SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11:- PROPERTY AND EQUIPMENT

	<u>Equipment</u>	<u>Office furniture and equipment</u>	<u>Motor vehicles</u>	<u>Leasehold improvements</u>	<u>Total</u>
	U.S. dollars in thousands				
Cost:					
Balance as of January 1, 2007	2,729	307	245	206	3,487
Additions during the year	83	-	-	-	83
Impairment of property and equipment *)	(266)	(18)	-	-	(284)
Disposals during the year	(3)	-	(35)	-	(38)
Balance as of December 31, 2007	2,543	289	210	206	3,248
Additions during the year	142	13	-	18	173
Impairment of property and equipment *)	(4)	-	-	-	(4)
Disposals during the year	-	-	(14)	-	(14)
Balance as of December 31, 2008	2,681	302	196	224	3,403
Accumulated depreciation:					
Balance as of January 1, 2007	2,205	239	82	110	2,636
Additions during the year	158	5	26	11	200
Impairment of property and equipment *)	(224)	(14)	-	-	(238)
Disposals during the year	(3)	-	(19)	-	(22)
Balance as of December 31, 2007	2,136	230	89	121	2,576
Additions during the year	133	38	27	13	211
Impairment of property and equipment *)	(4)	-	-	-	(4)
Disposals during the year	-	-	(14)	-	(14)
Balance as of December 31, 2008	2,265	268	102	134	2,769
Net carrying amount as of December 31, 2008	<u>416</u>	<u>34</u>	<u>94</u>	<u>90</u>	<u>634</u>
Net carrying amount as of December 31, 2007	<u>407</u>	<u>59</u>	<u>121</u>	<u>85</u>	<u>672</u>

*) Related to discontinued operations.

NOTE 12:- TRADE PAYABLES

	<u>December 31,</u>	
	<u>2007</u>	<u>2008</u>
	U.S. dollars in thousands	
Trade payables	2,202	2,703
Other payables	212	574
	<u>2,414</u>	<u>3,277</u>

Trade payables are non-interest bearing and are generally at 30-60 day terms.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13:- PROVISIONS

	Warranty
	U.S. dollars
	in thousands
Balance as of January 1, 2007	84
Additions during the year	110
Utilized	(128)
Balance as of December 31, 2007	66
Additions during the year	77
Utilized	(95)
Balance as of December 31, 2008	48

A provision is recognized for expected warranty costs on products sold, based on past experience of the level of repairs and returns.

NOTE 14:- OTHER CURRENT LIABILITIES

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Employees and payroll accruals	1,397	1,827
Related parties	79	63
Accrued expenses	74	19
Advances from customers	-	244
Other accounts payable	6	416
	1,556	2,569

NOTE 15:- ACCRUED SEVERANCE PAY, NET

The Company has one defined benefit plan covering substantially all of its employees, which requires contributions to be made to separately administered funds.

The following table summarizes the components of net benefit expenses recognized in the income statement and the funded status and amounts recognized in the balance sheet for the respective plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- ACCRUED SEVERANCE PAY, NET (Cont.)

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
Current service cost	417	387
Interest cost on benefit obligation	102	125
Expected return on plan assets	(100)	(67)
Net actuarial loss recognized in the year	44	198
Net benefit expenses	463	643
Actual return on plan assets	111	(146)
	December 31,	
	2007	2008
	U.S. dollars in thousands	
Benefit asset (liability):		
Defined benefit obligation	(2,319)	(2,490)
Fair value of plan assets	1,893	1,929
Benefit liability, net	(426)	(561)
Changes in the present value of the defined benefit obligation are as follows:		
Opening defined benefit obligation	2,029	2,319
Interest cost on benefit obligation	102	125
Current service cost	417	387
Benefit paid	(380)	(360)
Actuarial loss (gains) on obligations	55	(15)
Exchange differences	96	34
Closing defined benefit obligations	2,319	2,490
Changes in the fair value of plan assets are as follows:		
	December 31,	
	2007	2008
	U.S. dollars in thousands	
Opening defined plan assets	1,514	1,893
Expected return on plan assets	100	67
Contribution by employer	416	427
Benefit paid	(300)	(266)
Actuarial losses	11	(213)
Exchange differences	152	21
Fair value of plan assets as of December 31	1,893	1,929

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)

- c. Options held by directors to purchase Ordinary shares have the following expiry dates and exercise prices:

<u>Grant date</u>	<u>Number</u>	<u>Exercise price (€)</u>	<u>Expiry date</u>
2002	6,000	8.05	2009
2006	28,600	8	2013

- d. The Company granted several directors loans in the aggregate amount of \$ 203 thousand for the purpose of exercise of options. During 2007, a loan in the amount of \$ 163 thousand was repaid.
- f. Compensation of key management personnel of the Company:

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
Short-term benefits	946	881
Termination benefits	56	60
Share-based payment	293	231
	<u>1,295</u>	<u>1,172</u>

- g. As to the bonus commitment to the Company's CEO, see Note 18e.

NOTE 18:- COMMITMENTS AND CONTINGENT LIABILITIES

- a. Commitments:

1. The Company leases in an operating lease an industrial building for production and office use until October 31, 2010. The Company was granted options to extend the lease agreement by additional two years and three years, respectively. CMT Inc. leases an office building for office use until February 28, 2009. Future rental payments under non-cancelable operating leases as of December 31, 2008 which are payable in or linked to U.S. dollars, are as follows:

	U.S. dollars in thousands
2009	248
2010	248
2011	248
	<u>744</u>

Total rent expense for the years ended December 31, 2007 and 2008 was \$ 235 thousand and \$ 209 thousand, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

2. The Company leases motor vehicles under various operating lease agreements, which expire on various dates. Aggregate minimum lease commitments under non-cancelable leases as of December 31, 2008, are as follows:

	<u>U.S. dollars in thousands</u>
2009	197
2010	<u>87</u>
	<u>284</u>

b. Lawsuits:

In March 2002, the Company's board of directors decided to terminate the employment of the CEO and the CFO.

In May 2002, the Company filed claims against its former CEO and former CFO amounting to \$ 440 thousand and \$ 487 thousand, respectively, alleging that each of them had breached their duties and obligations as officers of the Company.

During July 2002, counter claims were filed against the Company and certain directors by its former CEO and former CFO amounting to \$ 3,355 thousand and \$ 875 thousand, respectively, mainly in respect of severance pay, vacation pay, bonus payments and loss of Company options.

In January 2003, the Company filed an amended claim against the former CEO and former CFO amounting to \$ 6,759 thousand and \$ 4,690 thousand, respectively.

In April 2003, the Company filed a criminal complaint against its former CEO. The cause of action is disclosure of confidential information of the Company.

As of balance sheet date there is a major progress made by the Company and the former CEO and former CFO in order to withdraw both claims. The Company recorded a provision to comply with a future reasonable compromise. The amount of such provision can not be disclosed since it will prejudice the position of the Company in the dispute.

- c. As to commitments relating to the "approved enterprise", see Note 21a.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19:- DISCONTINUED OPERATION

In September 2007, the Company's Board of Directors decided to cease the operations of Medibell a separate business segment that is part of the Company operations. The business of Medibell was developing a device in the field of ophthalmology. As of that date, Medibell's operations have been classified as discontinued operations in accordance with IFRS 5. In addition, the Company impaired goodwill in the amount of \$ 200 thousand recognized in 2006 from the acquisition of minority interests in Medibell.

The results of Medibell for the year are presented below:

	Year ended	
	December 31,	
	2007	2008
	U.S. dollars in thousands	
Revenue	51	-
Expenses	911	59
Gross loss	860	59
Financial expenses	30	-
Loss from discontinued operations	890	59
Net cash flows used in operating activities	(55)	(61)
Basic and diluted net loss per share from discontinued operations	(0.23)	(0.02)

NOTE 20:- EQUITY

a. General:

1. The Company's shares are traded on the Eurolist market, in France.
2. Each holder of an Ordinary share shall have the following rights: voting rights at the general meeting, right to receive dividends, rights upon liquidation of the Company and right to nominate directors in the Company
3. The Company has a buy-back program, according to which the Company can purchase 10% of its issued and outstanding share capital.
4. During 2007 and 2008, 38,689 and 114,965 Ordinary shares were purchased by the Company in consideration of \$ 410 thousand and \$ 490 thousand, respectively.

b. Stock Option Plan:

1. Under the Company's 1998, 2000, 2002 and 2003 Stock Option Plans, the Company reserved for issuance 1,888,662 Ordinary shares to be issued as stock options. As of December 31, 2008, an aggregate of 737,604 Ordinary shares of the Company are still available for future grants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20:- EQUITY (Cont.)

2. Each option granted under the plan is exercisable for a period of 7 years from the date of the grant. The exercise price of the options granted under the plan may not be less than the nominal value of the shares. Most of the options vest gradually over a period of 3 years. Part of the options vest quarterly over a period of 3 years. Any options that are canceled or forfeited before expiration become available for future grant.
3. A summary of the stock option activities in 2007 and 2008 is as follows:

	Options outstanding	
	Number of options	Weighted average exercise price per share
		Euro
Balance as of January 1, 2007	689,449	
Options granted	7,800	8
Options exercised (1)	(3,000)	6.85
Options forfeited	(117,433)	6.34
Balance as of December 31, 2007	576,816	
Options granted (2)	75,000	2.75
Options forfeited	(151,950)	7.26
Balance as of December 31, 2008	499,866	
Number of options exercisable as of:		
December 31, 2007	401,374	
December 31, 2008	262,458	

- (1) The weighted average share price at the date of exercise for the options exercised was € 7.71.
- (2) On December 28, 2008, the Company modified the term of the options. In the event of a change of control as determined in the agreement, the options shall become fully vested and exercisable immediately prior to the consummation of such transaction and the executive shall the right to sell the options to the Company in consideration of \$340,000. The modification of the vesting terms does not result in any additional expense to be recorded. Due to change of control in 2009, the options became fully vested and were sold to the Company in consideration of \$ 340,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20:- EQUITY (Cont.)

The options outstanding as of December 31, 2008, have been separated into ranges of exercise price as follows:

<u>Exercise price</u> <u>Euro</u>	<u>Options outstanding as of December 31, 2008</u>	<u>Weighted average remaining contractual life (years)</u>	<u>Options exercisable as of December 31, 2008</u>	<u>Weighted average exercise price of options exercisable</u> <u>Euro</u>
2.75	75,000	6.75	-	2.75
4.95	1,666	2	1,666	4.95
6.85	6,000	0.9	6,000	6.85
8.00	363,300	4.25	323,967	8.00
8.00	7,800	4.85	7,150	8.00
8.05	10,000	3.3	10,000	8.05
10.30	36,100	0.5	36,100	10.30
	<u>499,866</u>		<u>384,883</u>	

The weighted average fair value of options granted during the year was \$ 1.37 (\$2.62 in 2007).

- c. The fair value was estimated at the date of grant using the binomial model. The following table gives the assumptions made during 2007 and 2008:

	<u>2007 grant</u>	<u>2008 grant</u>
Share price (€)	8	2.75
Exercise price (€)	8	2.75
Volatility (%)	30.52 - 46.1	40.55-40.59
Risk-free interest rate (%)	3.3 - 4.25	3.96-4.45
Expected dividend (%)	5.43	4.25
Expected life (years)	5	7

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome. No other features of options granted were incorporated into the measurement of fair value.

Cost of share-based payments for the years ended December 31, 2007 and 2008 amounted to \$ 763 thousand and \$ 166, respectively.

- d. On November 24, 2008, the board of directors and the audit committee of the Company have approved in principle a grant of options under the 2003 plan to its directors, to purchase 95,000 ordinary shares. The grant and its terms are subject to the approval of the shareholders of the Company. The options shall vest over three years and shall be accelerated in the event of a change of control of the Company or a M&A transaction. On February 25, 2009, the options were granted to the directors. All options were exercised.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20:- EQUITY (Cont.)

e. Dividends:

In 2007, the Company paid dividends in the amount of \$ 805 thousand (€ 0.183 per share).

Such dividend is paid in Euro.

f. Loss per share:

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

	2007	2008
Weighted average number of Ordinary shares for basic loss per share	3,885,813	3,803,124
Effect of dilution:		
Share options	-	-
Weighted average number of Ordinary shares adjusted for the effect of dilution	<u>3,885,813</u>	<u>3,803,124</u>

There have been no other transactions involving Ordinary shares or potential Ordinary shares between the reporting date and the date of completion of these financial statements.

NOTE 21:- INCOME TAXES

a. The Law for the Encouragement of Capital Investments, 1959:

The Company has been granted "approved enterprises" and "beneficiary enterprise" status under the Law for Encouragement of Capital Investments, 1959 ("the Law"). According to the provisions of the Law, the Company has chosen to enjoy the alternative tax benefits track - waiver of grants in return for tax exemption - and, accordingly, its profit from the "approved enterprises" and "beneficiary enterprise" will be tax-exempt for a period of ten years.

The benefit period begins in the year in which taxable income is first earned, limited to 12 years from the year that the enterprise began operations, or 14 years from the year in which the approval was granted, whichever period ends earlier. In respect of expansion programs pursuant to Amendment No. 60 to the law, the benefit period commences in the later of the year elected by the Company or the first year in which the Company has taxable income, provided that 12 years have not elapsed from the beginning of the year of election and for companies in development area A - 14 years from the beginning of the year of election. The benefit period for part of the enterprises of the Company has ended and, for part, it will end in the years 2007 to 2014.

If dividends are distributed out of tax exempt profits, the Company will then become liable for tax at the rate applicable to its profits from the approved enterprise in the year in which the income was earned, as if it had not chosen the alternative track of benefits (tax at the rate of 15%).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21:- INCOME TAXES (Cont.)

Conditions for the entitlement to the benefits:

The above benefits are conditional upon the fulfillment of the conditions stipulated by the law, regulations published thereunder and the letters of approval for the specific investments in the approved enterprises. 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. The management believes that the Company meets the aforementioned conditions.

b. Tax laws applicable to the Group companies:

Income Tax (Inflationary Adjustments) Law, 1985:

According to the law, the results for tax purposes are measured based on the changes in the Consumer Price Index in Israel. The Company is taxed under this law.

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. Starting 2008, the results for tax purposes will be measured in nominal values, excluding certain adjustments for changes in the Consumer Price Index carried out in the period until December 31, 2007. The amended law includes, inter alia, the elimination of the inflationary additions and deductions and the additional deduction for depreciation starting 2008.

c. Capital gains/losses:

Pursuant to the provisions of the Law for Amendment of the Income Tax Ordinance (No. 132), 2003 ("the reform law"), tax at a reduced rate of 25% will apply on capital gains accrued after January 1, 2003, instead of the regular tax rate. In case of the sale of properties purchased before the adoption of the reform law, the reduced tax rate will apply only to the portion of the profit which accrued after the adoption of the law, as computed according to the law. Further, the reform law states that capital losses carried forward for tax purposes may be offset against capital gains indefinitely. The reform law also provides for the possibility to offset capital losses from sales of properties outside Israel against capital gains in Israel.

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

1. Companies in Israel:

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: 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 and thereafter - 25%.

Because the Company is operating under five approved plans, its effective tax rate is composed of a weighted combination of the various applicable rates or tax exemptions.

The computation is made for profit derived from each plan on the basis of formulas determined based on existing rules and regulations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21:- INCOME TAXES (Cont.)

2. Foreign subsidiary:

The principal tax rate applicable to CMT Inc. is 35%.

e. Final tax assessments:

The Company received final tax assessments through 2005.

Medibell received final tax assessments through 2003.

CMT Inc. has not been assessed since its incorporation.

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

The Company is an "industrial company", as defined by this law and, as such, is entitled to certain tax benefits, mainly accelerated depreciation and the right to claim public issuance expenses as a deduction for tax purposes.

g. Income tax reconciliation:

A reconciliation of theoretical tax expense assuming all profits and expenses are taxed at the statutory rate applicable to companies in Israel and the actual tax expense is as follows:

	Year ended	
	December 31,	
	2007	2008
	U.S. dollars in thousands	
Loss before income taxes	(892)	(3,838)
Statutory tax rate in Israel	29%	27%
Theoretical tax benefit	(259)	(1,036)
Non-deductible expenses	307	64
Losses for which deferred taxes were not provided	542	888
Taxes in respect of prior years	(23)	-
Changes in basis of measurement (1)	(392)	(243)
Others	(334)	46
Tax benefit reported in the income statements	(159)	(281)

(1) Resulting from the difference between the changes in the Israeli CPI and the exchange rate of the NIS/dollar.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21:- INCOME TAXES (Cont.)

- h. Income taxes included in the income statements:

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
Current taxes	144	-
Taxes in respect of prior years	(23)	-
Deferred taxes	<u>(280)</u>	<u>(281)</u>
 Tax benefit reported in income statements	 <u>(159)</u>	 <u>(281)</u>

- i. Deferred taxes:

Deferred taxes are calculated using tax rate of 15% in 2007 and 14% in 2008. The tax rate is composed of a weighted combination of the various applicable rates or tax exemptions. Significant components of the Group's deferred tax assets are as follows:

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Net operating losses	80	36
Employee benefits	180	199
Government grants	260	305
Research and development costs	346	615
Other deferred tax assets, net	<u>11</u>	<u>3</u>
 Total deferred tax assets	 <u>877</u>	 <u>1,158</u>

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
Net operating losses	-	44
Employee benefits	(22)	(19)
Government grants	(143)	(45)
Research and development costs	(117)	(269)
Other deferred tax assets, net	<u>2</u>	<u>8</u>
 Total deferred tax benefit	 <u>(280)</u>	 <u>(281)</u>

- j. Available carryforward tax losses:

Accumulated losses of Medibell for Israeli tax purposes, which were derived prior to 2004, in the amount of approximately \$ 4,900 thousand, may be carried forward and offset against its taxable income in the future, for an indefinite period. Due to cessation of Medibell's operations, such losses will not be used; therefore the Company did not record a deferred tax asset in respect of such losses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21:- INCOME TAXES (Cont.)

The Company and Medibell file a consolidated tax return commencing 2004.

Accordingly, Medibell's current operating losses (since 2004) for tax purposes can be offset against the Company's taxable income.

As of December 31, 2008, CMT Inc. had U.S. federal net operating loss carryforward of approximately \$ 750 thousand (\$ 60 thousand in 2007). The subsidiary's losses will expire in the years 2022 to 2024. Utilization of the U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

The Company and its subsidiaries did not record deferred tax assets amounting to approximately \$ 1,450 thousand (\$ 560 thousand in 2007) in respect of loss carryforward as it is uncertain whether there will be taxable income in the future.

NOTE 22:- SELECTED STATEMENTS OF INCOME DATA

a. Cost of revenues from sale of products:

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
Materials consumed	8,791	10,128
Salaries, wages and employee benefits	1,434	1,750
Share-based payments	97	97
Subcontractors	330	266
Other manufacturing costs	500	531
Depreciation	55	52
	11,207	12,824
Decrease (increase) in inventories:		
Work-in-progress	91	(25)
Finished products	(7)	68
	11,291	12,867
Cost of revenues from construction contracts:		
Salaries, wages and employee benefits	170	550
Major supplier data:		
Percentage of total materials consumed:		
A	10%	8%
B	49%	66%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22:- SELECTED STATEMENTS OF INCOME DATA (Cont.)

The Company obtains certain key components from two sources, which are located in Europe. The Company has strategic agreements with these suppliers, which defines CMT as a preferred customer. This preference minimizes the risk involved.

b. Research and development costs:

	Year ended	
	December 31,	
	2007	2008
	U.S. dollars in thousands	
Materials consumed	328	401
Salaries, wages and employee benefits	3,519	3,581
Share-based payments	133	73
Subcontractors	600	628
Depreciation	78	90
Car expenses	494	608
Rental fees, maintenance and office expenses	356	428
Others	95	101
	5,603	5,910

c. Selling and marketing:

Salaries, wages and employee benefits	1,602	1,475
Share-based payments	19	19
Advertising	104	118
Foreign travel	47	50
Depreciation	18	11
Car expenses	105	112
Rental fees, maintenance and office expenses	104	59
Others	611	354
	2,610	2,198

d. General and administrative:

Salaries, wages and employee benefits	1,169	1,223
Share-based payments	507	(24)
Rental fees, maintenance and office expenses	132	143
Professional fees	1,207	1,095
Depreciation	40	36
Car expenses	74	109
Bad debts	162	(33)
Impairment of goodwill	200	-
Others	113	419
	3,604	2,968

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22:- SELECTED STATEMENTS OF INCOME DATA (Cont.)

e. Financial income:

	Year ended December 31,	
	2007	2008
	U.S. dollars in thousands	
Interest on short-term deposits	655	426
Exchange rate differences	-	-
Others	71	85
	726	511

f. Financial expenses:

Amortization	-	12
Exchange rate differences	228	46
Bank charges	40	29
Interest on Government grants	38	77
	306	164

NOTE 23:- FINANCIAL INSTRUMENTS

a. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, short-term and long-term deposits, trade receivables, other current assets, trade payables and other current liabilities, approximate their fair value due to the short-term maturity of such instruments. The fair value of government grants amounts to \$ 1,946 thousand (2007: 1,321 thousand). Such fair value was calculated by discounting the expected future cash flows at prevailing market interest rate. The fair value of long-term investments amounts to 4,167 thousand. Such fair value is based on market prices of the debentures as of December 31, 2008.

b. Concentration of credit risks:

Financial instruments that potentially subject the Group to concentration of credit risks consist principally of cash, cash equivalents, short-term and long-term deposits and trade receivables.

Cash and cash equivalents and short-term and long-term deposits are invested in major banks in Israel and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company investments are financially sound and accordingly, minimal credit risk exists with respect to these investments.

The Group's maximum exposure to credit risk arising from default of the counter party is equal to the carrying amount of these instruments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

The Company's trade receivables are mainly derived from sales to customers in the Far East, North America and Europe. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. In addition, receivables balances are monitored on an ongoing basis with the result that the group's exposure to bad debts is not significant. An allowance for doubtful debts is determined with respect to these amounts that the Company has determined to be doubtful of collection. The maximum exposure is the carrying amount.

Market risk:

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market prices comprise three types of risk: interest rate risk, currency risk and other price risk, such as equity risk. Financial instruments affected by market risk include government grants, deposits, long-term investments, and derivative financial instruments.

The sensitivity analyses in the following sections relate to the position as at 31 December 2008 and 2007.

The sensitivity analyses have been prepared on the basis that the amount of net debt, the ratio of fixed to float interest rates of the debt and derivatives and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 31 December 2008.

The analyses exclude the impact of movements in market variables on the carrying value of pension and other post-retireent obligations, provisions and on the non-financial assets and liabilities of foreign operations.

The following assumptions have been made in calculating the sensitivity analyses:

- The balance sheet sensitivity relates only to derivatives and available-for-sale debt instruments.
- The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2008, including the effect of hedging instruments.
- The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets, including the effect of any associated hedges, and swaps designated as cash flow hedges, at 31 December 2008, for the effects of the assumed changes in interest rates. The sensitivity of equity is analyzed by maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity to non-parallel changes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

Consumer Price Index ("CPI") rate risk:

The CPI rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of change in market CPI rate. The Group's exposure to the risk of changes in market CPI rates relates primarily to the Group's long-term debt obligations with floating interest rates.

CPI rate sensitivity:

The following table demonstrates the sensitivity to a reasonably possible change in CPI rates, with all other variables held constant, of the group's profit before tax. There is only an immaterial impact on the Group's equity.

	<u>Increase/ decrease in CPI rate</u>	<u>Effect on profit before tax</u>
2007	+3%	-52
	-1%	17
2008	+3%	-66
	-1%	22

Foreign currency risk:

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Group's exposure to the risk of changes in foreign exchange rates relates primarily to the Group's operating activities (when revenue or expense are denominated in a different currency from the Group's functional currency).

	<u>Increase/ decrease in NIS and Euro rate</u>	<u>Effect on profit before tax</u>
2007	+10%	-187
	-10%	+187
2008	+10%	-338
	-10%	+338

c. Interest rate risk:

The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's long-term liability in respect of Government grants received with a floating interest rate of LIBOR.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

The following table sets out the carrying amount, by maturity, of the Group's financial instrument that is exposed to interest rate risk:

	Increase/ decrease in LIBOR rate	Effect on equity
2007	-5%	3
	-10%	6
2008	+5%	(3)
	+10%	(6)

d. 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 (short-term and long-term deposits) and financial assets (accounts receivables) and projected cash flows from operations.

The Group's long-term liability in respect of Government grants will be repaid in the future, in a manner of royalties at a rate of 3%-5% of the sales of products developed using these Government grants.

The table below summarizes the maturity profile of the Group's financial liabilities based on contractual undiscounted payments.

	Year ended December 31, 2008		
	Less than 1 year	1 to 5 years	Total
	U.S. dollars in thousands		
Trade payables and other current liabilities	5,433	-	5,433
Governments grants	-	2,184	2,184
	<u>5,433</u>	<u>2,184</u>	<u>7,617</u>

	Year ended December 31, 2007		
	Less than 1 year	1 to 5 years	Total
	U.S. dollars in thousands		
Trade payables and other current liabilities	3,970	-	3,970
Governments grants	-	1,732	1,732
	<u>3,970</u>	<u>1,732</u>	<u>5,702</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

e. Capital management:

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder's value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions.

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