



AVT Annual Report 2010

# HOW FAR CAN WE GO?

# Financial Highlights

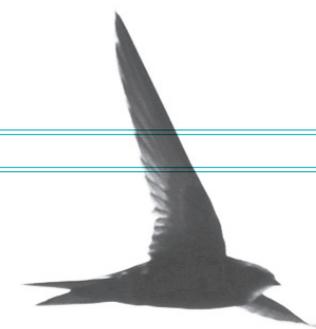
(US dollars in thousands, except per share amounts)  
Year ended December 31,

	2010	2009	2008
<b>Revenues and income</b>			
Revenues	39,681	37,231	60,320
Gross profit	19,636	15,951	26,344
Gross margin in %	49.5%	42.8%	43.7%
Research and development expenses, net	6,356	7,600	11,206
Selling and marketing expenses	8,217	9,043	13,402
General and administration expenses	4,707	5,891	8,427
Amortization of deferred stock-based compensation	611	739	939
Impairment of goodwill	-	2,045	17,192
Operating income (loss)	356	(8,916)	(23,883)
Operating margin in %	0.9%	(24.0%)	(39.6%)
Net income (loss)	561	(10,706)	(25,151)
<b>Cash flows</b>			
Cash flows used in operating activities	(3)	(1,507)	(2,906)
Cash flows provided by (used in) investing activities	1,705	(5,484)	(857)
Cash flows provided by financing activities	-	-	215
<b>Balance sheet as of December 31,</b>			
Cash and equivalents	10,816	11,114	13,105
Total assets	30,728	30,829	45,015
Total liabilities	13,192	14,465	18,684
Total shareholders' equity	17,536	16,364	26,331
<b>Share</b>			
Basic earnings (loss) per share in US dollars	0.11	(2.02)	(4.75)
Share price as of December 31,	3.13 Euro	2.84 Euro	2.15 Euro
<b>Employees</b>			
Employees as of December 31,	205	225	280

## Table of Contents;

AVT Annual Report 2010

- 4. Letter to Shareholders
- 6. The Management
- 12. How Far Can We Go?
- 18. Management's Discussion & Analysis
- 44. Financial Table of Contents
- 45. Report of Independent Auditors
- 46. Consolidated Balance Sheets
- 48. Consolidated Statements of Operations
- 49. Consolidated Statements of Change in Shareholders' Equity
- 50. Consolidated Statements of Cash Flow
- 51. Notes to Consolidated Financial Statements
- 76. Report of the Board of Directors
- 77. Members of the Board of Directors



# Dear Shareholders,



**In** what appears to be a slow, albeit steady recovery of the printing market--and the concurrent investments in capital equipment that can increase competitiveness and profitability-- AVT's offerings are ideally positioned to meet the challenging trends. These include addressing shorter jobs runs, higher yield with ever increasing quality, and incorporating new features into the traditional print process such as *brail* and variable data.

After two years of struggling with what is now called "the great recession", 2010 was a growth year for AVT. The best indicator of our business is order booking, and last year it grew by 22.5%. Our performance improved in all market segments, but most notably in the Packaging and Labels markets. These markets started to recover slowly at the end of 2009, and this trend continued last year. The commercial printing market is lagging behind, and projections are for an improvement in 2011. Our performance was positive in all regions worldwide. From our two largest regions, Europe started to recover earlier than the US. As of the 2nd half of 2010, the recovery in the North American region was evident as well. The fastest growing region in 2010 was Latin America, and in total it contributed around 10% of our overall order booking.

**But most importantly, I am pleased to report that AVT is back in the black!**

During the recession we streamlined our operating costs, and significantly lowered our breakeven point. When our revenues grew last year, AVT turned profitable. In 2011 we are a stronger and leaner company, and even moderate increase in our top line will have significant impact on our bottom-line.

AVT is the clear leader in Automatic Inspection and print process control in the printing industry. We have the best products in their respective categories, and thousands of satisfied customers. This position was achieved through focused R&D efforts and uncompromised customer support.

The 21st century business world is characterized by global competition. It is no longer enough to be the "best" in your territory. You must compete in quality, price, diversity and timeliness across-the-globe, and nowhere is this truer than in the printing industry. At AVT, we have an on-going dialogue with our customers, which enables us to address their business needs at specific market junctures at an affordable incremental investment.

This means a two-pronged development strategy. On the one hand, we develop new generation platforms that address both our established markets and new segments. On the other hand, we steadily introduce modules that can expand and enhance existing platform capabilities. Our customers have confidence that their investment in an AVT platform will have an extended life-cycle and maintain their competitive edge. All our customers can expand and upgrade their AVT solutions with our latest offerings, even years after their initial investment. Potential customers see our record as proof that they are entering a long-term relationship dedicated to their business interests. This strategy solidifies AVT's leadership position in our present markets.

**As** I look forward, I believe that our customer-oriented innovation and support will continue to be critical assets. This strategy has earned us a leadership position in the markets we serve, and is key to our efforts addressing new opportunities. Our employees are motivated by our vision, and our shareholders and management strengthen us in the commitment to value and excellence.

Sincerely yours,

Shlomo Amir, President & CEO

# The Management

## **Shlomo Amir, President and CEO**

Mr. Amir joined AVT in 1997. Before joining AVT, Mr. Amir served for two years as vice president of marketing and sales at Nice Systems Ltd., an Israel-based international high-tech company in the area of digital voice logging. Previously, Mr. Amir worked for 12 years at Scitex Corporation, an Israeli high-tech company serving the pre-press industry. In his last nine years with Scitex, he was based in its European subsidiary in Brussels, serving in various marketing, sales and management positions. Mr. Amir holds the degrees of a B.Sc. in Mathematics and Computer Science from Tel Aviv University, Israel, and an MBA from Boston University, Massachusetts, United States.

## **Barry Ben-Ezra, VP R&D**

Prior to joining AVT in 2007, Mr. Ben-Ezra worked for 12 years at Orbotech Ltd., an Israel-based international high-tech company, serving the Printed Circuit Board and Flat Panel Display manufacturing industries. As VP of the PCB Division he established and lead the company's disruptive Maskless Lithography program, responsible for development of technology, products, market and business. Prior to that, Barry served for six years at Scitex Corp., an Israeli high-tech company, serving the pre-press industry, and as VP R&D at Cubital, a Desktop Manufacturing spin-off of Scitex. Barry holds a BSc degree in Mathematics and Computer Science from the University of Tel-Aviv.

## **Nadav Yassour, Chief Financial Officer**

Mr. Yassour is a senior financial executive with over 20 years of experience in both international corporate finance and early venture development in leading high-tech companies. Before joining AVT in January 2009, Mr. Yassour served as EVP and Global CFO at Hobart Holdings Ltd. a prominent group of development stage medical device companies. Previously, he served as EVP & CFO of MessageVine Inc., provider of instant messaging systems for global wireless carriers. Prior to that, Mr. Yassour was VP Finance & CFO of InterPharm Laboratories Ltd., RT-SET Ltd. and Leaf Systems Inc. Mr. Yassour started his career at Scitex Corporation where he was the Manager of Corporate Economic and Financial Planning Department. Mr. Yassour holds a BA Degree in Economics and Political Science from Haifa University and an MBA from Oregon State University, United States.

## **Koby Shtaierman, Executive VP Corporate Sales & President AVT Europe**

Prior to joining AVT in 1999, Mr. Shtaierman was vice president of marketing at Technomatix, a multinational company headquartered in Israel that develops computer-aided production engineering software tools for the automotive and aerospace industries as well as heavy industries worldwide. Previously, Mr. Shtaierman served at Scitex Corporation for 10 years in various positions, including as R&D project manager and later as director of marketing for Scitex's input systems division. Mr. Shtaierman holds B.Sc. and M.Sc. degrees in Electronics and Computer Engineering from the Technion, Haifa, Israel.

## **Niki Bassat, VP Operations**

Mr. Bassat joined AVT from superDimension, a medical device company, where he was Chief Operating Officer and General Manager (Israel). Before that, he was Chief Operating Officer at RaySat, a manufacturer of in-motion satellite antennas. He was the Chief Operating Officer at Power Paper a provider of micro-powered devices. He was the Chief Operating Officer at SATLYNX, a pan-European two-way satellite broadband services provider, and served as managing director of SATLYNX GmbH. Prior to that, he was the Vice President, Operations, at Gilat Satellite Networks. Mr. Bassat also worked for Tadiran Telecommunications as Plant Manager. He holds a B.Sc. in industrial engineering from the Technion: Israel Institute of Technology, and studied towards an MBA at the Hebrew University of Jerusalem. He is the recipient of several awards, including the Kaplan Prize (1990) and "Excellence in Quality" awards from the Israeli government (1991,1994).

## **Gal Shamri, President, GMI Inc.**

current position he served as marketing and business development manager and later as corporate marketing manager. Prior to AVT, Mr. Shamri worked at Scitex Corporation for six years in the input division and served in various positions including application specialist and product line manager. Mr. Shamri holds a BA Degree in Economics and Business Management from Haifa University and an MBA degree from Tel Aviv University, both in Israel.

## **Lance Shumaker, President, AVT Inc.**

Mr. Shumaker joined AVT in 1998. Before joining AVT, Mr. Shumaker held various positions in the graphic arts market, including: director of sales for Indigo America, an Israel-based international high-tech company in the field of digital printing, and national accounts manager for Scitex America Corporation, an Israeli high-tech company serving the pre-press industry. Most recently, Mr. Shumaker was the vice president of sales for TeleServices International, a tele-marketing company. Mr. Shumaker holds a marketing degree from the University of Missouri, United States.

## **Amir Dekel, Corporate VP Marketing**

Amir holds a MS in Electrical Engineering in Communications and Computer Science from Polytechnic University NY, USA. For the past 8.5 years he has worked for AVT to establish an automatic inspection methodology for the labels market and as the Director of Marketing in AVT, Inc. in the US. Prior to AVT, Amir held various positions in the communications and telecommunications fields, including positions in China (GM of large telecommunication joint venture), in the US (8 years of various positions in the communications field and consumer products companies).



# How do you create patterns of success?

Our sales efforts address two main targets: printers and manufacturers of printing equipment. For the manufacturers, our solutions enhance their total offering value: reflected in both pricing and competitiveness.

For us at AVT, this translates into multiple sales to each partner, and increases our exposure at leading trade shows, where, our solutions are at work in the displays of some of the world's most prestigious printing equipment manufacturers.



# How do you motivate leadership?

AVT's technological leadership has never been in dispute. Moreover at AVT, we have also realized since Day 1 that technology is only as good as the people behind it: and they must represent two seemingly conflicting profiles: the inventive, out-of-the-box individuals, and the team that interacts to achieve common goals.

At AVT we nurture a corporate culture that motivates, rewards and often inspires both the individual and the team.



# How do you target opportunity?

Our recognized leadership in the EU and North America is one of the drivers of our successful penetration into emerging markets. In China, where we have had a presence for a number of years, there are tens of thousands of printers, many of whom strive to become preferred suppliers to customers in developed markets. Machine vision can deliver the quality, productivity and flexibility that are a must. In Latin American countries with fast-growing economies, we have identified similar opportunities.



AVT has, throughout its history, its finger on the pulse of current and anticipated events and opportunities: partnering with both equipment manufacturers and printers to create a diversified customer portfolio, building up a powerful presence in developed markets, while moving ambitiously into Far Eastern and Latin American territories; utilizing the economic downturns to create a leaner and effective organization, while offering customers affordable new products and enhancements; and continuously reviewing and refining its roadmap.

How do you  
read

the map?





# Together, we share a direct route to the future

AVT's management, employees, partners, customers and shareholders share a common vision, AVT is committed to continue growing its business and profitability based on technological leadership, customer-driven R&D, and talented employees.

These strengths drive our confidence in the future. We have earned and reinforced our leadership, successfully expanded into new technologies, regions and markets, and continuously adapted to rapidly changing market needs and economic conditions.



## Management's Discussion & Analysis of Financial Condition and Results of Operations

We may from time to time make written or verbal forward-looking statements, in reports to shareholders, in press releases and investors' webcasts. You may identify these forward-looking statements by use of words such as "strategy", "expects", "continues", "plans", "anticipates", "believes", "will", "estimates", "intends", "projects", "goals", "targets", and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot assure you that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements and whether to invest or remain invested in Advanced Vision Technology (AVT) Ltd. securities. The forward-looking statements relate to, among other things: operating results; anticipated cash flow; gross margins; adequacy of resources to fund operations and our ability to maintain average selling prices despite the aggressive marketing and pricing strategies of our competitors.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements, the related notes and other financial information included elsewhere in this annual report.

### Our Solutions

We have developed fully integrated solutions that include software applications and hardware components that can be deployed in a modular manner.

This flexibility allows our customers to incorporate additional functions and capabilities as their business or operation require.

## Management's Discussion & Analysis of Financial Condition and Results of Operations

Solution	Market Served	Purpose
PrintVision /Jupiter	Packaging - on press Process Control	The industry standard solution for on-press automatic inspection. The PV/Jupiter offers superior Process Control capabilities that reduces production cost and enhances product quality. The PV/Jupiter can be equipped with added value modules such as press control, color management and barcode verification.
PrintVision/Apollo	Packaging - 100% Quality Assurance	Equipped with 100% LCCD technology, the PV/Apollo offers Quality Assurance solution and can be integrated on press or on various post press stages such as Lamination, Doctoring or slitting rewinding.
PrintVision/Helios	Labels and narrow web printing inspection applications	Advanced 100% automatic inspection platform that support the specific label & narrow web application & workflows . Installed on press or on rewinder, the PV/Helios provides excellent Process Control & 100% Quality Assurance.
PrintVision/Argus	Packaging - on press Process Control & Quality Assurance	A unique combination of Process Control & Quality Assurance. PV/Argus is the top of the line solution for high quality packaging applications.
pRegister & iReg		Automatic register pre-setting and control module. The new iReg module adding simplicity of click and drag to the register process and does not require any special targets to bring the press into registration.
Presco		Automatic plate pressure pre-setting and control module

## Management's Discussion & Analysis of Financial Condition and Results of Operations

Solution	Market Served	Purpose
IΔEal		In line color measurement module for ΔE and ΔL*a*b*-based color pre- setting guidance and run-time color management.
SpectraLab	Packing	The latest in absolute color measurement technology deployed to the packaging market. A color measurement addition to the PrintVision family that measure and report spectral L*a*b* values utilizing true 31 channels spectrophotometer, the only inline device in the industry that is calibrated to ISO std.
PrintVision/Orion	Folding Carton	A quality assurance system that can inspect pre-folded carton for print defect. PV/Orion inspect at high speeds and ensure to defected carton goes to the next stage in the workflow.
Microcolor II	Web and sheetfed offset presses, all market segments (commercial, Newspaper, packaging, Labels)	Full-featured remote digital ink fountain control system suitable for use on virtually any sheetfed or web offset press, integrated into the printing units and allows the press operator to automatically and remotely control ink fountain key positions from a remote workstation.
PrintVision/ Neptune	Commercial Printing	AVT newest 100% automatic inspection platform that support the specific web offset and commercial Application. Installed on commercial presses, the PV/Neptune provides excellent Process Control & 100% Quality Assurance.

## Management's Discussion & Analysis of Financial Condition and Results of Operations

Solution	Market Served	Purpose
Microcolor/ Mercury	Web and sheetfed offset presses, all market segments (commercial, Newspaper, packaging, Labels)	Next generation remote ink control solution, utilizes new powerful HW & SW platform, ease-of-use touch screens, new Level of automation, and flexible reconfigurations for smooth upgrades.
ColorQuick	Commercial and newspaper printing/ Web Offset	Closed loop color control system that utilizes a spectrophotometer to measure colors on press. The CQ system converts spectrophotometric data to industry standard ink density and L*a*b* information and then compares the measured value to pre-defined job targets or standards. The system will automatically make adjustments to the press ink keys so that quality standards are met. The system reduces production cost while improving print quality.
ColorQuick/ Clarios	Commercial and newspaper printing/ Web Offset	Based on the proven ColorQuick spectral technology, this Next Generation color control solution, includes new powerful HW & SW platform with easy to use touch screen based operation, higher productivity and new added-value tools.
PrintQuick	Commercial printing/ Web Offset	A sophisticated automatic closed loop color-to-color register control designed for commercial presses.
RibbonQuick	Commercial printing/ Web Offset	An automatic system that determines and controls print-to-cut and print-to-fold position of web offset presses.

# Management's Discussion & Analysis of Financial Condition and Results of Operations

Our products and services are primarily sold directly to end-users; a portion of product sales are sold through distributors and strategic partners. By December 31st, 2010 approximately 2,370 PrintVision platforms, 3,200 Microcolor systems and 880 ColorQuick systems were installed worldwide. No distributor or end-user accounted for more than 10% of revenues in 2010 and 2009.

## Overview

AVT was incorporated in October, 1992 and introduced the prototype of its first product, the PrintVision/ 9000, in 1996. Commercial sales of PrintVision/ 9000 commenced in the second quarter of 1997.

We established AVT Inc. in October 1996 to serve as our direct distribution channels in the Americas.

On June 19th 2002 we concluded the acquisition of the assets of Geiger Vision Systems GmbH (GVS) of Munich, Germany for a consideration of approximately 1 (one) million Euro. The acquisition of GVS assets (mostly intangible) was a strategic decision to facilitate the penetration into the Labels print market. The acquisition was accounted for as a purchase, and accordingly, the purchase price was allocated to the assets acquired based on their respective fair values. Out of the total consideration, \$825 thousand were allocated to goodwill which was fully impaired in the fourth quarter of 2008 (See also critical accounting policies).

AVT (Germany) GmbH was established in June 2002 to absorb the assets and operations of GVS and became our selling arm in the German speaking countries in Europe. As of January 1st 2006 AVT (Germany) GmbH commenced serving as our direct distribution channel for Europe. AVT EMEA (Belgium) SCRL was established in July 2007 consolidating and controlling our European customer support operations.

On October 1, 2007, as part of our strategy of diversifying into new growth areas for process control technologies, AVT Inc., a wholly-owned subsidiary of AVT Ltd., acquired all of the outstanding shares of Graphics Microsystems Inc (GMI) and certain related intellectual property assets for approximately \$33.5 million in cash (including transaction expenses of \$0.5 million). GMI was a privately held US corporation, supplying Closed Loop Color control (CLC) systems, color management and reporting software, and remote digital ink fountain control systems to leading commercial printers and press manufacturers worldwide.

The purchase price was allocated to the various assets acquired and liabilities assumed, based on a study conducted by an independent appraiser.

# Management's Discussion & Analysis of Financial Condition and Results of Operations

The study determined the respective fair value of the various intangible assets and Goodwill as follows:

- **\$9,766 thousand were allocated to Technology and will be amortized over the useful life estimated at 7 years commencing at the closing date, out of which \$4,585 thousand impaired in the fourth quarter of 2008 and additional \$1,620 thousand impaired in the fourth quarter of 2009 (See also critical accounting policies).**
- **\$1,137 thousand were allocated to In Process Research and Development and was written off immediately at closing date.**
- **\$1,396 thousand were allocated to Order Back-Log and was amortized over 6 months commencing at the closing date.**
- **1,839 thousand were allocated to Customer Relationship and Trade Marks and will be amortized over 10 years commencing at the closing date, out of which \$871 thousand impaired in the fourth quarter of 2009 (See also critical accounting policies).**
- **\$18,412 thousand were allocated to Goodwill, out of which \$16,367 thousand impaired in the fourth quarter of 2008 and additional \$2,045 thousand impaired in the fourth quarter of 2009 (See also critical accounting policies).**

The results of operations related to GMI are included in our consolidated statement of income from the date of acquisition on October 1, 2007.

Via this acquisition AVT entered the commercial and newspaper printing markets. GMI's products are sold to leading commercial, semi-commercial, newspaper and specialty printers in the heatset and coldset web printing markets as well as printing press OEMs worldwide. In addition, GMI also supplies the industry with press controls such as closed loop color-to-color register and ribbon/cutoff control systems.

By purchasing GMI, we strategically expanded our market share in the printing industry both in terms of market segments addressed and process control solutions offered to the traditional markets of AVT and GMI. The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased market share and strategic positioning value.

Our future revenues and operating results may fluctuate on a quarterly and on an annual basis due to a combination of factors, including but not limited to: variations in the timing of orders and deliveries of our products; variations in payment terms;

# Management's Discussion & Analysis of Financial Condition and Results of Operations

variations in the size of orders and their internal product mix; by our customers; new product introductions; by the Company and its competitors; market acceptance of new products; the expansion and effectiveness of our distribution network; variations in capital spending budgets of print shops; foreign currency exchange rates; and general economic conditions and economic conditions specific to the printing industry.

Exchange rate exposure affects our results as we have both sales and costs in many currencies other than the US Dollar (mainly in Euro). In 2010 the European currency decreased in value relative to the US Dollar by approximately 7.4%. In Israel, during 2010, the New Israel Shekel ("NIS") increased in value relative to the US Dollar by 6.0%.

## Off-Balance Sheet Transactions

We have not engaged in nor been a party to off-balance sheet transactions.

## Information on the Company

### Manufacturing

Our manufacturing activities for systems consist primarily of the manufacturing, assembly and testing of components and subassemblies that are acquired from third party vendors and subcontractors and then integrated by us into a finished system. We manufacture our packaging and labels products in our facility in Hod Hasharon, Israel. Our commercial printing and newspapers products as well as our Closed Loop Color Control solutions are manufactured in our facility in Rockwall, Texas. Our products are built in accordance with industry standard infrastructure and are PC compatible. The hardware elements in our packaging and labels products are based primarily on standard commercial off-the-shelf components. The hardware elements for the commercial printing and newspapers products are manufactured mainly in the Rockwall facility. All products utilize proprietary in-house developed circuit boards and algorithms as well as image acquisition and image analysis techniques and software. Some of the components we use have a single approved manufacturer while others have two or more options for purchasing. In addition, for some of the components and subassemblies we maintain an inventory to limit the potential for interruption. We also carry out relationships directly with some of the more significant manufacturers of our components. Although certain components and subassemblies, we use in our existing products, are purchased from a limited number of suppliers, we believe that we can obtain alternative sources of supply in the event that such suppliers are unable to meet our requirements in a timely manner.

### Service and Support

We have focused on building a strong service and support organization for all our systems and have focused on assisting, the various regions, in which we operate, to be

# Management's Discussion & Analysis of Financial Condition and Results of Operations

as self sufficient as possible. We maintain a staff of highly skilled customer service engineers at our headquarters in Israel as well as in Rockwall Texas that offer support to our customers and distributors. These service engineers, as well as additional service engineers located in our subsidiaries in Europe and in the Americas, provide first class field services and support worldwide. We install, service and provide training to customers on all our products. Within a very short time after delivery and with a minimum amount of site preparation by the customer, installation of a typical system can usually be completed at the customer's site, either by us or by third parties. Generally, our customer support engineer installs and checks the system. As part of the installation procedure, we provide system documentation and simple training in maintenance and application.

We maintain regular training and installation support sessions for our service engineers and distributors. Our systems are generally sold with a warranty for repairs of hardware and software defects and malfunctions. The usual term of such warranty is one year after installation. In addition, for a fee, we offer customers service and maintenance contracts commencing after the expiration of the warranty period. Software, whether contained in optional features or forming an integral part of the functioning capacity of the system, is licensed. Software updates are typically included in the service fee.

### Research & Development

We believe that the development of new products and the enhancement of existing products are essential to our future success. Therefore, we intend to continue to devote substantial resources to research and new product development, and to continuously improve our systems and design processes in order to reduce the cost of our products. Our research and development efforts have been financed through our internal funds and certain programs sponsored through the Government of Israel. We believe our research and development effort has been an important factor in establishing and maintaining our competitive position.

### Selling and Marketing

We market our products for automatic inspection of printed materials and press control, Closed Loop Color control (CLC), color management and reporting software and provide customer support directly and through our wholly-owned subsidiaries in the United States and Europe and through network of dealers and representatives in Asia-Pacific. Each subsidiary employs local marketing, sales and customer support personnel. Worldwide marketing efforts are coordinated by the responsible marketing managers, who are based at Company headquarters in Israel and in the Company's subsidiaries in the US.

Approximately 35 people are engaged in the Company's worldwide selling and marketing efforts, which include participation in various trade shows and

# Management's Discussion & Analysis of Financial Condition and Results of Operations

conventions, publications and trade press, demonstrations performed in Company facilities and daily contact with customers by sales personnel.

## Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP"). While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. These policies are those that are both most important to the understanding of our financial condition and results of operations and require our management's most difficult, subjective and complex judgment and estimates. Actual results could differ from those estimates. For any given individual estimate or assumption made by us there may be alternative estimates or assumptions which are also reasonable. We believe that, given the facts and circumstances at the time of making the relevant judgments, estimates or assumptions, applying any such other reasonable judgment may cause a material effect on our consolidated results of operations, financial position or liquidity as presented in the consolidated financial statements.

Management believes that the significant accounting policies which affect its more significant judgments and estimates used in the preparation of the consolidated financial statements are the most critical to aid in fully understanding and evaluating our reported results include the following:

- Revenue Recognition
- Inventory Valuation
- Impairment of Long-Lived Assets and Goodwill
- Taxes on Income
- Stock-Based Compensation

**Revenues recognition.** We derive revenues primarily from two sources: product revenues, which include hardware and software. Service revenues, which is comprised mainly of income from hardware and software maintenance contracts; time and material charges; consulting, installation and training fees and sales of spare parts. Revenue related to the sale of our products is generally recognized when

# Management's Discussion & Analysis of Financial Condition and Results of Operations

persuasive evidence of an agreement exists; the product has been delivered; the sale price is fixed and determinable, no further obligations exist, and collection is probable. If a payment is conditioned by the installation of the product, the revenue recognition of the conditioned amount will be deferred, until the payment is due. Installation and training are not considered essential to the automatic inspection product capabilities since they do not require specialized skills and can be performed by other vendors. Conversely, upon delivery of our commercial web offset products, we defer revenue in an amount equivalent to the fair value of installation and training and recognize those deferred revenues once installation and training has been completed.

In the normal course of business, we do not provide a right of return to our customers. Sales agreements with specific acceptance terms are not recognized, until the customer has confirmed in writing that the product or service has been accepted. Revenues from maintenance and professional services are recognized ratably over the contract period, or as services are performed.

When transactions involve multiple elements, revenue is allocated to the elements based on the fair value of each element in the arrangement. The best evidence of fair value is the price of a deliverable when it is regularly sold on a standalone basis. Fair value is limited to (a) the price charged for a deliverable when it is sold separately or (b), for a deliverable not yet being sold separately, the price established by management having the relevant authority.

**Inventory Valuation.** At each balance sheet date, we evaluate our inventory balance for excess quantities and obsolescence. This evaluation includes analysis of sales levels by product line and projection of future demand. In addition, we write off inventories that are considered obsolete. Remaining inventory balances are adjusted to the lower of cost or market value. If future demand or market conditions are less favorable than our projections, additional inventory write-off may be required and would be reflected in cost of sales in the period the revision is made.

**Impairment of Long-Lived Assets, Other Intangible Assets and Goodwill.** Our long-lived assets include property and equipment, goodwill and other intangible assets. In assessing potential impairment of the long-lived assets, we consider the projected contribution of that asset, to our results of operations and other pertinent information. We will record an asset impairment charge when there are indicators that the asset has experienced a decline in value that is other than temporary. Based on our evaluation conducted during the fourth quarter of 2009 and fourth quarter of 2008, we recorded goodwill and other intangible assets impairment charges related to our long-lived assets. No impairment charge has arisen as a result of the impairment evaluation performed in the fourth quarter of 2010.

## Management's Discussion & Analysis of Financial Condition and Results of Operations

In assessing the recoverability of our property and equipment, goodwill and other intangible assets, we must make assumptions regarding the estimated future cash flow and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets.

During the fourth quarter of 2010, 2009 and 2008 we performed our annual impairment test of acquired intangible assets and goodwill as prescribed by ASC 350 and ASC 360 (formally known as SFAS No. 142, "Goodwill and Other Intangible Assets," and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," respectively) using a discounted cash-flow analysis to compare the fair market value of the reporting unit to its carrying value. Since the carrying amount exceeded the fair value in 2009 and 2008, the second step of the impairment evaluation was undertaken to calculate impairment loss. This evaluation of GMI's fair market value, performed by independent appraiser, indicated a non-cash impairment charge of \$1,620 thousand and of \$4,585 thousand against Technology intangible asset in the fourth quarter of 2009 and 2008, respectively, a non-cash impairment charge of \$871 thousand against Customer Relationships and Trademarks/Trade names intangible assets in the fourth quarter of 2009 and a non-cash impairment charge of \$2,045 thousand and of \$16,367 thousand against goodwill in the fourth quarter of 2009 and 2008, respectively. The reduction in carrying value of GMI's goodwill and other intangible assets is attributable to decline in the Company's forecasted business outlook, which management attributes to the impact of the global economic recession. In addition, during the fourth quarter of 2008 the company recorded non-cash impairment charge of \$825 thousand against goodwill related to Geiger Vision Systems GmbH (GVS) acquired on June 2002.

ASC 350 requires that goodwill be tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition or sale or disposition of a significant portion of a reporting unit. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized

## Management's Discussion & Analysis of Financial Condition and Results of Operations

for any excess of the carrying amount of the reporting units' goodwill over the implied fair value of that goodwill. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The fair value of each reporting unit is estimated using a discounted cash flow methodology. This requires significant judgments including estimation of future cash flow, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, the useful life over which cash flow will occur and determination of our weighted average cost of capital. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit. We allocate goodwill to reporting units based on the reporting unit expected benefit from the acquisition. We evaluate our reporting units on an annual basis and, if required, reassess goodwill using a relative fair value allocation approach.

We will perform impairment test at least annually and on interim basis should circumstances indicate that an impairment loss may exist. The outcome of such testing may lead to the recognition of additional impairments. As of December 31, 2010, the carrying value of our long-lived asset was \$1,443 thousand including Technology & Patents, Customer Relationships and Trademarks/Trade names intangible assets related to GMI acquisition. Impairment test performed in the fourth quarter of 2010 indicated that the aggregate undiscounted projected future cash flow exceeded the carrying value of the intangible assets hence we did not record any impairment charge in fiscal 2010.

We are required to assess the impairment of long-lived assets, tangible and intangible, other than goodwill, ASC 360 on a periodic basis, when events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment indicators include any significant changes in the manner of our use of the assets or the strategy of our overall business, significant negative industry or economic trends and significant decline in our share price for a sustained period. Upon determination that the carrying value of a long-lived asset may not be recoverable based upon a comparison of aggregate undiscounted projected future cash flow to the carrying amount of the asset, an impairment charge is recorded for the excess of carrying amount over the fair value. We measure fair value using discounted projected future cash flow.

**Taxes on Income.** Taxes on income are calculated based on our assumptions as to our entitlement to various benefits under the Approved Enterprise Law. Our entitlement to such benefits is conditional upon its compliance with the terms and conditions prescribed in this law.

We record income taxes using the asset and liability approach. Deferred income

## Management's Discussion & Analysis of Financial Condition and Results of Operations

tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and net operating loss and tax credit carry forwards. Our financial statements contain tax assets which have arisen as temporary differences between book and tax accounting. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have considered future taxable income, prudent and feasible tax planning strategies and other available evidence in determining the need for a valuation allowance. We evaluate all of these factors to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. If the realization of deferred tax assets in the future is considered more likely than not, an adjustment to the deferred tax assets would increase net income in the period such determination was made.

Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss, changes in the valuation allowance, changes in state or foreign tax laws, future expansion into geographic areas with varying country, state and local income tax rates, deductibility of certain costs and expenses by jurisdiction and as a result of acquisitions, divestitures and reorganizations.

**Stock-Based Compensation.** We account for stock-based compensation in accordance with the provisions of ASC 718 (formally known as SFAS No. 123(R), "Share-Based Payment"). Under the fair value recognition provisions of ASC 718, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. Determining the appropriate fair value model and calculating the fair value of stock-based awards, which includes estimates of stock price volatility, forfeiture rates and expected terms, requires judgment that could materially impact our operating results.

**Impact of Inflation and Exchange risk.** Our Consolidated Financial Statements are prepared in US Dollars. Substantially most of our revenues are made outside Israel in US Dollars. Sales in the United States and other regions except for the European Union are typically denominated in US Dollars, sales in Europe are primarily in Euro, US Dollars or Pound Sterling. Furthermore, a portion of our costs are incurred in US Dollars and another portion is incurred in New Israel Shekel ("Shekel" or "NIS") and Euro. Since the US Dollar is the primary currency in the economic environment in which the Company operates, the US Dollar is its functional currency and accordingly, monetary accounts maintained in currency other than the US Dollar are re-measured using the foreign exchange rate at the balance sheet date and transaction gains and losses from re-measurements are reflected in the

## Management's Discussion & Analysis of Financial Condition and Results of Operations

statement of operations as financial income or expenses, as appropriate.

Historically, the Israeli currency, the NIS has been devalued in relation to the US Dollar and other major currencies, principally to reflect the extent to which inflation in Israel exceeds average inflation rates in western economies. Such devaluations in any particular fiscal period are never completely synchronized with the rate of inflation, the annual rate of devaluation of the NIS against the US Dollar and the gap between them for the periods indicated:

	Year ended December 31,		
	2010	2009	2008
Inflation	2.7%	3.9%	3.8%
Revaluation	(6.0%)	(0.7%)	(1.1%)
Inflation gap	8.7%	4.9%	4.9%

Although a material portion of our costs relate to the operations in Israel, part of these Israeli costs are denominated in US Dollars or linked thereto. Costs not denominated in, or linked to, US Dollars are converted to US Dollars, when recorded, at the then prevailing exchange rates. To the extent such costs are linked to the Israeli Consumer Price Index, such costs may increase, if the rate of inflation in Israel exceeds the rate of devaluation on the NIS against the US Dollar, or if the timing of such devaluations were to lag considerably behind inflation. Conversely, such costs may, in US Dollar terms, decrease if the rate of inflation is lower than the rate of devaluation of the NIS against the US Dollar.

### Organizational Structure

The following is a list of all our subsidiaries, including the name, country of incorporation or residence, and the proportion of our ownership interest in each.

Name of Subsidiary	Country of Incorporation	Percentage of Ownership Interest
Advanced Vision Technology AVT (Germany) GmbH	Germany	100%
Advanced Vision Technology Inc	USA	100%
AVT EMEA CVBA	Belgium	100%
Graphics Microsystems Inc	USA	100%

## Management's Discussion & Analysis of Financial Condition and Results of Operations

The following table sets forth selected consolidated statements of income data for each of the years ended December 31, 2010, 2009 and 2008 in thousands US Dollars:

	U.S. dollars in thousands		
	2010	2009	2008
Revenues	39,681	37,231	60,320
Cost of revenues	20,045	21,280	33,976
Gross profit	19,636	15,951	26,344
Gross margin in %	49.5%	42.8%	43.7%
Operating expenses:			
Research and development, net	6,356	7,600	11,206
Selling and marketing	8,217	9,043	13,402
General and administrative	4,707	5,891	8,427
Restructuring	-	288	-
Impairment of goodwill	-	2,045	17,192
Total operating expenses	19,280	24,867	50,227
Operating income (loss)	356	(8,916)	(23,883)
Financial expense, net	(551)	(63)	(1,239)
Loss before taxes on income	(195)	(8,979)	(25,122)
Taxes on income (tax benefit)	(756)	1,727	29
Net income (loss)	561	(10,706)	(25,151)

## Management's Discussion & Analysis of Financial Condition and Results of Operations

The following table sets forth selected consolidated statements of income data for each of the three years ended December 31, 2010, 2009 and 2008 expressed as a percentage of total revenues:

	Year ended December 31,		
	2010	2009	2008
Revenues	100%	100%	100%
Products	79.6	75.5	84.3
Services	20.4	24.5	15.7
Cost of revenues	50.5	57.2	56.3
Gross profit	49.5	42.8	43.7
Operating expenses:			
Research and development, gross	17.9	22.7	20.0
Less - grants	(1.9)	(2.3)	(1.4)
Selling and marketing	20.7	24.3	22.2
General and administrative	11.9	15.8	14.0
Restructuring	-	0.8	-
Impairment of goodwill	-	5.5	28.5
Total operating expenses	48.6	66.8	83.3
Operating income (loss)	0.9	(24.0)	(39.6)
Financial expense, net	(1.4)	(0.2)	(2.1)
Loss before taxes on income	(0.5)	(24.2)	(41.7)
Taxes on income (tax benefit)	(1.9)	4.6	0.0
Net income (loss)	1.4	(28.8)	(41.7)

## Management's Discussion & Analysis of Financial Condition and Results of Operations

The results of 2009 and 2008 include non-cash impairment charge of \$2,045 thousand and \$17,192 thousand, respectively against Goodwill and non-cash impairment charge of \$1,620 thousand and \$4,585 thousand respectively against Technology intangible asset and in 2009 non-cash impairment charge of \$871 thousand against Customer Relationships and Trademarks/Trade Names. Out of the 2008 impairment charge against Goodwill, \$16,367 thousand are related to the GMI acquisition and \$825 thousand to Geiger Vision Systems (GVS) acquired in 2002. We did not record any such impairments in fiscal 2010. In addition, the annual schedule of amortization of acquired intangible assets in 2010, 2009 and 2008 is comprised of amortization of Technology of \$257 thousand, \$598 thousand and \$1,395 thousand, respectively, Customer Relationship and Trade Marks of \$41 thousand, \$321 thousand and \$79 thousand, respectively (as well as amortization of Order Back- Log of \$698 thousand in 2008).

Technology and Trade Marks are amortized ratably over 7 and 10 years, respectively and Customer Relationship is amortized using the accretion method over 10 years commencing from the date of closing on October 1, 2007. Half of Order Back- Log was amortized during the fourth quarter of 2007 and the remainder was amortized in the first quarter of 2008 (in addition, In Process Research and Development in the amount of \$1,137 thousand was written off at the date of closing of the GMI acquisition).

The following table sets forth selected proforma consolidated statements of income data adjusted to exclude the impact of non-cash impairment of goodwill and acquired intangible assets of \$4,536 thousand in 2009 and \$21,777 thousand in 2008, annual amortization of acquired intangible assets of \$297 thousand in 2010, \$919 thousand in 2009 and \$2,172 thousand in 2008. In addition, proforma consolidated statements of income excludes non cash stock-based compensation expenses of \$611 thousand in 2010, \$739 thousand in 2009 and \$939 thousand in 2008 and extraordinary GMI restructuring and integration costs of \$936 thousand in 2009 and \$1,615 thousand in 2008, for each of the years ended December 31 2010, 2009 and 2008 in thousands US Dollars:

## Management's Discussion & Analysis of Financial Condition and Results of Operations

	Year ended December 31,			
	2010	2009	2008	
Revenues	39,681	39,681	37,231	60,320
Cost of revenues	20,045	374	19,671	27,847
Gross profit	19,636	374	20,010	32,473
Gross margin in %	49.5%	50.4%	49.1%	53.8%
Operating expenses:				
Research and development, net	6,356	114	6,242	10,741
Selling and marketing	8,217	192	8,025	12,236
General and administrative	4,707	228	4,479	6,876
Total operating expenses	19,280	534	18,746	29,853
Operating income (loss)	356	908	1,264	2,620
Financial expense, net	(551)		(551)	(1,239)
Profit (loss) before taxes on income	(195)	908	713	1,381
Taxes on income (tax benefit)	(756)		(756)	29
Net income (loss)	561	908	1,469	1,352

### Year ended December 31, 2010, compared with year ended December 31, 2009

The year ended December 31, 2010 was a year in which we resume growth in our business and returned to profitability. During 2010 we have seen improvement in our business most particularly in the Packaging and Labels markets. While we are managing the business with utmost operational discipline, we remain cautiously optimistic and focused on realizing the benefits of the considerable operating leverage we have built into our business model and drive bottom-line growth.

# Management's Discussion & Analysis of Financial Condition and Results of Operations

## Revenues

Revenues are derived primarily from the sale of our systems. Additional revenues are generated through the sale of support services, training and software updates to customers.

Revenues in 2010 totaled \$39.7 million 6.6% higher than the \$37.2 million generated in 2009. Revenues in the fourth quarter of 2010 were \$10.1 million 11.1% higher than in Q4 2009. The increase in total revenues in 2010 is the result of the significant improvement in business conditions in the Packaging and Labels market segments.

Revenues from services are generated from maintenance contracts; time and material charges; consulting and training fees, installation and sales of spare parts. We recognize revenues over the contractual period or as services are performed. Service revenues in 2010 totaled \$8.1 million (out of the total revenues of \$39.7 million) a decline of 11.0% compared with the \$9.1 million generated in 2009. The decrease in service revenues is attributable primarily to the high level of installation revenues recognized during 2009.

Service orders received during 2010 were \$10.5 million, 19.6% higher than in 2009. The service orders, not yet recognized as revenues, will be recognized ratably over the contractual period.

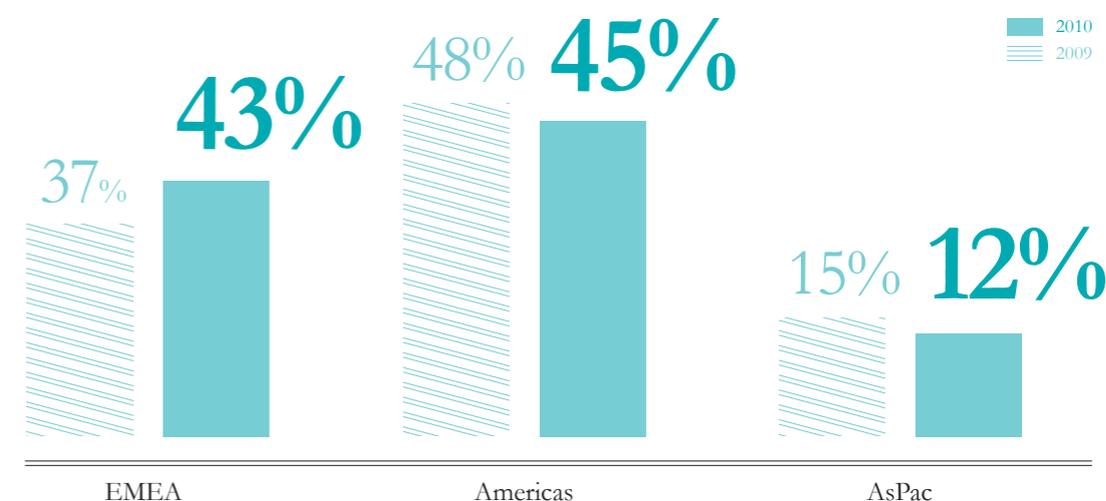
During 2010 order booking totaled \$43.2 million representing an increase of 22.5% over 2009 attributable to the improvements in all market segments and in particular in the Packaging and Labels markets. The ratio of total order booking to revenues in 2010 was 108.8% compared with 94.7% in 2009.

As of December 31, 2010 order backlog totaled \$14.5 million, an increase of 26.2% compared with the balance at December 31, 2009 providing us with visibility of approximately one quarter of revenues.

We estimate that out of this back-log, 55%-70% will become revenue during Q1 of 2011, while major part of the remainder will become revenue in the succeeding three quarters.

# Management's Discussion & Analysis of Financial Condition and Results of Operations

The following chart sets forth breakdown of revenues by territory for each of the two years ended December 31, 2010 and 2009:



In 2010 the American market contributed 45% of total revenues compared with 48% in 2009 while EMEA (Europe, Middle East & Africa) contributed only 43% of total revenue compared with 37% in 2009. Revenues generated in Asia-Pacific contributed 12% of total revenues compared with 15% in 2009.

## Cost of Revenues / Gross Profit

Cost of revenues includes materials, labor, and an estimate of costs associated with installation, warranty and training. We generally provide a one-year warranty to the end-user. A provision, based on our experience and engineering estimates, is recorded to cover probable costs in connection with such warranty, for the 12 months period commencing at the end of installation.

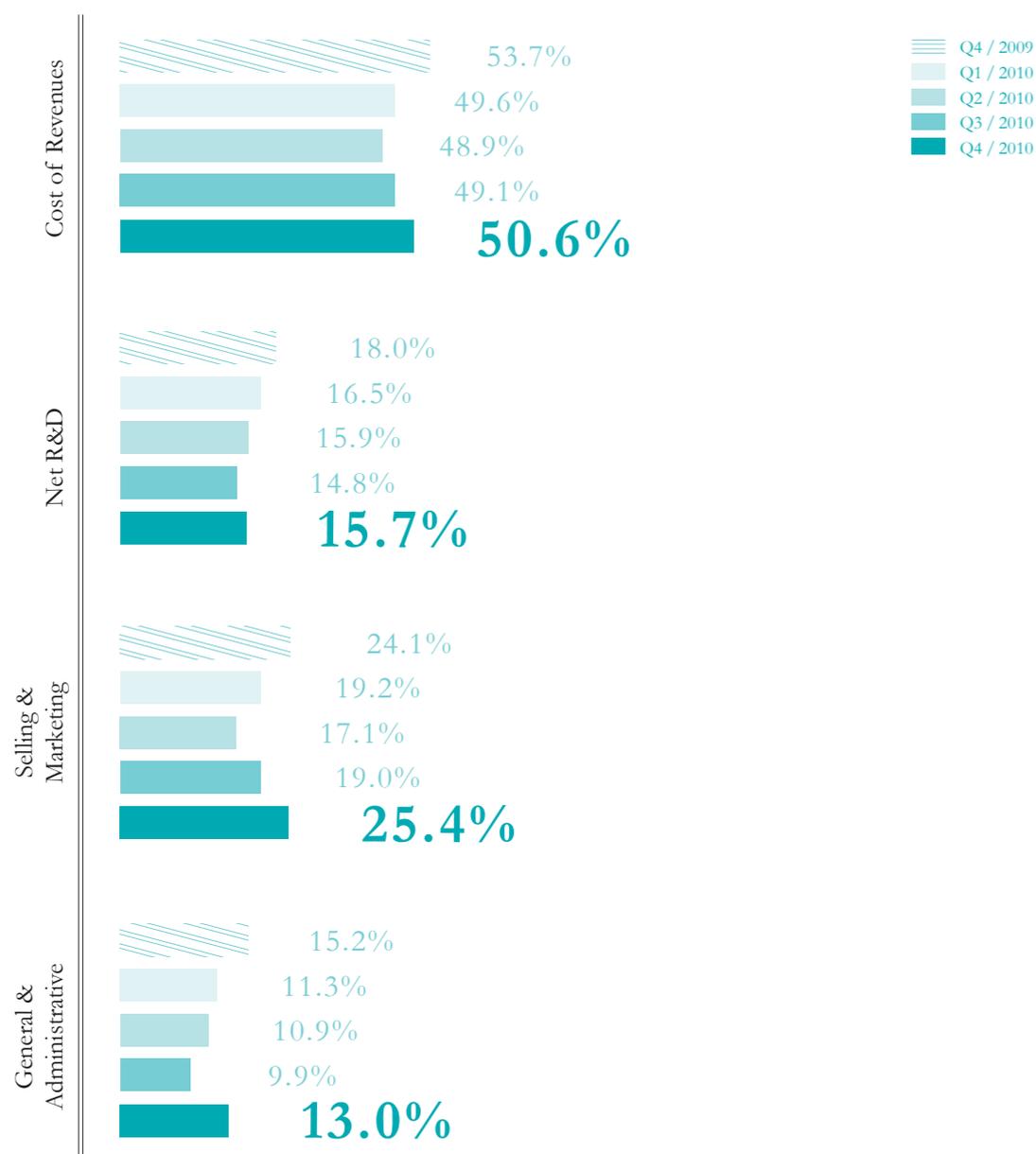
Gross margin in 2010 was 49.5% compared with 42.8%, in 2009. Proforma gross margin in 2010 (excluding the impact of non-cash amortization of acquired intangible assets, stock-based compensation expense and in addition, for 2009 excluding the impact of non-cash impairment charge and GMI restructuring and integration costs) was 50.4% compared with proforma gross margin of 49.1% in 2009.

The increase in proforma gross margin is due primarily to higher product sales coupled with favorable product mix partly offset by unfavorable impact of the Euro and Israeli Shekel exchange rates relative to the US Dollar.

Gross Margin may fluctuate due to changes in product mix as the sale of software options is generally increasing the platform's selling price while keeping the same bill of material cost, and thus improving the gross profit.

# Management's Discussion & Analysis of Financial Condition and Results of Operations

The following table sets forth selected proforma consolidated expenditures data (excluding non-cash impairment charges, amortization of acquired intangible assets and stock-based compensation expense) for each of the five quarters ended 31.12.2010, 30.9.2010, 30.6.2010, 31.3.2010 and 31.12.2009 expressed as a percentage of total quarterly revenues.



# Management's Discussion & Analysis of Financial Condition and Results of Operations

## Research and Development

Research and development costs are charged to the statement of operations as incurred. Government funding for the development of approved projects is recognized as a reduction of expenses as the related costs are incurred.

In 2010, net research and development expenses decreased to \$6,356 thousand, 16.4% less than in 2009 (\$7,600 thousand).

The gross costs of research and development are partially offset by government grants. In 2010 total government grants and participation recorded were \$752 thousand compared with \$848 thousand recorded in 2009.

Proforma net research and development expenses in 2010 (excluding the impact of non-cash stock-based compensation expense and in addition, for 2009 GMI restructuring and integration costs) decreased by 13.7% to \$6,242 thousand compared to \$7,231 thousand in 2009, primarily due to reduction in total personnel costs (R&D headcount at the end of 2010 was 60 employees compared with 75 employees at the end of 2009), closure of Sunnyvale office as of the end of Q1 2009 and rationalization of development programs.

## Selling and Marketing

In 2010, selling and marketing expenses decreased to \$8,217 thousand, 9.1% less than in 2009 (\$9,043 thousand).

Proforma selling and marketing expenses in 2010 (excluding the impact of non-cash amortization of acquired intangible assets, stock-based compensation expense and in addition, for 2009 impairment charge and GMI restructuring and integration costs) increased by 5.6% to \$8,025 thousand compared to \$7,602 thousand in 2009, primarily due to increase business activities in 2010 as evident by the higher total products order booking and products revenues.

## General and Administrative

In 2010, general and administrative expenses decreased to \$4,707 thousand, 20.1% less than 2009 (\$5,891 thousand).

Proforma expenses in 2010 (excluding the impact of non-cash stock-based compensation expense and in addition, for 2009 extraordinary GMI restructuring and integration costs) decreased by 14.2% to \$4,479 thousand compared to \$5,219 thousand in 2009, primarily due to reduction in total personnel costs (General and Administrative headcount at the end of 2010 was 28 employees compared with 30 at the end of 2009), closure of Sunnyvale office at the end of Q1 2009, lower provision for doubtful debts and tight expense control.

# Management's Discussion & Analysis of Financial Condition and Results of Operations

## Stock-Based Compensation

Based on ASC 718 we recorded commencing January 1, 2006, share-based payments as expenses based on their fair value at the grant date. The compensation is recorded over the requisite service period. The measurement of the benefit is based on the Monte Carlo simulation. Total stock-based compensation expense recorded during 2010 was \$611 thousand compared with \$739 thousand in 2009.

## Operating and Net Income

Net income for the full year ended December 31, 2010 was \$561 thousand or a profit of \$0.10 per share (diluted) compared with net loss of \$10,706 thousand or a loss of \$2.02 per share (diluted) in 2009.

Consolidated proforma net income for 2010 (excluding the impact of non-cash amortization of acquired intangible assets, stock-based compensation expense and in addition, for 2009 non-cash impairment charges and extraordinary GMI restructuring and integration costs), was \$1,469 thousand compared with proforma net loss of \$3,576 thousand in 2009.

Consolidated net income for 2009 included valuation allowance of \$1,660 thousand against deferred income tax assets compare with a reversal of provision for income tax in the amount of \$815 thousand recorded in 2010.

The total amount of items excluded in proforma financial results presentation comprising of non-cash amortization of intangibles, stock-based compensation expense and in addition, for 2009 non-cash impairment charges and extraordinary GMI restructuring and integration expenses totaled \$908 thousand in 2010 compared with a total of \$7,130 thousand in 2009.

Consolidated proforma operating income (excluding all expense items cited above) improved from a loss of \$1,786 thousand in 2009 to a profit of \$1,264 thousand in 2010. The increase in proforma EBIT in 2010 is due primarily to higher products revenues coupled with higher gross margin and lower operating expenses. Consolidated Proforma operating expenses were 47.2% of revenues in 2010 compared with 53.9% in 2009.

Proforma EBITDA in 2010 (excluding stock-based compensation expenses) improved from a loss of \$962 thousand in 2009 to a profit of \$1,874 thousand in 2010 primarily due to higher products revenues coupled with higher gross margin and lower operating expenses.

## Financial Expense, net

Financial expense is comprised of interest income incurred on time deposits less interest expenses on lines of credit and exchange rate differences. Net financial expenses

# Management's Discussion & Analysis of Financial Condition and Results of Operations

for 2010 were \$551 thousand compared with net expenses of \$63 thousand for 2009. The increase in financial expenses from previous year is attributable primarily to the devaluation of the US Dollar against the Euro and the Israeli Shekel. Financial income in 2010 accounted for \$50 thousand compared with \$17 thousand in 2009. An additional net expense of \$601 thousand was generated from exchange rate differences plus interest and bank charges.

## Taxes

We operate within multiple taxing jurisdictions and are subject to audit in those jurisdictions. For AVT product line we conducted a Transfer Pricing study during 2010 in the United States. For AVT and GMI product lines we conducted Transfer Pricing study during 2010 in Germany. The recommendations of those studies were incorporated in our tax estimates. In our opinion, an adequate asset and provision for income taxes has been made in the financial statements. This asset and provision takes into consideration the tax reform effective in Israel as of January 1, 2003 and potential tax liability in other jurisdictions.

During Q4 2010 the Israeli tax authorities have concluded tax assessment for the years 2006-2008. The conclusion of that assessment resulted in reversal of provision for income tax in the amount of \$815 thousand. At the end of 2009, in light of the continued economic slowdown and uncertain outlook, management concluded that it is not likely that certain deferred tax assets previously recorded will be realized, resulting in a valuation allowance of \$1,660 thousand recorded against our deferred income tax assets.

## Liquidity and Capital Resources

As of December 31, 2010 our total current assets were \$25.5 million, including a total cash balance and short term deposits of \$10.8 million compared with cash and financial investment balance of \$11.1 million on December 31, 2009.

During 2010, \$3 thousand were used in operating activities compared with \$1,507 thousand used in operating activities in 2009. Our 2010 net capital expenditures on fixed assets were \$295 thousand compared with \$484 thousand used during 2009. The company did not generate any cash from financing activities in 2010 and in 2009. We focus on managing our working capital, particularly in maintaining the relative low level of accounts receivable Days Sales Outstanding (DSO) and inventories. DSO in accounts receivable for the year ended December 31, 2010 were 52 days compared with 54 days for the year ended December 31, 2009.

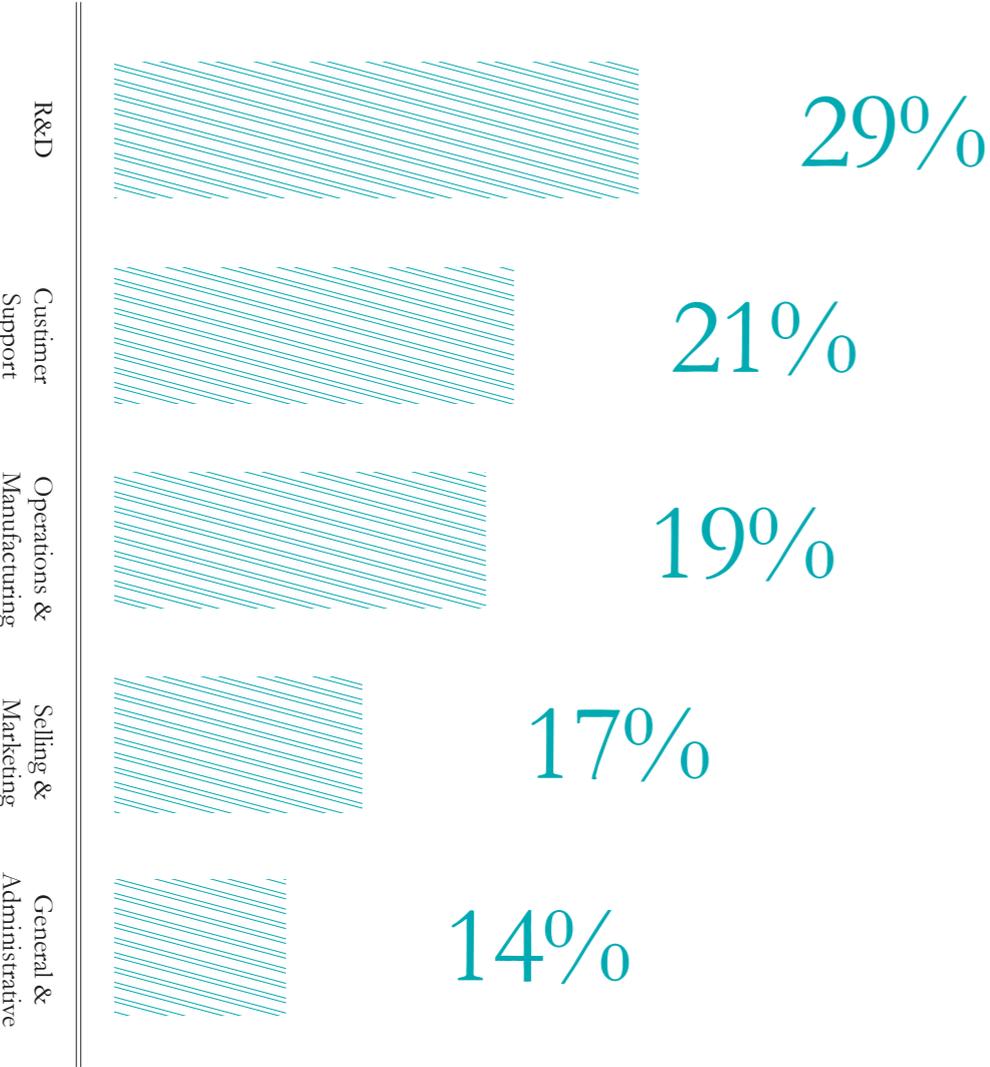
## Employees

Our employees consistently remain our major asset, committed to the drive for technological leadership and outstanding customer service. Our dedicated team has repeatedly demonstrated that it shares our vision, and has the motivation, innovation

# Management's Discussion & Analysis of Financial Condition and Results of Operations

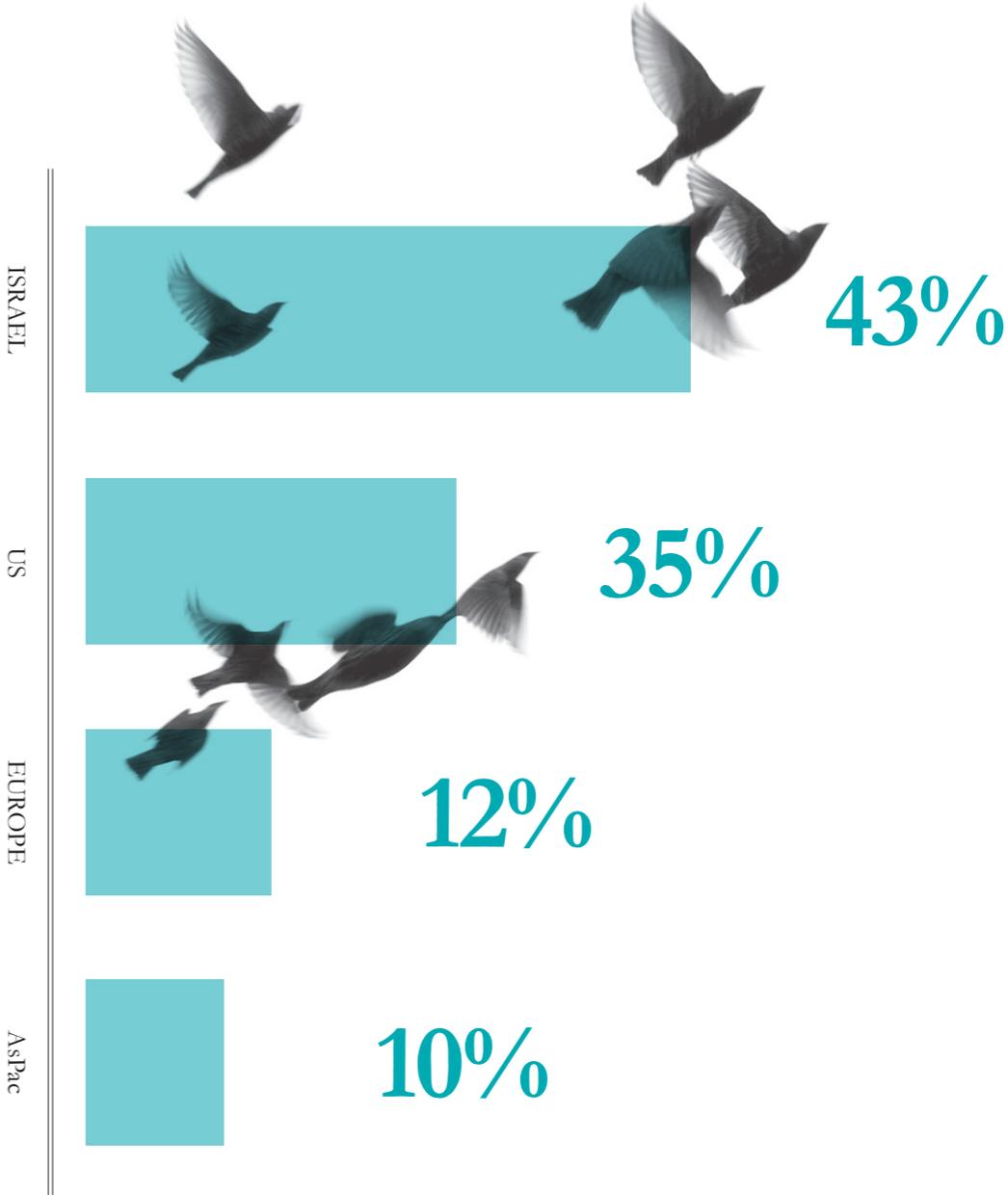
and commitment to customer satisfaction that are the key ingredients of healthy growth. On December 31, 2010, 205 people were employed by us worldwide compared with 225 people we employed at December 31 2009.

The breakdown of employees by activity is as follows:



# Management's Discussion & Analysis of Financial Condition and Results of Operations

Our employees are based in the following areas per their subsidiary affiliation:



## Financial Table of Contents;

AVT Annual Report 2010

45. Report of Independent Auditors
- 46-47. Consolidated Balance Sheets
48. Consolidated Statements of Operations
49. Consolidated Statements of Changes in Shareholders' Equity
50. Consolidated Statements of Cash Flow
- 51-75. Notes to consolidated financial statements

## Report of Independent Auditors

To the board of directors and shareholders of  
ADVANCED VISION TECHNOLOGY (A.V.T.) LTD.

We have audited the accompanying consolidated balance sheets of Advanced Vision Technology (A.V.T.) Ltd. (the "Company") and its subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
April 6, 2011

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

## Consolidated Balance Sheets

	U.S. dollars in thousands December 31,	
	2010	2009
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$7,816	\$6,114
Short term deposits	3,000	5,000
Trade receivables (net of allowance for doubtful accounts as of \$550 and \$710 as of December 31, 2010 and 2009, respectively)	5,696	5,554
Inventories	5,928	6,017
Other accounts receivable and prepaid expenses	3,051	2,638
<b>Total current assets</b>	<b>25,491</b>	<b>25,323</b>
SEVERANCE PAY FUND	2,358	2,015
PROPERTY AND EQUIPMENT, NET	1,436	1,751
INTANGIBLE ASSETS, NET	1,443	1,740
<b>Total assets</b>	<b>\$30,728</b>	<b>\$30,829</b>

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

## Consolidated Balance Sheets

	U.S. dollars in thousands (except share and per share amounts) December 31,	
	2010	2009
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$1,378	\$1,475
Employees and payroll accruals	2,400	1,891
Customer advances and deferred revenues	2,717	3,672
Accrued expenses and other liabilities	3,402	4,455
<b>Total current liabilities</b>	<b>9,897</b>	<b>11,493</b>
ACCRUED SEVERANCE PAY	3,295	2,972
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 2 par value:		
30,000,000 shares authorized at December 31, 2010 and		
2009; 6,296,898 shares issued at December 31, 2010 and		
2009; 5,327,366 and 5,320,349 shares outstanding at		
December 31, 2010 and 2009, respectively	3,402	3,402
Additional paid-in capital	62,337	61,771
Treasury shares at cost – 969,532 and 976,549 shares as of		
December 31, 2010 and 2009, respectively	(8,170)	(8,229)
Accumulated deficit	(40,033)	(40,580)
<b>Total shareholders' equity</b>	<b>17,536</b>	<b>16,364</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$30,728</b>	<b>\$30,829</b>

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

## Consolidated Statements of Operations

U.S. dollars in thousands (except share and per share amounts)  
December 31,

	2010	2009	2008
<b>Revenues:</b>			
Products	\$31,575	\$28,121	\$50,861
Services	8,106	9,110	9,459
<b>Total Revenues</b>	<b>39,681</b>	<b>37,231</b>	<b>60,320</b>
<b>Cost of revenues:</b>			
Products	12,341	12,543	23,244
Services	7,704	8,737	10,732
<b>Total cost of revenues</b>	<b>20,045</b>	<b>21,280</b>	<b>33,976</b>
<b>Gross profit</b>	<b>19,636</b>	<b>15,951</b>	<b>26,344</b>
<b>Operating expenses:</b>			
Research and development	7,108	8,448	12,048
Less - grants	(752)	(848)	(842)
Selling and marketing	8,217	9,043	13,402
General and administrative	4,707	5,891	8,427
Restructuring	-	288	-
Impairment of goodwill	-	2,045	17,192
<b>Total operating expenses</b>	<b>19,280</b>	<b>24,867</b>	<b>50,227</b>
<b>Operating income (loss)</b>	<b>356</b>	<b>(8,916)</b>	<b>(23,883)</b>
<b>Financial expense, net</b>	<b>(551)</b>	<b>(63)</b>	<b>(1,239)</b>
<b>Loss before taxes on income</b>	<b>(195)</b>	<b>(8,979)</b>	<b>(25,122)</b>
<b>Taxes on income (tax benefit)</b>	<b>(756)</b>	<b>1,727</b>	<b>29</b>
<b>Net income (loss)</b>	<b>\$561</b>	<b>\$(10,706)</b>	<b>\$(25,151)</b>
<b>Basic earnings (loss) per ordinary share</b>	<b>\$0.11</b>	<b>\$(2.02)</b>	<b>\$(4.75)</b>
<b>Diluted earnings (loss) per ordinary share</b>	<b>\$0.10</b>	<b>\$(2.02)</b>	<b>\$(4.75)</b>

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

## Consolidated Statements of Changes in Shareholders' Equity

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Treasury shares	Accumulated deficit	Total Shareholders' equity
Balance as of January 1, 2008	\$3,402	\$60,196	\$(8,776)	\$(4,494)	\$50,328
<b>Issuance of treasury shares</b>					
upon exercise of options	-	(81)	433	(137)	215
<b>Stock-based compensation related</b>					
to options granted to employees	-	939	-	-	939
<b>Net loss</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(25,151)</b>	<b>(25,151)</b>
<b>Balance as of December 31, 2008</b>	<b>\$3,402</b>	<b>\$61,054</b>	<b>\$(8,343)</b>	<b>\$(29,782)</b>	<b>\$26,331</b>
<b>Issuance of treasury shares upon</b>					
exercise of options	-	(22)	114	(92)	-
<b>Stock-based compensation related</b>					
to options granted to employees	-	739	-	-	739
<b>Net loss</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(10,706)</b>	<b>(10,706)</b>
<b>Balance as of December 31, 2009</b>	<b>\$3,402</b>	<b>\$61,771</b>	<b>\$(8,229)</b>	<b>\$(40,580)</b>	<b>\$16,364</b>
<b>Issuance of treasury shares upon</b>					
exercise of options	-	(45)	59	(14)	-
<b>Stock-based compensation related</b>					
to options granted to employees	-	611	-	-	611
<b>Net income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>561</b>	<b>561</b>
<b>Balance as of December 31, 2010</b>	<b>\$3,402</b>	<b>\$62,337</b>	<b>\$(8,170)</b>	<b>\$(40,033)</b>	<b>\$17,536</b>

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

# Consolidated Statements of Cash Flow

	U.S. dollars in thousands Year ended December 31,		
	2010	2009	2008
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$561	\$(10,706)	\$(25,151)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Stock-based compensation related to options granted to employees	611	739	939
Depreciation of property and equipment	610	823	840
Amortization of intangible assets	297	919	2,172
Capital loss	-	-	23
Impairment of goodwill and other intangible assets	-	4,537	21,777
Decrease (increase) in trade receivables, net	(142)	3,134	811
Decrease (increase) in inventories	89	1,116	(965)
Decrease (increase) in other accounts receivable and prepaid expenses	(413)	604	173
Decrease in deferred income taxes, net	-	1,660	-
Decrease in trade payables	(97)	(183)	(284)
Increase (decrease) in employees and payroll accruals	509	(1,287)	(814)
Decrease in customer advances and deferred revenues	(955)	(2,271)	(1,028)
Decrease in accrued expenses and other liabilities	(1,053)	(326)	(1,515)
Increase (decrease) in accrued severance pay, net	(20)	(266)	116
Net cash used in operating activities	(3)	(1,507)	(2,906)
<b>Cash flows from investing activities:</b>			
Investment in short-term deposit	(3,000)	(5,000)	-
Proceeds from maturity of short-term deposit	5,000	-	-
Purchase of property and equipment	(295)	(484)	(857)
Net cash provided by (used in) investing activities	1,705	(5,484)	(857)
<b>Cash flows from financing activities:</b>			
Proceeds from exercise of options granted to employees	-	-	215
Net cash provided by financing activities	-	-	215
Increase (decrease) in cash and cash equivalents	1,702	(6,991)	(3,548)
Cash and cash equivalents at the beginning of the year	6,114	13,105	16,653
Cash and cash equivalents at the end of the year	\$7,816	\$6,114	\$13,105
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid during the year for income taxes	\$64	\$66	\$582

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

# Notes to Consolidated Financial Statements

## 1. General

### General:

Advanced Vision Technology (A.V.T.) Ltd. (“A.V.T.”) was incorporated under the laws of the State of Israel on December 10, 1992 and commenced operations thereafter. A.V.T. and its wholly-owned subsidiaries (“the Company”) design, develop, manufacture, market and support an advanced video-based print inspection system that automatically detects defects in various types of printing processes.

The Company’s products are marketed and supported in the U.S. and Europe through its wholly-owned subsidiaries, Advanced Vision Technology Inc. located in the United States and Advanced Vision Technology (Germany) GmbH located in Germany.

In 2007, the Company acquired Graphics Microsystems, Inc (“GMI”), a manufacturer of pressroom equipment engaged in the business of developing, manufacturing and selling of closed loop color control (CLC) systems, color management and reporting software, and remote digital ink fountain control systems to leading commercial printers and press manufacturers worldwide.

## 2. Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with US generally accepted accounting principles (“U.S. GAAP”).

### a. Use of estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company’s management believes that the estimates, judgment and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### b. Financial statements in U.S. dollars:

A majority of the revenues of the Company are generated in U.S. dollars (“dollars”). In addition, a substantial portion of the Company’s costs is incurred in dollars. Since management believes that the dollar is the currency of the primary economic environment in which the Company operates, the dollar is its functional and reporting

# Notes to Consolidated Financial Statements

currency. Accordingly, amounts in currencies other than U.S dollars have been remeasured in accordance with ASC 830, “Foreign Currency Matters”, as follows:

- Monetary balances - at the exchange rate in effect on the balance sheet date.
- Expenses - at the exchange rates in effect as of the date of recognition of the transaction.
- All exchange gains and losses from the remeasurement mentioned above are reflected in the statement of operations in financial income, net.
- Management considers the non-U.S. subsidiaries to be a direct, integral extension of the parent company’s operations. Accordingly, the functional currency of these subsidiaries is dollar.

## c. Principles of consolidation:

The consolidated financial statements include the financial statements of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions including profits from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

## d. Cash equivalents:

Cash equivalents include short-term bank deposits that are readily convertible to cash with original maturities of three months or less at the date of acquisition.

## e. Short-term deposits:

A short-term bank deposit is a deposit with a maturity of more than three months but less than one year. As of December 31, 2010, the deposit bears interest at an annual rate of 1. 8%. As of December 31, 2009, the deposits bear interest at an annual rates of 0.6% and 1. 5%.

## f. Inventories:

Inventories are stated at the lower of cost or market. The Company evaluates periodically the quantities on hand relative to current selling prices and historical and forecasted sales volumes. Based on these evaluations, provisions are recorded if required to write down inventory to its net realizable value. Such provisions are included in the cost of revenues. . For all years presented the write-offs were insignificant.

Cost is determined as follows:

- Raw materials - according to the “average cost method”.
- Work in progress and finished products- based on average direct manufacturing costs and allocable indirect manufacturing costs.
- Spare parts for customer support - according to the “average cost method”.

# Notes to Consolidated Financial Statements

## g. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method, over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and peripheral equipment	20 - 33 (mainly 33)
Machinery and equipment	6 - 20 (mainly 20)
Office furniture and equipment	6 - 20 (mainly 6)
Leasehold improvements	The shorter of the term of the lease or the useful life of the asset

## h. Intangible assets:

The intangible assets are stated at cost, net of accumulated amortization. The intangible assets are amortized over their estimated useful life using the straight-line method or the accelerated method. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset is reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates.

The amortization expense of intangible assets which is recognized in the statement of operations in the expense category, consistent with the function of the intangible asset.

## i. Impairment of long-lived assets and intangible assets subject to amortization:

The Company’s long-lived assets and intangible assets subject to amortization are reviewed for impairment in accordance with ASC 360, “Property, Plant, and Equipment” and ASC 350, “Intangibles—Goodwill and Other”, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. During 2010, no impairment losses have been identified.

# Notes to Consolidated Financial Statements

The Company performed impairment tests as of December 31, 2009 and 2008 since indicators of impairment were present. Following the tests, the Company recorded during 2009 and 2008 an impairment of the technology, customer relationships and trademarks related to the acquisition of GMI in the amounts of \$2,491 and \$4,585, respectively.

In performing the above analyses and tests, the Company's management provided forecasts and related assumptions to the third party valuation firm, which applied its valuation techniques and required economic models. These assumptions and results may differ from actual results due to, among other things, technological change, economic conditions, changes to its business models or changes in operating performance and an impairment charge may be required in the future. Fair value is determined using the discounted future cash flows method. Significant estimates used in the methodology include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital.

## **j. Goodwill:**

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net assets acquired. Under ASC 350, "Intangibles-Goodwill and Other", goodwill is not amortized, but tested for impairment at least annually or more frequently if certain indicators of possible impairment arise. ASC 350 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment.

In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

For the years ended December 31, 2009 and 2008 the Company engaged an independent valuation firm to perform its annual goodwill impairment test. The fair value of a reporting unit is determined using the discounted future cash flows method. Significant estimates used in the methodology include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units.

The Company identified two reporting units based on the guidance of ASC 350.

# Notes to Consolidated Financial Statements

The Company performed its annual impairment test as of December 31, 2009 and 2008. Since the carrying value of each of the reporting units exceeded their fair value, and based on the second phase of the impairment test, the Company recorded during 2009 and 2008 an impairment of the entire goodwill related to the acquisition of GMI in the amount of \$2,045 and \$16,367, respectively. In addition, the Company recorded in 2008 an impairment of the entire goodwill related to the other reporting unit which was derived from an acquisition made in June 2002 of Geiger Vision Systems GmbH (GVS) in the amount of \$825.

## **k. Research and development costs:**

Research and development costs, net of grants received, are charged to the statements of operations as incurred.

## **l. Revenue recognition:**

The Company derives its revenues from selling its products to end users and to printing press manufacturers through Original Equipment Manufacturer ("OEM") partners. The Company also generates revenues from maintenance, support and repair services related to these sales.

Revenues from product sales are recognized in accordance with ASC 605, "Revenue Recognition" and SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" ("SAB 104"), when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no future obligation exists and collectibility is probable.

The Company generally does not grant a right of return to its customers. When sale arrangements include a customer acceptance provision with respect to products, revenue is not recognized before the Company has demonstrated that the criteria specified in the acceptance provisions have been satisfied, or that the acceptance provision has lapsed.

In cases where the arrangement involves the delivery of products and post delivery installation services that are not essential to the functionality of the equipment, the Company follows the requirements set forth in ASC 605-25, "Revenue Arrangements with Multiple Deliverables", relating to the separation of multiple deliverables into individual accounting units. Revenue from such deliverables is recognized in accordance with SAB 104.

In arrangements which include multiple elements, the Company considers the sale of equipment and its installation to be two separate units of accounting in the arrangement, since the installation is not essential to the functionality of the

## Notes to Consolidated Financial Statements

equipment, the equipment has value to the customer on a standalone basis, and fair value of the installation services exists. The Company defers the fair value of the installation service (but not less than the amount contingent upon completion of installation, if any) to the period in which such installation occurs.

Deferred revenues include amounts received from customers for which revenue has not been recognized.

### **m. Warranty costs:**

The Company provides a 12 month warranty for its products at no charge. The Company estimates the costs that may be incurred during the warranty period and records a liability for the amount of such costs at the time revenue from the product sale is recognized. Changes in the Company's provision for warranty during the respective years are as follows:

	2010	2009
Balance at beginning of period	\$538	\$646
Warranties utilized and expired during the year	(538)	(646)
Warranties issued during the year	576	538
Balance at end of period	\$576	\$538

### **n. Concentrations of credit risk:**

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, short-term deposits and trade receivables.

Cash and cash equivalents and short-term deposits are deposited with major banks in Israel and in 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's investments are institutions with high credit standing, and accordingly, low credit risk exists with respect to these investments.

The Company's trade receivables are derived from sales to customers located primarily in the United States and Europe. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. In certain circumstances, the Company may require letters of credit or other collateral. The Company maintains an allowance for doubtful accounts receivable based upon

## Notes to Consolidated Financial Statements

management's experience. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.

As of December 31, 2010 and 2009, the allowance for doubtful accounts amounted to \$550 and \$710, respectively. Bad debt expense amounted to \$13, \$513 and \$510 in 2010, 2009 and 2008, respectively. The risk of collection associated with account receivables is mitigated by the diversity and number of customers.

### **o. Accounting for stock-based compensation:**

The Company accounts for stock-based compensation in accordance with ASC 718, "Compensation - Stock Compensation". ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the statement of operations.

The Company recognizes compensation expense for the value of its awards granted based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company selected the Monte Carlo simulation option pricing model as the most appropriate fair value method for its equity-based awards and values options based on the market value of the underlying shares on the date of grant. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected term of the equity-based award. Expected volatility is calculated based upon actual historical stock price movements. The suboptimal exercise factor represents the value of the underlying share as a multiple of the exercise price of the option which, if achieved, results in exercise of the option. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for these options was estimated at the date of grant, using the Monte Carlo simulation model for options granted with the following weighted-average assumptions:

## Notes to Consolidated Financial Statements

	Year ended December 31,		
	2010	2009	2008
Risk-free interest rate	1.58%	1.49%	1.88%
Suboptimal exercise multiple	2.22/2.48	2.22/2.48	2.22/2.48
Forfeiture rate	10.0%	10.00%	7.11%
Dividend yield	-	-	-
Expected volatility	54%	70%	56%

### p. Comprehensive income:

The Company accounts for comprehensive income in accordance with ASC 220, "Comprehensive Income". ASC 220 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in stockholders' equity during the period except those resulting from investments by, or distributions to, stockholders. Net income and comprehensive income of the Company are identical for all periods presented.

### q. Treasury stock:

On June 27, 2003, the Company repurchased some of its shares in a tender offer and thereafter held those shares as treasury shares. The Company presents the cost to repurchase treasury shares as a reduction of shareholders' equity.

From time to time the Company may reissue treasury shares upon exercise of options. When treasury shares are reissued, the Company charges to retained earnings the excess of the purchase cost over the exercise price and the accumulated stock based compensation. The purchase cost is calculated based on the specific identification method. If the purchase cost is less than the exercise price, the Company credits the difference to additional paid-in capital.

### r. Royalty-bearing grants:

Royalty-bearing grants from the Chief Scientist of the Ministry of Industry and Trade in Israel for funding certain approved research and development projects are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred and are included as a deduction from research and development costs.

Research and development grants recognized amounted to \$752, \$848 and \$842 in 2010, 2009 and 2008, respectively. Total royalties accrued or paid amounted to \$975, \$739 and \$1,041 in 2010, 2009 and 2008, respectively and were recorded in the cost of revenues.

## Notes to Consolidated Financial Statements

### s. Fair value of financial instruments:

The carrying amounts reported in the balance sheet for cash and cash equivalents, short-term deposits, trade receivables, other accounts receivable, trade payables and accrued liabilities approximate their fair values due to the short-term maturities of such instruments.

The Company measures the fair value based on guidance of ASC 820, "Fair Value Measurements and Disclosures", which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements.

The Company adopted the provisions of ASC 820, with respect to non-financial assets and liabilities measured at fair value on a non-recurring basis.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 describes three levels of inputs that may be used to measure fair value as follows:

- Level 1:** quoted prices in active markets for identical assets or liabilities;
- Level 2:** significant other observable inputs based on market data obtained from sources independent of the reporting entity;
- Level 3:** inputs that are unobservable (for example cash flow modeling inputs based on assumptions).

### t. Severance pay:

The Company's liability for its Israeli employee's severance pay is calculated pursuant to the Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for all of those employees is covered by monthly deposits with severance pay funds, insurance policies and by an accrual.

The deposited funds may be withdrawn only upon fulfillment of the obligation pursuant to the Israeli severance pay law or labor agreements. The value of the insurance policies is based on the cash surrender value which includes profits or losses accumulated up to the balance sheet date. The funds and insurance policies are recorded as an asset in the Company's balance sheet.

Severance expenses for the years ended December 31, 2010, 2009 and 2008 amounted to \$413, \$438 and \$641, respectively.

## Notes to Consolidated Financial Statements

### u. Basic and diluted net earnings per share:

Basic net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year.

Diluted net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during the year plus dilutive potential equivalent Ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings Per Share". For the years ended December 31, 2009 and 2008, all outstanding options to purchase shares were excluded from the calculation of diluted loss per share because their effect on the loss per share is anti-dilutive.

### v. Income taxes:

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes". ASC 740 prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to amounts more likely than not to be realized.

Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences if not related to an asset or liability for financial reporting.

The Company accounts for its uncertain tax positions in accordance with ASC 740 which contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company reevaluates its income tax positions to consider factors such as changes in facts or circumstances, changes in or interpretations of tax

law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in recognition of a tax benefit or an additional charge to the tax provision. The Company accrues interest and penalties related to unrecognized tax benefits in tax expense.

## Notes to Consolidated Financial Statements

### w. Impact of recently issued accounting pronouncements:

In October 2009, the FASB issued an update to ASC 605-25, "Revenue recognition - Multiple-Element Arrangements", that provides amendments to the criteria for separating consideration in multiple-deliverable arrangements to:

- Provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
- Require an entity to allocate revenue in an arrangement using estimated selling prices ("ESP") of deliverables if a vendor does not have vendor-specific objective evidence of selling price ("VSOE") or third-party evidence of selling price ("TPE"), and eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.
- Require expanded disclosures of qualitative and quantitative information regarding application of the multiple-deliverable revenue arrangement guidance.

The Company may elect to adopt the update prospectively, to new or materially modified arrangements beginning on the adoption date, or retrospectively, for all periods presented. The Company is currently evaluating the impact that the adoption of these ASUs will have on its consolidated financial statements. As the deferred revenues of the Company have not been significant in the past, the Company does not expect that adoption of these ASUs in 2011 will have a material impact on the timing of the recognition of revenues from sales of multiple deliverables.

## 3. Other Accounts Receivable and Prepaid Expenses

	December 31,	
	2010	2009
Government grants	\$244	\$187
Government authorities	1,839	1,863
Prepaid expenses	465	415
Other accounts receivable	503	173
	\$3,051	\$2,638

## Notes to Consolidated Financial Statements

### 4. Inventories

	December 31,	
	2010	2009
Raw materials	\$2,139	\$2,563
Work in progress	1,253	968
Finished products	1,116	1,134
Spare parts for customer support	1,420	1,352
	\$5,928	\$6,017

### 5. Property and Equipment

	December 31,	
	2010	2009
Cost:		
Computers and peripheral equipment	\$2,844	\$2,621
Machinery and equipment	1,603	1,587
Office furniture and equipment	576	571
Leasehold improvements	452	401
	5,475	5,180
Accumulated depreciation:		
Computers and peripheral equipment	2,544	2,220
Machinery and equipment	1,077	860
Office furniture and equipment	255	217
Leasehold improvements	163	132
	4,039	3,429
Property and equipment, net	\$1,436	\$1,751

Depreciation expense for the years ended December 31, 2010, 2009 and 2008 was \$610, \$823 and \$840, respectively.

During 2008, the Company recorded a reduction of approximately \$45 and \$22 to the cost and accumulated depreciation, respectively, of equipment no longer in use, following an assessment made by the Company.

For liens, see Note 8d.

## Notes to Consolidated Financial Statements

### 6. Intangible Assets, Net

	December 31,	
	2010	2009
Cost:		
Technology (1)	\$3,767	\$3,767
Customer Relationships (2)	670	670
Trademarks (3)	298	298
	4,735	4,735
Accumulated amortization:		
Technology	2,804	2,548
Customer relationships	364	349
Trademarks	124	98
	3,292	2,995
Intangible assets, net	\$1,443	\$1,740

(1) Net of accumulated impairment of \$6,205 on December 31, 2010 and 2009 (see Note 2i).

(2) Net of accumulated impairment of \$735 on December 31, 2010 and 2009 (see Note 2i).

(3) Net of accumulated impairment of \$136 on December 31, 2010 and 2009 (see Note 2i).

Amortization expense amounted to \$297, \$919 and \$2,172 for the years ended December 31, 2010, 2009 and 2008, respectively.

Estimated amortization expense for the years ended:

Year	December 31,
2011	\$ 374
2012	363
2013	339
2014	254
2015	47
2016	66
	\$ 1,443

## Notes to Consolidated Financial Statements

### 7. Accrued Expenses and Other Liabilities

	December 31,	
	2010	2009
Provision for warranty costs	\$576	\$538
Government authorities and tax provision	736	2,255
Accrued expenses and other liabilities	2,090	1,662
	\$3,402	\$4,455

### 8. Commitments and Contingent Liabilities

#### a. Lease commitments:

The Company and its subsidiaries lease office facilities and motor vehicles, under operating leases, for periods ending in 2016.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2010, are as follows:

Year	Lease commitment
2011	\$ 1,524
2012	1,477
2013	1,154
2014	368
2015	368
2016	305
	\$ 5,196

Total rent expense for the years ended December 31, 2010, 2009 and 2008 amounted to \$2,082, \$2,135 and \$2,294, respectively.

The Company leases motor vehicles under cancelable operating lease agreements. The Company has an option to be released from this agreement, which may result in penalties in a maximum amount of \$93 as of December 31, 2010.

## Notes to Consolidated Financial Statements

#### b. Royalty commitments:

The Company is committed to pay royalties to the Chief Scientist of Israel's Ministry of Industry and Trade at a rate of 3.5% of all revenues from the sales of products and services that are developed with the assistance of the Chief Scientist by way of grants.

The total royalties that the Company will be obligated to pay will not exceed 100% of the amount of the grant plus interest at the applicable LIBOR rate at the time the grants were received.

As of December 31, 2010, the Company has a contingent obligation to pay royalties in respect of the aforementioned grants in the approximate amount of \$2,300.

#### c. Legal proceedings:

From time to time the Company is a party to various litigation matters incidental to the conduct of its business. There is no pending or threatened legal proceeding to which the Company is a party that, to its opinion, is likely to have a material adverse effect on its future financial results.

#### d. Liens:

To secure its line of credit from banks, the Company has recorded a fixed lien on its share capital, notes and other documents, property and equipment. As of December 31, 2010, no credit was utilized.

## 9. Income Taxes

#### a. General:

The Company operates within multiple taxing jurisdictions (primarily in Israel) and is subject to an audit in those jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. In management's opinion, adequate provisions for income taxes have been made.

#### b. Israel taxation:

##### 1. Corporate tax structure:

Taxable income of Israeli companies is subject to tax at the rate of 27% in 2008, 26% in 2009, 25% in 2010, 24% in 2011, 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015, 18% in 2016 and thereafter.

## Notes to Consolidated Financial Statements

### 2. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the “Law”):

Substantially all of the Company’s production facilities in Israel have been granted status as an “Approved Enterprise” or a “Privileged Enterprise”, under the Law, in four investment programs.

In accordance with the Law, the Company has elected the “Alternative tax benefits.” On April 1, 2005, an amendment to the Law came into effect (“the Amendment”) and has significantly changed the provisions of the Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a “Privileged Enterprise” (rather than the previous terminology of “Approved Enterprise”), such as by requiring that at least 25% of the “Privileged Enterprise’s” income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. However, the Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Law as they were on the date of such approval. Therefore, the Company’s existing “Approved Enterprise” will generally not be subject to the provisions of the Amendment. As a result of the amendment, tax-exempt income generated under the provisions of the amended Law, will subject the Company to taxes upon distribution or complete liquidation (for “Approved Enterprise” only upon distribution).

Accordingly, Company’s income attributed to its “Approved Enterprise” and “Privileged Enterprise” programs is tax exempt for a period of two years and is subject to a reduced corporate tax rate of 10% - 25% for an additional period of five to eight years, depending on the percentage of foreign investment in the Company.

The duration of tax benefits for the program is subject to limitations of the earlier of 12 years from commencement of investment, or 14 years from receipt of approval as an “Approved Enterprise” under the Law.

The entitlement to the above benefits is conditional upon Company’s fulfilling the conditions stipulated by the Law, regulations published thereunder and the certificates of approval for the specific investments in “Approved Enterprises”.

Should the Company fail to meet such requirements in the future, income attributable to its “Approved Enterprise” or “Privileged Enterprise” programs could be subject to the statutory Israeli corporate tax rate, and the Company

## Notes to Consolidated Financial Statements

could be required to refund the tax benefits already received with respect to such program, in whole or in part, including interest.

In the event of distribution of dividend from the above mentioned tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise’s and Privileged Enterprise’s income.

Out of the Company’s earnings available for distribution as of December 31, 2010, \$13,593 is tax-exempt attributable to its “Approved Enterprise” program. If such tax-exempt income is distributed in a manner other than upon the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits and an income tax liability of up to approximately \$3,398 would be incurred as of December 31, 2010. The tax-exempt income attributable to the “Approved Enterprise” can be distributed to shareholders without imposing tax liability on the Company only upon the complete liquidation of the Company.

The Company has determined that it will not distribute any amounts of its undistributed tax-exempt income as dividend. The Company intends to reinvest its tax-exempt income and not to distribute such income as a dividend. Accordingly, no deferred income taxes have been provided on income attributable to the Company’s Approved Enterprise programs as the undistributed tax-exempt income is essentially permanent in duration.

Since part of the Company’s taxable income is not entitled to tax benefits under the Law and is taxed at the regular tax rate, its effective tax rate is the result of a weighted combination of the various applicable rates and tax exemptions, and the computation is made for income derived from each program on the basis of formulas specified in the Law and in the approvals.

On January 6, 2011, an additional amendment to the Investment Law came into effect (“the Second Amendment”) which has significantly changed the provision of the Investment Law (see Note 14).

### c. Carryforward tax losses:

As of December 31, 2010, the Company had approximately \$3,500 of Israeli carryforward tax losses, which may be carried forward and offset against taxable income in the future for an indefinite period.

As of December 31, 2010, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately \$5,400 that can be carried forward and offset against taxable income for 12-20 years and expire from 2020-2029. As of December 31, 2010, the German subsidiary had carryforward tax losses of approximately \$1,200, which may be carried forward and offset against taxable income in the future for an indefinite period.

## Notes to Consolidated Financial Statements

### d. Final tax assessments:

A.V.T. Ltd. has received final tax assessments in Israel through 2008.

### e. Deferred income taxes:

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. As of December 31, 2010, 2009 and 2008, the Company's deferred taxes were in respect of the following:

	December 31,		
	2010	2009	2008
Deferred tax assets:			
Net operating loss carryforwards	\$3,240	\$2,580	\$2,463
Different amortization rates of intangible assets	2,092	2,204	1,565
Reserves and allowances	1,814	2,025	3,023
<b>Total deferred tax assets</b>	<b>7,146</b>	<b>6,809</b>	<b>7,051</b>
Deferred tax liability:			
Different depreciation rates of property and equipment	(60)	(93)	(141)
<b>Total deferred tax liability</b>	<b>(60)</b>	<b>(93)</b>	<b>(141)</b>
Net deferred tax asset before valuation allowance	7,086	6,716	6,910
Valuation allowance	(7,086)	(6,716)	(5,250)
<b>Net deferred tax asset</b>	<b>\$-</b>	<b>\$-</b>	<b>\$1,660</b>

### f. Loss before taxes on income consists of the following:

	Year ended December 31,		
	2010	2009	2008
Domestic	\$1,250	\$(3,030)	\$(2,617)
Foreign	(1,445)	(5,949)	(22,505)
	\$(195)	\$(8,979)	\$(25,122)

## Notes to Consolidated Financial Statements

### g. Taxes on income (tax benefit) are comprised as follows:

	Year ended December 31,		
	2010	2009	2008
Current	\$(756)	\$67	\$29
Deferred	-	1,660	-
	\$(756)	\$1,727	\$29
Domestic:			
Current	\$(814)	\$-	\$286
Deferred	-	1,660	(628)
	\$(814)	\$1,660	\$(342)
Foreign:			
Current	\$58	\$67	\$(257)
Deferred	-	-	628
	\$58	\$67	\$371

### h. Reconciliation of the theoretical tax expense:

	Year ended December 31,		
	2010	2009	2008
Loss before taxes on income	\$(195)	\$(8,979)	\$(25,122)
Statutory tax rate	25%	26%	27%
Theoretical tax at statutory tax rate	\$(49)	\$(2,335)	\$(6,783)
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation allowance was provided	433	1,101	686
Utilization of carryforward losses for which valuation allowance was provided in prior year	(430)	-	(159)
Tax adjustment in respect of "Approved Enterprise" status	-	-	(371)
Tax adjustment in respect of foreign subsidiaries different tax rates	(225)	(804)	(2,768)
Stock-based compensation expense	164	205	265
Non-deductible expenses	114	162	618
Impairment of goodwill and intangible assets	-	1,769	8,171
Valuation allowance for previously recognized deferred tax asset	-	1,660	629
Reductions of uncertain tax positions relating to a			
settlement with the tax authorities	(814)	-	-
Other	50	(31)	(259)
<b>Actual tax expense (benefit)</b>	<b>\$(756)</b>	<b>\$1,727</b>	<b>\$29</b>

## Notes to Consolidated Financial Statements

**i.** The balances at December 31, 2010 and 2009, include a liability for unrecognized tax benefits of \$747 and \$1,895, respectively, with respect to the eligibility of certain profits to reduced tax rates under the Company's Approved Enterprise programs, taxation of certain of the Company's income under foreign jurisdictions as well as certain limitations of the utilization of carryforward losses. The Company recognized \$115 and \$86, for the years ended December 31, 2010 and 2009, respectively, as interest accrued and rate differences related to unrecognized tax benefits as tax expense. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2010	2009
Balance at beginning of period	\$1,895	\$1,895
Additions for tax positions of prior years	115	86
Reductions relating to settlements with the tax authorities	(1,263)	-
Reductions for tax positions of prior years	-	(86)
Balance at end of period	\$747	\$1,895

The Company and its subsidiaries are routinely examined by various taxing authorities. The Company's tax year 2009 remain subject to examination by the Israeli Tax Authorities. The U.S. subsidiaries tax years 2004 through 2008 remain subject to examination by the IRS for U.S. federal tax purposes. Also during 2010, the Israeli tax authorities completed its examination for the years 2006 through 2008 resulting in a settlement for those years. As a result of the settlement, the Company paid \$341 and released certain tax reserves during the year ended December 31, 2010. There are tax years which remain subject to examination in various other jurisdictions that are not material to the Company's financial statements.

## 10. Share Capital

### a. General:

Ordinary shares confer upon their holders the right to receive notice to participate and vote in general meetings of the Company, and the right to receive dividends if declared.

The Company's board of directors has determined that it will not distribute any amounts of its undistributed tax exempt income as dividend.

## Notes to Consolidated Financial Statements

**b.** On March 17, 2003, the Company announced that its Board of Directors has decided to make a tender offer to all shareholders and holders of vested options to acquire up to one third of all shares, pro rata to the respective share of the shareholders and option holders, at a price of \$8.5 per share. As a result of the tender offer, the Company purchased 1,890,752 shares at a cost of \$15,933, out of which a total of 298,220 treasury shares were issued to employees until December 31, 2010 as result of exercise of options made by employees. As of December 31, 2010 and 2009, the Company is holding 969,532 and 976,549 treasury shares, respectively.

### c. Stock option plans:

Under the 2003 Stock Option Plans, the Company is authorized to grant options to purchase Ordinary shares to its Israeli employees, non-employees directors and non-employees consultants. Under the 1999 U.S. Option Plan and the Global Plan, the Company is authorized to grant stock options to non-Israeli employees, officers and non-employees consultants. The plans authorize the grant of options to purchase up to 2,096,050 Ordinary shares.

Options granted under the four plans expire between six to ten years from the date of grant or upon termination of the option's employment or other relationship with the Company. The options generally vest over three to four years. Any options that are cancelled or forfeited before expiration become available for future grants.

As of December 31, 2010, 166,703 options are available for future grants.

## Notes to Consolidated Financial Statements

A summary of the stock option activities in 2010 is as follows:

	Amount	Weighted average exercise price	Weighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at January 1, 2010	582,317	4.34		
Granted	115,000	3.92		
Exercised	(7,017)	0.00		
Forfeited	(31,250)	7.57		
Outstanding at December 31, 2010	659,050	4.16	4.49	*) 723
Vested and expected to vest at December 31, 2010	580,380	4.25	4.48	***) 648
Exercisable at December 31, 2010	295,329	4.89	4.19	***) 314

\*) Represents intrinsic value of 459,775 outstanding options that are in-the-money as of December 31, 2010. The remaining 199,275 outstanding options are out of the money as of December 31, 2010 and their intrinsic value was considered as zero.

\*\*\*) Represents intrinsic value of 386,581 vested and expected to vest options that are in-the-money as of December 31, 2010. The remaining 193,799 vested and expected to vest options are out of the money as of December 31, 2010 and their intrinsic value was considered as zero.

\*\*\*) Represents intrinsic value of 128,679 exercisable options that are in-the-money as of December 31, 2010. The remaining 166,650 exercisable options are out of the money as of December 31, 2010 and their intrinsic value was considered as zero.

As of December 31, 2010, \$458 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.43 years.

The weighted-average grant-date fair value of options granted during the years 2010, 2009 and 2008 was \$1.85, \$1.51, and \$4.69, respectively. The total intrinsic value of options exercised during the years ended December 31, 2010, 2009 and 2008, was \$27, \$54 and \$326, respectively.

## Notes to Consolidated Financial Statements

Following are the outstanding options by exercise price as of December 31, 2010:

Outstanding		Exercisable				
Exercise price	Number exercisable	Wighted average remaining contractual life (years)	Wighted average exercise price	Number exercisable	Wighted average remaining contractual life (years)	Wighted average exercise price
0	67,500	5.70	-	50,000	5.36	-
2.12-3.00	270,275	4.37	2.72	78,679	4.68	2.84
3.05-4.78	197,275	4.16	4.05	60,275	2.49	4.35
6.84-8.00	79,500	3.50	7.22	79,500	3.50	7.22
12.58-15.45	44,500	6.60	14.22	26,875	6.42	14.30
	659,050	4.49	4.16	295,329	4.19	4.89

The following table sets forth the total stock-based compensation expense resulting from stock options:

### 11. Earnings Per Share

The following table sets forth the computation of basic and diluted Earnings Per Share ("EPS"):

	Year ended December 31,		
	2010	2009	2008
Net income (loss)	\$561	\$(10,706)	\$(25,151)
Weighted average Ordinary shares outstanding - Basic EPS	5,324,547	5,310,677	5,290,919
Dilutive effect:			
Employee stock options	86,981	-	-
Weighted average Ordinary shares outstanding - Diluted EPS	5,411,528	5,310,677	5,290,919
Basic earnings (loss) per share	0.11	(2.02)	(4.75)
Diluted earnings (loss) per share	0.10	(2.02)	(4.75)

## Notes to Consolidated Financial Statements

The total numbers of options excluded from the calculation of diluted net earnings per share, as they would have an anti-dilutive effect were 572,069 and 582,317 and 446,955 for the years ended December 31, 2010, 2009 and 2008, respectively.

### 12. Segment Information

The Company operates in one reporting segment; see Note 1 for a brief description of the Company's business.

Operations in Israel include research and development, marketing and sales. Operations in the U.S. and Europe include marketing, support and sales. The following is a summary of operations within geographic areas:

	Year ended December 31,		
	2010	2009	2008
Revenues based on the customer's location:			
United States	\$18,040	\$17,686	\$25,215
Europe (other than Germany)	13,543	11,068	16,524
Germany	3,462	2,852	7,827
Other	4,636	5,625	10,754
	\$39,681	\$37,231	\$60,320

	December 31,	
	2010	2009
Long-lived assets by geographic location:		
Israel	\$870	\$985
Europe	16	12
United States	550	754
	\$1,436	\$1,751

## Notes to Consolidated Financial Statements

### 13. Selected Statements of Operations Data

Financial expense, net:

	Year ended December 31,		
	2010	2009	2008
Financial income:			
Interest	\$50	\$17	\$286
Foreign currency translation differences, net	-	104	-
	50	121	286
Financial expenses			
Bank charges	148	184	210
Foreign currency translation differences, net	453	-	1,315
	601	184	1,525
	\$(551)	\$(63)	\$(1,239)

### 14. Subsequent Event

On January 6, 2011, an amendment to the Law for the Encouragement of Capital Investments, 1959 ("the Law") was enacted. According to the amendment, the benefit tracks in the Law were modified and a flat tax rate may apply to the Company's entire preferred income. The Company may make a non revocable election to apply the amendment and thereafter it will be subject to the amended tax rates that are: 2011 and 2012 - 15%, 2013 and 2014 - 12.5% and in 2015 and thereafter - 12%.

The Company is examining the possible effect of the amendment on the financial statements, if at all, and at this time has not yet decided whether to apply the amendment.

# Report of the Board of Directors

## Dear Shareholders,

During 2010 we performed our duties as outlined by the law and according to corporate governance prevailing in the State of Israel. As part of our duties, we have supervised the ongoing conduct of the company's management and were informed, at the Board of Directors' meetings, of business developments and material corporate issues related to the company and its subsidiaries.

As of December 31, 2010, the Board of Directors consisted of 6 members, including 2 external Directors. Board meetings focused on strategies for profitable organic growth, opening up of new markets' selling opportunities and on business development in emerging markets which have growth potential.

In compliance with the Israel Companies Law, the Board of Directors has an Audit Committee, which consists of 3 Board members, the 2 external directors and an additional director who is neither an officer of the company nor the chairman (as required by Israeli Law). The committee is responsible, among other issues, for the review of the financial statements, the accounting standards applicable to the company, and financial presentation of issues subject to management judgment and to compensation issues related to directors and officers. The committee is also responsible for the nomination of the company's Internal Auditor, the determination of his annual audit plan, review of his final reports, and the supervision of his recommendations' implementation. During 2010, we held 8 Board of Directors meetings, 4 Audit Committee meetings, and various Board committee meetings. All Board of Directors meetings consisted of a legal quorum of more than four attendees and the Audit Committee was attended by at least 2 Directors.

The management of the company prepared the annual consolidated Financial Statements in accordance with US GAAP. The consolidated balance sheets of the company and its subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in shareholders' equity and cash flow for each of the three years ended December 31, 2010, were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee meeting held on February 7, 2011 and Board of Directors meetings held on February 9, 2011 and April 6, 2011, attended by the company's auditors and legal counsel, we discussed the 2010 Financial Statements and resolved to approve the Annual Report. We have further resolved to present the Financial Statements for review and discussion at the Annual General Meeting of Shareholders.

I would like to thank our customers for their business and for their continued confidence in AVT and to our employees, partners and suppliers for their hard work and contribution to our growth and success.

Hod Hasharon, April 6, 2010



Yeoshua Agassi  
Chairman

# Members of the Board of Directors

## Yeoshua Agassi Chairman of the Board of Directors

Mr. Agassi has served as CEO & President of Scitex Corporation Ltd from 2001 until 2003, In parallel Mr. Agassi has served as Executive Vice President of Clal Industries and Investments Ltd. one of Israel's largest investment and holding companies in Israel. During 2000, Mr. Agassi served as General Manager of Leumicard Ltd., one of Israel's leading credit card services owned by Bank Leumi. From 1993 until 1998, Mr. Agassi served as the General Manager of Israeli Direct Insurance Company (IDI), a direct insurer located in Tel Aviv, which he co-founded in 1993. Mr. Agassi has earned an MBA in Marketing from Bar Ilan University, as well as a B.A. in Economics from Tel Aviv University. Currently Mr. Agassi is the chairman of the board of two privately owned companies.

## Nurit Nahum Director

Mrs. Nahum joined AVT's Board of Directors in 2008. Currently Mrs. Nahum is the CEO of Ronin Investment Managing Company Ltd., a privately owned investment company. Prior to joining Ronin, she was the Chairman of the Board of Plastnir Flexible Plastic Packaging; a board member of Israel Cold Storage & Supply Company and a board member of Elran Holdings Ltd. Previous to that, Nurit Nahum was Vice President of Economic and Business Development at Packer Plada Ltd., and held several positions at Price Waterhouse Coopers, Israel, also serving as the CEO of the business consulting unit. Mrs. Nahum holds an MBA degree in Finance and International Marketing from the Tel-Aviv University.

## Shlomo Amir CEO

Mr. Amir joined AVT in 1997. Before joining AVT, Mr. Amir served for two years as vice president of marketing and sales at Nice Systems Ltd., an Israel-based international high-tech company in the area of digital voice logging. Previously, Mr. Amir worked for 12 years at Scitex Corporation, an Israeli high-tech company serving the pre-press industry. In his last nine years with Scitex he was based in its European subsidiary in Brussels, serving in various marketing, sales and management positions. Mr. Amir holds the degrees of B.Sc. in Mathematics and Computer Science from Tel Aviv University, Israel, and an MBA from Boston University, Massachusetts, United States.

## Ytzhak Edelman Director

Mr. Edelman joined AVT Board of Directors as of December 2010. Mr. Edelman currently serves as a Director in both Boards of Directors of Bezeq, The Israel Telecommunication Corp., Limited and Leumi Partners Underwriters Ltd. Prior to that, Mr. Edelman served as a Chief Financial Officer and Vice President at Ness Technologies, Inc., and as Chief Financial Officer at Cellcom Israel Ltd. Mr. Edelman holds a BA in Finance and Economics from Tel-Aviv University, and is a graduate of the General Manager Program at Harvard Business School.

## Members of the Board of Directors

[www.avt-inc.com](http://www.avt-inc.com)

### **Arie Weisberg** Director

Mr. Weisberg joined AVT Board of Directors as of December 2010. Mr. Weisberg currently serves as a Director in the Board of Directors at Orbotech Ltd., and as an independent advisor. Prior to that, Mr. Weisberg held several executive positions, most recently as the President and Chief Operating Officer of Orbotech, and as the Chairman of the Board at Orbograph and Frontline. Mr. Weisberg holds a BSc. in Agriculture Economics from the Hebrew University, Jerusalem.

### **Ofer Neeman** Director

Ofer Neeman was born and raised in Kibbutz Yechiam in the Western Galilee, Israel. He joined Evergreen in 1996 as CEO and President of Evergreen, a leading private equity firm in Israel. In 1998 became c-owner together with founder Jacob Burak. In 2005 management of Evergreen was handed over to the younger generation of managers and partners. Ofer is Chairman of Beterem (Safe Kids Israel) as well as a member of the Advisory Board of The School of Government of Tel Aviv University. Ofer holds a BA in Accounting and Economics from Tel Aviv University and is a graduate of the Harvard Business School executive program.

### **AVT LTD.**

6 Hanagar St., P.O.B 7295, Hod-Hasharon 45241, Israel  
Tel. +972 9 761 4444 / Fax. +972 9 761 4555

### **AVT GmbH**

Donnersbergerstrasse 22a, 80634 Munich, Germany  
Tel. +49 89 216 68 079 / Fax. +49 89 216 68166

### **AVT EMEA**

Mechelsesteenweg 132, B-2860 Sint-Katelijne-Waver, Belgium  
Tel. +32 (0) 15 56 03 80 / Fax. +32 (0) 15 55 39 97

### **AVT China**

AVT Ltd Shanghai Representative Office,  
Room 808B, Building 555, No. 555 Nanjing Xilu, Shanghai 200041, China  
Tel. +86 21 6258 2367 / Fax. +86 21 62582359

### **AVT INC.**

900 Circle 75 Parkway, Suite 175, Atlanta, GA 30339, USA  
Tel. +1 770 541 9780 / Fax. +1 770 541 9342

### **GMI INC.**

1655 Science Place, Rockwall, TX 75032, USA  
Tel. + 1 972 290 3200 / Fax. + 1 972 722 1128

AVT and PrintVision are trademarks owned by AVT Ltd. AVT reserves the right to make changes to the specifications without prior notification.



