MAGAL SECURITY SYSTEMS LTD
Form 20-F
July 13, 2009

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 20-F

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report ....

Commission file number: 0-21388

MAGAL SECURITY SYSTEMS LTD.

(Exact Name of Registrant as specified in its charter
and translation of Registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

P.O. Box 70, Industrial Zone, Yehud 56100, Israel
(Address of principal executive offices)

+972-3-5391444 (phone), +972-3-5366245 (fax)
P.O. Box 70, Industrial Zone, Yehud 56100, Israel
(Name, Telephone, E-mail and/or Facsimile number of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 0.1 Par Value	**NASDAQ Global Market**

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary Shares, par value NIS 1.0 per share..........10,396,548
(as of December 31, 2008)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP x	International Financial Reporting Standards as issued by the International Accounting Standards Board o	Other o

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

This Annual Report on Form 20-F is incorporated by reference into the Registrant s Registration Statements on Form S-8, File Nos. 333-96929 and 333-127340.

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INTRODUCTION

Magal Security Systems Ltd. is a leading international solutions provider of safety, security, site management and intelligence gathering and compilation. Based on 35 years of experience and interaction with customers, we have developed a unique set of solutions and products, optimized for perimeter, outdoor and general security applications. Our turnkey solutions are typically integrated and managed by sophisticated modular command and control software, supported by expert systems for real-time decision support. Our portfolio of critical infrastructure protection and site protection technologies includes a variety of smart barriers and fences, fence mounted detectors, virtual gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. A world innovator in the development of closed circuit television, or CCTV, intelligence video analysis and motion detection technology for outdoor operation, we have successfully installed customized solutions and products in more than 75 countries worldwide. Our ordinary shares are traded on the NASDAQ Global Market and on the Tel Aviv Stock Exchange under the symbol MAGS. Our address on the Internet is www.magal-ssl.com. The information on our website is not incorporated by reference into this annual report. As used in this annual report, the terms we, us and our mean Magal Security Systems Ltd. and its subsidiaries, unless otherwise indicated.

We have trademark rights in the United States and other national jurisdictions arising out of our trademark registrations, applications, and/or use of the following trademarks and service marks: SENSTAR-STELLAR logo, the S logos, SENSTAR-STELLAR, SENSTAR-STELLAR (and design) SENSTAR, STELLAR, STELLAR SYSTEMS, STELLAR SYSTEMS (and design), PANTHER, GUIDAR, REPELS, SENNET, PERIMITRAX, INTELLI-FLEX, INTELLI-FIELD, X-FIELD, OMNITRAX, STARLED, STARNET, FRONTLINE, E-FIELD, H-FIELD, E-FLEX, ARMOURFLEX, SIMPL, CROSSFIRE, ECHOCHECK, FLASH, FLARE, SENTRAX, OMNITRAX, XFIELD, DTR, DreamBox, Magal logo and all other marks used to identify particular products and services associated with our businesses. Any other trademarks and trade names appearing in this annual report are owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to dollars or $ are to U.S. dollars and all references in this annual report to NIS are to New Israeli Shekels. The representative exchange rate between the NIS and the dollar as published by the Bank of Israel on June 30, 2009 was NIS 3.919 per $1.00.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

This Annual Report on Form 20-F contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward-looking statements usually include the verbs, anticipates, believes, estimates, expects, intends, plans, projects, understands verbs suggesting uncertainty. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. We have attempted to identify additional significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section which appears in Item 3.D Key Information -Risk Factors.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Consolidated Financial Data.

The following selected consolidated financial data for and as of the five years ended December 31, 2008 are derived from our audited consolidated financial statements which have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2006 and 2007 and for each of the years ended December 31, 2006, 2007 and 2008 from our consolidated financial statements set forth elsewhere in this annual report that have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2004, 2005 and 2006 and for each of the years ended December 31, 2004 and 2005 from our audited consolidated financial statements not included in this annual report. The selected consolidated financial data set forth below should be read in conjunction with and are qualified by reference to Item 5 Operating and Financial Review and Prospects and our audited consolidated financial statements and notes thereto included elsewhere in this annual report.

	Year Ended December 31,				
	2004(1)	2005	2006	2007(*)	2008
	(in thousands except per share data)				
Consolidated Statement of Operations Data:					
Revenues	$ 58,408	$ 58,385	$ 63,600	$ 72,375	$ 70,355
Cost of revenues	30,532	36,658	37,236	43,510	49,205
Gross profit	27,876	21,727	26,364	28,865	21,150
Operating expenses:					
Research and development, net	4,683	5,265	5,378	5,764	6,195
Selling and marketing, net	11,923	12,385	11,603	12,930	17,179
General and administrative	4,767	4,965	5,547	6,561	10,888
Impairment of goodwill and other intangible assets	-	-	-	-	12,887
Post employment and termination benefits	-	-	-	904	2,582
Award granted by principal shareholders	1,172	-	-	-	-
Total operating expenses	22,545	22,615	22,528	26,159	49,731
Operating income (loss)	5,331	(888)	3,836	2,706	(28,581)
Financial expenses, net	774	813	864	2,137	2,006
Income (loss) before income taxes	4,557	(1,701)	2,972	569	(30,587)
Income taxes (tax benefit)	1,574	(28)	943	373	1,618
Income (loss) from continuing operations	2,983	(1,673)	2,029	196	(32,205)
Income (loss) from discontinued operations, net	(1,930)	(1,538)	(1,219)	1,686	(397)
Net income (loss)	$ 1,053	$ (3,211)	$ 810	$ 1,882	$ (32,602)
Basic net earnings (loss) per share from					

	Year Ended December 31,				
continuing operations	$ 0.35	$ (0.17)	$ 0.20	$ 0.02	$ (3.11)
Basic net earnings (loss)per share from discontinued operations	(0.23)	(0.15)	(0.12)	0.16	(0.03)
Basic net earnings (loss) per share	$ 0.12	$ (0.32)	$ 0.08	$ 0.18	$ (3.14)
Diluted net earnings (loss) per share from continuing operations	$ 0.35	$ (0.17)	$ 0.20	$ 0.02	$ (3.11)
Diluted net earnings (loss)per share from discontinued operations	$ (0.23)	$ (0.15)	$ (0.12)	$ 0.16	$ (0.03)
Diluted net earnings (loss) per share	$ 0.12	$ (0.32)	$ 0.08	$ 0.18	$ (3.14)
Weighted average number of ordinary shares used in computing basic net earnings per share	8,581	9,883	10,384	10,395	10,397
Weighted average number of ordinary shares used in computing diluted net earnings per share	8,636	9,900	10,442	10,431	10,397

(1) In July 2004, our board of directors declared a share dividend distribution of 5.0%, which was paid to our shareholders in August 2004 as a final dividend for 2003. Per share data for 2004 in the above table has been adjusted to reflect the share dividend.

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	As of December 31,				
	2004	2005	2006	2007(*)	2008
	(in thousands)				
Consolidated Balance Sheets Data:					
Cash and cash equivalents	$ 11,964	$ 10,099	$ 4,908	$ 9,205	$ 16,835
Short and long-term bank deposits, restricted deposits, marketable securities and escrow deposit	5,994	18,853	22,053	26,972	8,137
Working capital	21,504	35,071	39,884	41,526	16,379
Total assets	77,976	101,842	103,681	126,157	90,537
Short-term bank credit (including current maturities of long-term loans)	17,467	21,715	17,821	20,737	23,995
Long-term bank loans	3,500	1,653	7,399	3,095	2,282
Total shareholders' equity	43,548	56,950	58,150	65,578	30,718

(*) Effective as of September 1, 2007, our consolidated financial statements include those of the European integration company that we acquired in September 2007. In December 2007, we disposed of our U.S. based video monitoring business. Accordingly, the operating results, balance sheet and cash flows relating to the video monitoring operations were presented in our statements of income, balance sheets and cash flows as discontinued operations, and the comparative figures were reclassified for all periods presented.

B. Capitalization and Indebtedness.

Not applicable

C. Reasons for the Offer and Use of Proceeds.

Not applicable.

D. Risk Factors.

Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. If any of the following risks actually occurs, our business, prospects, financial condition and results of operations could be harmed. In that case, the value of our ordinary shares could decline, and you could lose all or part of your investment.

Risks Related to Our Business

Recent worldwide economic downturn may adversely affect our customers, which directly impacts our business and results of operations.

Our operations and performance depend on our customers, including those from the governmental sector, having adequate resources to purchase our products. The unprecedented turmoil in the credit markets and the global economic downturn generally adversely impact our customers and potential customers. These economic conditions have continued to deteriorate despite government intervention globally, and may remain volatile and uncertain for the foreseeable future. Customers have altered and may continue to alter their purchasing activities in response to lack of credit, economic uncertainty and concern about the stability of markets in general, and have reduced or delayed purchases of our products. As a result of slow moving inventory due to the global economic slowdown, we may be required in the future to record additional impairment charges relating to the carrying value of our intangible assets, increase our reserves for doubtful accounts and further write-down our tax assets. In addition, the fair value of some of our assets may decrease further as a result of the weak economy and as a result, we may be required to record further impairment charges in the future. If we are unable to adequately respond to changes in demand resulting from deteriorating economic conditions, our financial condition and operating results may be materially adversely affected.

Failure of our European subsidiary to complete projects or to collect revenues derived from such projects may cause us material losses.

Our recently acquired European subsidiary is engaged in turn-key projects in Africa. These projects are executed with the assistance of a local subcontractor. Due to lack of management and financial skills of the subsidiary s employees and to limited physical access to these projects sites, the European subsidiary encountered difficulties in the evaluation of the operating results of these projects during their respective execution periods, as well as in the measurement of the expected costs and resources that will be necessary to complete them. Insufficient managerial oversight by the local subcontractor created additional burdens on the subsidiary s management, affecting its ability to complete these projects. Due to the foregoing reasons and the inherent difficulty in managing projects in Africa, our European subsidiary may encounter difficulties in the collection of the revenues associated with such projects. The difficulties described may also cause delays in the completion of these projects and may result in the imposition of penalties and the extension of warranties. Any such occurrence could have a material adverse effect on our business, financial condition and results of operations.

We depend on large orders from a relatively small number of customers for a substantial portion of our revenues. As a result, our revenues and operating results may vary from quarter to quarter.

We receive large orders from a relatively small number of customers and our revenues and operating results are subject to substantial periodic variations. Individual orders from customers can represent a substantial portion of our revenues in any one period and significant orders by a customer during one period may not be followed by further orders from the same customer in subsequent periods. As a result, our revenues and operating results for a specific quarter may not be indicative of our future performance and quarter-to-quarter comparisons of our operating results may not be meaningful, making it difficult for investors to evaluate our future prospects based on the results of any quarter. In addition, we have a limited order backlog, which makes revenues in any quarter substantially dependent upon orders we deliver in that quarter.

Our revenues depend on government procurement procedures and practices. A substantial decrease in our customers budgets would adversely affect our results of operations.

Our products are primarily sold to governmental agencies, governmental authorities and government-owned companies, many of which have complex and time-consuming procurement procedures. A substantial period of time often elapses from the time we begin marketing a product until we actually sell that product to a particular customer. In addition, our sales to governmental agencies, authorities and companies are directly affected by these customers budgetary constraints and the priority given in their budgets to the procurement of our products. A decrease in governmental funding for our customers budgets would adversely affect our results of operations. This risk is heightened during periods of global economic slowdown.

Accordingly, governmental purchases of our systems, products and services may decline in the future as the governmental purchasing agencies may terminate, reduce or modify contracts or subcontracts if:

their requirements or budgetary constraints change;

they cancel multi-year contracts and related orders if funds become unavailable;

they shift spending priorities into other areas or for other products; and

they adjust contract costs and fees on the basis of audits.

Any such event may have a material adverse affect on us.

The loss of one or more of our key customers would result in a loss of a significant amount of our revenues.

A relatively few customers account for a large percentage of our revenues. For the years ended December 31, 2007 and 2008, one customer accounted for 13.4% and 18.8%, respectively, of our revenues. In addition for the years ended December 31, 2006, 2007 and 2008, revenues generated from sales to the Israeli Ministry of Defense, or MOD, accounted for 33.7%, 13.0% and 8.8%, respectively, of our revenues. The loss of one our more of our key customers without replacement by a customer or customers of similar volume would have a material adverse effect on our financial results.

We have identified a material weakness in our internal control over financial reporting in one of our subsidiaries and cannot assure you that additional material weaknesses will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in material misstatements in our financial statements.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 governing internal controls and procedures for financial reporting, which started in connection with our Annual Report on Form 20-F for the year ended December 31, 2006, have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. Section 404 of the Sarbanes-Oxley Act requires (i) management s annual review and evaluation of our internal control over financial reporting and (ii) an attestation report by our independent registered public accounting firm on the effectiveness of our internal control over financial reporting, in connection with the filing of the Annual Report on Form 20-F for each fiscal year.

Management has identified a material weakness in our internal control over financial reporting in one of our subsidiaries as of December 31, 2008. We may identify additional material weaknesses or significant deficiencies in our internal control over financial reporting in the future. Any failure to maintain or implement required new or improved controls, or any difficulties that may be encountered in their implementation, could result in additional significant deficiencies or material weaknesses or in material misstatements in our financial statements. Any such failure could also adversely affect the results of our management s evaluations and annual auditor reports regarding the effectiveness of our internal control over financial reporting. Failure to maintain or implement effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

We may be adversely affected by our long sales cycles.

We have in the past and expect in the future to experience long time periods between initial sales contacts and the execution of formal contracts for our products and completion of product installations. The cycle from first contact to revenue generation in our business involves, among other things, selling the concept of our technology and products, developing and implementing a pilot program to demonstrate the capabilities and accuracy of our products, negotiating prices and other contract terms, and, finally, installing and implementing our products on a full-scale basis. This cycle entails a substantial period of time, sometimes as much as one or more years, and the lack of revenues during this cycle and the expenses involved in bringing new sales to the point of revenue generation may put a substantial strain on our resources.

Our failure to retain and attract personnel could harm our business, operations and product development efforts.

Our products require sophisticated research and development, marketing and sales and technical customer support. Our success depends on our ability to attract, train and retain qualified research and development, marketing and sales and technical customer support personnel. Competition for personnel in all of these areas is intense and we may not be able to hire sufficient personnel to achieve our goals or support the anticipated growth in our business. If we fail to attract and retain qualified personnel, our business, operations and product development efforts would suffer.

Our financial results may be adversely affected by currency fluctuations.

We sell most of our products in North America, Europe and Israel. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non- U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies. In 2006, 2007 and 2008, the NIS appreciated by approximately 8.2%, 9.0% and 1.1%, respectively, against the U.S. dollar, which had a significant adverse affect on our results of operations. In 2008, the Euro depreciated against the U.S. dollar by 5.3%, while in 2007 and 2006, the Euro appreciated against the U.S. dollar by 11.7% and 11.3%, respectively. In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2008, the Canadian dollar depreciated against the U.S. dollar by approximately 19.7%, while in 2007 and 2006, the Canadian dollar appreciated against the U.S. dollar by 18.4% and 0.4%, respectively.

During the years ended December 31, 2007 and 2008, foreign currency fluctuations had an adverse impact on our results of operations and we recorded foreign exchange losses, net of $792,000 and $246,000, respectively. Our results of operations may be materially adversely affected by currency fluctuations in the future.

If we do not receive Israeli MOD approvals necessary for us to export the products we produce in Israel, our revenues may decrease.

Israel s defense export policy regulates the sale of a number of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy. A license is required to initiate marketing activities. We are also required to obtain a specific export license for any hardware eventually exported from Israel. We may not be able to receive all the required permits and licenses for which we may apply in the future. If we do not receive the required permits for which we apply, our revenues may decrease.

We are subject to laws regulating export of dual use items (items that are typically sold in the commercial market, but that also may be used in the defense market) and defense export control legislation. Additionally, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process. We may not be able to respond quickly and effectively to changing laws and regulations and any failure to comply with such laws and regulations may subject us to significant liability and penalties.

We face risks associated with doing business in international markets.

A large portion of our sales is to markets outside of Israel. For the years ended December 31, 2006, 2007 and 2008, approximately 58.5%, 78.4% and 82.8%, respectively, of our revenues were derived from sales to markets outside of Israel. A key component of our strategy is to continue to expand in such international markets. Our international sales efforts are affected by costs associated with the shipping of our products and risks inherent in doing business in international markets, including:

- different and changing regulatory requirements in the jurisdictions in which we currently operate or may operate in the future;
- fluctuations in foreign currency exchange rates;
- export restrictions, tariffs and other trade barriers;
- difficulties in staffing, managing and supporting foreign operations;
- longer payment cycles;
- difficulties in collecting accounts receivable;
- political and economic changes, hostilities and other disruptions in regions where we currently sell or products or may sell our products in the future; and
- seasonal reductions in business activities.

Negative developments in any of these areas in one or more countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, difficulty in collecting receivables, and a higher cost of doing business, any of which could adversely affect our business, results of operations or financial condition.

We may not be able to implement our growth strategy and may not be able to successfully integrate the operations of acquired businesses into our business.

As part of our growth strategy, we acquire or invest in complementary (including competitive) businesses, products and technologies. We may not be able to consummate any acquisition or investment in the future. In addition, the process of integrating acquired assets into our operations may result in unforeseen operating difficulties and expenditures and may absorb significant management attention that would otherwise be available for the ongoing development of our business.

We may not be able to realize the anticipated benefits of any acquisition. Moreover, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to identifiable intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience. Our failure to successfully integrate the operations of an acquired business or to retain key employees of acquired businesses and integrate and manage our growth may have a material adverse effect on our business, financial conditions, results of operation or prospects.

Our due diligence for acquisitions may not adequately cover all risks.

There may be liabilities or risks that we fail to discover in performing due diligence investigations relating to businesses we have acquired or may acquire in the future. Examples of these liabilities include employee benefit contribution obligations, estimated costs to complete contracts, environmental liabilities or liabilities for infringement of third party intellectual property rights for which we, as a successor owner, may be responsible. Such risks may include changes in estimated costs to complete programs and estimated future revenues. In addition, there may be additional costs relating to acquisitions including, but not limited to, possible purchase price adjustments provided in the applicable acquisition agreement or impairment write downs, if the value of the acquired company were to decrease after the acquisition, or after follow-on investments in that company. In addition, any indemnification covenants we may obtain from the sellers of businesses we acquire may not be applicable, enforceable, collectible or sufficient to fully offset the possible liabilities. Such liabilities could have a material adverse effect on our business, financial condition, results of operations or prospects. In addition, there may be situations in which our management determines, based on market conditions or other applicable considerations, to pursue an acquisition with limited due diligence or without performing any due diligence at all.

Reduction in Israeli government spending or changes in priorities for homeland security products may adversely affect our financial condition, operating results and prospects.

Historically a significant portion of our revenues were from sales to the Israeli government and our financial condition, operating results and prospects would be adversely affected by Israeli. government budget cutbacks or spending reductions. We believe that the success and growth of our business will continue to depend to a certain extent upon our successful procurement of Israeli government contracts. The award of additional contracts from the Israeli government could be adversely affected by spending reductions or budget cutbacks at government agencies that currently use or are likely to use our products. The Israeli government may reduce its expenditures for homeland security or change its defense priorities in the coming years. Our programs may be affected in the future if there is a reduction in Israeli government defense spending for our programs or a change in priorities to products other than ours. Accordingly, changes in government contracting policies, budgetary constraints and delays or changes in the appropriations process could have an adverse affect on our business, financial condition and results of operations.

We may not be able to protect our proprietary technology and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

Our success and ability to compete depend in large part upon protecting our proprietary technology. We have approximately 46 patents and have patent applications pending. We also rely on a combination of trade secret and copyright law and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees, distributors and agents, suppliers and subcontractors. These measures may not be adequate to protect our technology from third-party infringement, and our competitors may independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection to intellectual property than that provided under U.S. or Israeli laws.

We could become subject to litigation regarding intellectual property rights, which could seriously harm our business.

Third parties may in the future assert against us infringement claims or claims asserting that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. In addition, we purchase components for our turnkey products from independent suppliers. Certain of these components contain proprietary intellectual property of these independent suppliers. Third parties may in the future assert claims against our suppliers that such suppliers have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. If such infringement by our suppliers or us were found to exist, a party could seek an injunction preventing the use of their intellectual property. In addition, if an infringement by us were found to exist, we may attempt to acquire a license or right to use such technology or intellectual property. Any infringement claim, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Undetected defects in our products may increase our costs and impair the market acceptance of our products.

The development, enhancement and implementation of our complex systems entail substantial risks of product defects or failures. Despite testing by us and our customers, errors may be found in existing or new products, resulting in delay or loss of revenues, warranty expense, loss of market share or failure to achieve market acceptance, or otherwise adversely affecting our business, financial condition and results of operations. Moreover, the complexities involved in implementing our systems entail additional risks of performance failures. We may encounter substantial delays or other difficulties due to such complexities. Any such occurrence could have a material adverse effect upon our business, financial condition and results of operations. In addition, the potential harm to our reputation that may result from product defects or implementation errors could be damaging to us.

The market for our products is characterized by changing technology, requirements, standards and products, and we may be adversely affected if we do not respond promptly and effectively to these changes.

The market for our products is characterized by evolving technologies, changing industry standards, changing regulatory environments, frequent new product introductions and rapid changes in customer requirements. The introduction of products embodying new technologies and the emergence of new industry standards and practices can render existing products obsolete and unmarketable. Our future success will depend on our ability to enhance our existing products and to develop and introduce, on a timely and cost-effective basis, new products and product features that keep pace with technological developments and emerging industry standards and address the increasingly sophisticated needs of our customers. In the future:

- we may not be successful in developing and marketing new products or product features that respond to technological change or evolving industry standards;

we may experience difficulties that could delay or prevent the successful development, introduction and marketing of these new products and features; or

our new products and product features may not adequately meet the requirements of the marketplace and achieve market acceptance.

If we are unable to respond promptly and effectively to changing technology, we will be unable to compete effectively in the future.

We depend on limited sources for components utilized in our products, and if we are unable to obtain these components when needed, we will experience delays in manufacturing our products and our financial results may be adversely affected.

We acquire most of the components utilized in our products, including our turnkey products and certain services, from a limited number of suppliers and subcontractors. We may not be able to obtain such items from these suppliers and subcontractors in the future, or we may not be able to obtain them on satisfactory terms. Temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results.

We currently benefit from government programs and tax benefits that may be discontinued or reduced in the future, which would increase our future tax expenses.

We currently benefit from grants and tax benefits under Israeli government programs, which require us to meet specified conditions, including, but not limited to, making specified investments from our equity in fixed assets and paying royalties with respect to grants received. In addition, some of these programs restrict our ability to manufacture particular products or transfer particular technology outside of Israel. If we fail to comply with these conditions in the future, the benefits we receive could be cancelled and we could be required to refund any payments previously received under these programs, including any accrued interest, or pay increased taxes or royalties. Such a result would adversely affect our results of operations and financial condition. The Israeli government has reduced the benefits available under these programs in recent years and these programs and benefits may be discontinued or curtailed in the future. If the Israeli government ends these programs and benefits, our business, financial condition, results of operations and net income could be materially adversely affected.

Risks Relating to Our Ordinary Shares

Volatility of the market price of our ordinary shares could adversely affect our shareholders and us.

The market price of our ordinary shares has been, and is likely to be, highly volatile and could be subject to wide fluctuations in response to numerous factors, including the following:

actual or anticipated variations in our quarterly operating results or those of our competitors;

announcements by us or our competitors of technological innovations or new and enhanced products;

developments or disputes concerning proprietary rights;

introduction and adoption of new industry standards;

changes in financial estimates by securities analysts;

market conditions or trends in our industry;

changes in the market valuations of our competitors;

announcements by us or our competitors of significant acquisitions;

entry into strategic partnerships or joint ventures by us or our competitors;

additions or departures of key personnel;

political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events; and

other events or factors in any of the countries in which we do business, including those resulting from war, incidents of terrorism, natural disasters or responses to such events.

In addition, the stock market in general, and the market for Israeli companies and home defense companies in particular, has been highly volatile. Many of these factors are beyond our control and may materially adversely affect the market price of our ordinary shares, regardless of our performance. In the past, following periods of market volatility, shareholders have often instituted securities class action litigation relating to the stock trading and price volatility of the software company in question. If we were involved in any securities litigation, it could result in substantial cost to us to defend and divert resources and the attention of management from our business.

We do not expect to distribute dividends in the foreseeable future.

We currently intend to retain our current and any future earnings to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (as defined by the Israeli Companies Law), provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due, or otherwise upon the permission of the court. In the event cash dividends are declared, such dividends will be paid in NIS. The declaration of dividends is subject to the discretion of our board of directors and would depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment.

Risks Relating to Our Location in Israel

Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Major hostilities between Israel and its neighbors may hinder Israel s international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business. Since September 2000, there has been an increase in unrest and terrorist activity in Israel of varying levels of severity. In recent years, there has been an escalation in violence among Israel, Hamas, Hezbollah, the Palestinian Authority and other groups. There were extensive hostilities along Israel s northern border with Lebanon in the summer of 2006. Since June 2007, when Hamas effectively took control of the Gaza Strip, there have been extensive hostilities along Israel s border with the Gaza Strip. Hamas has launched hundreds of missiles from the Gaza Strip against Israeli population centers, which led to an armed conflict between Israel and Hamas during December 2008 and January 2009. The recent violence has generally taken a toll on Israeli business overseas. Ongoing violence between Israel and the Palestinians as well as tension between Israel and neighboring Syria and Lebanon or Iran may have a material adverse effect on our business, financial conditions and results of operations.

Political relations could limit our ability to sell our services and products or obtain components internationally.

We could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli companies and others doing business with Israel or with Israeli companies. As a result, we are precluded from marketing our products to these countries, companies and organizations. Foreign government defense export policies towards Israel could also make it more difficult for us to obtain the export authorizations necessary for our activities. Also, over the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. Restrictive laws, policies or practices directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

Our results of operations may be negatively affected by the obligation of our personnel to perform reserve military service.

Many of our employees and some of our directors and officers in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company s articles of association, increases in a company s authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

Service and enforcement of legal process on us and our directors and officers may be difficult to obtain.

Service of process upon our directors and officers and the Israeli experts named herein, all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, since substantially all of our assets, all of our directors and officers and the Israeli experts named in this annual report are located outside the United States, any judgment obtained in the United States against us or these individuals or entities may not be collectible within the United States.

There is doubt as to the enforceability of civil liabilities under the Securities Act and the Securities Exchange Act in original actions instituted in Israel. However, subject to certain time limitations and other conditions, Israeli courts may enforce final judgments of United States courts for liquidated amounts in civil matters, including judgments based upon the civil liability provisions of those and similar acts.

As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements. We follow Israeli law and practice instead of NASDAQ rules regarding the director nomination process, compensation of executive officers and the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present.

As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of The NASDAQ Marketplace Rules. We follow Israeli law and practice instead of NASDAQ rules regarding the director nomination process, compensation of executive officers and the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present. As a foreign private issuer listed on the NASDAQ Global Market, we may also follow home country practice with regard to, among other things, the composition of the board of directors and quorum at shareholders meetings. In addition, we may follow home country practice instead of the NASDAQ requirement to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer s home country certifying that the issuer s practices are not prohibited by the home country s laws. In addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ s corporate governance rules.

ITEM 4. Information on the Company

A. History and Development of the Company.

We were incorporated under the laws of the State of Israel on March 27, 1984 under the name Magal Security Systems Ltd. We are a public limited liability company under the Israeli Companies Law, 5739-1999 and operate under this law and associated legislation. Our principal executive offices and primary manufacturing and research and development facilities are located near Tel Aviv, Israel, in the Yehud Industrial Zone. Our mailing address is P.O. Box 70, Industrial Zone, Yehud 56100, Israel and our telephone number is 972-3-539-1444. Our agent for service of process in the United States is Senstar Inc., 13783 Park Center Road, Suite 316, Herndon, Virginia 20171. Our address on the Internet is www.magal-ssl.com. The information on our website is not incorporated by reference into this annual report.

We are a leading international solutions provider of safety, security, site management and intelligence gathering and compilation. Based on 35 years of experience and interaction with customers, we have developed a unique set of solutions and products, optimized for perimeter, outdoor and general security applications. Our turnkey solutions are typically integrated and managed by sophisticated modular command and control software, supported by expert systems for real-time decision support. Our portfolio of critical infrastructure protection and site protection technologies includes a variety of smart barriers and fences, fence mounted detectors, virtual gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. A world innovator in the development of CCTV, intelligence video analysis and motion detection technology for outdoor operation, we have successfully installed customized solutions and products in more than 75 countries worldwide.

Due to the need to reduce cost and operate more efficiently and effectively, we resolved to merge certain activities that were operated out of different locations in North America. As a result, we have merged the manufacturing, product development and technical support function of our California subsidiary with our operations in Ottawa, Canada. All products that are manufactured in the United States through subcontractors will continue to be produced by subcontractors, however the process will be managed out of our facilities in Ottawa, Canada. The sales and marketing activity of our California subsidiary have been moved to and will be managed from our office in Herndon, Virginia, which is in the Washington, D.C. metropolitan area. The transitions described above were completed in June 2009. A small team of seven people are still operating temporarily out of our facility in Fremont, California. Our building in Fremont, California has been put up for sale or for lease.

Recent key personnel changes. On December 31, 2007, the former Chairman of our Board of Directors, Mr. Jacob Even-Ezra, retired from such position and was replaced by Mr. Jacob Perry, who has served as the Chairman of our Board of Directors since January 1, 2008. On November 10, 2008, Mr. Izhar Dekel, our former President and chief executive officer and a former director, resigned from such offices. Mr. Dekel remained with our company for a transition period until February 27, 2009. Mr. Yoav Stern was appointed as our acting President as of November 10, 2008 and as our acting President and chief executive officer as of March 1, 2009, and he served in such positions until May 2009. On June 3, 2009, our Board of Directors appointed Mr. Eitan Livneh as our President and chief executive officer, commencing August 2, 2009. On April 16, 2009, Ms. Lian Goldstein, our former Vice President Finance and chief financial officer, resigned from such office and was replaced by Mr. Zev Morgenstern. On May 4, 2009, Mr. Dany Pizen, our Vice President East European and CIS Marketing retired from such position. On January 1, 2009, Mr. Hagai Katz joined us as Senior Vice President Marketing and Products, General Manager of the Israeli Division and Chief Information Officer. At the same time, Mr. Asaf Even Ezra, previously Executive Vice President Marketing and Sales, assumed the position of Senior Vice President Sales. In December 2008, we also replaced the senior personnel in our research and development department. Mr. Yehonatan Ben Hamozeg was appointed as Senior Vice President Product Development and Projects and Mr. Zvi Dank, formerly our Vice President Research and Development, retired from such position in March 2009.

Capital expenditures. Our capital expenditures for the years ended December 31, 2006, 2007 and 2008 were approximately $906,000, $890,000 and $1.7 million, respectively. These expenditures were principally for the renovation and expansion of our offices and production facilities in Israel, as well as for computers, other machinery, commercial vehicles and equipment. The increase in our capital expenditures in 2008 compared with 2007 is primarily attributable to major renovations at our offices and factory in Israel in 2008 and due to increased capital expenditures attributable to our new European integration company that we acquired in September 2007.

B. Business Overview.

Overview and Strategy

We develop, manufacture, market and sell complex computerized security systems. Our systems are used in more than75 countries to protect sensitive facilities, including national borders, military bases, power plant installations, airports, postal facilities, prisons, industrial locations and municipalities from terrorism, theft and other threats.

Based on 35 years of experience and interaction with customers, we have developed a comprehensive set of solutions and products, optimized for perimeter, outdoor and general security applications. Our turnkey solutions are typically integrated and managed by a single sophisticated modular command and control software, supported by expert systems for real-time decision support. Our portfolio of mission critical infrastructure and site protection technologies includes a variety of smart barriers and fences, fence mounted detectors, virtual gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. We have successfully installed customized solutions and products in more than 75 countries worldwide.

By broadening our product range to include both indoor and outdoor security systems and by developing our security management and control systems and Dreambox all in one CCTV security solution, we offer comprehensive turnkey security solutions that provide a comprehensive security implementation process. This process entails: in-depth threat analysis; determination of the appropriate hardware and software solutions; training sessions for systems operators; and upon customer approval, integration of the required systems into our security management and control systems. We believe that the market for turnkey security solutions presents a significant opportunity. We are emphasizing our ability to offer turnkey solutions in keeping with our objective of becoming a leading provider of comprehensive security solutions.

Our revenues are principally derived from:

- installation of comprehensive security systems for which revenues are generated from long-term fixed price contracts;
- sales of security products; and
- services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts.

Our primary objective is to become a leading international solution provider of safety, security, site management and intelligence gathering and compilation. To achieve this objective, we have implemented a business strategy incorporating the following key elements:

- *Refine and Broaden Product Line*. We have identified the security needs of our customers and intend to enhance our current products and develop new products to meet those needs. We intend to continue to focus on developing new products, expanding the capabilities of existing products and making customized enhancements for specific projects.
- *Enter New Markets and Strengthen Presence in Existing Markets*. We intend to continue to penetrate new geographic markets by various means, including the establishment of alliances with local distributors and international integrators of security systems. We also intend to increase our marketing efforts in our existing markets and to acquire or invest in complementary, including competitive, businesses, products and technologies.

- *Leverage Existing Customer Base; Cross-Market Products*. We believe that we have the capability to offer certain of our customers a comprehensive security package. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. We intend to expand the depth and breadth of our existing customer relationships while initiating similar new relationships

Products and Services

Perimeter Security Systems

Perimeter security systems enable customers to monitor, limit and control access by unauthorized personnel to specific regions or areas. High-end perimeter systems are sophisticated in nature and are used by correctional facilities, military installations, power companies and other high-security installations. We believe that we are a leading provider of security systems and maintenance in this industry.

Our line of perimeter security systems utilizes sophisticated sensor devices to detect and locate intruders and identify the nature of intrusions. Our perimeter security systems have been installed along thousands of kilometers of borders and facility boundaries throughout the world, including more than 600correctional institutions in the United States and correctional institutions in several other countries. In addition, we have installed several hundred kilometers of high security electronic perimeter systems along Israel s borders.

Our line of perimeter security systems consists of the following:

taut wire perimeter intrusion detection systems;

vibration detection systems;

field disturbance sensors;

video analytics and video motion detection systems;

the MTC-1500E and the MSS-1500 thermal and optical cameras;

buried cable sensors; and

copper wire sensors.

Taut Wire Perimeter Intrusion Detection Systems

Our taut wire perimeter systems consist of wire strung at high tension between anchor posts. Sensor posts are located at the middle between anchor posts. These sensor posts contain one or more devices that detect changes in the tension being exerted on and by the taut wires. Any force applied against these wires or released from them (such as by cutting) that is not within the parameters designed into the sensors themselves or programmed into the central control units, automatically triggers an alarm. We use taut wire perimeter systems as both an integral component of intruder detection systems and as a physical barrier to infiltration.

Our sealed sensors are not affected by radio frequency interference, climatic or atmospheric conditions, or electrical transients from power lines or passing vehicles. The sensors self-adjust to, or remain unaffected by, extreme temperature variations, minor soil movements and other similar environmental changes that might trigger false alarms in less sophisticated systems. Our taut wire perimeter systems are designed to discriminate automatically between fence tension changes typically caused by small animals or violent weather and forces more typically exerted by a human intruder.

Our taut wire perimeter systems offer customers a wide range of installation options. Sensor posts can be as far as 200 feet apart, with relatively inexpensive ordinary fence anchor posts between them. These systems may stand alone, be mounted on a variety of fence posts or added to an existing wall or other structure, or mounted on short posts, with or without outriggers.

Taut wire perimeter systems have been approved by various Israeli and U.S. security and military authorities. We have installed several hundred kilometers of these perimeter systems along Israel s borders to assist in preventing unauthorized entry and infiltration. Our taut wire perimeter systems are sold for approximately $50-$150 per meter.

Vibration Detection Systems

We offer various types of vibration detection systems. While less sensitive than taut wire installations, the adaptability of these systems to a wide range of pre-existing barrier structures makes these products viable alternatives for cost-conscious customers. Our vibration detection devices are most effective when installed on common metal fabric perimeter systems, such as chain link or welded mesh. In our BARRICADE 500 system, pairs of electro-mechanical sensors are attached to fence panels three meters apart on any of several common types of fence structures. Once attached to the fence, each sensor detects vibrations in the underlying structures. The sensor system s built-in electro-mechanical filtering combines with system input from a weather sensor to minimize the rate of false alarms from wind, hail or other sources of nuisance vibrations.

Intelli-FLEX, Intelli-FIBER and fence protection systems, or FPS, microprocessor-based triboelectric and electric cable fence sensors are vibration sensitive transducers. These systems detect any attempt to cut, climb or penetrate the fence and have microphonic properties. The microphonic feature permits audio to be used for low-cost alarm assessment, providing users with an additional tool for determining the nature of an attempted intrusion. Our vibration detection system is sold for between $9-$60 per meter.

Field Disturbance Sensors

We offer a number of types of field disturbance sensors that detect intrusions before the intruder touches the sensor. Our line of field disturbance sensors consists of the following:

The Intelli-Field volumetric electronic field disturbance sensor can be installed outdoors on perimeter systems, buildings or as free-standing units. The Intelli-Field system is sold for approximately $95-$160 per meter. Omnitrax is a fifth generation, covert outdoor perimeter security intrusion detection sensor that generates an invisible radar detection field around buried sensor cables. An alarm is emitted and the exact location identified within one meter if an intruder disturbs the field. Targets are detected by their conductivity, size and movement and the digital processor is able to filter out common alarms caused by environmental conditions and small animals. The Omnitrax system is sold for approximately $40-$60 per meter.

X-Field is a terrain following, volumetric sensor that creates an electrostatic field around a set of four or eight parallel field and sense wires. These wires can be mounted on free-standing poles, existing fences, walls or rooftops and will sense changes, via the processor, in the electrostatic field when events such as intruders penetrating through the wires take place. The system s tall, narrow, well contained detection zone allows the sensor to be installed in almost any application and minimizes nuisance alarms caused by nearby moving objects. The X-Field system is sold for approximately $100-$130 per meter.

We have installed high-security taut wire electronic perimeter systems over several hundred kilometers of Israel s borders and have sold a number of our high-security perimeter systems to protect other locations in Israel, including Ben-Gurion International Airport, facilities of Israel Aircraft Industries Ltd., or IAI, and the Israel Electric Company, industrial plants, prisons, refineries, ports and military bases. Outside Israel, our high-security perimeter systems have been purchased to protect various sites, including military installations, airports, ports, refineries, conventional and nuclear power stations, oil tank farms, industrial facilities, storage areas and warehouses, royal palaces and presidential residences in various European countries, North America, South America, Africa and the Far East.

Currently, airport security activities concentrate almost exclusively on screening passengers and luggage within the airport terminal in connection with passenger check-in. We are aware of only a few airports in the world which currently have high-security perimeter protection systems to prevent infiltrators from reaching the airport s grounds from outside. Few of these airports utilize a system manufactured by us. In marketing our high-security perimeter systems, we target authorities responsible for airport security. To date, we have sold and installed perimeter systems at certain airports in Israel, Europe, the United States and the Far East. We are continuing to negotiate with authorities in several other countries to install our perimeter systems around airports. However, we cannot assure you that any revenues will result from these negotiations.

Our high-security perimeter systems offer prison authorities the opportunity to address an escape attempt in real-time, rather than at the next roll call, which may be several hours after the escape. Our high-security perimeter systems have already been installed in prisons in Australia, Europe, Israel, North America, South America and the Far East.

The IDF has tested our perimeter security products along with those of several of our competitors and our system and two competitor s systems were the only systems to be approved for participation in the MOD s bid for perimeter security systems.

Video analytics and video motion detection systems

The DreamBox is a state-of-the-art embedded hardware and software product, which integrates a number of CCTV related applications into one box. The system is designed to be economical, as well as compact to save space, by avoiding the use of a complicated cable installation and integration. It contains 12 different applications, including a digital video and audio recording, video and audio matrix switcher, outdoor and indoor video motion detection, or VMD, system, security management system, or SMS, and a transmission system.

The DreamBox, is sold at a substantially lower price than the cost of the other product applications if sold separately, a factor which positions DreamBox as the leading security solution for all strategic facilities. Its target markets include governmental, institutional and other sensitive facilities, such as airports, train stations, seaports, prisons, casinos and hospitals, all of which require the use of high quality CCTV applications.

We refer to the DreamBox s target market as an add-on market for us, and believe that this product is substantially broadening our target markets. One of the DreamBox s applications has allowed us to enter the field of digital video recording.

MTC-1500E

The MTC-1500E is an integrated thermal/daylight camera designed for strategic sites and secured areas such as borders, airports, seaports, pipelines, refineries, communication centers, prisons, special operations and municipal surveillance. The all-weather sealed unit provides high resolution multi-sensor monitoring, utilizing an electro-optical video system, which combines a micro bolometric thermal camera for night vision and a CCD camera for daylight use. This solution is able to detect human targets from more then 1500 meters under variable lighting, temperature and weather conditions, day or night, from sub-zero to very high temperatures, in rain, dust, sand or fog.

MSS-1500

The MSS-1500 is a rapidly-deployable, flexible, high-definition, surveillance system for use by surveillance and security forces. It monitors situations and detect intrusions and suspicious movements through high-quality optical and thermal cameras having a continuous operating capability of over four hours. The MSS-1500 is a stand-alone system consisting of a remote observation unit, self-sufficient power supply and command center. The system may be set up and be fully deployed in just four minutes. It is a vital resource in special surveillance situations, including criminal investigation, crowd and riot control and border patrol.

Security Management and Control Systems

The deployment of multiple security systems creates the need for a system that can manage and control these systems through a single database. In response to this need, we offer MagNet and Fortis, security management and control systems that integrate the management, control and display of various security systems, both outdoor, such as perimeter security systems, and indoor, such as fire detection, entry monitoring and alarm systems, into a single, real-time database, and support real-time decision making and wide area command and control. These systems were developed to improve the response to real-time security events by sharing video and geographical information between the control center and security personnel acting in the field. Since their introduction, we have sold our security management systems and provided turnkey projects to several customers, including large international companies and international airports.

MagNet Security Management System

MagNet, our security management system, integrates the management, control and display of various security systems into a single, real-time database. MagNet, which is based on computer communications and controlled by a unique server developed by us, converts real-time data received from field units, analyzes that data and transmits operational commands accordingly. It also generates alarms to indicate problems with any connected security system and provides explanations as to the causes of the alarms. MagNet displays video pictures of the alarm source, using an advanced video matrix with a user-friendly interface. The operational commands transmitted by MagNet are routed back to the field units or to operator workstations, which then convert these commands to visual information and allow the system operator to respond and influence the system s operation.

MagNet integrates various detection technologies, including infrared and microwave, and enables multiple operators to simultaneously control the system. It can serve and manage multiple security systems, sensors, detectors and controllers, and is unaffected by the distance between the various system components under its control. MagNet can integrate and control both outdoor security systems and indoor security systems, and its open architecture enables operation with systems manufactured by other manufacturers as well as those manufactured by us. Data can be entered into the MagNet system from anywhere in the world through the Internet, provided appropriate authorization exists. In addition, MagNet s TCP/IP protocol and Ethernet boards, using the Windows NT operating system, allow the system to use a wide range of communications media, such as telephone lines, fiber optics and wireless communication. MagNet operates with, and can provide solutions for, various types of security configurations, as well as adaptations for additional and new security systems.

Fortis Integrated Command and Control System

Fortis, our fully integrated command and control system, supports real-time decision making and wide-area command and control. Fortis reduces the period of time from intruder detection to intruder engagement to a minimum. Fortis was developed to improve the response to real-time security events by sharing video and geographical information between the control center and security personnel acting in the field.

The system creates a unified and interactive intelligence picture drawing data from all sensors, while displaying the movement of security personnel in the field and adding other relevant information, such as video from various sources, auxiliary services and weather conditions. This combined picture, which is continuously updated, is sent by the central command to all security personnel in the command chain, and serves as a unified basis for operational planning and allocation of tasks. Using advanced technology, Fortis provides the security officer with a graphical command tool, which updates the location details and video view of the alerting area, while simultaneously enabling a constant watch over security personnel movements, thus optimizing the operational response.

Fortis target markets include governmental, institutional and large sensitive facilities, such as borders, airports, hospitals, power plants and water sources, as well as large manufacturing facilities requiring real-time control and protection.

Pipeline Security Systems

As of end of 2008, there were an estimated three million miles of unprotected oil and gas pipelines worldwide. Although the need for securing these pipelines has been strongly recognized by the oil and gas industry for years, and in spite of increasing threats since the events of 9/11 and current instability in Iraq and elsewhere in the Middle East, there was no effective solution for securing buried pipes against damage caused by terror, sabotage, theft or other third party threats. We have identified the demand and have implemented a technology aimed at meeting this challenge. PipeGuard, our pipeline security system, provides a solution for securing buried assets and infrastructure, including oil and gas pipelines and buried communication lines such as fiber optic cables.

PipeGuard utilizes an innovative and unique technology to guard buried pipelines, regardless of pipeline length, with the ability to detect potential attack and alert authorities before potential harm or damage occurs. PipeGuard is suitable for all pipes or cables, from existing and operational pipelines, to new pipelines under construction. The system can easily be integrated into a full turnkey security solution, including perimeter protection, ground or air patrol and others.

PipeGuard s target market includes oil and gas companies, owners and operators of pipelines or communication cables and governmental agencies dealing with security and environment. By answering the challenge of securing pipelines, we offer a total security solution for the oil and gas industry from the oil field to the refineries.

In addition, we market and sell PipeGuard to banks, to protect them from underground intrusions. Following a long and thorough market study, we determined that one of the major physical threats that banks worldwide currently face are robberies of valuables contained in safes located below ground by the digging of tunnels beneath the bank s building. PipeGuard has the ability to prevent underground intrusions into bank buildings and break-ins into bank s safes and other secure areas.

PipeGuard combines well proven sensors, geophones, with advanced edge of technology recognition algorithm capabilities based on the analysis of seismic signals, effectively filtering out false alarms. Using state of the art communications technology enables the filtering of signals and transmission of only predefined signals to the control station.

Personal Emergency Location Systems

Our products deliver high reliability personal portable duress alarm systems to protect personnel in correctional facilities. These products identify individuals in distress and can pinpoint the location of the distress signal with an indoor-to-outdoor and floor-to-floor accuracy unmatched by any other product.

Flash Personal Emergency Alarm Systems, or Flash, and Flare Personal Emergency Locating Systems, or Flare, use radio frequency technology to provide a one touch emergency system that is so small it can be worn on a belt. The systems, sold mainly to correctional facilities, consist of transmitters that send distress signals to receivers mounted throughout the building. Receivers relay the signal to a central location indicating someone requires assistance and their location in the building. The systems employ automated testing procedures that help to reduce maintenance costs. The hardware and software was developed and researched in the United States and competes against infrared and ultrasonic technologies.

Our personal alarm system, or PAS, uses an ultrasonic based emergency notification and communication system. The system, sold mainly to correctional facilities, allows individuals moving throughout a facility to quickly indicate their exact location in a crisis situation through a transmitter that is carried by them.

Marketing, Sales and Distribution

We believe that our reputation as a vendor of high-security products in one of the world s most security-conscious countries often provides us and our sales representatives with direct access to senior government and corporate officials in charge of security matters elsewhere.

We also distribute perimeter intrusion detection systems to private corporations. We attempt to initiate contacts with potential customers at trade shows, where we demonstrate our products and distribute promotional materials. After initial discussions, we generally seek to provide potential customers with products on a trial basis or in a small-scale installation. We believe that this affords prospective purchasers an opportunity to assess our products over a sustained period of time under realistic conditions. We have sales offices in the United Kingdom, Germany, Mexico, the United States, China, Romania and Poland.

We have marketing and sales offices located in Herndon, Virginia (in the Washington D.C. metropolitan area), Ottawa, Canada, Cuernavaca, Mexico, the United Kingdom, Germany, China and Israel. These offices serve the growing needs of local, state and federal homeland security requirements. These offices focus exclusively on providing a comprehensive security architecture for perimeter applications, which is comprised of command and control, physical security sensors, and intelligent video. The office hosts a solution center demonstrating several of our advanced sensor solutions for intrusion detection, pipeline infiltration, intelligent video surveillance, multi-sensor command and control, as well as integration of our leading perimeter sensors, with advanced intelligent video for real time decision support on the response to possible intrusions.

Perimeter Intrusion Detection Systems

We generally sell our perimeter intrusion detection systems to distributors and systems integrators for various geographic territories or for specific projects. These distributors and system integrators then resell these products at prices negotiated with their respective customers. In some cases, however, we pay commissions on these third-party sales either to the distributor or to the sales representatives responsible for facilitating the transaction. In addition to marketing activities, some of our distributors and system integrators also provide installation and maintenance services for our products. We currently have over 50 distributors and system integrators who resell these systems. We occasionally use agents to find suitable distributors and pay finders fees to these agents for their services.

Security Management and Control Systems, DreamBox and Turnkey Projects

Our marketing efforts for our security management and control systems, DreamBox and turnkey projects consists of direct contacts with potential customers. We offer the MagNet, Fortis and DreamBox products primarily as part of comprehensive turnkey project solutions or, at the customer s preference, as stand-alone products. We distribute our systems in the United States and Canada through our U.S. and Canadian subsidiaries**.**

Pipeline Security Systems

The target markets for our pipeline security systems include oil and gas companies, owners and operators of pipelines or communication cables and governmental agencies engaged with security and environment issues.

Personal Emergency Location Systems

We market our personal emergency location systems directly to potential customers, mainly correctional facilities in North America.

The following table shows the breakdown of our consolidated revenues for the calendar years 2006, 2007 and 2008 by operating segment:

	Year Ended December 31,

	Year Ended December 31,		
	2006	2007	2008
	(In thousands)		
Perimeter products	$ 47,186	$ 43,781	$ 41,126
Turnkey projects	16,167	28,167	28,977
Other	247	427	252
Total	$ 63,600	$ 72,375	$ 70,355

Customers

The following table shows the geographical breakdown of our consolidated revenues for the calendar years 2006, 2007 and 2008:

	Year Ended December 31,		
	2006	2007	2008
	(In thousands)		
Israel	$ 26,385	$ 15,663	$ 12,097
North America	14,176	14,869	15,648
Europe	9,793	18,342	15,603
South and Latin America	7,456	6,818	4,542
Africa	321	10,879	14,569
Others	5,469	5,804	7,896
Total	$ 63,600	$ 72,375	$ 70,355

For the years ended December 31, 2007 and 2008, one customer accounted for 13.4% and 18.8%, respectively, of our revenues. In addition, for the years ended December 31, 2006, 2007 and 2008, revenues generated from sales to the MOD and IDF, accounted for 33.7%, 13% and 8.8%, respectively, of our revenues. We cannot assure you that the MOD, IDF or any of our other major customers will maintain their volume of business with us or that, if such volume is reduced, other customers generating similar revenues will replace the lost business. The loss of one or more of these existing customers without replacement by a customer or customers of similar volume would have a material adverse effect on our financial results.

Support and Maintenance

Our systems are installed by us or by the customer after appropriate training, depending on the size of the specific project and the location of the customer s facilities, as well as on the customer s prior experience with our systems. We generally provide our customers with training on the use and maintenance of our systems. This training is conducted either on-site or at our facilities. In addition, some of our local perimeter security systems customers have signed maintenance contracts with us. For systems installed outside of Israel, maintenance is provided by an independent third party, by distributors or by the end-user. We also provide services, maintenance and support on an as needed basis.

We require distributors of our high-security perimeter systems to purchase a demonstration kit that includes full-scale models of our perimeter products, and to send technical personnel to Israel to participate in courses given by us that focus on the marketing, installation and servicing of our products.

The life expectancy of a high-security perimeter system is approximately ten years. Consequently, many miles of perimeter systems need to be replaced each year.

During 2008, we derived approximately 6.5% of our total revenues from maintenance and services. We generally provide a 12 to 24 months warranty on most of our products.

Research and Development; Royalties

We place considerable emphasis on research and development to improve our existing products and technology and to develop new products and technology. We believe that our future success will depend upon our ability to enhance our existing products and technology and to introduce on a timely basis new commercially viable products and technology addressing the needs of our customers. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. Our development activities are a direct result of the input and guidance we receive from our marketing personnel during our annual meetings with such personnel. In addition, the heads of research and development for each of our development centers discussed below meet annually to identify market needs for new products.

Our research and development expenses during 2006, 2007 and 2008 were approximately $5.5 million, $5.9 million and $6.4 million, respectively, which were offset by Canadian investment tax credits of approximately $162,000 , $160,000 and $234,000, respectively. In addition to our own research and development activities, we also acquire know-how from external sources. We cannot assure you that any of our research and development projects will yield profitable results.

We have the following two development centers, each of which develops products and technologies based on its area of expertise:

In Israel we develop a wide range of products including our taut wire, mechanical vibration, video and high-end SMS systems and PipeGuard; and

In Canada we develop our leaky coax radar, triboelectric and fiber-optic fence sensors, electrostatic volumetric detection, medium to high-end control systems, personal emergency location systems, microwave detection, personal alarm systems and small to medium control systems.

Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor

We have historically sought co-financing of our development projects from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS. We are obligated to pay royalties to the OCS, amounting to 3% to 4.5% of revenues derived from sales of the products funded with these grants and ancillary services, up to an amount equal to 100% of the grants received, linked to the U.S. dollar. All grants received after January 1, 1999 also bear interest equal to the 12 month LIBOR rate. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales, no payment is required. We paid royalties amounting to $79,000, $143,000 and $125,000 in the years ended December 31, 2006, 2007 and 2008, respectively. As of December 31, 2008, our aggregate contingent obligation to the OCS amounted to $1.37 million.

The terms of these grants require that the manufacture of products developed with these grants be performed in Israel and prohibit transferring technology developed with grants without the prior consent of the Research Committee of the OCS. We cannot assure you that, if requested, the OCS will grant such consent. Each application to the OCS is reviewed separately, so we cannot assure you that the Israeli Government will continue to support our research and development.

Manufacturing and Supply

Our manufacturing operations consist of designing and developing our products, fabricating and assembling components and finished products, quality control and final testing. Substantially all of our manufacturing operations are currently performed at our plant in Yehud, Israel and in Ottawa, Canada. See Item 4D., Information on the Company Property, Plants and Equipment.

We acquire most of the components utilized in our products, including our turnkey products, and certain services from a limited number of suppliers and subcontractors. We cannot assure you that we will continue to be able to obtain such items from these suppliers on satisfactory terms. Alternative sources of supply are available, and therefore, we are not dependent upon these suppliers and subcontractors. We also maintain an inventory of systems and spare parts in order to enable us to overcome potential temporary supply shortages until an alternate source of supply is available. Nevertheless, temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results.

Our North American manufacturing operations are located at our facility in Carp, Ontario, Canada and consist of design and development, assembly, final testing and quality control. We use local subcontractors for producing and mounting our printed circuit board assemblies. Prior to May 31, 2009, our U.S. manufacturing operations were located at our facility in Fremont, California, at which time such operations were integrated into our manufacturing operations located in Carp, Ontario, Canada.

Competition

The principal factors affecting competition in the market for security systems are a system s high probability for detection and low probability of false and nuisance alarms. We believe that a manufacturer s reputation for reliable equipment is a major competitive advantage, and that such a reputation will usually be based on the performance of the manufacturer s installed systems. Additional competitive factors include quality of customer support, maintenance and price. We believe that we are competitive with respect to these factors and that we have a good reputation in the markets in which we compete.

Several companies, including Elbit Systems Ltd., Elfar Ltd. and RB-Tec Ltd. in Israel, and Del-Norte Security, Detektion Security Systems Inc., Geoquip Ltd., Herras, Remsdaq, Siemens AG and Southwest Microwave Inc. outside of Israel, produce high-security detection systems.

There are a number of companies that have developed video motion detection systems, including Bosch, Geutebruck GmbH, Ioimage Ltd., Nice Systems Ltd., ObjectVideo Inc., Siemens AG and Xtralis.

We believe that our principal competitors for Dreambox systems are DVTel Inc, Indigo, Nice Systems Ltd. and Verint Systems Inc.

We believe that our principal competitors for security management and control systems and turnkey project offerings include, among others, Dornier, EADS N.V., Elbit Systems Ltd., Honeywell Inc., Lockheed Martin Corporation, Rafael Advanced Defense Systems Ltd, Raytheon Company, Siemens AG, Thales and 4D.

We believe that our principal competitor for the Pipeguard system is an Australian company, Future Fibre Technologies Pty. Ltd.

We believe that our principal competitors for personal emergency location systems are Actall Corp. and Visonic Networks.

Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support, or more extensive business experience than we do. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively.

Intellectual Property Rights

We have approximately 46 patents issued and have patent applications pending in the United States and in several other countries and have obtained licenses to use proprietary technologies developed by third parties. We cannot assure you:

- that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect our technology;
- that any patents issued or licensed to us will not be challenged, invalidated or circumvented; or
- as to the degree or adequacy of protection any patents or patent applications may or will afford.

In addition, we claim proprietary rights in various technologies, know-how, trade secrets and trademarks relating to our principal products and operations. We cannot assure you as to the degree of protection these claims may or will afford. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees and distributors. We cannot assure you as to the degree of protection these contractual measures may or will afford. Although we are not aware that we are infringing upon the intellectual property rights of others, we cannot assure you that an infringement claim will not be asserted against us in the future. We believe that our success is less dependent on the legal protection that our patents and other proprietary rights may or will afford than on the knowledge, ability, experience and technological expertise of our employees. We cannot provide any assurance that we will be able to protect our proprietary technology. The unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively. We could become subject to litigation regarding intellectual property rights, which could seriously harm our business.

We have trademark rights associated with our use of Flash and Intelli-FLEX, and rights obtained by trademark registration for Flare, Perimitrax, Panther, Intelli-FIELD, Senstar, Senstar-Stellar and the Senstar-Stellar logo, Sentrax, Omnitrax, Xfield, DTR ,DreamBox and the Magal logo.

Government Regulations

Israel s defense export policy regulates the sale of a number of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy. A license is required to initiate marketing activities. We are also required to obtain a specific export license for any hardware eventually exported from Israel. We cannot assure you that we will receive all the required permits and licenses for which we may apply in the future.

In 2007, an Israeli law regulating export of dual use items (items that are typically sold in the commercial market, but that also may be used in the defense market) came into effect. In addition, a new Defense Export Control Law was adopted in 2007 and the law s supplemental regulations became effective in February 2008. The new regulations and law enhance enforcement of export control legislation, provide certain exemptions from license requirements and broaden certain areas of licensing, particularly with respect to transfer of technology. In addition, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process.

In addition, antitrust laws and regulations in Israel and other countries often require governmental approvals for transactions that are considered to limit competition. Such transactions may include cooperative agreements for specific programs or areas, as well as mergers and acquisitions.

C. Organizational Structure.

We, or one of our subsidiaries, own 100% of the outstanding capital stock of subsidiaries operating in Canada, the United States, Germany, Mexico, the United Kingdom and Romania.

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D. Property, Plants and Equipment.

Our principal facility in Israel is a two-story 2,533 square meter facility located on a 4,352 square meter parcel in the Yehud Industrial Zone. Approximately 600 square meters are devoted to administrative, marketing and management functions and approximately 700 square meters are used for engineering, system integration and customer service. We use the remaining 1,233 square meters for production management, production operations, including manufacturing, assembly, testing, warehousing, shipping and receiving. In accordance with Israeli law, this parcel of land is still registered in the name of the Israel Land Authority. However, we have received the necessary approval and will be entitled to have title to the property recorded in our name when Israeli authorities subdivide the property into parcels. Such subdivision has been concluded and we are now in the final stages of the recordation. This procedure is a statutory requirement for transferring land ownership in Israel. In 2007, we entered into a lease for a one-story 810 square meter facility located on a 1,820 square meter parcel in the Yehud Industrial Zone for $80,000 per year for use in production and operations. The lease is for a period of 23 years. The products that we manufacture at our facilities in the Yehud Industrial Zone include our taut-wire intrusion detection systems, our vibration detection systems, our video-motion detection systems, MagNet, Fortis, DreamBox, PipeGuard, MTC-1500, MSS-1500 and other perimeter systems.

We own a 33,000 square foot facility in Carp, Ontario, Canada. Approximately 7,000 square feet are devoted to administrative, marketing and management functions and approximately 8,000 square feet are used for engineering, system integration and customer service. We use the remaining 18,000 square feet for production operations, including cable manufacturing, assembly, testing, warehousing, shipping and receiving. We own an additional 182,516 square feet of vacant land adjacent to this property, which is being held for future expansion. We also rent 358,560 square feet of land near this facility for use as an outdoor sensor test and demonstration site for our products including the

Perimitrax/Panther 2000 and Omnitrex buried cable intrusion detection systems, the Intelli-Field electro static detection system, the X-Field volumetric system the Intelli-FLEX microphonic fence detection system, Flash and Flare, and various perimeter monitoring and control systems. The rent for this site is Canadian $2,500 per year under a lease that expires in November 2009, which is renewable for an additional ten years. In addition, we lease a 1,900 square foot facility adjacent to our Carp, Ontario property for Canadian $20,000 per year for use as additional storage and system integration space under a month to month tenancy.

We own a 20,000 square foot facility in Fremont, California that formerly served as a manufacturing and sales facility. We are currently seeking to sell this facility.

We lease 2,793 square feet of office space in Herndon, Virginia at a cost of $5,754 per month. The lease commenced on December 1, 2006 and will terminate on November 30, 2010. We utilize this space, which houses marketing demo rooms, as a sales office for our U.S. subsidiary.

We also lease small offices in Germany, the United Kingdom, Mexico and Romania for our sales and marketing entities. The aggregate annual rent for such offices was approximately $0.2 million in 2008.

We believe that our facilities are suitable and adequate for our current operations and the foreseeable future.

ITEM 4A. Unresolved Staff Comments

None.

ITEM 5. Operating and Financial Review and Prospects

The following discussion of our results of operations and financial condition should be read in conjunction with our consolidated financial statements and the related notes thereto included elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth in Item 3.D. Key Information Risk Factors.

A. Operating Results.

Overview

We develop, manufacture, market and sell complex computerized security systems. Our systems are used in more than 75 countries to protect aircraft, national borders and sensitive facilities, including military bases, power plant installations, airports, postal facilities, prisons and industrial locations from terrorism, theft and other security threats. Our revenues are principally derived from:

- installation of comprehensive security systems for which revenues are generated from long-term fixed price contracts;
- sales of security products; and
- services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts.

Business Challenges/Areas of Focus

Our recently acquired European subsidiary is engaged in turn-key projects in Africa. These projects are executed with the assistance of a local subcontractor. Due to lack of management and financial skills of the subsidiary s employees and to limited physical access to these projects sites, the European subsidiary encountered difficulties in the evaluation of the operating results of these projects during their respective execution periods, as well as in the measurement of the expected costs and resources that will be necessary to complete them. Insufficient managerial oversight by the local subcontractor created additional burdens on the subsidiary s management, affecting its ability to complete these projects. Due to the foregoing reasons and the inherent difficulty in managing projects in Africa, our European subsidiary may encounter difficulties in the collection of the revenues associated with such projects. The difficulties described may also cause delays in the completion of these projects and may result in the imposition of penalties and the extension of warranties. Any such occurrence could have a material adverse effect on our business, financial condition and results of operations.

In addition to the above, our primary business challenges and areas of focus include:

continuing the growth of revenues and profitability of our perimeter security system line of products;

enhancing the introduction and recognition of our new products into the markets;

penetrating into new markets and strengthening our presence in existing markets; and

succeeding in selling our comprehensive turnkey solutions.

Our business is subject to the effects of general global economic conditions. If general economic conditions fail to improve, or if they deteriorate, demand for our products could be adversely affected.

Key Performance Indicators and Sources of Revenues

Our management believes that our revenues, sources of revenues and operating income are among the key performance indicators for our business. Our revenues from our principal lines of business for the three years ended December 31, 2006, 2007 and 2008 were as follows:

	Year Ended December 31,		
	2006	2007	2008
		(In thousands)	
Perimeter products	$ 47,186	$ 43,781	$ 41,126
Turnkey projects	16,167	28,167	28,977
Other	247	427	252
Total	$ 63,600	$ 72,375	$ 70,355

Our operating income (loss) from our principal lines of business for the three years ended December 31, 2006, 2007 and 2008 were as follows:

	Year Ended December 31,		
	2006	2007	2008
		(In thousands)	
Perimeter products	$ 3,070	$ 2,421	$ (9,103)
Turnkey projects	935	506	(19,485)
Other	(138)	(193)	7
Eliminations	(31)	(28)	-

	Year Ended December 31,		
Total	$ 3,836	$ 2,706	$ (28,581)

Cost and Expenses

Cost of revenues. Our cost of revenues for perimeter products consists of component and material costs, direct labor costs, shipping expenses, overhead related to manufacturing and depreciation. Our cost of revenues for turnkey projects consists primarily of component and material costs, subcontractor costs, direct labor costs and overhead related to the turnkey projects. Our cost of revenues for other consists primarily of direct labor costs and material costs relating to our maintenance services.

Our gross margin is affected by the proportion of our revenues generated from perimeter products, turnkey projects and other. Our revenues from perimeter products generally have higher gross margins than our other segments.

Research and development expenses, net. Research and development expenses, net consists primarily of expenses for on-going research and development activities and other related costs.

Selling and marketing expenses. Selling and marketing expenses consist primarily of commission payments, compensation and related expenses of our sales teams, attendance at trade shows and advertising expenses and related costs for facilities and equipment.

General and administrative expenses. Our general and administrative expenses consist primarily of salary and related costs associated with our executive and administrative functions, legal and accounting expenses, allowances for doubtful accounts and bad debts and other miscellaneous expenses. Staff costs include direct salary costs and related costs, such as severance pay, social security and retirement fund contributions, vacation and other pay.

Depreciation and Amortization. The amount of depreciation and amortization attributable to our business segments for the years ended December 31, 2006, 2007 and 2008 are as follows:

	Year Ended December 31,		
	2006	2007	2008
		(In thousands)	
Perimeter products	$ 1,070	$ 1,087	$ 1,078
Turnkey projects	133	966	1,985
Other	-	2	-
Total	$ 1,203	$ 2,055	$ 3,063

Financial Expenses, Net. Financial expenses, net include exchange rate differences arising from changes in the value of monetary assets and monetary liabilities stated in currencies other than the functional currency of each entity, interest charged on loans from banks as well as interest income on our cash and cash equivalents and short term investments.

Tax expense. Tax expense consists of federal, state and local taxes on the income of our business. Our taxable income in Israel was subject to corporate tax at the statutory rate of 29% in 2007 and 27% in 2008. The applicable rate for 2009 is 26% and from 2010 onward the tax rate will be 25%.

Discussion of Critical Accounting Policies

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and the use of different assumptions would likely result in materially different results of operations. Critical accounting policies are those that are both most important to the portrayal of our financial position and results of operations, and require management s most difficult, subjective or complex judgments. Although not all of our significant accounting policies require management to make difficult, subjective or complex judgments or estimates, the following policies and estimates are those that we deem most critical:

Revenue Recognition

We generate our revenues mainly from (i) installation of comprehensive security systems for which revenues are generated from long-term fixed price contracts; (ii) sales of security products; and (iii) services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts.

Revenues from installation of comprehensive security systems are generated from fixed-price contracts, according to which the time between the signing of the contract and the final customer acceptance is usually over one year. Such contracts require significant customization for each customer s specific needs and, as such, revenues from these types of contracts are recognized using contract accounting on a percentage of completion method. Accounting for long-term contracts using the percentage-of-completion method stipulates that revenue and expense are recognized throughout the life of the contract, even though the project is not completed and the purchaser does not have possession of the project. Percentage of completion is calculated based on the Input Method.

Project costs include materials purchased to produce the system, related labor and overhead expenses and subcontractor s costs. The percentage to completion is measured by monitoring costs and efforts devoted using records of actual costs incurred to date in the project compared to the total estimated project requirement, which corresponds to the costs related to earned revenues. The amounts of revenues recognized are based on the total fees under the agreements and the percentage of completion achieved. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

We believe that the use of the percentage of completion method is generally appropriate as we have the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, executed contracts include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of terminations for convenience. In most cases we expect to perform our contractual obligations and our customers are expected to satisfy their obligations under the contract.

Fees are payable upon completion of agreed upon milestones and subject to customer acceptance. Amounts of revenues recognized in advance of contractual billing are recorded as unbilled accounts receivable. The period between most instances of advanced recognition of revenues and the customers billing generally ranges between one to six months. As of December 31, 2008, we had recorded $5.1 million of such unbilled receivables.

Although our basic accounting policy is percentage-of-completion, the completed-contract method is used for certain contracts when we cannot make reasonably dependable estimates for such contracts or if inherent hazards make estimates doubtful. Inherent hazards are conditions and events that do not occur in the normal course of business. Under the completed-contract method, billings and costs are accumulated on the balance sheet under the caption cost incurred on long term contracts while the contract is in progress, but no revenue is recognized until the contract is completed or substantially completed. When revenues and costs are recognized based upon substantial completion of the contract, an accrual is recorded for the estimated remaining costs to be incurred and for the estimated amounts of any unresolved claims or disputes related to the contract that are probable of payment. During 2008, we concluded that the projects in Africa are not typical compared to our other projects and identified inherent hazards related to these projects and a delay in payments from the customer. As a result, we concluded that we cannot make reasonably dependable estimates in order to calculate the percentage of completion of these projects and therefore, in 2008 we began to apply the completed contract method to these projects.

We sell security products to customers according to customers orders without installation work. The customers are not entitled to return the products. Revenues from security product sales are recognized when delivery has occurred, persuasive evidence of an agreement exists, the vendor s fee is fixed or determinable, no further obligation exists and collectibility is probable.

Services and maintenance are performed under either fixed-price based or time-and-materials based contracts. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time-and-materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and for materials. Related revenues from such service contracts are recognized as those services are performed or over the term of the related agreements, provided that evidence of an arrangement has been obtained, fees are fixed and determinable and collectibility is reasonably assured.

Deferred revenue includes unearned amounts under installation services, service contracts and maintenance agreements.

Inventories

Inventories are stated at the lower of cost or market value. We periodically evaluate the quantities on hand relative to historical and projected sales volumes, current and historical selling prices and contractual obligations to maintain certain levels of parts. Based on these evaluations, inventory write-offs are provided to cover risks arising from slow-moving items, discontinued products, excess inventories, market prices lower than cost and adjusted revenue forecasts. Cost is determined as follows:

Raw materials, parts and supplies using the first-in, first-out method.

Work-in-progress and finished products on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

During 2006, 2007 and 2008, we recorded inventory write-offs from continuing operations in the amounts of $760,000, $646,000 and $2.0 million, respectively. Such write-offs were included in cost of revenues.

Income taxes

We account for income taxes in accordance with Financial Accounting Standards Board, or FASB, Statement of Financial Accounting Standard, or SFAS, No. 109, *Accounting for Income Taxes*. This statement 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. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and we must establish a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of income.

At December 31, 2008, we had a deferred tax asset of $269,000 attributable to our subsidiaries and had total estimated available carryforward tax losses of $14.9 million. As of December 31, 2008, we recorded a full valuation allowance on these carryforward tax losses due to the uncertainty of their future realization. As of December 31, 2008, our subsidiaries had estimated total available carryforward tax losses of $9.1 million, which may be used as an offset against future taxable income for periods ranging between 13-20 years. As of December 31, 2008, we recorded a valuation allowance for most of our subsidiaries carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the change in ownership provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Goodwill

Goodwill represents excess of the costs over the net fair value of the assets of the businesses acquired. FASB SFAS No. 142, *Goodwill and Other Intangible Assets* requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized. SFAS 142 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. Fair value is determined using discounted cash flows. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reportable units. During 2005, 2006 and 2007, no impairment losses have been identified.

In 2008, following our annual impairment test of goodwill, we determined that the fair value of our European subsidiary had decreased and that as a result, goodwill in the amount of $8.4 million established in connection with its acquisition in September 2007 had been impaired. Following the 2008 annual impairment test, we also determined that the fair value of our U.S. subsidiary had significantly declined and that as a result, goodwill in the amount of $2.4 million attributable to the subsidiary had been impaired. During 2006 and 2007, no impairment losses were identified.

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Impairment of long lived assets

Our long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of a group of assets may not be recoverable. Recoverability of a group of assets to be held and used is measured by a comparison of the carrying amount of the group of assets to the future undiscounted cash flows expected to be generated by the group of assets. If such group of assets is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the group of assets exceeds their fair value.

During 2006 and 2007, no impairment losses were identified. In 2008, we determined that intangible assets attributable to customers of our European subsidiary in the amount of $1.7 million had been impaired, and as a result, we recorded an impairment charge of $1.7 million attributable to such intangible assets. As of December 31, 2008, following such impairment, we had $2.5 million of intangible assets attributable to customers of our European subsidiary. In addition, impairment of other intangible assets amounted to approximately $350,000 in 2008 attributable to the write-off of certain know-how.

Functional Currency and Financial Statements in U.S. Dollars

We have determined that our reporting currency is the U.S. dollar. As of October 1, 2006, our functional currency changed from the U.S. dollar to NIS. Translation adjustments resulting from translating our financial statements from NIS to the U.S. dollar are reported as a separate component in shareholders equity. As of December 31, 2006, 2007 and 2008 our foreign currency translations totaled $297,000, $2.6 million and $3.3 million, respectively.

Accordingly, as of December 31, 2006, 2007 and 2008, we recorded accumulated foreign currency translation income of approximately $2.3, $5.8 million and $2.5 million, included in our balance sheets as part of accumulated other comprehensive income. As of 2006, 2007 and 2008, foreign currency translation adjustments, net of ($72,000), $3.5 million and ($3.4 million), respectively, were included under accumulated other comprehensive income. Had we determined that the functional currency of our subsidiaries (not including our U.S. subsidiaries) was the U.S. dollar, these gains would have increased our income for each of the years presented.

The first step in the translation process is to identify the functional currency for each entity included in the financial statements. The accounts of each entity are then re-measured in its functional currency. All transaction gains and losses from the re-measurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate.

After the re-measurement process is complete the financial statements are translated into the reporting currency, which is the U.S. dollar, using the current rate method. Equity accounts are translated using historical exchange rates. All other balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders equity in accumulated other comprehensive income (loss).

Concentrations of credit risk

Financial instruments that are potentially subject to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term bank deposits, marketable securities, unbilled accounts receivable, trade receivables, long-term trade receivables and long-term loans.

Of our cash and cash equivalents, marketable securities and short-term and long-term bank deposits at December 31, 2008, $ 14.6 million was invested in major Israeli and U.S. banks and approximately $10.4 million was invested in other banks, mainly with Deutsche Bank, Commerzbank, Leutkircher Bank, Natwest Bank and RBC Royal Bank. Cash and cash equivalents invested in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally these deposits maybe redeemed upon demand and therefore bear low risk. Our marketable securities include investments in U.S. corporate bonds.

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The short-term and long-term trade receivables and the unbilled accounts receivable of our company and our subsidiaries are derived from sales to large and solid organizations located mainly in Israel, the United States, Canada, Mexico and Europe. We perform ongoing credit evaluations of our customers and to date have not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that we have determined to be doubtful of collection and in accordance with an aging policy. In certain circumstances, we may require letters of credit, other collateral or additional guarantees. During the years ended December 31, 2006, 2007 and 2008, we recorded $138,000, ($68,000) and $1,223,000 of expenses (income) related to doubtful accounts, respectively. The increase in expenses related to doubtful accounts in 2008 is primarily a result of the recent global economic downturn, which has had an adverse influence on the liquidity of some of our clients. As of December 31, 2008, our allowance for doubtful accounts amounted to $1.5 million.

A loan granted to a third party entity in connection with a possible future cooperation between us and the entity is secured by a personal guarantee of the beneficial owner of the entity. However, we evaluated the anticipated repayment of the loan and due to anticipated difficulties in implementation of the projects for which the loan was provided, we estimated that 50% of the loan will not be repaid and therefore, recorded a provision of $550,000 attributable to the loan. See Note 11h to the consolidated financial statements.

We have no significant off-balance sheet concentration of credit risks, such as foreign exchange contracts or foreign hedging arrangements, except derivative instruments, which are detailed below.

Derivative instruments

We recognize our derivative instruments as either assets or liabilities in our statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged.

To protect against the change in the forecasted foreign currency cash flows of certain sale arrangements resulting from changes in the exchange rate, from time to time we have entered into forward contracts to hedge portions of our forecasted revenue and unbilled accounts receivable denominated in foreign currencies. We have designated the forward instruments as cash flow hedges for accounting purposes.

For derivative instruments designated as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

On October 1, 2006, we changed our functional currency from the U.S. dollar to NIS. Changes in the fair value of the forward contracts from October 1, 2006 were charged to financial expenses. We recorded $915,000, $666,000 and $291,000 as financial expenses related to forward contracts transactions in 2006, 2007 and 2008, respectively.

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Fair value of financial instruments

The following methods and assumptions were used by us and our subsidiaries in estimating the fair value of our financial instruments:

the carrying amounts of cash and cash equivalents, marketable securities, short-term bank deposits, trade receivables, unbilled accounts receivable, restricted deposits, short-term bank credit and trade payables approximate their fair value due to the short-term maturity of such instruments.

the carrying amount of our long-term trade receivables and long-term bank deposits approximate their fair value. The fair value was estimated using discounted cash flows analysis, based on our investment rates for similar types of investment arrangements.

the carrying amounts of our long-term bank debt are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. As of December 31, 2008, the fair value of our long-term borrowings was approximately $3.0 million, compared to the carrying amount of approximately $3.1 million.

Due to the nature of our customers and products, our revenues are often generated from a relatively small number of large orders. Consequently, individual orders from individual customers can represent a substantial portion of our revenues in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our revenues and operating results may, therefore, vary substantially from period to period. Consequently, we do not believe that our revenues and operating results should necessarily be judged on a quarter-to-quarter comparative basis.

Results of Operations

The following table presents, for the periods indicated, certain financial data expressed as a percentage of revenues:

	Year Ended December 31,		
	2006	**2007**	**2008**
	(in thousands, except per share data)		
Revenues	100.0%	100.0%	100.0%
Cost of revenues	59.0	60.0	69.9
Gross profit	41.0	40.0	30.1
Operating expenses:			
Research and development, net	8.0	8.0	8.8
Selling and marketing, net	18.0	18.0	24.4
General and administrative	9.0	9.0	15.5
Impairment of goodwill and other intangible assets	-	-	18.3
Post employment and termination benefits	-	1.2	3.7
Operating income (loss)	6.0	3.8	(40.6)
Financial expenses, net	(1.0)	(3.0)	(2.9)
Income (loss) before income taxes	5.0	0.8	(43.5)
Income taxes	2.0	0.5	2.3
Income (loss) from continuing operations	3.0	0.3	(45.8)
Income (loss) from discontinued operations, net	(2.0)	2.3	(0.5)
Net income (loss)	1.0%	2.6%	(46.3)%

Year Ended December 31, 2008 Compared with Year Ended December 31, 2007

Revenues. Revenues decreased by 2.8% from $72.4 million in the year ended December 31, 2007 to $70.4 million in the year ended December 31, 2008. Revenues from sales of perimeter systems decreased by 6.1% from $43.8 million in 2007 to $41.1 million in 2008, primarily due to a reduction in sales in Israel and the United States as a result of the global economic slowdown and reduced spending in the U.S. market. Revenues from security turnkey projects increased by 2.9% from $28.2 million in 2007 to $29.0 million in 2008. The increase is primarily attributable to revenues generated by our European integration subsidiary that was acquired in September 2007. This increase was offset in part by the cancellation and postponement of certain projects in Latin America. Other revenues (mostly service revenues and revenues derived from newly developed products) decreased by 41% from $427,000 in the year ended December 31, 2007 to $252,000 in 2008. As revenues attributable to our European subsidiary are now recognized in accordance with the completed-contracts accounting method, we are unable to provide a projection for our revenues in 2009.

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Cost of revenues. Cost of revenues increased by 13.1% from $43.5 million in the year ended December 31, 2007 to $49.2 million in the year ended December 31, 2008. The increase was primarily due to inventory write-off of $2.0 million in 2008 following the cancellation of a project in Latin America and the write-off of certain products and equipment associated with our North American research and development and manufacturing activities, compared to an inventory write-off $646,000 in 2007. In addition, our cost of revenues were adversely impacted by the appreciation of the NIS against the U.S. dollar in 2008, which increased the U.S. dollar value of our NIS denominated expenses by 12.8%. Following its acquisition in September 2007, our new European subsidiary also contributed to the increase in our cost of revenues in 2008. The gross margin of our other subsidiaries was adversely affected by a decrease in their revenues, while their cost of revenues decreased by a smaller percentage due to fixed costs. In 2008, our cost of revenues also include a loss provision attributable to two strategic projects that had a negative gross margin. Cost of revenues as a percentage of revenues increased from 60.1% in 2007 to 69. 9% in 2008, primarily as our new European subsidiary was responsible in 2008 for a greater portion of total revenues than in 2007, while its gross margin is relatively low. Our European subsidiary s gross margin was adversely affected in 2008 by a 10% penalty provision netted from its revenues. Our cost of revenues as a percentage of revenues was also adversely impacted by the appreciation of the NIS against the U.S. dollar in 2008, as the percentage of our cost of revenues denominated in NIS is higher than the percentage of revenues denominated in NIS. As expenses attributable to our European subsidiary are recognized in accordance with the completed-contracts accounting method, we are unable to provide a projection for our cost of revenues in 2009.

Research and development expenses, net. Research and development expenses, net increased by 7.5% from $5.8 million for the year ended December 31, 2007, to $6.2 million for the year ended December 31, 2008. The increase in research and development expenses is primarily attributable to the appreciation of the NIS against the U.S. dollar in 2008 that increased the U.S. dollar value of our NIS denominated expenses by 12.8%. In addition, we invested additional funds in the development and further improvement of our products in 2008, mainly the Fortis integrated command and control system. This increase was offset in part by a decrease in the number of our U.S. subsidiary s research and development staff and by an investment tax credit recorded by our Canadian subsidiary. Research and development expenses, net amounted to 8.0% of revenues in 2007, compared to 8.8% in 2008. The research and development expenses of our Canadian subsidiary are net of investment tax credits, which totaled $160,000 in 2007 and $234,000 in 2008. We anticipate that our research and development expenses will not materially change in 2009.

Selling and marketing expenses, net. Selling and marketing expenses, net increased by 32.9% from $12.9 million for the year ended December 31, 2007 to $17.2 million for the year ended December 31, 2008. The increase in selling and marketing expenses in 2008 was primarily due to the consolidation of our new European subsidiary as of September 2007. In addition, as a result of an increase in our European subsidiary s revenues in 2008, the amortization of customer related intangible assets recorded in 2008 was higher than the amortization of customer related intangible assets recorded in 2007. Sales commission also increased in 2008 due to a different mix of revenues recorded in 2008 compared to 2007. The increase in selling and marketing expenses is also attributable to the appreciation of the NIS against the U.S. dollar in 2008, which increased the U.S. dollar value of our NIS denominated expenses by 12.8%. Selling and marketing expenses, net amounted to 17.9% and 24.4% of revenues in 2007 and 2008, respectively.

General and administrative expenses. General and administrative expenses increased from $6.6 million for the year ended December 31, 2007 to $10.9 million for the year ended December 31, 2008, an increase of 66.0%. The increase in general and administrative expenses in 2008 was primarily due to an increase in our allowance for doubtful accounts of approximately $1.3 million as a result of the recent global economic downturn, which had an adverse affect on the liquidity of some of our customers. In addition, we recorded a provision of $550,000 related to a loan granted to a third party following our determination that the full amount of the loan will not be repaid. In 2008, costs associated with our compliance with the requirements of the Sarbanes-Oxley Act of 2002 (including the implementation of internal controls) and other audit expenses increased by approximately $600,000. The increase in general and administrative expenses is also attributable to the appreciation of the NIS against the U.S. dollar in 2008 that increased the U.S. dollar value of our NIS denominated expenses by 12.8%. General and administrative expenses amounted to 9.1% of revenues in 2007 compared to 15.5% in 2008.

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Impairment of goodwill and other intangible assets. In 2008, following our annual impairment test of goodwill and long lived assets, we determined that the fair value of our European subsidiary acquired in September 2007 had decreased and that as a result, goodwill in the amount of $8.4 million (including $3.3 million attributable to amounts prepaid on account of future earn-out payments) had been impaired. As a result, for the year ended December 31, 2008, we recorded a non-cash goodwill impairment charge of $8.4 million. In addition, we determined that $1.7 million of intangible assets attributable to customers of our European subsidiary had been impaired, and as a result, we recorded an impairment charge of $1.7 million. Following the 2008 annual impairment test, we also determined that the fair value of our U.S. subsidiary had significantly declined and that as a result, goodwill in the amount of $2.4 million attributable to the U.S. subsidiary had been impaired. Impairment of other intangible assets amounted to approximately $350,000 in 2008 attributable to the write-off of certain know-how. We did not record any impairment of goodwill and other intangible assets for the year ended December 31, 2007.

Post employment and termination benefits. For the year ended December 31, 2008, we recorded a post employment and termination benefits expense of $2.6 million, or 3.7% of our total revenues, related to benefits payable to our former president and chief executive officer and other senior employees in connection with their retirement from their respective offices. For the year ended December 31, 2007, we recorded a post employment and termination benefits expense of $904,000, or 1.2% of our total revenues, related to benefits payable to the former chairman of our board of directors in connection with his retirement.

Operating income (loss). We had operating income of $2.7 million for the year ended December 31, 2007 compared to an operating loss of $28.6 million for the year ended December 31, 2008. The operating income (loss) of our three business segments for the years ended December 31, 2007 and 2008 are as follows:

	Year Ended December 31,	
	2007	2008
	(In thousands)	
Perimeter products	$ 2,421	$ (9,103)
Turnkey projects	506	(19,485)
Other	(193)	7
Eliminations	(28)	-
Total	$ 2,706	$ (28,581)

The operating income of our perimeter products segment decreased from $2.4 million for the year ended December 31, 2007 to an operating loss of $9.1 million for the year ended December 31, 2008, primarily as a result of the decrease in revenues of this segment, compared with a smaller decrease in cost of revenues due to the fixed-cost portion of our expenses. The decrease in 2008 is also due to a $2.8 million impairment of goodwill and other intangible assets charge, an increase in doubtful debt expenses and the appreciation of the NIS against the U.S. dollar in 2008, which increased our NIS denominated expenses by 12.8%. The operating income of our turnkey projects segment decreased from $506,000 in the year ended December 31, 2007 to an operating loss of $19.5 million in the year ended December 31, 2008, primarily as a result of a $10.1 million impairment of goodwill and customer related intangible assets charge attributable to our European subsidiary acquired in September 2007. In addition, we recorded a $2.5 million provision for penalties attributable to a project of our new European subsidiary. In 2008, we also recorded a loss provision attributable to two strategic projects that had a negative gross margin. The operating results from other operations improved from an operating loss of $193,000 for the year ended December 31, 2007 to operating income of $7,000 for the year ended December 31, 2008.

Financial expenses, net. Financial expenses, net, decreased from $2.1 million for the year ended December 31, 2007 to $2.0 million for the year ended December 31, 2008, a decrease of 6.1%. The decrease was primarily due to a decrease in interest expenses, net, recorded on long and short-term debt, a decrease in forward contract losses and a decrease in foreign exchange losses compared with 2007. The decrease was offset in part by a loss of $955,000 attributable to our investments in marketable securities.

Income taxes. We recorded an income tax expense of $373,000 for the year ended December 31, 2007 compared to an income tax expense of $1.6 million for the year ended December 31, 2008, primarily as a result of an increase in the valuation allowance that we recorded with respect to our carryforward tax losses in 2008. In 2008, we recorded a full valuation allowance with respect to our carryforward tax losses compared with a partial allowance recorded in 2007, due to the uncertainty of their future realization. The increase was offset in part by a decrease in tax expenses with respect to prior years.

Year Ended December 31, 2007 Compared with Year Ended December 31, 2006

Revenues. Revenues increased by 13.8% from $63.6 million in the year ended December 31, 2006 to $72.4 million in the year ended December 31, 2007. Revenues from sales of perimeter systems decreased by 6.1% from $47.2 million in 2006 to $43.8 million in 2007, a decrease of 7.2%, primarily as a result of a decrease in orders from the Israeli MOD, which was partly offset by increased orders from clients outside of Israel. Revenues from security turnkey projects increased by 74.2% from $16.2 million in 2006 to $28.2 million in 2007, primarily due to a $5.7 million project performed for the Israeli government and the acquisition of a European integration company in September 2007. Other revenues, mainly from services for screening pallets and newly developed products, increased by 72.9% from $247,000 in the year ended December 31, 2006 to $427,000 in the year ended December 31, 2007.

Cost of revenues. Cost of revenues increased by 16.8% from $37.2 million in the year ended December 31, 2006 to $43.5 million in the year ended December 31, 2007, primarily as a result of the increase in revenues. Cost of revenues as a percentage of revenues increased from 58.5% in 2006 to 60.1% in 2007, primarily as a result of the increase in the turnkey projects segment of our business, which has a lower profit margin. In addition, we recorded a loss provision for one of the projects performed for the Israeli government. In our perimeter segment, our cost of sales was adversely affected by an increase in production costs.

Research and development expenses, net. Research and development expenses, net increased from $5.4 million for the year ended December 31, 2006, to $5.8 million for the year ended December 31, 2007, an increase of 7.2%. The increase in research and development expenses is primarily attributable to the appreciation of the NIS and Canadian dollar against the U.S. dollar in 2007, which adversely affected research and development expenses denominated in such currencies, and to bonuses paid to employees in 2007. Research and development expenses, net amounted to 8.5% of revenues in 2006, compared to 8.0% in 2007. The research and development expenses of our Canadian subsidiary are net of investment tax credits, which totaled $162,000 in 2006 and $160,000 in 2007.

Selling and marketing expenses, net. Selling and marketing expenses, increased from $11.6 million for the year ended December 31, 2006 to $12.9 million for the year ended December 31, 2007, an increase of 11.4%. The increase in selling and marketing expenses in 2007 was primarily due to the amortization of customer related assets attributable to the acquisition of the European integration company in September 2007. Selling and marketing expenses amounted to 18.2% and 17.9% of revenues in each of 2006 and 2007, respectively.

General and administrative expenses. General and administrative expenses increased from $5.5 million for the year ended December 31, 2006 to $6.6 million for the year ended December 31, 2007, an increase of 18.3%. The increase in general and administrative expenses was due to expenses associated with our compliance with the requirements of the Sarbanes-Oxley Act, including the implementation of internal controls over financial reporting, and an increase in salaries and legal expenses. General and administrative expenses amounted to 8.7% of revenues in 2006 compared to 9.1% in 2007.

Impairment of goodwill and other intangible assets. We did not record any impairment of goodwill and other intangible assets for the years ended December 31, 2006 and 2007.

Post employment and termination benefits. For the year ended December 31, 2007, we recorded a post employment and termination benefits expense of $904,000, or 1.2% of our total revenues, related to benefits payable to the former chairman of our board of directors in connection with his retirement from such office. We did not record any post employment and termination benefits expense for the year ended December 31, 2006.

Operating income (loss). Our operating income declined from $3.8 million for the year ended December 31, 2006 to $2.7 million for the year ended December 31, 2007. The operating income (loss) of our three business segments for the years ended December 31, 2006 and 2007 are as follows:

	Year Ended December 31, 2006	Year Ended December 31, 2007
	(In thousands)	
Perimeter products	$ 3,070	$ 2,421
Turnkey projects	935	506
Other	(138)	(193)
Eliminations	(31)	(28)

	Year Ended December 31,	
Total	$ 3,836	$ 2,706

The operating income of our perimeter products segment decreased from $3.1 million in the year ended December 31, 2006 to $2.4 million in the year ended December 31, 2007, primarily as a result of the increase in production costs and the depreciation of the U.S. dollar against the NIS and the Canadian dollar, which adversely affected the U.S. dollar of our revenues denominated in such currencies. The operating results for our turnkey projects segment declined from an operating income of $935,000 in the year ended December 31, 2006 to operating income of $506,000 in the year ended December 31, 2007, primarily as a result of a loss incurred with respect to one of our major projects and the amortization of the customer related assets attributable to the acquisition of the European integration company in September 2007. The operating loss from our other operations increased from $138,000 in the year ended December 31, 2006 to $193,000 in the year ended December 31, 2007.

Financial expenses, net. Financial expenses, net increased from $864,000 for the year ended December 31, 2006 to $2.1 million for the year ended December 31, 2007, an increase of 147.3%. Our financial expenses increased by $1.3 million, mainly due to the depreciation of the U.S. dollar against the NIS and the Canadian dollar, which caused an increase of foreign exchange losses, net of $1.1 million. In addition, interest on short-term bank credits increased by $648,000 due to the higher level of short-term loans incurred in 2007, which was offset in part by a decease in forward contracts loss of $249,000.

Income taxes. We recorded income tax expenses of $943,000 for the year ended December 31, 2006 compared to income tax expenses of $373,000 for the year ended December 31, 2007. The decrease is primarily as a result of the decrease in our income before taxes. The effective tax rate increased to 65.6% for 2007 compared to 31.7% in 2006 due to the fact that we recorded a valuation allowance on losses of $765,000, as a result of the low likelihood that our deferred tax assets will be recovered from future taxable income.

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Quarterly Results of Operations

Our recently acquired European subsidiary is engaged in turn-key projects in Africa. These projects are executed with the assistance of a local subcontractor. Due to lack of managerial and financial skills of the subsidiary s employees and to limited physical access to these projects sites, the European subsidiary encountered difficulties in the evaluation of the operating results of these projects during their respective execution periods, as well as in the measurement of the expected costs and resources that will be necessary to complete them. Insufficient managerial oversight by the local subcontractor created additional burdens on the subsidiary s management, affecting its ability to complete these projects. During the fourth quarter of 2008, management concluded that the projects in Africa are not typical compared to our other projects and identified inherent hazards related to these projects. As a result, management decided to change the accounting method applied to these projects to the completed-contracts method and to revise the results of operations previously reported for the first three quarters of 2008.

The following tables set forth certain unaudited quarterly consolidated statements of income data for the two years ended December 31, 2008, as revised, as well as the percentage of our revenues represented by each item. We prepare our unaudited quarterly consolidated financial statements on the same basis as our audited annual consolidated financial statements included elsewhere in this annual report and include all adjustments (consisting only of normal recurring adjustments) that we consider necessary for a fair presentation of such information. The operating results for any quarter are not necessarily indicative of results for any future periods. You should read this information in conjunction with our consolidated financial statements, including the related notes, appearing in Item 18 Financial Statements.

	Three months ended							
	2007				2008			
	Mar. 31,	Jun. 30,	Sept. 30,	Dec. 31,	Mar. 31,	Jun. 30,	Sept. 30,	Dec. 31,
	(In thousands)							
Revenues	$ 14,113	$ 14,091	$ 21,016	$ 23,155	$ 13,735	$ 11,319	$ 15,407	$ 29,894
Cost of revenues	7,732	7,650	13,291	14,837	8,900	5,897	10,932	23,476

	Three months ended							
Gross profit	6,381	6,441	7,725	8,318	4,835	5,422	4,475	6,418
Operating expenses:	-	-	-	-				
Research and development, net	1,454	1,148	1,283	1,879	1,625	1,529	1,623	1,418
Selling and marketing, net	2,709	3,028	3,794	3,399	3,142	3,432	3,653	6,952
General and administrative	1,316	1,407	1,505	2,333	2,095	2,467	1,948	4,378
Impairment of goodwill and other intangible assets	-	-	-	-	-	-	-	12,887
Post employment and termination benefits	-	-	960	(56)	438	-	-	2,144
Total operating expenses	5,479	5,583	7,542	7,555	7,300	7,428	7,224	27,779
Operating income (loss)	902	858	183	763	(2,465)	(2,006)	(2,749)	(21,361)
Financial expenses, net	303	141	983	710	984	415	383	224
Income (loss) before income taxes	599	717	(800)	53	(3,449)	(2,421)	(3,132)	(21,585)
Income taxes (tax benefit)	148	280	749	(804)	(661)	(374)	258	2,395
Income (loss) from continuing operations	451	437	(1,549)	857	(2,788)	(2,047)	(3,390)	(23,980)
Loss from discontinued operations, net	(153)	(95)	(88)	2,022	(248)	(61)	(42)	(46)
Net income (loss)	298	342	(1,637)	2,879	(3,036)	(2,108)	(3,432)	(24,026)

	Three months ended							
	2007				2008			
	Mar. 31,	Jun. 30,	Sept. 30,	Dec. 31,	Mar. 31,	Jun. 30,	Sept. 30,	Dec. 31,
	(As percentage of totals revenues)							
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0
Cost of revenues	54.8	54.3	63.2	64.1	64.8	52.1	71.0	78.5
Gross profit	45.2	45.7	36.8	35.9	35.2	47.9	29.0	21.5
Operating expenses:								
Research and development, net	10.3	8.1	6.1	8.1	11.8	13.5	10.5	4.7
Selling and marketing, net	19.2	21.5	18.0	14.7	22.9	30.3	23.7	23.3
General and administrative	9.3	10.0	7.2	10.0	15.3	21.8	12.6	14.6
Impairment of goodwill and other intangible assets	-	-	-	-	-	-	-	43.1
Post employment and termination benefits	-	-	4.6	(0.2)	3.2	-	-	7.2

	Three months ended							
Total operating expenses	38.8	39.6	35.9	32.6	53.2	65.6	46.8	92.9
Operating income (loss)	6.4	6.1	0.9	3.3	(18)	(17.7)	(17.8)	(71.4)
Financial expenses, net	2.2	1	4.7	3.1	7.2	3.7	2.5	0.8
Income (loss) before income taxes	4.2	5.1	(3.8)	0.2	(25.2)	(21.4)	(20.3)	(72.2)
Income taxes (tax benefit)	1	2	3.6	(3.5)	(4.8)	(3.3)	1.7	8.0
Income (loss) from continuing operations	3.2	3.1	(7.4)	3.7	(20.4)	(18.1)	(22.0)	(80.2)
Loss from discontinued operations, net	(1.1)	(0.7)	(0.4)	8.7	(1.8)	(0.5)	(0.3)	(0.2)
Net income (loss)	2.1%	2.4%	(7.8)%	12.4%	(22.2)	(18.6)	(22.3)	(80.4)

Seasonality

Our operating results are characterized by a seasonal pattern, with a higher volume of revenues towards the end of the year and lower revenues in the first part of the year. This pattern, which is expected to continue, is mainly due to two factors:

our customers are mainly budget-oriented organizations with lengthy decision processes, which tend to mature late in the year; and

due to weather and other conditions, payments are often postponed from the first quarter to subsequent quarters.

See also Item 3.D. Key Information Risk Factors. Our revenues are dependent on government procurement procedures and practices, and because we receive large product orders from a relatively small number of customers, our revenues and operating results are subject to substantial periodic variations.

Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets

We sell most of our products in North America, Europe and Israel. Our financial results, which are reported in U.S. dollars, are affected by changes in foreign currency. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non- U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies.

The appreciation of the NIS in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked assets and the U.S. dollar amounts of any unlinked liabilities and increasing the U.S. dollar value of revenues and expenses denominated in other currencies. Conversely, the depreciation of the NIS in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our liabilities which are payable in NIS (unless such costs or payables are linked to the U.S. dollar). Such depreciation also has the effect of decreasing the U.S. dollar value of any asset that is denominated in NIS or receivables payable in NIS (unless such receivables are linked to the U.S. dollar). In addition, the U.S. dollar value of revenues and expenses denominated in NIS would increase. Because foreign currency exchange rates fluctuate continuously, exchange rate fluctuations, may have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

The following table presents information about the rate of inflation in Israel, the rate of depreciation or appreciation of the NIS against the U.S. dollar, and the rate of inflation of Israel adjusted for the devaluation:

Year ended December 31,	Israeli inflation rate %	NIS depreciation (appreciation) rate %	Israeli inflation adjusted for devaluation (appreciation) %
2004	1.2	(1.6)	2.8
2005	2.4	6.8	(4.4)
2006	(0.1)	(8.2)	8.1
2007	3.4	(9.0)	12.4
2008	3.8	(1.1)	4.9

In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2008, the Canadian dollar depreciated against the U.S. dollar by approximately 19.7%, while in 2007 and 2006, the Canadian dollar appreciated against the U.S. dollar by 18.4% and 0.4%, respectively.

For the year ended December 31, 2006, we recorded foreign currency exchange gains, net of $276,000, while we recorded foreign currency exchange losses, net of $792,000 and $246,000 for the years ended December 31, 2007 and 2008, respectively. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

To manage this risk, from time to time, we have entered into forward exchange contracts to hedge some of our foreign currency exposure relating to revenue and unbilled accounts receivable denominated in foreign currencies. We have designated the forward instruments as cash flow hedges for accounting purposes. For derivative instruments designated as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earning.

On October 1, 2006, we changed our functional currency from the U.S. dollar to NIS. Changes in the fair value of the forward exchange contracts from October 1, 2006 are charged to financial expenses. We recorded $915,000, $666,000 and $291,000 of financial expenses attributable to forward exchange contracts transactions for the year ended December 31, 2006, 2007 and 2008, respectively.

Conditions in Israel

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. See Item 3D Key Information Risk Factors Risks Relating to Our Location in Israel for a description of governmental, economic, fiscal, monetary or political polices or factors that have materially affected or could materially affect our operations.

Effective Corporate Tax Rate

Israeli companies are generally subject to income tax on their worldwide taxable income. The applicable rate for 2008 was 27%, which was reduced to 26% in 2009, and will be further reduced to 25% in 2010 and thereafter. However, certain of our manufacturing facilities have been granted Approved Enterprise status under the Law for the Encouragement of Capital Investments, 1959, as amended, commonly referred to as the Investments Law, and, consequently, are eligible, subject to compliance with specified requirements, for tax benefits beginning when such facilities first generate taxable income. The tax benefits under the Investments Law are not available with respect to income derived from products manufactured outside of Israel. We have derived, and expect to continue to derive, a substantial portion of our income from our Approved Enterprise facilities. Subject to certain restrictions, we are entitled to a tax exemption in respect of income derived from our approved facilities for a period of two years, commencing in the first year in which such income is earned, and will be entitled to a reduced tax rate of 10% to 25% for an additional five to eight years depending on our compliance as a foreign investors company. If we do not qualify as a foreign investors company, we will instead be entitled to a reduced rate of 25% for an additional five years, rather than eight years. A foreign investors company is defined in the Investments Law as a company in which more than 25% of its shareholders are non-Israeli residents. Pursuant to the Investments Law, a foreign investors company may enjoy benefits for a period of up to ten years (the actual length of the benefits period is graduated based on the percentage of foreign ownership).

Our effective corporate tax rate may substantially exceed the Israeli tax rate. Our U.S. subsidiaries will generally be subject to applicable federal, state, local and foreign taxation, and we may also be subject to taxation in the other foreign jurisdictions in which we own assets, have employees or conduct activities. Because of the complexity of these local tax provisions, it is not possible to anticipate the actual combined effective corporate tax rate, which will apply to us.

As of December 31, 2008, we had a deferred tax asset of $269,000 attributable to our subsidiaries and had estimated total available carry forward tax losses of $14.9 million to offset against future taxable income. We have recorded a full valuation allowance over such carryforward tax losses due to the uncertainty of the deferred tax asset realization. As of December 31, 2008, our subsidiaries had estimated total available carryforward tax losses of $9.1 million to offset against future taxable income, which may be used as an offset against future taxable income for periods ranging between 13-20 years. As of December 31, 2008, we recorded a valuation allowance for most of our subsidiaries carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the change in ownership provisions of the Internal Revenue Code of 1986 and similar state tax law provisions. The annual limitation may result in the expiration of net operating losses before utilization.

In December 2007, we finalized with the Israeli Tax Authority our tax assessments with respect to the years 2001 to 2004.

Recently Issued Accounting Standards

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations,* or SFAS 141R. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquired and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008 and early adoption is prohibited. We believe that the impact of SFAS 141R on our consolidated results of operations and financial condition will depend on the nature and size of acquisitions, if any, subsequent to the effective date.

In April 2008, the FASB issued FASB Staff Position, or FSP, FAS 142-3, *Determination of the Useful Life of Intangible Assets,* or FSP FAS 142-3. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB SFAS No. 142, *Goodwill and Other Intangible Assets.* FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and early adoption is prohibited. We believe that the adoption of FPS FAS 142-3 will not have impact on our consolidated financial statements.

In October 2008, the FASB issued FSP No.132 (R)-a, *Employers Disclosures about Pensions and Other Postretirement Benefits*, to require that an employer disclose the following information about the fair value of plan assets: 1) the level within the fair value hierarchy in which fair value measurements of plan assets fall; 2) information about the inputs and valuation techniques used to measure the fair value of plan assets; and 3) a reconciliation of beginning and ending balances for fair value measurements of plan assets using significant unobservable inputs. The FSP will be effective for fiscal years ending after December 15, 2009, with early application permitted. Application of the FSP would not be required for earlier periods that are presented for comparative purposes. We are currently evaluating the potential impact of adopting this FSP on our disclosures in the financial statements.

In November 2008, the Emerging Issues Task Force, or EITF, issued EITF Issue No. 08-7, *Defensive Intangible Assets,* or EITF 08-7, which requires an acquiring entity to account defensive intangible assets as a separate unit of accounting. Defensive intangible assets should not be included as part of the cost of the acquirer s existing intangible assets because the defensive intangible assets are separately identifiable. Defensive intangible assets must be recognized at fair value in accordance with SFAS 141(R) and SFAS 157. EITF 08-7 will be effective for the reporting period beginning after December 15, 2008. We do not expect a material impact on our consolidated financial statements from the adoption of EITF 08-7.

In April 2009, the FASB issued FSP No. FAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, or the FSP No. 115-2. FSP No. 115-2 is intended to provide greater clarity to investors about the credit and noncredit component of an other-than-temporary impairment event and to more effectively communicate when an other-than-temporary impairment event has occurred. FSP No. 115-2 applies to fixed maturity securities only and requires separate display of losses related to credit deterioration and losses related to other market factors. When an entity does not intend to sell the security and it is more likely than not that an entity will not have to sell the security before recovery of its cost basis, it must recognize the credit component of an other-than-temporary impairment in earnings and the remaining portion in other comprehensive income. Upon adoption of the FSP No. 115-2, an entity will be required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to accumulated other comprehensive income. The FSP will be effective for us for the quarter ending June 30, 2009. We are currently evaluating the impact of adopting the FSP.

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, or FSP 157-4. FSP 157-4 provides additional authoritative guidance to assist both issuers and users of financial statements in determining whether a market is active or inactive, and whether a transaction is distressed. FSP 157-4 will be effective for us for the quarter ending June 30, 2009. We do not expect the adoption of FSP 157-4 to have a material impact on our consolidated financial position and results of operations.

B. Liquidity and Capital Resources

General

From our inception until our initial public offering in March 1993, we financed our activities mainly through cash flow from operations and bank loans. In March 1993, we received proceeds of $9.8 million from an initial public offering of 1,380,000 ordinary shares. In February 1997, we raised $9.4 million from a follow-on offering of 2,085,000 ordinary shares and in April 2005, we raised an additional $14.9 million from a follow-on offering of 1,700,000 ordinary shares. The proceeds from these offerings together with cash flow from operations and our credit facilities are our main sources of working capital.

Our working capital decreased from $41.5 million at December 31, 2007 to $16.4 million at December 31, 2008. Cash and cash equivalents amounted to $9.2 million at December 31, 2007 compared to $16.8 million at December 31, 2008. Short-term and long-term bank deposits, marketable securities, restricted bank deposits and escrow deposits amounted to $26.9 million at December 31, 2007 compared to $8.1 million at December 31, 2008. Our cash and cash equivalents, short and long-term bank deposits and marketable securities are held mainly in U.S. dollars, Euros and NIS.

We expect to fund our short-term liquidity needs, including our obligations under our credit facilities, other contractual agreements and any other working capital requirements, from cash and cash equivalents, operating cash flows and our credit facilities. We believe that our current cash and cash equivalents, including bank deposits, marketable securities and our expected cash flows from operations in 2009 will be sufficient to meet our cash requirements through 2009. However, our liquidity could be negatively affected by a decrease in demand for our products, including the impact of potential reductions in customer purchases that may result from the current general economic downturn.

Cash Flows

The following table summarizes our cash flows for the periods presented:

	Year ended December 31,		
	2006	**2007**	**2008**
		(in thousands)	
Net cash provided by (used in) continuing operations	$ (2,019)	10,420	$ 1,596
Net cash provided by (used in) discontinued operations	643	(519)	(881)
Net cash provided by (used in) operating activities	(1,376)	9,901	715
Net cash provided by (used in) investing activities	(5,248)	(464)	6,639
Net cash provided by financing activities	1,688	(5,477)	2,665
Effect of exchange rate changes on cash and cash equivalents	(255)	337	(2,389)
Increase (decrease) in cash and cash equivalents	(5,191)	4,297	7,630
Cash and cash equivalents at the beginning of the year	10,099	4,908	9,205
Cash and cash equivalents at the end of the year	$ 4,908	$ 9,205	16,835

Net cash used in operating activities was approximately $1.4 million in the year ended December 31, 2006 compared to $9.9 million net cash provided by operating activities in the year ended December 31, 2007 and $0.7 million net cash provided by operating activities in the year ended December 31, 2008. Net cash used in operating activities in the year ended December 31, 2006 was primarily attributable to an increase in trade receivables of $4.4 million, an increase in inventories of $2.7 million, a return of $2.8 million of customer advances and a decrease in trade payables of $666,000, which was offset in part by net income of $810,000, depreciation and amortization of $1.2 million, a decrease in unbilled accounts receivable of $3.5 million, an increase in other accounts payable and accrued expenses of $717,000 and a $437,000 decrease in other accounts receivable and prepaid expenses. Net cash provided by operating activities in the year ended December 31, 2007 was primarily attributable to an increase in customer advances of $10.4 million, an increase of $4.3 million and $1.8 million in trade receivables and unbilled accounts receivable, respectively, an increase of $1.8 million in accrued interest on marketable securities and short-term and long-term bank deposits and depreciation and amortization of $2.1 million, which was offset in part by a decrease in trade payables of $6.3 million, a decrease in other accounts payable and accrued expenses of $1.8 million, an increase in long-term trade receivables of $1.8 million and a gain from discontinued operations of $1.7 million. Net cash provided by operating activities in the year ended December 31, 2008 was primarily attributable to a $12.9 million non-cash goodwill and other intangible assets impairment charge, $ 3.1 million depreciation and amortization expenses, a decrease in trade receivable of $10.6 million, a decrease in inventories of $ 8.9 million and an increase of $6.5 million, $7.6 million and $ 3.4 million in accounts payables, cost incurred on long-term contracts and unbilled other payables, respectively, and a decrease of $2.1 million in accrued interest and exchange differences on marketable securities and short-term and long-term bank deposits, which was offset in part by a decrease in customer advances of $9.3 million and an increase in unbilled accounts receivables of $1.2 million.

Net cash used in investing activities was approximately $5.2 million and $464,000 for the years ended December 31, 2006 and 2007, respectively, compared to $6.6 million net cash provided by investing activities in the year ended December 31, 2008. In the year ended December 31, 2006, we purchased $906,000 of property and equipment, $8.2 million of marketable securities, invested $622,000 in a long-term loan and purchased know-how and patents for $148,000 with the proceeds from the sale of marketable securities of $5.2 million. In the year ended December 31, 2007, we acquired a European integration company for $4.0 million and purchased $10.8 million of marketable securities, $4.4 million of escrow deposits and $890,000 of property and equipment, which was offset by proceeds of $8.5 million from the sale of the assets and business of a subsidiary, proceeds of $5.6 million from the sale of marketable securities and $5.7 million from the sale of short-term bank deposits. In the year ended December 31, 2008, we had proceeds of $5.1 million from the sale of marketable securities and $11.1 million from the sale of short-term bank deposits, which amounts were offset in part by purchases of $1.4 million, $3.3 million and $2.0 million of short-term bank deposits, restricted bank deposits and marketable securities, respectively. In addition, we purchased $1.7 million of property, plant and equipment and $1.1 million of know-how and patents.

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In the year ended December 31, 2006, net cash provided by financing activities of $1.7 million was primarily attributable to $3.2 million from proceeds of long-term loans that we obtained to finance the costs incurred in connection with the cancellation of a project in Eastern Europe and our receipt of $163,000 from the exercise of employee stock options, which was offset in part by $1.4 million from short-term bank credits to finance the operations of our video monitoring segment and the repayment of $306,000 of long-term bank loans. In the year ended December 31, 2007, net cash used in financing activities of $5.5 million was primarily due to the repayment of $4.7 million of short-term bank credits and repayment of $796,000 of long-term bank loans, which was offset in part by receipt of $43,000 from the exercise of employee stock options. In the year ended December 31, 2008, net cash provided by financing activities of $2.7 million was primarily due to an increase of $7.0 million in short-term bank credits, which was offset by the repayment of $4.3 million of long-term bank loans.

We had capital expenditures of approximately $906,000, $890,000 and $1.7 million in 2006, 2007 and 2008, respectively. These capital expenditures were principally for computers, other machinery and equipment and for expanding and renovating our facilities. We estimate that our capital expenditures for 2009 will total approximately $1.7 million, substantially all of which will relate to our perimeter security and project segments. We expect to finance these expenditures primarily from our cash and cash equivalents, operating cash flows and our credit facilities. However, the actual amount of our capital expenditures will depend on a variety of factors, including general economic conditions, changes in the demand for our products.

Credit Lines and Other Debt

We currently have credit lines with Bank Leumi Le-Israel B.M., or BLL, Union Bank of Israel Ltd., or Union Bank, Mizrahi Tefahot Bank B.M., or MTB, and Bank Hapoalim B.M., BNP Paribas S,A totaling $46.1 million in the aggregate. There are no restrictions as to our use of any of these credit lines. We agreed not to pledge any of our assets without the consent of these banks. Our loans under these credit lines are denominated in dollars and NIS. As of December 31, 2008, we are not under any obligation to maintain financial ratios or other terms in respect of our credit lines.

In addition, our subsidiaries currently have credit lines with Bank Leumi USA, Royal Bank of Canada, Commerz Bank, Leuitkircher Bank and Deutsche Bank, totaling $9.9 million in the aggregate.

Our Canadian subsidiary, which is primarily engaged in sale of perimeter products and turnkey projects, has undertaken to maintain general covenants and the following financial ratios and terms in respect of its outstanding credit lines: a quick ratio of not less than 1.25; a ratio of total liabilities to tangible net worth of not greater than 0.75; and tangible net worth of at least $9.0 million. As of December 31, 2008, our Canadian subsidiary was in compliance with these ratios and terms.

As of December 31, 2008, we had approximately $19.2 million available under our credit lines. In addition, our subsidiaries had approximately $5.1 million available under their credit lines. As of December 31, 2008, our outstanding balances under our credit lines consisted of:

Short-term NIS-denominated loans of approximately $23.2 million, bearing an average interest at a rate of 4.25%;

Long-term U.S. dollar-denominated loans of approximately $1.8 million, bearing an average interest at a rate of 2.75%; and

Several bank performance and advance payment guarantees totaling approximately $11.4 million, at an annual cost of 0.5%-1%.

As of December 31, 2008, our subsidiaries had $1.3 million in long-term loans primarily relating to our perimeter security segment as follows:

$355,000 bearing interest at a fixed rate of 5.45%. The loan is payable in 20 quarterly installments of $47,200, commencing February 2006. We have guaranteed the full amount of this loan; and

$980,000 bearing interest at a fixed rate of 5.45%. The loan is due in one installment in November 2010. We have guaranteed the full amount of this loan.

C. Research and Development, Patents and Licenses.

Government Grants

We participate in programs sponsored by the Israeli Government for the support of research and development activities. In the past we have received royalty-bearing grants from the OCS for certain of our research and development projects for perimeter security products. We did not obtain any grants from the OCS for the years ended December 31, 2006, 2007 and 2008. We are obligated to pay royalties to the OCS amounting to 3%-4.5% of revenues derived from sales of the products funded with these grants and ancillary services, up to 100% of the grants received, linked to the U.S. dollar. All grants received after January 1, 1999 also bear interest equal to the 12 month LIBOR rate. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales no payment is required.

For the years ended December 31, 2006, 2007 and 2008, we paid the OCS royalties in the amount of $79,000, $143,000 and $125,000, respectively. These royalties related to sales of perimeter security products and management security system. As of December 31, 2008, we had a contingent obligation to pay royalties to the OCS in the amount of approximately $1.37 million upon the successful sale of perimeter security products developed using research and development programs sponsored by the OCS.

The Israeli Government, through the Fund for the Encouragement of Marketing Activities, or the Fund, awarded us grants for overseas marketing expenses during the years 2001 to 2003. To date, we have received an aggregate $253,000 in grants from the Fund. Under the terms of the grants, we are obligated to pay certain royalties on the increase in export sales from the year the grant was received and the following year, up to the amount of the grants we received. During the years ended December 31, 2006, 2007 and 2008, we did not pay any royalties. As of December 31, 2008, we had a remaining contingent obligation to the Fund of $82,000.

Investment Tax Credit

Our Canadian and U.S subsidiaries are eligible for investment tax credits on their research and development activities and on certain current and capital expenditures. For the years ended December 31, 2006, 2007 and 2008, our Canadian subsidiary recognized $162,000, $160,000 and $234,000, respectively, of investment tax credits as a reduction of research and development expenses. In addition, as of December 31, 2008, our Canadian and U.S subsidiaries had available investment tax credits of approximately $706,000 to reduce future federal income taxes payable. These credits will expire in 2019 through 2028. See also Item 4.B. Information on the Company Business Overview Research and Development; Royalties.

D. Trend Information.

In recent years consolidation in the defense industry has affected competition resulting in an increase in the relative size and resources of our competitors. We adapt to evolving market conditions by adjusting our technology and business strategy. We also anticipate increased competition in defense markets due to declining defense budgets in certain countries. The recent financial developments worldwide may reduce defense spending. However, we believe in our ability to compete on the basis of our technology and systems development that offers customers overall solutions to technological and operational needs.

We cannot assure you that the MOD, IDF or any of our other major customers will maintain their volume of business with us or that, if such volume is reduced, other customers of similar volume will replace the lost business. The loss of one or more of these existing customers without replacement by a customer or customers of similar volume would have a material adverse effect on our financial results.

As of December 31,2008, our backlog amounted to approximately $60.9 million, of which approximately $31.3 million is expected to be delivered by the end of 2009, $17.6 million is expected to be delivered by the end of 2010 and $12.0 million is expected to be delivered thereafter.

See also discussion in Item 5A. Operating and Financial Review and Prospects Operating Results.

E. Off-Balance Sheet Arrangements.

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

F. Tabular Disclosure of Contractual Obligations.

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2008 and the effect we expect them to have on our liquidity and cash flow in future periods.

	Payments due by period				
Contractual Obligations	**Total**	**Less than 1 year**	**1-2 years**	**3-5 years**	**More than 5 years**
			(in thousands)		
Long-term bank debt obligations	$ 3,095	$ 813	$ 2,282	$ -	$ -
Operating lease obligations	2,936	697	796	1,443	-
Purchase obligations	-	-	-	-	-
Other long-term liabilities reflected on our balance sheet under U.S. GAAP	3,823	-	-		3,823
Total	$ 9,854	$ 1,510	$ 3,078	$ 1,443	$ 3,823

In addition, we have guaranteed the advance payments and the performance of our work to certain of our customers (usually government entities). Such guarantees are required by contract for our performance during the installation and operational period of projects throughout Israel and the rest of the world. The guarantees for installation typically expire soon after certain milestones are met and guarantees for operations typically expire proportionally over the contract period. The maximum potential amount of future payments we could be required to make under our guarantees at December 31, 2008 and March 31, 2009 were $11.4 million and $12.3 million, respectively. We have not recorded any liability for such amounts as we expect that our performance will be acceptable and to date, no performance bank guarantees have been exercised against us except with respect to our dispute relating to the project in Eastern Europe. See Item 8.A Consolidated Statements and Other Financial Information-Legal Proceedings.

ITEM 6. Directors, Senior Management and Employees

A. Directors and Senior Management.

Set forth below are the name, age, principal position and a biographical description of each of our directors and executive officers:

Name	Age	Position
Jacob Perry	65	Chairman of the Board of Directors
Hagai Katz	58	General Manager, Israel Division, Senior Vice President - Marketing and Products and Chief Information Officer
Asaf Even-Ezra	44	Senior Vice President -Sales
Yehonatan Ben-Hamozeg	50	Senior Vice President - Product Development and Projects
Zev Morgensten	45	Vice President - Finance, Chief Financial Officer and Secretary
Jacob Even-Ezra (1)	78	Director
Nathan Kirsh	78	Director
Shaul Kobrinsky(1)(2)	57	External Director
Zeev Livne	65	Director
Jacob Nuss(2)	62	Director
Barry Stiefel	59	Director
Anat Winner (1)(2)	49	External Director

(1) Member of our Investment Committee.
(2) Member of our Audit Committee.

Messrs. Perry, Even-Ezra, Kirsh, Livne, Nuss and Steifel will serve as directors until our 2009 Annual General Meeting of Shareholders. Mr. Kobrinsky and Ms. Winner will serve as external directors pursuant to the provisions of the Israeli Companies Law for three-year terms until our 2010 annual general meeting of shareholders.

Mr. Jacob Even-Ezra is the father of Mr. Asaf Even-Ezra. There are no other family relationships among our directors and senior executives.

Effective as of August 2, 2009, Mr. Eitan Livneh will assume the positions of President and chief executive officer of our company.

Jacob Perry has served as the chairman of our board of directors since January 2008. Prior thereto, Mr. Perry served as the deputy chairman of our board of directors from 2006 and has served as a director of our company since December 2002. From 1995 to December 2002, Mr. Perry served as the President and chief executive of Cellcom Israel Ltd., one of Israel s leading cellular phone operator. Mr. Perry served 29 years with the Israeli General Security Service, and served as its director from 1988 until 1995. Mr. Perry has also served as a coordinator to the Israeli Prime Minister on the subject of prisoners of war and missing persons. He was a board member of El-Al Israel Airlines and a member of the management of many public organizations. Mr. Perry is also a chairman of the board of directors of various companies, including Mizrahi Tefahot Bank B.M., Pinpoint Advanced Corp., Inc., a blank check company traded in the United States, and Keren Mor, a real estate fund. Mr. Perry serves as a director of Tamarind Technologies, Leadcom Integrated Solutions Ltd., an Israeli public company that engages in construction infrastructure for cellular communication, and New Kopel, an Israeli vehicle and car service group. Mr. Perry holds a B.A. degree in Oriental Studies and History of the Jewish People from Tel-Aviv University and completed the Advanced Management Program at Harvard Business School.

Hagai Katz has served as our general manager, Israel division and corporate vice president marketing and products since January 2009. Prior to joining our company and from 2007, Mr. Katz served as the chief executive officer of Transtech Airport Solutions Ltd. From 2004 to 2007 Mr. Katz served as the chief executive officer of UAV Tactical Systems Ltd., based in the United Kingdom. Prior to that, Mr. Katz served in a number of leading technology companies, including NICE Systems (NASDAQ: NICE), where he served in various senior positions including chief operating officer and President of its video analytics division. Mr. Katz holds a B.A. degree in Computer Sciences from the Technion Israel Institute of Technology and an M.Sc. degree in Business Engineering from the Ben-Gurion University of the Negev.

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Asaf Even-Ezra has served as our senior vice president sales since December 2008 Mr. Even-Ezra joined our company in 1995 and served as our vice president Israel and West European marketing from 1998 to July 2007 and as our executive vice president sales and marketing from July 2007 to December 2008. Mr. Even-Ezra holds a B.A. degree and an M.B.A. degree in Business, both from the New York Institute of Technology.

Yehonatan Ben-Hamozeg has served as our vice president product development and projects since January 2009. Mr. Ben Hamozeg joined our company in December 2002 and served as our vice president integrated systems development until January 2009. Before joining our company, Mr. Ben Hamozeg served in the IDF for 24 years and retired as a Colonel. Mr. Ben Hamozeg holds a B.A. degree in Economics and Statistics and an M.B.A. degree in Business Management, both from Haifa University.

Zev Morgensten has served as our vice president finance, chief financial officer and secretary since April 2009. Prior to joining our company and from 1997, Mr. Morgenstern served as the chief financial officer of Advanced Vision Technology Ltd., a public company traded on the Frankfurt Stock Exchange, a world leading supplier of automatic optical inspection and quality assurance systems for the printing industry. From 1994 to 1997, Mr. Morgenstern served as the finance manager of Precise Software Solutions, a company listed on the NASDAQ stock exchange, headquartered in Boston, MA. From 1985 to 1994, Mr. Morgenstern served as a senior auditor at Braude & Co., a member firm of KPMG International. Mr. Morgenstern holds a B.A. degree in Accounting and Economics from Bar Ilan University in Israel and is a Certified Public Accountant (Israel).

Jacob Even-Ezra has served as a director since 1984 and is a member of our investment committee. From 1984 until December 2007, Mr. Even-Ezra served as the chairman of our board of directors. From 1984 until 2006, Mr. Even-Ezra also served as our chief executive officer, and from 1987 until 1990 he also served as our president. Mr. Even-Ezra is currently a member of the Executive Council and the Management Committee of Tel Aviv University. From 1985 to 1988, Mr. Even-Ezra also served as the chairman of the Israel Export Institute. Mr. Even-Ezra holds a B.Sc. degree in Electrical Engineering from the Technion Israel Institute of Technology.

Nathan Kirsh has served as a director since 1984. Mr. Kirsh is an independent investor. Mr. Kirsh serves as one of the trustees of the Eurona Foundation, the beneficial owner of 100% of the ordinary shares of our company that are held by Mira Mag Inc. Mr. Kirsh holds a B.S. degree in Commerce from the University of Witwatersrand, Johannesburg, South Africa.

Barry Stiefel, was appointed by our board of directors as a director in November 2008. Mr. Stiefel served as a director of one of our UK subsidiaries from 1986 to 1990. Since 2001, Mr. Stiefel has served as a consultant for a variety of companies, including Premedia Limited and its subsidiaries. From 1990 until 2001, Mr. Stiefel was the chief executive officer of Meridian VAT Reclaim Group, which he founded. Between 1985 and 1990, Mr. Stiefel served as consultant in the field of trade finance. From 1981 to 1985, Mr. Stiefel served as finance director of Fisher Brothers Lumber Company Limited, a South African company. Mr. Stiefel holds a B.Sc degree in Mathematics and Chemistry and a B.A. degree in Accounting, both from the University of Witwatersrand in South Africa. Mr. Stiefel is a chartered accountant in South Africa, and is registered as an auditor (not in public practice) in the United Kingdom.

Zeev Livne has served as a director since July 2004. Mr. Livne has served as the chairman of Livne Strategic Consultants Ltd. since 2001. Prior to that, Mr. Livne served in the IDF for 39 years and retired as a Major General. During his long military career with the IDF, Mr. Livne served as the Defense Attaché to the United States and Canada from 1997 to 2001, Military Secretary to the Prime Minister of Israel from 1996 to 1997 and Ground Force Commander from 1994 to 1996. From 1992 to 1994 Mr. Livne established the IDF Home Front Command and served as its first Commander. Mr. Livne serves on the board of directors of PAZKAR Ltd., a private Israeli company. Mr. Livne holds a B.A. degree in History from Tel Aviv University and an M.A. degree in Geography from the University of Haifa.

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Shaul Kobrinsky has served as an external director since July 2004 and is the chairman of our audit committee and a member of our investment committee. Mr. Kobrinsky has served as the President and Chief Executive Officer of Urdan Industries Ltd., an investment and holding company since 1997. Since 2003, Mr. Kobrinsky has served as senior managing director of Alagem Capital Group a Beverly Hills based investment group. From 1989 to 1997, Mr. Kobrinsky served as chief executive officer of Cargal Ltd., an Israeli company that manufactures corrugates. Prior to that and from 1984, Mr. Kobrinsky served as deputy managing director of Clal Industries Ltd., a holding and investment company. Mr. Kobrinsky holds a B.A. degree in Economics from Tel Aviv University. Mr. Kobrinsky is a member of the anti-trust court of the State of Israel.

Jacob Nuss has served as a director since 1993 and is a member of our audit committee. Mr. Nuss has served as the vice president internal auditing of IAI since 2004, and served as IAI s deputy vice president internal auditing from 1999 to 2003. From 1993 to 1999, Mr. Nuss served as the director of finance of IAI s electronics group. From 1991 to 1993, Mr. Nuss served as assistant to the chairman of the board of directors of IAI. Mr. Nuss has served in various financial management capacities at IAI since 1975. Mr. Nuss holds a B.A. degree in Economics and Business Management from Bar Ilan University and an M.B.A. degree in Business from Tel Aviv University. Mr. Nuss holds a certificate in internal auditing.

Anat Winner has served as an external director since July 2004 and is a member of our audit committee and our investment committee. Ms. Winner has been self employed as a business advisor since July 2003. Ms. Winner also serves as a director of Internet Gold-Golden Lines Ltd. (NASDAQ: IGLD) and 012 Smile Communications Ltd. (NASDAQ: SMLC). From October 2001 to May 2003, Ms. Winner served as chief executive officer and chief financial officer of Israel News Ltd. From 1999 to October 2001, Ms. Winner served as chief financial officer of DBS Satellite Services (1998) Ltd. (YES), an Israeli company that is engaged in setting up and operating broadcasting satellite television television systems. From 1995 to 1998, Ms. Winner served as chief financial officer of Eurocom Cellular Communications Ltd., an Israeli company that is engaged in importing and marketing cellular phones. From 1989 to 1995, Ms. Winner served in various finance positions, including chief financial officer of the Seed Company (1939) Ltd. From 1984 to 1989 Ms. Winner served as a senior audit manager with Ronel Stetner & Co., certified public accountants in Israel. Ms. Winner holds a B.A. degree in Accounting and Economics from Haifa University and has been a certified public accountant in Israel since 1987.

B. Compensation.

During the year ended December 31, 2008, we paid an aggregate compensation to our executive officers and directors as a group (consisting of 17 persons, of whom five retired subsequent to December 31, 2008) of approximately $1.97 million. This amount does not include certain consideration paid in connection with the retirement of one of our directors. As of December 31, 2008, the aggregate amount set aside or accrued for pension, retirement, recreation payments and vacation or similar benefits for our directors and executive officers was approximately $3.8 million. In addition, we have provided automobiles to our executive officers at our expense, and Mr. Jacob Even-Ezra, a director, is reimbursed for the costs of a chauffeur.

As of January 1, 2008, we pay Mr. Perry, the chairman of our board of directors, a monthly payment of NIS 50,000 (approximately $13,000), which amount is linked to the Israeli consumer price index and subject to a 10% annual increase, and he is also entitled to an annual bonus based on our performance and customary social benefits.

From January 1, 2008 until March 6, 2008, we paid our external directors and independent directors (directors who are not employees of our company or officers or employees of any entity that beneficially owns 5% or more of our ordinary shares) an annual fee (on a pro rata basis) of $8,000 and a fee of $300 for each board or committee meeting that they attended. Since March 6, 2008, we pay our external directors and such independent directors an annual fee of NIS 59,100 (approximately $16,500) and a fee of NIS 2,200 (approximately $615) for each board or committee meeting that they attend. Such amounts are linked to the Israeli consumer price index and are updated on a semi-annual basis and accordingly, were adjusted to reflect changes in the Israeli consumer price index in August 2008 and February 2009.

As of December 31, 2008, our directors and executive officers as a group, then consisting of 16 persons, held options to purchase an aggregate of 431,200 ordinary shares, having exercise prices ranging from $6.12 to $13.00. Generally, the options vest over a two to four years period. Of such options, options to purchase 52,500 ordinary shares subsequently expired in January 2009, options to purchase 48,700 ordinary shares expire in December 2010, options to purchase 30,000 ordinary shares expire in January, 2015 and options to purchase 300,000 ordinary shares expire in three equal portions of 100,000 ordinary shares each in August 2013, 3014 and 2015, or earlier upon termination of employment as an executive officer or service as a director of our company. As of June 30, 2009, our directors and executive officers as a group, then consisting of 12 persons, held options to purchase an aggregate of 466,000 ordinary shares, having exercise prices ranging from $4.09 to $8.56. Of such options, options to purchase 18,000 ordinary shares expire in December 2010, options to purchase 300,000 ordinary shares expire in three equal portions of 100,000 ordinary shares each in August 2013, 3014 and 2015, options to purchase 98,000 ordinary shares expire in four equal portions of 24,500 ordinary shares each in April 2013, 2014, 2015 and 2016, options to purchase 17,500 ordinary shares expire in January 2014, options to purchase 11,250 ordinary shares expire in January 2015, options to purchase 11,250 ordinary shares expire in January 2016 and options to purchase 10,000 ordinary shares expire in April 2016, or earlier upon termination of employment as an executive officer or service as a director of our company. All of such options were granted under our 2003 Stock Option Plan. See this Item 6E. Directors, Senior Management and Employees Share Ownership Stock Option Plans.

We follow Israeli law and practice, instead of the requirements of the NASDAQ Marketplace Rules, with regard to the compensation of our chief executive office and other executive officers. See Item 16G. Corporate Governance.

C. Board Practices

Introduction

According to the Israeli Companies Law and our Articles of Association, the management of our business is vested in our board of directors. The board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our chief executive officer and board of directors. Executive officers are appointed by and serve at the discretion of the board of directors, subject to any applicable agreements.

Election of Directors

Our articles of association provide for a board of directors of not less than three and not more than 11 members, as may be determined from time to time at our annual general meeting. Our board of directors is currently composed of eight directors.

Our directors (except the external directors, as detailed below), are elected by our shareholders at our annual general meeting and hold office until the next annual general meeting. All the members of our board of directors (except the external directors), may be reelected upon completion of their term of office. Our annual general meetings of shareholders are held at least once every calendar year, but not more than 15 months after the last preceding annual general meeting. In the intervals between our annual general meetings of shareholders, the board of directors may from time to time appoint a new director to fill a casual vacancy or to add to their number, and any director so appointed will remain in officer until our next annual general meeting of shareholders and may be re-elected.

Under the Israeli Companies Law, our board of directors is required to determine the minimum number of directors who must have accounting and financial expertise, as such term is defined in regulations promulgated under the Israeli Companies Law. Our board of directors has determined that at least one director must have accounting and financial expertise. Our board of directors has further determined that Ms. Anat Winner has the requisite accounting and financial expertise.

We do not follow the requirements of the NASDAQ Marketplace Rules with regard to the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which our directors are recommended by our board of directors for election by our shareholders. See Item 16G. Corporate Governance.

External and Independent Directors

External directors. The Israeli Companies Law requires Israeli companies with shares that have been offered to the public in or outside of Israel to appoint at least two external directors. The Israeli Companies Law provides that a person may not be appointed as an external director if the person, or the person s relative, partner, employer or an entity under that person s control, has or had during the two years preceding the date of appointment any affiliation with the company, or any entity controlling, controlled by or under common control with the company. The term relative means a spouse, sibling, parent, grandparent, child or child of spouse or spouse of any of the above. In general, the term affiliation includes an employment relationship, a business or professional relationship maintained on a regular basis, control and service as an office holder. Regulations promulgated under the Israeli Companies Law include certain additional relationships that would not be deemed an affiliation with a company for the purpose of service as an external director.

In addition, no person may serve as an external director if the person s position or other activities create, or may create, a conflict of interest with the person s responsibilities as director or may otherwise interfere with the person s ability to serve as director. If, at the time an external director is appointed, all current members of the board of directors are of the same gender, then that external director must be of the other gender. A director of one company may not be appointed as an external director of another company if a director of the other company is acting as an external director of the first company at such time.

At least one of the elected external directors must have accounting and financial expertise and any other external director must have accounting and financial expertise or professional qualification, as such terms are defined by regulations promulgated under the Israeli Companies Law. However, Israeli companies listed on certain stock exchanges outside Israel, including The NASDAQ Global Market, such as our company, are not required to appoint an external director with accounting and financial expertise if a director with accounting and financial expertise who qualifies as an independent director for purposes of audit committee membership under the laws of the foreign country in which the stock exchange is located serves on its board of directors. All of the external directors of such a company must have professional qualification.

The external directors are elected by shareholders at a general meeting. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who voted on the matter. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company.

In general, external directors serve for a three-year term and may be reelected to one additional three-year term. However, Israeli companies listed on certain stock exchanges outside Israel, including The NASDAQ Global Market, such as our company, may appoint an external director for additional terms of not more than three years subject to certain conditions. Such conditions include the determination by the audit committee and board of directors, that in view of the director s professional expertise and special contribution to the company s board of directors and its committees, the appointment of the external director for an additional term is in the best interest of the company. External directors can be removed from office only by the same special percentage of shareholders that can elect them, or by a court, and then only if the external directors cease to meet the statutory qualifications with respect to their appointment or if they violate their fiduciary duty to the company.

Each committee of the board of directors that is authorized to exercise powers vested in the board of directors must include at least one external director and the audit committee must include all the external directors. An external director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

Independent Directors. In general, NASDAQ Marketplace Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors and that its audit committee have at least three members and be comprised only of independent directors, each of whom satisfies the respective independence requirements of NASDAQ and the Securities and Exchange Commission. However, foreign private issuers, such as our company, may follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. On June 30, 2006, we provided NASDAQ with a notice of non-compliance with respect to the requirement to maintain a majority of independent directors, as defined under NASDAQ Marketplace Rules. Instead, under Israeli law and practice we are required to appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors. However, despite such notification of non-compliance, we maintain a majority of independent directors. In addition, in accordance with the rules of the Securities and Exchange Commission and NASDAQ, we have the mandated three independent directors, as defined by the rules of the Securities and Exchange Commission and NASDAQ, on our audit committee.

Pursuant to a recent amendment to the Israeli Companies Law, an Israeli company whose shares are publicly traded may elect to adopt a provision in its articles of association pursuant to which a majority of its board of directors will constitute individuals complying with certain independence criteria prescribed by the Israeli Companies Law. We have not included such a provision in our articles of association.

Our board of directors has determined that Ms. Winner and Mr. Kobrinsky qualify both as independent directors under the requirements of the Securities and Exchange Commission and NASDAQ and as external directors under the requirements of the Israeli Companies Law. Our board of directors has further determined that Messrs. Nuss and Livne qualify as independent directors under the requirements of the Securities and Exchange Commission and NASDAQ.

Audit Committee

Under the Israeli Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the external directors. The audit committee may not include the chairman of the board of directors; any director employed by the company or providing services to the company on an ongoing basis; or a controlling shareholder or any of the controlling shareholder s relatives. The responsibilities of the audit committee include identifying irregularities in the management of the company s business and approving related party transactions as required by law. Under Israeli law, an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

In addition, the NASDAQ Marketplace Rules require us to establish an audit committee comprised of at least three members, all of whom must be independent directors, each of whom is financially literate and satisfies the respective independence requirements of the Securities and Exchange Commission and NASDAQ and one of whom has accounting or related financial management expertise at senior levels within a company.

Our audit committee consists of three board members who satisfy the respective independence requirements of the Securities and Exchange Commission, NASDAQ and Israeli law for audit committee members. Our audit committee is currently composed of Messrs. Shaul Kobrinsky and Jacob Nuss and Ms. Anat Winner. The audit committee meets at least once each quarter. Our audit committee charter is available on our website at www.magal-ssl.com.

Investment Committee

Our board of directors has established an investment committee, which is responsible for the investment of our cash and our hedging transactions. The investment committee is currently composed of Messrs. Jacob Even-Ezra and Shaul Kobrinsky and Ms. Winner,

Internal Auditor

Under the Israeli Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is to examine whether the company s actions comply with the law, integrity and orderly business practice. Under the Israeli Companies Law, the internal auditor may not be an interested party, an office holder, or an affiliate, or a relative of an interested party, office holder or affiliate, nor may the internal auditor be the company s independent accountant or its representative. Mr. Daniel Shapira, Certified Public Accountant (Israel) is our internal auditor.

Directors Service Contracts

There are no arrangements or understandings between us and any of our subsidiaries, on the one hand, and any of our directors, on the other hand, providing for benefits upon termination of their employment or service as directors of our company or any of our subsidiaries.

Approval of Related Party Transactions Under Israeli Law

Fiduciary Duties of Office Holders

The Israeli Companies Law codifies the fiduciary duties that office holders, including directors and executive officers, owe to a company. An office holder is defined in the Israeli Companies Law as a director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions without regard to such person s title. An office holder s fiduciary duties consist of a duty of care and a fiduciary duty. The duty of care requires an office holder to act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (i) information regarding the appropriateness of a given action brought for his approval or performed by him by virtue of his position and (ii) all other information of importance pertaining to the foregoing actions. The fiduciary duty includes (i) avoiding any conflict of interest between the office holder s position in the company and any other position he holds or his personal affairs, (ii) avoiding any competition with the company s business, (iii) avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and (iv) disclosing to the company any information or documents relating to the company s affairs that the office holder has received due to his position as an office holder.

Disclosure of Personal Interests of an Office Holder; Approval of Transactions with Office Holders

The Israeli Companies Law requires that an office holder promptly, and no later than the first board meeting at which such transaction is considered, disclose any personal interest that he or she may have and all related material information known to him or her and any documents in their position, in connection with any existing or proposed transaction by us. In addition, if the transaction is an extraordinary transaction, that is, a transaction other than in the ordinary course of business, other than on market terms, or likely to have a material impact on the company s profitability, assets or liabilities, the office holder must also disclose any personal interest held by the office holder s spouse, siblings, parents, grandparents, descendants, spouse s descendants and the spouses of any of the foregoing, or by any corporation in which the office holder or a relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager.

Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors require approval by the board of directors, and exculpation, insurance and indemnification of, or an undertaking to, indemnify an office holder who is not a director requires both board of directors and audit committee approval. The compensation of office holders who are directors must be approved by our audit committee, board of directors and shareholders.

Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has an interest) must be approved by the board of directors or as otherwise provided for in a company s articles of association, however, a transaction that is adverse to the company s interest may not be approved. In some cases, such a transaction must be approved by the audit committee and by the board of directors itself, and under certain circumstances shareholder approval may be required. A director who has a personal interest in a transaction that is considered at a meeting of the board of directors or the audit committee may not be present during the board of directors or audit committee discussions and may not vote on the transaction, unless the transaction is not an extraordinary transaction or the majority of the members of the board or the audit committee have a personal interest, as the case may be. In the event the majority of the members of the board of directors or the audit committee have a personal interest, then the approval of the general meeting of shareholders is also required.

Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders

The disclosure requirements that apply to an office holder also apply to a transaction in which a controlling shareholder with respect to his or her personal interest in any existing or proposed transaction by us. The Israeli Companies Law provides that an extraordinary transaction with a controlling shareholder or an extraordinary transaction with another person in whom the controlling shareholder has a personal interest or a transaction with a controlling shareholder or his relative regarding terms of service and employment, must be approved by the audit committee, the board of directors and shareholders. The shareholder approval for such a transaction must include at least one-third of the shareholders who have no personal interest in the transaction who voted on the matter (not including abstentions). The transaction can be approved by shareholders without this one-third approval if the total shareholdings of those shareholders who have no personal interest and voted against the transaction do not represent more than one percent of the voting rights in the company.

Under the Companies Regulations (Relief from Related Party Transactions), 5760-2000, promulgated under the Israeli Companies Law, as amended, certain extraordinary transactions between a public company and its controlling shareholder(s) do not require shareholder approval. In addition, under such regulations, directors compensation and employment arrangements in a public company do not require the approval of the shareholders if both the audit committee and the board of directors agree that such arrangements are solely for the benefit of the company. Also, employment and compensation arrangements for an office holder that is a controlling shareholder of a public company do not require shareholder approval if certain criteria are met. The foregoing exemptions from shareholder approval will not apply if one or more shareholders holding at least 1% of the issued and outstanding share capital of the company or of the company s voting rights, objects to the use of these exemptions provided that such objection is submitted to the company in writing not later than fourteen days from the date of the filing of a report regarding the adoption of such resolution by the company pursuant to the requirements of the Israeli Securities Law, 5328-1968. If such objection is duly and timely submitted, then the transaction or compensation arrangement of the directors will require shareholders approval as detailed above.

In addition, a private placement of securities requires the approval of the board of directors and shareholders of the company if (i) the private placement will cause a person to become a controlling shareholder or (ii) 20% or more of the company s outstanding share capital prior to the private placement are offered and the payment for which (in whole or in part) is not in cash or registered securities or that is not under market terms, and the private placement will increase the relative holdings of a shareholder that holds 5% or more of the company s outstanding share capital or will cause any person to become a holder of more than 5% of the company s outstanding share capital. Other than as described, under Israeli law private placements require the approval of the board of directors.

The Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company. This rule does not apply if there is already another 25% or greater shareholder of the company. Similarly, the Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would hold greater than a 45% interest in the company, unless there is another shareholder holding more than a 45% interest in the company. These requirements do not apply if, in general, (i) the acquisition was made in a private placement that received shareholder approval, (ii) was from a 25% or greater shareholder of the company which resulted in the acquirer becoming a 25% or greater shareholder of the company, if there is not already a 25% or greater shareholder of the company, or (iii) was from a shareholder holding a 45% interest in the company which resulted in the acquirer becoming a holder of a 45% interest in the company if there is not already a 45% or greater shareholder of the company.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of a public company s outstanding shares or a class of shares, the acquisition must be made by means of a tender offer for all of the outstanding shares or a class of shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to the acquirer. The Israeli Companies Law provides for appraisal rights if any shareholder files a request in court within three months following the consummation of a full tender offer. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares.

Exculpation, Indemnification and Insurance of Directors and Officers

Exculpation of Office Holders. The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his or her fiduciary duty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care in the event of distributions.

Office Holders Insurance. Israeli law provides that a company may, if permitted by its articles of association, enter into a contract to insure its office holders for liabilities incurred by the office holder with a respect to an act performed in his or her capacity as an office holder, as a result of: (i) a breach of the office holder s duty of care to the company or another person; (ii) a breach of the office holder s fiduciary duty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that the act would not prejudice the company s interests; and (iii) a financial liability imposed upon the office holder in favor of another person.

Indemnification of Office Holders. Under Israeli law a company may, if permitted by its articles of association, indemnify an office holder for acts performed by the office holder in such capacity for (i) a monetary liability imposed upon the office holder in favor of another person by any court judgment, including a settlement or an arbitration award approved by a court; (ii) reasonable litigation expenses, including attorney s fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on him or her in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (iii) reasonable litigation expenses, including attorneys fees, actually incurred by the office holder or imposed upon the office holder by a court: in an action, suit or proceeding brought against the office holder by or on behalf of the company or another person, or in connection with a criminal action in which the office holder was acquitted, or in connection with a criminal action in which the office holder was convicted of a criminal offence that does not require proof of criminal intent.

Israeli law provides that a company s articles of association may permit the company to (a) indemnify an office holder retroactively, following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified; and (b) undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the opinion of the company s board of directors, are, at the time of the undertaking, foreseeable due to the company s activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances.

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Limitations on Exculpation, Insurance and Indemnification. The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exculpating an office holder from duty to the company shall be valid, where such insurance, indemnification or exculpation relates to any of the following: (i) a breach by the office holder of his fiduciary duty unless, with respect to insurance coverage or indemnification, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company; (ii) a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission done with the intent to unlawfully yield a personal benefit; or (iv) any fine or forfeiture imposed on the office holder.

Pursuant to the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our audit committee and board of directors and, if the office holder is a director, also by our shareholders.

Our Articles of Association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by Israeli law. We maintain a directors and officers liability insurance policy with a per claim and aggregate coverage limit of $10 million, including legal costs incurred in Israel. Our Audit Committee and Board of Directors have resolved to increase the aggregate coverage limit of our directors and officers liability insurance to $ 10 million, which increase is subject to the approval of our shareholders. In addition, our audit committee, board of directors and shareholders resolved to indemnify our office holders, pursuant to a standard indemnification agreement that provides for indemnification of an office holder in an amount up to $5 million. To date, we have provided letters of indemnification to certain of our officers and directors.

D. Employees

As of December 31, 2008, we employed 321 full-time employees, of whom 39 were employed in general management and administration, 45 were employed in selling and marketing, 22 were employed in production management, 164 were employed in production, installation and maintenance, and 51 were employed in engineering and research and development. Of such full-time employees, 151 were located in Israel, 29 were in the United States, 89 were in Canada and 52 were in various other countries.

As of December 31, 2007, we employed 303 full-time employees, of whom 38 were employed in general management and administration, 42 were employed in marketing, 22 were employed in production management, 149 were employed in production, installation and maintenance, and 52 were employed in engineering and research and development. Of such full-time employees, 143 were located in Israel, 34 were in the United States, 81 were in Canada and 45 were in various other countries.

As of December 31, 2006, we employed 294 full-time employees, of whom 34 were employed in general management and administration, 43 were employed in marketing, 23 were employed in production management, 143 were employed in production, installation and maintenance, and 51 were employed in engineering and research and development. Of our 294 full time employees, 135 were in Israel, 49 located were in the United States, 78 were in Canada and 32 were in various other countries.

Our relationships with our employees in Israel are governed by Israeli labor legislation and regulations, extension orders of the Israeli Ministry of Labor and personal employment agreements. We are subject to various Israeli labor laws, collective bargaining agreements entered into from time to time between the Manufacturers Association and the Histadrut, as well as collective bargaining arrangements. Such laws, agreements and arrangements cover a wide range of areas, including minimum employment standards, such as working hours, minimum wages, vacation, procedures for dismissing employees, severance pay and pension plans and special issues, such as equal pay for equal work, equal opportunity in employment and employment of youth and army veterans. Certain of our employees are parties to individual employment agreements. We generally provide our employees with benefits and working conditions beyond the required minimums. Each of our subsidiaries provides a benefits package and working conditions which are competitive with other companies in their area of operations.

Israeli law requires severance pay upon certain circumstances, including upon the retirement or death of an employee or termination of employment without due cause. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration, which amounts also include payments for national health insurance.

E. Share Ownership.

The following table sets forth certain information regarding the ownership of our ordinary shares by our directors and executive officers as of June 30, 2009.

Name	Number of Ordinary Shares Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Jacob Perry	-	-
Hagai Katz	-	-
Zev Morgensten	-	-
Asaf Even-Ezra (3)	124,926	1.20%
Yehonatan Ben-Hamozeg	*	*
Jacob Even-Ezra (4)	370,742	3.56%
Nathan Kirsh (5)	2,516,268	24.20%
Shaul Kobrinsky	-	-
Zeev Livne	-	-
Jacob Nuss	-	-
Barry Stiefel		
Anat Winner	-	-
All directors and executive officers as a group (12 persons)	3,249,252	31.19%

Name	Number of Ordinary Shares Owned(1)	Percentage of Outstanding Ordinary Shares(2)

*Less than 1%

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible debenture notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 10,396,548 ordinary shares issued and outstanding as of June 30, 2009.

(3) Includes 9,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $8.56 per share that expire in December 2010. Asaf Even-Ezra is Jacob Even-Ezra s son.

(4) Includes 76,915 ordinary shares held by a trustee. Jacob Even-Ezra is the father of Asaf Even-Ezra.

(5) Based upon a Schedule 13D/A filed with the Securities and Exchange Commission on January 16, 2009 and other information available to the company. Includes: (i) 346,375 ordinary shares held of record by Mr. Kirsh; (ii) 1,485,852 ordinary shares held of record by Mira Mag Inc., or Mira Mag, a company organized in Liberia; and (iii) 684,041 ordinary shares held of record by Ki Corporation Limited, or Ki Corporation, a company organized in Liberia. The Eurona Foundation holds 100% of Ki Corporation. Ki Corporation holds 100% of the shares of Mira Mag. The Eurona Foundation is a Liechtenstein trust controlled by Mr. Kirsh, who also serves as its trustee. Mr. Kirsh may be deemed to have beneficial ownership of the ordinary shares held of record by Mira Mag and Ki Corporation.

2003 Israeli Share Option Plan

On October 27, 2003, our board of directors adopted our 2003 Israeli Share Option Plan, or the 2003 Plan, which was approved by our shareholders in July 2004. Under the 2003 Plan, stock options will be periodically granted to our employees, directors, officers and consultants, in accordance with the decision of our board of directors.

Our board of directors has the authority to determine the vesting schedule of such options and the exercise price. Under the 2003 Plan, unless determined otherwise by the Board, no option may be exercised before the second anniversary of the date on which it was granted, and each option expires on or before the fifth anniversary of the date on which it was granted. Pursuant to the 2003 Plan, any options that are cancelled or not exercised within the option period will become available for future grants. Our board of directors has elected to allot options to Israeli employees under Israel s capital gain tax treatment.

Pursuant to the provisions of the 2003 Plan, if we issue a stock dividend, the number of shares purchasable by any grantee upon the exercise of options that were granted prior to the issuance of the stock dividend will be correspondingly increased.

In May 2008, our board of directors approved an amendment to the 2003 Plan, which was approved by our shareholders in August 2008, that increased the number of ordinary shares available for issuance under the 2003 Plan by 1,000,000, and extended the termination of the 2003 Plan from October 2013 to October 2018.

As of December 31, 2008, options to purchase 724,500 ordinary shares were outstanding under the 2003 Plan, exercisable at an average exercise price of 7.92 per share. None of the options awarded under the 2003 Plan were exercised during 2008. As of December 31, 2008, 894,075 ordinary shares remained available for future option grants under the 2003 Plan.

ITEM 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

The following table sets forth certain information as of June 30 , 2009 regarding the beneficial ownership of our ordinary shares, by each person or entity known to us to own beneficially 5.0% or more of our ordinary shares.

Name	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Nathan Kirsh (3)	2,516,268	24.2%
Diker Management LLC (4)	968,468	9.32%
Clough Capital Partners L.P. (5)	770,842	7.41%
Grace & White, Inc. (6)	596,148	5.73%
Prescot Group Aggressive Small Cap Master Fund, G.P. (7)	547,127	5.26%

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 10,396,548 ordinary shares issued and outstanding as of June 30, 2009.

(3) Based upon a Schedule 13D/A filed with the Securities and Exchange Commission on January 16, 2009 and other information available to the company. Includes: (i) 346,375 ordinary shares held of record by Mr. Kirsh; (ii) 1,485,852 ordinary shares held of record by Mira Mag Inc., or Mira Mag, a company organized in Liberia; and (iii) 684,041 ordinary shares held of record by Ki Corporation Limited, or Ki Corporation, a company organized in Liberia. The Eurona Foundation holds 100% of Ki Corporation. Ki Corporation holds 100% of the shares of Mira Mag. The Eurona Foundation is a Liechtenstein trust controlled by Mr. Kirsh, who also serves as its trustee. Mr. Kirsh may be deemed to have beneficial ownership of the ordinary shares held of record by Mira Mag and Ki Corporation.

(4) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the Securities and Exchange Commission on February 17, 2009. The Schedule 13G/A indicates that as the sole general partner of certain Diker partnerships with respect to stock directly owned by certain Diker funds, or the Diker Funds, Diker GP, has the power to vote and dispose of the shares owned by the Diker Funds and, accordingly, may be deemed the beneficial owner of such shares. Pursuant to investment advisory agreements, Diker Management, LLC serves as the investment manager of the Diker Funds. Accordingly, Diker Management may be deemed the beneficial owner of shares held by the Diker Funds. Charles M. Diker and Mark N. Diker are the managing members of each of Diker GP, LLC and Diker Management LLC, and in that capacity direct their operations. Therefore, Charles M. Diker and Mark N. Diker may be deemed the beneficial owners of shares beneficially owned by Diker GP, LLC and Diker Management LLC. Diker GP, LLC, Diker Management LLC, Charles M. Diker and Mark N. Diker disclaim all beneficial ownership, however, as affiliates of a registered investment adviser, and in any case disclaim beneficial ownership except to the extent of their pecuniary interest in the shares.

(5) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the Securities and Exchange Commission on February 10, 2009. The Schedule 13G/A indicates that the shares include shares beneficially owned by investment companies, pooled investment vehicles and other accounts for which Clough Capital Partners L.P. serves as investment adviser. Such shares may be deemed beneficially owner by (a) Clough Capital Partners L.P., (b) Clough Capital Partners LLC, the general partner of Clough Capital Partners L.P., and (c) Messrs. Charles Clough, James Canty and Eric Brock, the managing members of Clough Capital Partners LLC. Each such reporting person disclaims beneficial ownership of such shares except to the extent of its respective pecuniary interest therein.

(6)

Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the Securities and Exchange Commission on February 4, 2009. The Schedule 13G/A indicates that Grace & White, Inc. is a registered investment adviser.

(7) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the Securities and Exchange Commission on February 10, 2009. The Schedule 13G/A indicates that Prescott Group Aggressive Small Cap, L.P. and Prescott Group Aggressive Small Cap II, L.P., referred to together as the Small Cap Funds, are the general partners of Prescot Group Aggressive Small Cap Master Fund, G.P., or Prescott Master Fund. Prescott Group Capital Management, L.L.C., or Prescott Capital, serves as the general partner of the Small Cap Funds and may direct the Small Cap Funds, the general partners of Prescott Master Fund, to direct the vote and disposition of the ordinary shares held by the Master Fund. Mr. Frohlich, the principal of Prescott Capital, may direct the vote and disposition of the ordinary shares held by Prescott Master Fund.

Significant Changes in the Ownership of Major Shareholders

As of December 26, 2005, Mr. Nathan Kirsh beneficially owned 1,832,227 or 17.66% of our ordinary shares, in accordance with a Schedule 13D/A filed with the Securities and Exchange Commission, or SEC on February 13, 2006. On January 10, 2008, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 1,913,601, or 18.41% of our ordinary shares. On April 24, 2008, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,191,162, or 21.08% of our ordinary shares. On April 25, 2008, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,191,162, or 21.08% of our ordinary shares. On January 16, 2009, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,516,268, or 24.20% of our ordinary shares.

On February 6, 2007, Clough Capital Partners, L.P. filed an amendment to its Schedule 13G, on Schedule 13G/A, with the SEC reflecting beneficial ownership of 711,669 or 6.85% of our ordinary shares. On February 11, 2008, Clough Capital Partners, L.P. filed an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 712,269 or 6.85% of our ordinary shares. On February 10, 2009, Clough Capital Partners, L.P. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 770,842 or 7.41% of our ordinary shares.

On February 2, 2007, Diker GP, LLC, Diker Management LLC, or Diker Management, Messrs. Charles M. Diker and Mark N. Diker filed a Schedule 13G with the SEC reflecting beneficial ownership of 1,007,601 or 9.70% of our ordinary shares. On February 12, 2008, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 1,014,425, or 9.76%, of our ordinary shares. On February 17, 2009, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 968,468 or 9.32% of our ordinary shares.

On February 4, 2008, Grace & White, Inc. filed a Schedule 13G with the SEC reflecting beneficial ownership of 574,254 or 5.52% of our ordinary shares. On February 10, 2009, Grace & White, Inc. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 596,148 or 5.73% of our ordinary shares.

On February 14, 2008, Prescott Capital, Prescott Group Aggressive Small Cap, L.P., Prescott Group Aggressive Small Cap II, L.P. and Mr. Phil Frohlich filed a Schedule 13G with the SEC reflecting beneficial ownership of 539,097 or 5.19% of our ordinary shares. On February 10, 2009, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 547,127 or 5.3% of our ordinary shares.

Major Shareholders Voting Rights

The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares.

Record Holders

Based on a review of the information provided to us by our transfer agent, as of July 10, 2009, there were 58 holders of record of our ordinary shares, of which 46 record holders holding approximately 77.14% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor is it representative of where such beneficial holders reside since many of these ordinary shares were held of record by brokers or other nominees, including CEDE & Co., the nominee for the Depositary Trust Company (the central depositary for the U.S. brokerage community), which held approximately 76.93% of our outstanding ordinary shares as of such date.

B. Related Party Transactions.

On January 22, 2008, we entered into a retirement agreement with Mr. Jacob Even-Ezra, who retired from his position as the chairman of our board of directors as of January 1, 2008, based on the terms approved by our shareholders in August 2007. Subsequent to the annual general meeting of our shareholders held in August 2007, our board of directors required that Mr. Even-Ezra s retirement agreement be amended to include a non-compete undertaking. Pursuant to the retirement agreement, as amended, Mr. Even- Ezra has undertaken not to compete with our company for a period of three years following his retirement. In consideration, we agreed to pay Mr. Even-Ezra $360,000. Such amendment was approved in January 2008 by our audit committee and board of directors without shareholder approval in accordance with the Companies Regulations (Relief from Related Party Transactions) 5760-2000, promulgated under the Israeli Companies Law, since such amendment is solely for the benefit of the our company. In the event that within 14 days from the date of the disclosure of the resolution of the audit committee and the board of directors shareholders holding at least 1% of our voting rights will so request, such resolution will be subject to the approval of the general meeting of our shareholders. In addition, as gratitude for his long term and outstanding efforts to further our business and interests, we agreed to provide to Mr. Even-Ezra with certain benefits and services, the value thereof presently estimated to be $50,000 per year, for the rest of his life. As of December 31, 2008, the actuarial value of these perquisites is estimated by approximately $603,000.

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On August 21, 2008, we entered into an agreement with Mr. Jacob Perry, in connection with his services as the chairman of our board of directors. Pursuant to the terms of the agreement, Mr. Perry agreed to serve as the chairman of our board of directors on a part time basis and has undertaken to devote 50%-60% of his business time and attention to the development of our business. Mr. Perry s service as the chairman of our board of directors is for an unlimited period, however each party may terminate the agreement without cause by giving 90 days notice to the other party. Mr. Perry is entitled to receive as compensation for his services as chairman of our board of directors a monthly fee of NIS 50,000 (approximately $13,000) effective as of the date of his appointment as chairman of our board of directors on January 1, 2008. Such compensation is linked to the Israeli consumer price index and will be adjusted every six months. In addition, in the event that our annual income before taxes (after deduction of any and all bonuses paid to all other employees including our chief executive officer, and excluding any non-recurring capital gain or loss), will be higher than $3,000,000, or the Base Amount we will pay Mr. Perry an annual bonus that will be equal to 5% of our company s annual income before taxes, but in any event not more than $500,000 per year. On January 1 of each year, the Base Amount is increased by 10% per year. Mr. Perry is also entitled to receive all customary social benefits such as managers insurance and education fund, such amount will be paid to him or to third parties for his benefit. In November 2008, our agreement with Mr. Perry was amended, pursuant to which until September 1, 2008, Mr. Perry was engaged by us as an as independent contractor through a company controlled by him and after September 1, 2008, is an employee of our company. Such amendment was approved in January 2008 by our audit committee and board of directors without shareholder approval in accordance with the Companies Regulations (Relief from Related Party Transactions) 5760-2000, promulgated under the Israeli Companies Law, since such amendment is solely for the benefit of the our company. In the event that within 14 days from the date of the disclosure of the resolution of the audit committee and the board of directors shareholders holding at least 1% of our voting rights will so request, such resolution will be subject to the approval of the general meeting of our shareholders.

Mr. Perry is also the chairman of the board of directors of Mizrahi Tefahot Bank B.M. We have a credit line with Mizrahi Tefahot Bank B.M., totaling approximately $5.0 million since July 2006. Our board of directors determined that this a transaction in the ordinary cause of business, that was made on an arm s length basis and is in the best interest of our company.

Our former U.S. subsidiary, Smart Interactive Systems Inc., provided video monitoring services to companies controlled by Mr. Nathan Kirsh, our principal shareholder and a director. The terms of the contracts under which we made sales to these companies were negotiated on an arm s length basis and the terms of such contracts were no more favorable to these companies than those it could have obtained from an unaffiliated third party. Our sales to these companies during the years ended 2006 and 2007, were $765,000 and $781,000, respectively. In December 2007, we disposed of our U.S. based video monitoring business.

In November 2008, our audit committee and board of directors approved, subject to the approval of our shareholders, that Mr. Zeev Livne, a director, is entitled to a commission equal to 1.5% of the net revenues actually received by us from certain transactions in a number of Eastern European countries.

We have entered into retirement agreements with our certain of our officers under which we have paid post employment and retirement liabilities in the aggregate amount of approximately $2.6 million. Of such amount, approximately $1.7 million was paid to Mr. Izhar Dekel, our former President and chief executive officer, who had been employed by our company and served in various positions from 1984 until February 2009. These payments include consideration for a non-compete undertaking as well as severance payments and other retirement related payments in accordance with Mr. Dekel s retirement agreement and Israeli law.

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C. Interests of Experts and Counsel.

Not applicable.

ITEM 8. Financial Information

A. Consolidated Statements and Other Financial Information.

Consolidated Financial Statements

See the consolidated financial statements included under Item 18, Financial Statements.

Export Sales

In 2006, 2007 and 2008, the total amount of our revenues from our facilities located outside of Israel to customers outside of Israel was approximately \$37.0 million, \$49.1 million and \$48.3 million, respectively, or 55.2%, 67.9% and 68.7% of our total revenues, respectively. In 2006, 2007 and 2008, the total amount of our export revenues from our Israeli facilities to countries outside of Israel was approximately \$3.6 million, \$7.6 million and \$9.9 million, respectively, or 5.4%, 10.5% and 14.1% of our total revenues, respectively.

Legal Proceedings

In May 2005, we entered into an agreement to supply comprehensive security solutions for a sensitive site in Eastern Europe. As part of the agreement, we received an advance payment, secured by a bank advanced payment guarantee that was to be reduced proportionally as execution of the project progressed. In addition, we issued to the customer a performance bank guarantee. We commenced the project and delivered some of the equipment and other deliverables to the customer in 2005. In April 2006, the customer informed us that it was canceling the agreement due to errors in the design documents that we submitted. In addition, the customer did not make payments required under the agreement. Based on its cancellation of the agreement, the customer collected \$3.2 million under the performance bank guarantee on June 20, 2006. Due to the uncertainty, we did not recognize any revenues from this project.

On July 11, 2006, the customer made a demand for additional \$1.4 million payment under the performance bank guarantee. Upon our motion, the District Court in Haifa, Israel issued a temporary injunction against the payment of such guarantee pending a hearing in August 2006. At the hearing, we reached a settlement with the customer pursuant to which we paid the customer approximately \$700,000 of the disputed amount and the balance will be repaid only if we are found liable for damages exceeding the amount paid by us. In view of the above and due to the uncertainty of our preventing the forfeiture of the performance bank guarantee, we included a \$1.4 million provision in respect of this guarantee in our financial statements for the year ended December 31, 2005. Based on the settlement, we cancelled the balance of the provision made in our financial statements in 2006.

On June 6, 2007, the Court of Arbitration awarded its decision in the arbitration and stated that the agreement concluded between us and the customer is void due to legal mistakes made by the customer in the tender process. As a result of this award and as agreed in the settlement agreement, the performance bank guarantee was cancelled in February 2008. Based on the above we decided to institute a new legal action against the customer and seek compensation for the damages we incurred. We initiated the following motions: (1) on December 10, 2007 a motion for reconciliation was submitted to a Public Court; and (2) on December 11, 2007 a claim for compensation was submitted to the Court of Arbitration. In both actions the claim was in the amount of \$21,533,998. On February 2008, the customer denied our request for reconciliation and as a result this process has been concluded. The arbitration proceeding is still pending.

In addition, we are subject to legal proceedings arising in the normal course of business. Based on the advice of our legal counsel, management believes that these proceedings will not have a material adverse effect on our financial position or results of operations.

Dividend Distribution Policy

We currently intend to retain future earnings for use in our business and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. Future dividend distributions are subject to the discretion of our board of directors and will depend on a number of factors, including our operating results, future capital resources available for distribution, capital requirements, financial condition, the tax implications of dividend distributions on our income, future prospects and any other factors our board of directors may deem relevant.

The distribution of dividends also may be limited by Israeli law, which permits the distribution of dividends only out of profits (as defined by the Israeli Companies Law) or otherwise upon the permission of the court. Profits are defined in the Israeli Companies Law as the balance of surpluses, or the surpluses accumulated over the past two years, whichever is the greater, in accordance with the latest adjusted financial statements, audited or reviewed, prepared by the company, provided that the date in respect of which the statements were prepared is no earlier than six months prior to the date of distribution. Surplus means sums included in a company s shareholders equity originating from the net profit of the company, as determined according to generally accepted accounting principles, and sums other than share capital or premiums that are included in shareholders equity under generally accepted accounting principles and the Minister of Justice prescribed that they are to be considered surplus.

B. Significant Changes.

Since the date of the annual consolidated financial statements included in this annual report, no significant changes have occurred.

ITEM 9. The Offer and Listing

A. Offer and Listing Details.

Annual Stock Information

The following table sets forth, for each of the years indicated, the high and low market prices of our ordinary shares on the NASDAQ Global Market and the Tel Aviv Stock Exchange:

	NASDAQ Global Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
2004	$ 40.35	$ 6.75	NIS 156.68	NIS 32.25
2005	$ 12.22	$ 7.87	NIS 53.45	NIS 35.74
2006	$ 14.20	$ 8.51	NIS 64.78	NIS 36.10
2007	$ 12.00	$ 6.26	NIS 51.00	NIS 23.50
2008	$ 9.30	$ 4.61	NIS 32.44	NIS 18.60

Quarterly Stock Information

The following table sets forth, for each of the full financial quarters in the years indicated and any subsequent period, the high and market prices of our ordinary shares on the NASDAQ Global Market and the Tel Aviv Stock Exchange:

	NASDAQ Global Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
2007				
First Quarter	$ 12.00	$ 8.53	NIS 51.00	NIS 36.25
Second Quarter	$ 11.18	$ 9.91	NIS 46.06	NIS 40.20
Third Quarter	$ 10.49	$ 7.50	NIS 43.95	NIS 34.01

	NASDAQ Global Market				Tel Aviv Stock Exchange			
Fourth Quarter	$	9.15	$	6.26	NIS	36.99	NIS	23.50
2008								
First Quarter	$	7.70	$	5.09	NIS	28.20	NIS	19.00
Second Quarter	$	8.81	$	5.84	NIS	29.55	NIS	19.00
Third Quarter	$	9.30	$	6.80	NIS	32.44	NIS	23.01
Fourth Quarter	$	8.87	$	4.61	NIS	31.97	NIS	18.60
2009								
First Quarter	$	6.40	$	3.79	NIS	24.50	NIS	16.00

Monthly Stock Information

The following table sets forth, for each of the most recent six months, the high and low market prices of our ordinary shares on the NASDAQ Global Market and the Tel Aviv Stock Exchange:

	NASDAQ Global Market				Tel Aviv Stock Exchange			
	High		Low		High		Low	
December 2008	$	6.24	$	4.76	NIS	23.00	NIS	18.60
January 2009	$	6.40	$	5.37	NIS	24.50	NIS	21.05
February 2009	$	5.76	$	4.67	NIS	23.78	NIS	21.00
March 2009	$	5.21	$	3.79	NIS	22.15	NIS	16.00
April 2009	$	4.75	$	3.80	NIS	18.94	NIS	16.61
May 2009	$	4.69	$	4.07	NIS	19.70	NIS	17.02

B. Plan of Distribution.

Not applicable.

C. Markets.

Our ordinary shares have traded on the NASDAQ Global Market under the symbol MAGS since our initial public offering in 1993. Our ordinary shares have also traded on the Tel Aviv Stock Exchange under the symbol MAGS since July 1, 2001.

D. Selling Shareholders.

Not applicable.

E. Dilution.

Not applicable.

F. Expenses of the Issue.

Not applicable.

ITEM 10. Additional Information

A. Share Capital.

Not applicable.

B. Memorandum and Articles of Association.

Purposes and Objects of the Company

We are a public company registered with the Israeli Companies Registrar and have been assigned company number 52-003892-8. Section 2 of our memorandum of association provides, among other things, that we were established for the purposes of acquiring from IAI a plant, known as the Magal Plant, engaged in the development, manufacture, sale and support of alarm devices and dealing in the development, manufacturing and support of security alarm devices and other similar products. In addition, the purpose of our company is to be eligible to perform and act in connection with any right or obligation of whatever kind or nature permissible under Israeli law.

Board of Directors

The strategic management of our business (as distinguished from the daily management of our business affairs) is vested in our board of directors, which may exercise all such powers and do all such acts as our company is authorized to exercise and do, and which are not required to be exercised by a resolution of the general meeting of our shareholders. The board of directors may, subject to the provisions of the Israeli Companies Law, delegate some of its powers to committees, each consisting of one or more directors, provided that at least one member of such committee is an external director.

According to the Israeli Companies Law, we may stipulate in our articles of association that the general meeting of shareholders is authorized to assume the responsibilities of the board of directors. In the event the board of directors is unable to act or exercise its powers, the general meeting of shareholders is authorized to exercise the powers of the board of directors, even if the articles of association do not stipulate so. Our board of directors has the power to assume the responsibilities of our chief executive officer if he is unable to act or exercise his powers or if he fails to fulfill the instructions of the board of directors with respect to a specific matter.

Our articles of association do not impose any mandatory retirement or age limit requirements on our directors and our directors are not required to own shares in our company in order to qualify to serve as directors.

The authority of our directors to enter into borrowing arrangements on our behalf is not limited, except in the same manner as any other transaction by us.

For a discussion of Israeli law concerning a director s fiduciary duties and the approval of transactions with office holders, see Item 6.C. Directors, Senior Management and Employees-Board Practices Approval of Related Party Transactions under Israeli Law.

Rights Attached to Shares

Our authorized share capital consists of NIS 19,748,000 ordinary shares, par value NIS 1.00 each. All our ordinary shares have the same rights, preferences and restrictions, some of which are detailed below. At the general meeting of shareholders, our shareholders may, subject to certain provisions detailed below, create different classes of shares, each class bearing different rights, preferences and restrictions.

The rights attached to the ordinary shares are as follows:

Dividends Rights.

Holders of ordinary shares are entitled to participate in the payment of dividends in accordance with the amounts paid-up or credited as paid up on the nominal value of such ordinary shares at the time of payment (without taking into account any premium paid thereon). However, under article 13 of our articles of association no shareholder shall be entitled to receive any dividends until the shareholder has paid all calls then currently due and payable on each ordinary share held by such shareholder.

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The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. Declaration of a final dividend requires the approval by ordinary resolution of our shareholders at a general meeting of shareholders. Such resolution may reduce but not increase the dividend amount recommended by the board of directors. Dividends may be paid, in whole or in part, by way of distribution of dividends in kind. See Item 8A. Financial Information Consolidated Statements and Other Financial Information Dividend Distributions Policy.

Voting Rights

Holders of ordinary shares are entitled to one vote for each share held of record on all matters submitted to a vote of shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

Generally, resolutions are adopted at the general meeting of shareholders by an ordinary resolution, unless the Israeli Companies Law or our articles of association require an extraordinary resolution. An ordinary resolution, such as a resolution approving the declaration of dividends or the appointment of auditors, requires approval by the holders of a simple majority of the shares represented at the meeting, in person or by proxy, and voting on the matter. An extraordinary resolution requires approval by the holders of at least 75% of the shares represented at the meeting, in person or by proxy, and voting on the matter. The primary resolutions required to be adopted by an extraordinary resolution of the general meeting of shareholders are resolutions to:

- amend the memorandum of association or articles of association;
- change the share capital, for example, increasing or canceling the authorized share capital or modifying the rights attached to shares; and
- approve mergers, consolidations or winding up of our company.

Our articles of association do not contain any provisions regarding a classified board of directors or cumulative voting for the election of directors. Pursuant to our articles of association, our directors (except the external directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our board of directors (except the external directors) may be reelected upon completion of their term of office. For information regarding the election of external directors, see Item 6C. Directors, Senior Management and Employees Directors and Senior Management Board Practices Election of Directors.

Rights to Share in the Company's Profits

Our shareholders have the right to share in our profits distributed as a dividend or any other permitted distributions. See this Item 10B. Additional Information Memorandum and Articles of Association Rights Attached to Shares Dividend Rights.

Liquidation Rights

Article 111 of our articles of association provides that upon any liquidation, dissolution or winding-up of our company, our remaining assets shall be distributed pro-rata to our ordinary shareholders.

Redemption

Under Article 38 of our articles of association, we may issue redeemable stock and redeem the same.

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Capital Calls

Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

Substantial limitations on shareholders

See Item 6.C. Directors, Senior Management and Employees-Board Practices Approval of Related PartyTransactions.

Modifications of Share Rights

The rights attached to a class of shares may be altered by an extraordinary resolution of the general meeting of shareholders, provided the holders of 75% of the issued shares of that class approve such change by the adoption of an extraordinary resolution at a separate meeting of such class, subject to the terms of such class. The provisions of the articles of association pertaining to general meetings of shareholders also apply to a separate meeting of a class of shareholders. Shares which confer preferential or subordinate rights relating to, among other things, dividends, voting, and payment of capital may be created only by an extraordinary resolution of the general meeting of shareholders.

General Meetings of Shareholders

Under the Israeli Companies Law a company must convene an annual meeting of shareholders at least once every calendar year and within 15 months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as special general meetings. In addition, the board must convene a special general meeting upon the demand of two of the directors, 25% of the nominated directors, one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company. See this Item 10B. Additional Information Memorandum and Articles of Association- Rights Attached to Shares-Voting Rights.

A shareholder present, in person or by proxy, at the commencement of a general meeting of shareholders may not seek the cancellation of any proceedings or resolutions adopted at such general meeting of shareholders on account of any defect in the notice of such meeting relating to the time or the place thereof. Shareholders who are registered in our register of shareholders at the record date may vote at the general meeting of shareholders. The record date is set in the resolution to convene the general meeting of shareholders, provided, however, that such record date must be between 14 to 21 days or, in the event of a vote by ballots, between 28 to 40 days prior the date the general meeting of shareholders is held.

The quorum required for a general meeting of shareholders consists of at least two record shareholders, present in person or by proxy, who hold, in the aggregate, at least one third of the voting power of our outstanding shares. A general meeting of shareholders will be adjourned for lack of a quorum after half an hour from the time appointed for such meeting to the same day in the following week at the same time and place or any other time and place as the board of directors designates in a notice to the shareholders. At such reconvened meeting, if a quorum is not present within half an hour from the time appointed for such meeting, two or more shareholders, present in person or by proxy, will constitute a quorum. The only business that may be considered at an adjourned general meeting of shareholders is the business that might have been lawfully considered at the general meeting of shareholders originally convened and the only resolutions that may be adopted are the resolutions that could have been adopted at the general meeting of shareholders originally convened.

Limitations on the Right to Own Our Securities

Neither our memorandum or articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of our ordinary shares by non-residents, except that the laws of the State of Israel may restrict the ownership of ordinary shares by residents of countries that are in a state of war with Israel.

Provisions Restricting a Change in Control of Our Company

The Israeli Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such boards confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated merger. Under our articles of association, such merger must be approved by a resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder. See also Item 6C. Directors, Senior Management and Employees Board Practices Approval of Related Party Transactions Under Israeli Law.

Disclosure of Shareholders Ownership

The Israeli Securities Law, 5728-1968 and regulations promulgated thereunder contain various provisions regarding the ownership threshold above which shareholders must disclose their share ownership. However, these provisions do not apply to companies, such as ours, whose shares are publicly traded in Israel as well as outside of Israel. As a result of the listing of our ordinary shares on the Tel Aviv Stock Exchange, we are required pursuant to the Israeli Securities Law and the regulations promulgated thereunder to deliver to the Israeli Share Registrar, the Israeli Securities Exchange Commission and the Tel Aviv Stock Exchange, all reports, documents, forms and information received by us from our shareholders regarding their shareholdings, provided that such information was published or required to be published under applicable foreign law.

C. Material Contracts.

None.

D. Exchange Controls.

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new general permit was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under such law, and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

Non-residents of Israel who purchase our ordinary shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

E. Taxation.

The following is a discussion of Israeli and United States tax consequences material to us and to our shareholders. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, the views expressed in the discussion might not be accepted by the tax authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.

Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

ISRAELI TAX CONSIDERATIONS

The following is a summary of the material Israeli tax laws applicable to us, and some Israeli Government programs benefiting us. This section also contains a discussion of material Israeli tax consequences concerning the ownership of and disposition of our ordinary shares. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of

Israel or traders in securities who are subject to special tax regimes not covered in this discussion. Since some parts of this discussion are based on new tax legislation that has not yet been subject to judicial or administrative interpretation, we cannot assure you that the appropriate tax authorities or the courts will accept the views expressed in this discussion.

The discussion below should not be construed as legal or professional tax advice and does not cover all possible tax considerations. Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including in particular, the effect of any foreign, state or local taxes.

General Corporate Tax Structure

Israeli companies are subject to income tax on their worldwide income regardless of the territorial source of such income. Generally, Israeli companies are subject to corporate tax on their taxable income. On July 25, 2005, the Knesset (Israeli Parliament) approved the Law of the Amendment of the Income Tax Ordinance (No. 147), 2005, or the Israel Tax Ordinance, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 31%, in 2007 29%, in 2008 27%, in 2009 26% and in 2010 and thereafter 25%. Capital gains derived after January 1, 2003 (other than gains derived from the sale of listed securities that are taxed at the prevailing corporate tax rates) are generally subject to tax at a rate of 25%. However, the effective tax rate payable by a company that derives income from an Approved Enterprise, discussed further below, may be considerably less. See Tax Benefits under the Law for the Encouragement of Capital Investments, 1959.

Following an amendment to the Israeli Tax Ordinance, which came into effect on January 1, 2009, an Israeli corporation may elect a 5% rate of corporate tax (instead of 25%) for income from dividend distributions received from a foreign subsidiary which is used in Israel in 2009, or within one year after actual receipt of the dividend, whichever is later. The 5% tax rate is subject to various conditions, which include conditions with regard to the identity of the corporation that distributes the dividends, the source of the dividend, the nature of the use of the dividend income, and the period during which the dividend income will be used in Israel.

Israeli Transfer Pricing Regulations

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Israeli Tax Ordinance, came into effect, or the TP Regs. Section 85A of the Tax Ordinance and the TP Regs generally require that all cross-border transactions carried out between related parties be conducted on an arm s length principle basis and will be taxed accordingly. The TP Regs are not expected to have a material affect on us.

Tax Benefits for Research and Development

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, in the year incurred relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli Government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period.

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Encouragement of Capital Investments Law, 5719-1959

The Investments Law Prior to the 2005 Amendment

The Law for the Encouragement of Capital Investments, 1959, or the Investments Law, as in effect prior to April 1, 2005 provided that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an approved enterprise. The Investment Center based its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and regulations, the then prevailing policy of the Investment Center, and the specific objectives and financial criteria of the applicant. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program.

The Investments Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise s ordinary course of business. If a company has more than one approval enterprise or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a consumer price index linkage adjustment and interest.

The Investments Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period. This period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income (after the commencement of production), and is limited to 12 years from commencement of production or 14 years from the date of approval, whichever is earlier, referred to as the Years Limitation.

A company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company s undistributed income derived from the approved enterprise will be exempt from corporate tax for a period of between two and ten years from the first year the company derives taxable income under the program, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. The Years Limitation does not apply to the exemption period. A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to corporate tax in respect of the gross amount distributed, including any taxes thereon, at the rate which would have been applicable had it not elected the alternative package of benefits, generally 10%-25%, depending on the percentage of the company s ordinary shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. The company must withhold this tax at source.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors company. A foreign investors company is a company which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two to ten years, and will be subject to a reduced tax rate for the remainder of the benefits period. The tax rate for the remainder of the benefits period will be 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate will be 20% if the foreign investment is more than 49% and less than 74%; 15% if more than 74% and less than 90%; and 10% if 90% or more.

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Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the company s effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year s profits to declare dividends. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

The Israeli government may reduce or eliminate tax benefits available to approved enterprise programs in the future. We cannot assure you that our approved program and the benefits thereunder shall continue in the future at its current level or at any level.

Currently, we have two valid expansion programs that were granted approved enterprise status under the Investments Law prior to its amendment.

2005 Amendment to the Investments Law

An amendment to the Investments Law, which was published on April 1, 2005, or the Amendment, has changed certain provisions of the Investments Law. As a result of the Amendment, a company is no longer obliged to acquire approved enterprise status in order to receive the tax benefits previously available under the alternative benefits provisions, and therefore generally there is no need to apply to the Investment Center for this purpose (approved enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investments Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the

Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export, referred to as a Benefited Enterprise. In order to receive the tax benefits, the Amendment states that the company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise, referred to as the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company s effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company s production assets before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of seven to ten years from the commencement year, or 12 years from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following new tax routes, which may be applicable to us:

Similar to the currently available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) with respect to the gross amount of dividend distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and

A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is Abundant in Foreign Investment, as defined in the Investments Law, is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The Amendment changes the definition of foreign investment in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company s outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition are retroactive from 2003.

The Amendment applies to approved enterprise programs in which the year of election under the Investments Law is 2004 or later, unless such programs received Approved Enterprise approval from the Investment Center on or prior to December 31, 2004, in which case the Amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investments Law as they were on the date of such approval.

Should we elect to utilize tax benefits under the Amendment to the Investments Law, any such tax exempt profits might be subject to future taxation on the corporate level upon distribution to shareholders by a way of dividend or liquidation. Accordingly, we may be required to recognize deferred tax liability with respect to such tax exempt profits.

A substantial portion of our taxable operating income is derived from our approved enterprise program and we expect that a substantial portion of any taxable operating income that we may realize in the future will be also derived from such program. There is no assurance that our facilities will continue to enjoy such status in the future.

On March 3, 2007, we received a pre-ruling from the Israeli Tax Authority confirming that our most recent development program will be deemed a Benefiting Enterprise under the amended Investments Law. Our income from this program is tax-exempt for a period of two years, and is subject to a reduced tax rate of 10%-25 for a period of five to eight years (depending upon the percentage of foreign ownership of the Company). We have not enjoyed any tax benefits under this program to date.

Encouragement of Industry (Taxes) Law, 5729-1969

Under the Encouragement of Industry (Taxes) Law, 5729-1969, or the Industry Encouragement Law, Industrial Companies are entitled to certain corporate tax benefits, including, among others:

Amortization, under certain conditions, of purchases of know-how and patents and of rights to use a patent and know-how which are used for the development or advancement of the company, over an eight-year period for tax purposes;

Right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies; and

Accelerated depreciation rates on equipment and buildings; and

Deductions over a three-year period of expenses in connection with the issuance and listing of shares on a recognized stock market.

Eligibility for benefits under the Industry Encouragement Law is not subject to the prior approval of any governmental authority. Under the Industry Encouragement Law, an Industrial Company is a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an Industrial Enterprise owned by it. An Industrial Enterprise is an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an industrial company as defined by the Industry Encouragement Law. We cannot assure you that we will continue to qualify as an industrial company or that the benefits described above will be available to us in the future.

Encouragement of Industrial Research and Development Law, 5744-1984

Under the Encouragement of Industrial Research and Development Law, 5744-1984, or the Research Law, research and development programs that meet specified criteria and are approved by a governmental committee of the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS, are eligible for grants between 20%-50% of certain of the project s expenditures, as determined by the research committee of the OCS. In exchange, the recipient of such grants is required to pay the OCS royalties from the revenues derived from products incorporating technology developed within the framework of the approved research and development program or derived from such program (including ancillary services in connection with such program), usually up to 100% of the U.S. dollar-linked value of the total grants received in respect of such program, plus LIBOR interest.

The terms of the Israeli government participation also require that products developed with government grants be manufactured in Israel. However, under regulations promulgated under the Research Law, upon the approval of the OCS, some of the manufacturing volume may be performed outside Israel, provided that the grant recipient pays royalties at an increased rate. The Research Law also allows for the approval of grants in cases in which the applicant declares that part or all of the manufacturing will be performed outside of Israel or by foreign residents and the research committee of the OCS is convinced that this is essential for the execution of the program. The Research Law also provides that know-how developed under an approved research and development program may not be transferred to third parties in Israel without the prior approval of the research committee of the OCS. The Research Law further provides that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel. No approval is required for the sale or export of any products resulting from such research and development.

In June 2005, an amendment to the Research Law became effective, which amendment was intended to make the Research Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of OCS funded know-how outside of Israel. The amendment permits the OCS, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of demanding the recipient to pay increased royalties as described above. The amendment further permits, under certain circumstances and subject to the OCS s prior approval, the transfer outside Isra