

ELBIT VISION SYSTEMS LTD.
(An Israeli Corporation)
2006 CONSOLIDATED FINANCIAL STATEMENTS

ELBIT VISION SYSTEMS LTD.
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of Elbit Vision Systems Ltd.

We have audited the accompanying consolidated balance sheet of Elbit Vision Systems Ltd. ("the Company") and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of the Company for the year ended December 31, 2004, before the effects of the retrospective adjustments for the discontinued operations discussed in Note 3a to the consolidated financial statements, were audited by other auditors whose reports, dated July 8, 2005 and July 14, 2005, expressed an unqualified opinion on those statements.

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

In our opinion, such consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2006 and 2005 and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited the retrospective adjustments to the 2004 financial statements for the discontinued operations, as discussed in Note 3a to the financial statements. Our procedures included (1) comparing the reclassified amounts related to the discontinued operations to the Company's underlying analysis obtained from management, and (2) testing the mathematical accuracy of the amounts to the consolidated financial statements. In our opinion, such retrospective adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2004 financial statements of the Company other than with respect to the retrospective adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2004 financial statements taken as a whole.

Brightman Almagor & Co.
Brightman Almagor & Co.

Certified Public Accountants

A member firm of Deloitte Touche Tohmatsu

Tel Aviv, Israel
June 29, 2007

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ELBIT VISION SYSTEMS LTD.
CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	Note	December 31	
		2006	2005
A s s e t s			
CURRENT ASSETS:			
Cash and cash equivalents		1,060	710
Restricted deposit (short term)	14	688	1,810
Accounts receivable:	15a		
Trade (net of allowance for doubtful account 2006- \$936, 2005- \$ 774)		3,198	3,355
Other		603	1,147
Inventories	4	3,968	4,559
Assets held for sale	3a	-	2,597
T o t a l current assets		<u>9,517</u>	<u>14,178</u>
INVESTMENTS AND LONG-TERM RECEIVABLES:			
Severance pay fund	8	1,891	1,633
Other long-term receivables	5	1,066	107
		<u>2,957</u>	<u>1,740</u>
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization			
	6	455	535
OTHER ASSETS, net of accumulated amortization			
Goodwill		2,363	2,359
Other intangible assets	7	4,098	3,252
		<u>6,461</u>	<u>5,611</u>
T o t a l assets		<u><u>19,390</u></u>	<u><u>22,064</u></u>

The accompanying notes are an integral part of the financial statements

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED BALANCE SHEETS (Cont.)

U.S. dollars in thousands

	Note	December 31	
		2006	2005
Liabilities and shareholders' equity			
CURRENT LIABILITIES:			
Credit from banks	15c	4,713	2,113
Current maturities of loan from shareholder	9a	160	160
Short term loan from banks	9a	2,015	-
Credit from Cornell Capital Partners L.P.	11(a5)	-	1,449
Accounts payable and accruals:			
Trade		3,502	2,478
Deferred income	2j	1,617	2,485
Other	15b	3,583	4,670
Liabilities associated with assets held for sale	3a	-	802
T o t a l current liabilities		<u>15,590</u>	<u>14,157</u>
LONG-TERM LIABILITIES:			
Loans and other liabilities (net of current maturities)	9	-	1,500
Loans from Related Parties (net of current maturities)	9	609	236
Accrued severance pay	8	2,190	2,072
T o t a l long-term liabilities		<u>2,799</u>	<u>3,808</u>
COMMITMENTS AND CONTINGENT LIABILITIES			
T o t a l liabilities	10	<u>18,389</u>	<u>17,965</u>
SHAREHOLDERS' EQUITY:			
Share capital - ordinary shares of NIS 1 par value ("Ordinary Shares"); Authorized - 60,000,000 Ordinary Shares as of December 31, 2006 60,000,000 ordinary shares as of December 31, 2005	11		
Issued and outstanding:			
December 31, 2006 – 29,516,314 Ordinary shares			
December 31, 2005 – 26,762,217 Ordinary shares		5,091	4,529
Warrants		968	521
Additional paid-in capital		24,878	22,803
Foreign currency translation adjustment		-	89
Accumulated deficit		(29,936)	(23,843)
T o t a l shareholders' equity		<u>1,001</u>	<u>4,099</u>
T o t a l liabilities and shareholders' equity		<u>19,390</u>	<u>22,064</u>

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

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS
U.S. dollars in thousands (except per share data)

	Note	2006	2005	2004
REVENUES:				
Sale of products		14,527	15,428	8,190
Services rendered		2,470	4,151	2,209
		<u>16,997</u>	<u>19,579</u>	<u>10,399</u>
COST OF REVENUES:				
	15d			
Cost of products sold		10,367	9,422	6,525
Cost of services rendered		1,869	2,211	1,515
		<u>12,236</u>	<u>11,633</u>	<u>8,040</u>
GROSS PROFIT		4,761	7,946	2,359
RESEARCH AND DEVELOPMENT COSTS - NET	15e	2,562	2,039	2,456
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:				
Marketing and selling		4,149	3,583	3,491
General and administrative		1,870	1,127	1,817
Reorganization expenses		200	-	-
		<u>(4,020)</u>	<u>1,197</u>	<u>(5,405)</u>
OPERATING INCOME (LOSS)		(4,020)	1,197	(5,405)
FINANCIAL EXPENSES - NET	15f	(1,332)	(437)	(365)
INCOME (LOSS) BEFORE OTHER INCOME(EXPENSES)		(5,352)	760	(5,770)
OTHER INCOME (EXPENSES)		(5)	7	115
		<u>(5,357)</u>	<u>767</u>	<u>(5,655)</u>
INCOME (LOSS) BEFORE TAXES ON INCOME		(5,357)	767	(5,655)
TAXES ON INCOME	12d	5	4	6
INCOME (LOSS) FOR THE YEAR FROM CONTINUING OPERATIONS		<u>(5,362)</u>	<u>763</u>	<u>(5,661)</u>
LOSS FROM OPERATIONS OF DISCONTINUED COMPONENT	3a	(180)	(152)	(244)
NET LOSS ON DISPOSAL OF DISCONTINUED OPERATION	3a	(551)	-	-
INCOME (LOSS) FOR THE YEAR		<u>(6,093)</u>	<u>611</u>	<u>(5,905)</u>
EARNING (LOSS) PER SHARE FROM CONTINUING OPERATIONS:				
Basic	2n	(0.186)	0.029	(0.307)
Diluted		<u>(0.186)</u>	<u>0.026</u>	<u>(0.307)</u>
LOSS PER SHARE FROM DISCONTINUED OPERATIONS:				
Basic	2n	(0.026)	(0.006)	(0.013)
Diluted		<u>(0.026)</u>	<u>(0.005)</u>	<u>(0.013)</u>
EARNING (LOSS) PER SHARE:				
Basic	2n	(0.212)	0.023	(0.320)
Diluted		<u>(0.212)</u>	<u>0.021</u>	<u>(0.320)</u>
WEIGHTED AVERAGE NUMBER OF SHARES USED IN COMPUTATION OF EARNING (LOSS) PER SHARE – BASIC (IN THOUSANDS)				
		28,778	26,500	18,724
DILUTED (IN THOUSANDS)		<u>28,778</u>	<u>28,421</u>	<u>18,724</u>

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

ELBIT VISION SYSTEMS LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital		Receipts on		Warrants (see notes 3a,11a)	Additional paid-in capital	Other comprehensive income	Accumulated deficit	Total shareholders' equity
	Number of shares	Amount	account of shares to be allotted	U.S. dollars in thousands					
BALANCE - DECEMBER 31, 2003	13,006	1,856	140	267	18,662		(18,549)	2,376	
CHANGES DURING 2004:									
Net loss for the year								(5,905)	
Currency translation differences							132	132	
Total comprehensive loss								(5,773)	
Employee stock options exercised and paid	393	85						85	
Receipts on account of shares to be allotted (note 11a)			*424					424	
Issuance of share capital and warrants (notes 3a,3b,11a)	11,957	1,848	(494)	*300	*3,161			4,815	
Warrant exercised and paid (note 11a)	326	74		(71)	216			219	
BALANCE - DECEMBER 31, 2004	25,682	3,863	70	496	22,039		(24,454)	2,146	
CHANGES DURING 2005:									
Net income for the year							611	611	
Currency translation differences							(43)	(43)	
Total comprehensive income								568	
Employee stock options exercised and paid	82	18			(1)			17	
Receipts on account of shares to be allotted (note 11a)			105					105	
Issuance of share capital and warrants (notes 3a,3b,11a)	815	607	(175)	25	741			1,198	
Warrant exercised and paid (note 11a,11b)	183	41			24			65	
BALANCE - DECEMBER 31, 2005	26,762	4,529	-	521	22,803	89	(23,843)	4,099	
CHANGES DURING 2006:									
Loss for the year							(6,093)	(6,093)	
Currency translation differences							(89)	(89)	
Total comprehensive income								(6,182)	
Employee stock options exercised and paid	182	40			(1)			39	
Issuance of share capital and warrants (notes 3c,11a5))	2,441	494		447	1,159			2,100	
Beneficial conversion feature (note 9a(3))					900			900	
Warrant exercised and paid	131	28			17			45	
BALANCE - DECEMBER 31, 2006	29,516	5,091	-	968	24,878	-	(29,936)	1,001	

* Net of share issuance costs.

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

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	<u>2006</u>	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (Loss)	(6,093)	611	(5,905)
Adjustments to reconcile net income (loss) to net cash provided by or used in operating activities:			
Depreciation and amortization	1,411	886	1,047
Amortization of discount on loan from shareholder	285		
Loss from disposal of property	48	7	-
Loss from disposal of discontinued operation	551	-	-
Liability for employee rights upon retirement	118	55	(56)
Changes in operating assets and liabilities:			
Decrease (increase) in trade accounts receivable (including non-current portion)	283	(1,013)	(288)
Decrease (increase) in other accounts receivable	443	(168)	278
Increase (decrease) in trade account payable	1,003	29	451
Deferred income	(897)	1,725	(79)
Other	(2,212)	(1,523)	1,887
Decrease in inventories	591	123	803
Net cash provided by (used in) operating activities	<u>(4,469)</u>	<u>432</u>	<u>(1,862)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of subsidiaries consolidated for the first time (a)	-	-	(4,035)
Disposal of subsidiary (b)	120	-	-
Purchase of property and equipment	(130)	(222)	(243)
Long-term receivables	(101)	7	18
Investment in long-term deposits	-	-	(50)
Redemption of (investment in) restricted deposit	1,122	(1,042)	434
Proceeds from disposal of property and equipment	30	16	-
Long-term loan granted	-	-	(8)
Amounts carried to other assets and deferred charges	-	-	(310)
Funds severance pay	(258)	(244)	(27)
Net cash provided by (used in) investing activities	<u>783</u>	<u>(1,485)</u>	<u>(4,221)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of share capital and warrants - net of issuance costs	964	-	2,265
Short-term credit from bank - net	2,281	797	(564)
Proceeds from exercise of options and warrants	77	187	304
Retirement of long-term loan from shareholder	(27)	-	(80)
Proceeds from long-term loans from shareholder	1,556		
Proceeds from long-term loans from bank	547	1,454	(22)
Short-term credit received from (paid to) Cornell Capital Partners L.P. - net	(1,449)	(1,719)	3,601
Net cash provided by financing activities	<u>3,949</u>	<u>719</u>	<u>5,504</u>
TRANSLATION DIFFERENCES ON CASH BALANCES OF CONSOLIDATED SUBSIDIARY	<u>(89)</u>	<u>(2)</u>	<u>12</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>174</u>	<u>(336)</u>	<u>(567)</u>
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>886*</u>	<u>1,222*</u>	<u>1,789</u>
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>1,060</u>	<u>886*</u>	<u>1,222*</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION - cash paid during the year for:			
Interest paid - net	415	295	71
Income taxes paid - net	5	4	7

* Including cash and cash equivalents from discontinuing operation.

The accompanying notes are an integral part of these financial statements.

ELBIT VISION SYSTEMS LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)

	2006	2004
	U.S. dollars in thousands	U.S. dollars in thousands
(a) Acquisition of subsidiaries consolidated for the first time, see also note 3:		
Assets and liabilities of the subsidiaries at date of acquisition:		
Working capital (excluding cash and cash equivalents)	(1,033)	9
Fixed assets	59	618
Long-term receivables	12	982
Other assets	1,514	4,661
Long-term loans and other liabilities	(9)	(1,724)
Goodwill arising on acquisition	-	2,296
	543	6,842
Less:		
Issuance of share capital and warrants (see c3 hereafter)	(543)	(2,501)
Legal commitment to acquire 19% of Yuravision Co. Ltd.'s shares (see also Note 3a)	-	(306)
	-	4,035

	2006
	U.S. dollars in thousands
(b) Disposal of subsidiary	
Assets and liabilities of the subsidiary at date of disposal:	
Working capital (excluding cash and cash equivalents)	346
Fixed assets	(284)
Long-term receivables	(193)
Other assets	(148)
Long-term loans and other liabilities	232
Goodwill	(1,039)
	(1,086)
Less:	
Future proceeds from selling the subsidiary	966
	(120)

(c) Supplementary information on financing activities not involving cash flow:

- 1) In 2004, the Company repaid \$ 273,000, which constitutes part of a loan received from Cornell Capital Partner L.P. Repayment was made by way of issuance of shares. The said amount is not reflected in the statement of cash flows for the year ended December 31, 2004.
- 2) In 2004, the Company issued Cornell Capital Partners L.P. and Newbridge Securities Coporation 156,250 of its ordinary shares in an amount equivalent to \$ 200,000 as part of the Standby Equity Distribution Agreement (see Note 11a5). The said amount is not reflected in the statement of cash flows for the year ended December 31, 2004.
- 3) Part of the acquisitions of the subsidiaries was executed through issuance of share capital and warrants in an amount equivalent to \$ 2,501,000 and \$ 543,000 in 2004 and 2006, respectively.

The accompanying notes are an integral part of these financial statements.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - GENERAL

Elbit Vision Systems Ltd. (the "Company") is an Israeli corporation, which, together with its subsidiaries (the "Group"), is principally engaged in the design, development, manufacturing and marketing automatic vision and ultrasonic inspection and quality monitoring systems, and rendering services related to those systems.

Elbit Vision Systems Inc. ("EVS Inc.") incorporated in Delaware U.S.A. and Elbit Vision Systems B.V. ("EVS BV") incorporated in the Netherlands are wholly-owned subsidiaries, engaged in the selling and marketing of the Company's products worldwide.

In June 2004, the Company expanded its activities and entered into new fields of operations through the acquisition of 70% of Yuravision Co. Ltd.'s ("Yuravision") shares, a South Korean developer of visual inspection software and systems for the microelectronics industry and display industries. This investment was sold during December 2006 and therefore presented as discontinued operation in the financial statements (see Note 3a).

In September 2004, the Company also completed the acquisition of the entire shareholding of ScanMaster Systems (IRT) Ltd. ("ScanMaster Ltd."), an Israeli company and IRT ScanMaster System Inc. ("ScanMaster Inc."), a new Hampshire corporation (collectively - "ScanMaster"). ScanMaster is engaged in the development, manufacturing and marketing of equipment for the ultrasonic inspection of industrial parts and components for the automotive and transportation industries, the metal industry as well as applications for aircraft and jet engine inspection (see Note 3b).

In January 2006, the Company acquired business, assets and liabilities of Panoptes Ltd. ("Panoptes") and ScanMaster Ltd. acquired 100% of the shares of Panoptes.

Panoptes Ltd. is principally engaged in the design, development, manufacturing and marketing automatic vision and quality monitoring systems for surface inspection, especially textiles, glass fabric and technical woven materials (see Note 3c).

As to Business and Geographical segments – see Note 17.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

The consolidated financial statements are prepared in accordance with accounting principles generally accepted ("GAAP") in the United States of America.

a. Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates.

Estimates and assumptions which, in the opinion of management, are significant to the underlying amounts included in the financial statements and for which it would be reasonably possible that future events or information could change those estimates include: (i) impairment assessments of goodwill and long-lived assets; (ii) realization of deferred income tax assets; and (iii) provisions for obsolete and slow moving inventory. These estimates are discussed further throughout the accompanying notes.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Functional Currency and Financial Statements in U.S. Dollars

The currency of the primary economic environment in which operations of the Company and its subsidiaries are conducted, except for its Korean subsidiary, is the U.S. dollar (the "dollar").

Virtually all sales by the Company and its subsidiaries are made outside Israel in non-Israeli currencies, mainly the dollar. Most purchases of materials and components are made in dollars or in Israeli currency under contracts linked to the dollar. In addition, most marketing and service costs are incurred outside Israel, primarily in dollars, through the Company's wholly-owned non-Israeli subsidiaries. Thus, the functional currency of the Company and its subsidiaries is the dollar.

Transactions in currencies other than each company's functional currency are translated based on the average currency exchange rates in accordance with the principles set forth in Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation". All gains and losses from translation of monetary balance sheet items and transactions denominated in currencies other than the functional currency are recorded in the statements of income as financial income, net as they arise.

c. Principles of consolidation

The consolidated financial statements include the financial statements of the company and its wholly-owned subsidiaries.

All material inter-company transactions and balances have been eliminated.

d. Cash Equivalents

Cash equivalent consist of short-term highly liquid investments, that are readily convertible into cash with original maturities when purchased of three month or less.

e. Allowance for doubtful accounts

The allowance for doubtful accounts has been made on the specific identification basis.

f. Inventories

Inventories are stated at the lower of cost or market. Cost is determined as follows:

Raw materials and spare parts - on moving average basis.

Product in process and finished products – on basis of production costs.

Inventories are written-down for estimated obsolescence, based on assumptions about future demand and market conditions.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

g. **Property and equipment**

- (1) Property and equipment are stated at cost. Depreciation is calculated by the straight-line method over the estimated useful lives of assets, as follows:

	<u>%</u>
Machinery and equipment	10-33 (mainly 33%)
Office furniture and equipment	6-20
Vehicles	15-20

Leasehold improvements are amortized by the straight-line method over the term of the lease, or the estimated useful life of the improvements, whichever is shorter.

- (2) **Impairment of long-lived assets** – Impairment examinations and recognition are performed and determined based on the provisions of FASB Statement No. 144, “*Accounting for the Impairment or Disposal of Long-Lived Assets*” (“SFAS 144”). SFAS 144 requires that long-lived assets and certain identifiable assets held for use be reviewed for impairment on a periodic basis, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of an asset to be held and used is determined by a comparison of the carrying amount of the asset and the amount of undiscounted future net cash flows to be generated by the asset. In the event that an asset is considered to be impaired, an impairment charge is recorded in the amount by which the carrying amount of the asset exceeds its estimated fair value.

h. **Other assets- Goodwill and Intangible Assets**

(1) **Goodwill**

Under FASB Statement No. 142, “*Goodwill and Other Intangible Assets*” (“SFAS 142”), goodwill is not amortized to earnings, but rather is subject to periodic testing for impairment, at the reporting unit level, at least annually or more frequently if certain events or indicators of impairment occur. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Measurement of an impairment loss is an estimate, performed based on the following: If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The Group uses the discounted cash flow method to determine the fair value of the reporting unit. The Company’s reporting units consist of reportable segments; goodwill is allocated to the Non-destructive automated inspection segment (see also Note 17).

The Company has designated December 31 of each year as the date on which it will perform its annual goodwill impairment test. No impairment resulted from the annual review performed in the year 2006.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Other assets- Goodwill and Intangible Assets (Cont.)

(2) Other intangible assets

These assets are amortized by the straight-line method over their estimated useful lives. Annual rates of amortization are as follows:

	<u>%</u>
Technology	10;20
Customer relations	10;20
Distribution network	10
Brand name	8.33

The backlog is amortized according to revenues, which are derived from specific orders.

i. Impairment of long-lived assets

Long-lived assets held and used by the Group are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Under FAS 144, if the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets would be written down to their estimated fair values.

j. Revenue recognition:

1) Sale of products:

a. General

Revenues from sales of products and supplies are recognized when an arrangement exists, delivery has occurred and title passed to the customer, Group's price to the customer is fixed or determinable and collectibility is reasonably assured.

With respect to systems sold with installation requirements, the installation is not considered to be a separate earnings process; thus, revenue is recognized when all of the above criteria are met and installation is completed.

b. Acceptance clause, customers' support service and warranty

The Group distinguishes between revenue recognition in respect of revenue derived from automatic vision inspection products (sold by the Company) and ultrasonic inspection products (sold by ScanMaster).

The terms of the agreements between the Company and its customers are substantially different from the terms of the agreements between ScanMaster and its customers. Therefore, the revenue recognition accounting policy applied by each of the companies is different in this case. Set forth below are the main accounting policies applied by each of the companies:

The Company

In case that Company's agreement with the customer includes an "acceptance" clause, revenue recognition will take place after the Company receives the "acceptance certificate" from the customer. In some cases, the Company grants its customers a trial period, usually several months, in order to evaluate prototype the system's performance. In case that the systems performance meets the customer's requirements, he purchases the system at the end of the trial period. The Company does not recognize sales revenue from products shipped to customers for trial until such products are actually purchased. Until purchased, these products are recorded as consignment inventory at the lower of cost or market.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

j. Revenue recognition (Cont.):

1) Sale of products: (Cont.)

b. Acceptance clause, customers' support service and warranty

ScanMaster

ScanMaster's agreements with its customers usually include acceptance testing procedures clause ("ATP"). Each product of ScanMaster has standard performance specifications that are examined in the ATP; usually, the performance specifications are not customized for the specific needs of the customer. Also, unlike in the case of the company, ScanMaster does not grant its customers a trial period in the normal course of business. The agreements with the clients do not include the right of the clients to a refund in case the ATP is not to their satisfaction. However, the collection of the final payment from the customer (usually 10% out of the total consideration) is dependent upon receiving the signed ATP.

ScanMaster distinguishes between sales of new products, in respect of which ScanMaster has no past installation experience and sales of products, in installation of which the company is well experienced. In respect of sales of new products ScanMaster recognizes revenues only after the company receives the ATP from the customer. In respect of sales of other products, in the installation of which the company is well experienced, the ATP is only a formal procedure, and therefore, the installation of products is a sufficient requirement to recognize revenues.

ScanMaster provides for warranty costs at the same time as the revenue is recognized. The annual provision is calculated at rates of 1%-3% of the sales, based on past experience.

c. Right of return

The Group does not provide, in the normal course of business, a right of return to its customers. If uncertainties exist, such as the granting to the customer of a right of cancellation, revenue is recognized when the uncertainties are resolved.

d. Revenues from systems that require significant customization, integration and installation are recognized based on SOP 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts", using contract accounting on the percentage of completion method, based on the relationship of actual labor costs incurred, to total labor costs estimated to be incurred over the duration of the contract. 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.

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When services are considered essential, revenue under the arrangement is recognized using contract accounting.

When services are not considered essential, the revenue allocable to the software services is recognized as the services are performed.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

j. Revenue recognition (Cont.):

2) Services rendered

Service revenue in respect of the Group's products is recognized ratably over the contractual period, or as services are performed.

3) Deferred income

The deferred income balance as of December 31, 2006 and 2005 include amounts of revenues that were invoiced and cash was received, but deferred less applicable product and warranty costs.

k. Research and development

Research and development expenses net of third party grants, are expensed as incurred. The Company has no obligation to repay the grants if sales are not generated.

l. Advertising expenses

Advertising expenses are expensed as incurred. Advertising expenses for the years ended December 31, 2006, 2005 and 2004 were \$ 470,000, \$ 122,000, and \$ 132,000, respectively.

m. Deferred income taxes

The company accounts for income taxes in accordance with FASB Statement No. 109, "Accounting for Income Taxes" ("SFAS 109"). Deferred income taxes are determined by the asset and liability method based on the estimated future tax effects attributable to temporary differences between income tax bases of assets and liabilities and their reported amounts in the financial statements, and to carryforwards for tax losses and deductions. Deferred tax balances are computed using the enacted tax rates to be in effect at the time when these differences are expected to reverse, as they are known at the balance sheet date.

Deferred tax assets and liabilities are classified as current or non-current according to the classification of the respective asset or liability, or the expected reversal date of the specific temporary difference, if not related to a specific asset or liability.

Valuation allowances in respect of deferred tax assets are established when it is more likely than not that all or a portion of the deferred income tax assets will not be realized.

n. Earning (loss) per share ("EPS")

Basic EPS is computed based on the weighted average number of shares outstanding during each year. 3,707,000 ordinary shares, which were issued and were placed in escrow (see Note 3b) were reflected in basic and diluted EPS shares. Total common stock equivalents, related to options and warrants, 1,921,496 were reflected in diluted EPS for the year ended December 31, 2005. Total common stock equivalents, related to options and warrants 9,322,308, 8,716,907 and 6,262,882 shares for the years 2006, 2005 and 2004, respectively, were excluded from EPS calculation, because the effect of such options and warrants is antidilutive.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Stock-based compensation

In January 2006, the Company adopted SFAS No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"), using the modified prospective application method as its transition method. The Company recognizes \$341,000 of compensation expenses in 2006 as a result of the application of SFAS 123 (R). Until the adoption of SFAS No. 123(R) the Company accounted for employees and directors stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and in accordance with FASB Interpretation No. 44 ("FIN 44"). Pursuant to these accounting pronouncements, the Company recorded compensation for stock options granted to employees and directors over the vesting period of the options based on the difference, if any, between the exercise price of the options and the market price of the underlying shares at that date.

Had compensation cost for the Company's stock option plans been determined based on fair value at the grant dates for all awards made in 2005 and 2004 in accordance with the provisions of SFAS No. 123 ("SFAS 123"), as amended by SFAS No. 148 "Accounting for Stock-Based Compensation" ("SFAS 148"), the Company's pro forma net loss per share would have been as follows:

	Year ended December 31	
	2005	2004
	\$ in thousands (except per share data)	
Net income (loss), as reported	611	(5,905)
Less - stock-based employee compensation expense determined under fair value method	(559)	(988)
Pro forma net income (loss)	52	(6,893)
Earning (loss) per share:		
Basic - as reported	\$ 0.023	\$ (0.32)
Diluted - as reported	\$ 0.021	\$ (0.32)
Basic - pro forma	\$0.0019	\$ (0.37)
Diluted - pro forma	\$ 0.0018	\$ (0.37)

As to information about the stock option plans and assumptions used in calculating the pro forma information, see Note 11b.

p. Comprehensive income

In addition to income (loss), other comprehensive income includes exchange differences arising from the translation of the net investment in subsidiary.

q. Reclassification

Certain comparative figures have been reclassified to conform to the current year presentation.

r. Concentration of credit risk

As of December 31, 2006 and 2005, the Group held cash and cash equivalents and short-term bank deposits, most of which were deposited with major Israeli, European, and U.S. banks. The Company is of the opinion that the credit risk in respect of these balances is insignificant.

The Group performs ongoing credit evaluations of its customers for the purpose of determining the appropriate allowance for doubtful accounts. In respect of sales to customers in emerging economies, the Group requires letters of credit from banks.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. Recently issued accounting pronouncements:

- 1) In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48"). FIN 48 prescribes a comprehensive model for recognizing, measuring and presenting in the financial statements tax positions taken or expected to be taken on a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties and disclosure requirements for uncertain tax positions. FIN 48 is effective for fiscal years beginning on or after December 15, 2006 (January 1, 2007, for the Company). The provisions of FIN 48 shall be applied to all tax positions upon initial adoption of this Interpretation. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of this Interpretation. The Company is of the opinion that the adoption of FIN 48 is not expected to have a material effect on the Company's financial statements.
- 2) In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective for fiscal years ending after November 15, 2006. The company adopted SAB 108 in these financial statements and accordingly, follows SAB 108 requirements when quantifying financial statement misstatements.

The adoption of SAB No.108 did not result in corrections of the Company's financial statements.

- 3) In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements; however, it does not require any new fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for the Company). Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. The Company is currently evaluating the impact of the provisions of FAS 157 on its financial position and results of operations.
- 4) In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106, and 132R) (FAS 158), requires an employer to: (a) Recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status; (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income of a business entity and in changes in net assets of a not-for-profit organization. The requirement by FAS 158 to recognize the funded status of a benefit plan and the disclosure requirements of FAS 158 are effective as of the end of the fiscal year ending after December 15, 2006 for entities with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company does not expect the adoption of FAS 158 to have a material effect on the financial position of the company at December 31, 2006

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. Recently issued accounting pronouncements (Cont.):

- 5) In February 2007, the FASB issued FASB No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in FASB No. 159 are elective; however, the amendment to FASB No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. The fair value option established by FASB No. 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. FASB No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company does not expect the adoption of FASB No. 159 to have a material impact on its consolidated financial statements.

NOTE 3 - CONSOLIDATED SUBSIDIARIES

a. Acquisition and Disposal of Yuravision

On December 2, 2003, the Company signed a term sheet (the validity of which was extended on February 16, 2004) to acquire 100% of the shares of Yuravision (as to the nature of operation of Yuravision, see Note 1).

Pursuant to the term sheet, through May 31, 2004, the Company entered into a series of purchase agreements with some of Yuravision's shareholders. Under those agreements, the Company purchased 51% of Yuravision's shares for an aggregate amount of \$ 1,014,000, in cash and has a legal commitment to purchase additional 19% of Yuravision shares.

The said shares, which represented a holding of app. 19% in Yuravision, should have been purchased in cash payment of \$ 306,000 , or by way of swap transaction.

Under the swap transaction, the company was about to purchase these shares in consideration for the issuance of 320,547 company shares (at a conversion rate of 0.955455).

The manner in which the purchase will be made (cash or swap transaction) was about to be determined by the sellers.

In addition to the cash payment, the Company issued to one of Yuravision's shareholders warrants to purchase 50,000 of the Company's shares, at an exercise price of \$ 0.75; the warrants were exercisable for a period of two years from the date of issuance.

The weighted fair value of the warrants granted was \$ 0.6. The said fair value was determined in accordance with the Black&Scholes model, based on the following assumptions: dividend yield – 0%; expected volatility – 146%; risk free interest – 2.1%; expected life – 1 year.

The total cost of acquisition amounted to \$ 1,484,000 (including legal fees and other direct costs of \$ 134,000, and the aggregate fair value of the warrants issued to Yuravision's shareholder of \$ 30,000).

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - CONSOLIDATED SUBSIDIARIES (Cont.)

a. Acquisition and Disposal of Yuravision (Cont.)

Upon purchase of Yuravision, the Company had fully undertaken upon itself the capital deficiency Yuravision had as of date of purchase (the minority shareholders of Yuravision were not committed to bear any losses in excess of their investment). As long as Yuravision has a capital deficiency, the Company fully presented its share (100%) in the profits, or losses of Yuravision.

On December 1, 2006, the Company executed an agreement with a Korean corporation for the sale of Yuravision shares in consideration for \$950,000, or the Purchase Price, plus the purchase from the Company of its right to receive from Yuravision repayment of an \$800,000 loan, or the Loan Amount in consideration for the full value of the loan. Half of the Purchase Price was paid upon the closing of the transaction on December 15, 2006, and the remaining half of the Purchase Price will be payable no later than December 1, 2008. The purchaser has undertaken to pay the Company half of the Loan Amount by no later than December 1, 2008 and the remaining half, or the Outstanding Payment, by no later than May 1, 2009. The Outstanding Payment may become reduced in the event that certain of the employees of Yuravision resign from Yuravision prior to December 1, 2008.

The Company have received a stand by letter of credit from the purchaser guaranteeing payment of the Loan Amount.

Yuravision is classified as discontinued operation in the consolidated financial statement and its results of operation and financial position are separately reported for all periods presented. Summarized financial information for Yuravision is as follows:

	Year ended December 31		
	2006	2005	2004
	\$ in thousands		
Revenues	707	1,212	561
Cost of revenues	345	590	502
Gross profit	362	622	59
Research and development costs, net	207	154	-
Marketing and selling expenses	48	182	36
General and administrative expenses	319	438	336
Operating loss	(212)	(152)	(313)
Financial income (expenses)	(66)	(34)	68
Other income	98	34	1
Net loss of discontinued operation	(180)	(152)	(244)

	December 31
	2005
	\$ in thousands
Cash and cash equivalents	176
Accounts receivable	246
Long-term receivables	73
Property and equipment, net	335
Other assets, net	1,767
Total assets held for sale	2,597
Credit from banks	78
Accounts payable and accruals	474
Long term liabilities	126
Accrued severance pay	124
Total liabilities associated with assets held for sale	802

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – CONSOLIDATED SUBSIDIARIES (cont.):

b. Acquisition of ScanMaster

In September 2004, the Company acquired 100% of the shares of ScanMaster (as to the nature of operations of ScanMaster – see Note1).

The Company acquired ScanMaster for total consideration in the amount of \$ 8,193,000 (including estimated direct transaction costs amounting to \$ 151,000). The consideration for the acquisition of ScanMaster consisted of \$ 3,000,000 in cash and 7,414,213 ordinary shares of the Company, which represented approximately 27.9% of the issued and outstanding share capital of the Company after giving effect to the issuance. The value of the shares issued was calculated based upon the average of the closing prices per Company's shares for the period of two days before through two days after the announcement of the agreement. For the purposes of the financial statements as of December 31, 2004, the acquisition cost was recorded at the amount of \$ 5,680,000, after eliminating a consideration of \$ 2,521,000 in shares, which are considered as contingent consideration, and are placed in escrow as follows:

An aggregate of 3,707,106 ordinary shares were placed in escrow as follows: (i) 1,718,749 ordinary shares - until March 15, 2007, as a guarantee for certain representations and undertakings of some of ScanMaster's former shareholders (mainly for certain issues with respect to the Israeli Tax Authorities) and (ii) an aggregate of 1,988,357 ordinary shares - until June 1, 2005, to guarantee certain projected revenues of ScanMaster for the period from September 1, 2004 until March 31, 2005 (The said shares were released from escrow in May 2005).

A cash amount of \$300,000, which was placed in escrow to guarantee certain projected revenues of ScanMaster for the period from September 1, 2004 until December 31, 2004, was paid in March 2005.

The results of ScanMaster's operations have been included in the consolidated financial statements as from September 8, 2004.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

	At September 8, 2004
	(\$ in thousands)
Current assets	5,573
Long-term receivables	924
Property, plant, and equipment	272
Intangible assets	4,153
Goodwill	964
Total assets acquired	11,886
Current liabilities	(4,793)
Long-term liabilities	(1,413)
Total liabilities assumed	(6,206)
Net assets acquired	5,680

Of the \$ 4,153,000 of acquired intangible assets, \$ 1,802,000 were assigned to current technology, which represents patent and other intellectual properties (10 years useful life); \$ 1,110,000 were assigned to customer relations (12 years useful life), \$ 338,000 were assigned to distribution networks (10 years useful life), \$ 489,000 were assigned to ScanMaster's brand name (12 years useful life) and \$ 414,000 were assigned to backlog; \$ 964,000 representing the goodwill, was assigned to the non-destructive automated inspection segment.

As to proforma data, see e. below

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – CONSOLIDATED SUBSIDIARIES (cont.)

c. Acquisition of Panoptes Ltd.

In January 2006, the Company acquired business, assets and liabilities of Panoptes Ltd., and its subsidiary acquired 100% of the shares of Panoptes Ltd. Panoptes Ltd. is principally engaged in the design, development, manufacturing and marketing automatic vision and quality monitoring systems for surface inspection, especially textiles, glass fabric and technical woven materials.

The total consideration of acquisition of Panoptes Ltd. amounted to \$ 622,000 (including estimated direct transaction costs amounting to \$ 79,000). The Company issued 800,000 ordinary shares amounting to \$ 543,000 and, subject to certain instances, will pay cash royalties equaling 3.5% of sales of EVS optical inspection systems between January 2006 and the end of December 2008 to Ma'aragim Panoptes' controlling shareholder (see Note 10a5)). The transaction is subject to the completion of certain customary closing conditions.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

	<u>At January 1, 2006</u> <u>(\$ in thousands)</u>
Long-term receivables	12
Property, plant, and equipment	59
Intangible assets	1,514
Total assets acquired	<u>1,585</u>
Current liabilities	(954)
Long-term liabilities	(9)
Total liabilities assumed	<u>(963)</u>
Net assets acquired	<u>622</u>

Of the \$ 1,514,000 of acquired intangible assets, \$ 1,025,000 were assigned to current technology, which represents patent and other intellectual properties (5 years useful life); \$ 489,000 were assigned to customer relations (5 years useful life).

As to proforma data, see e. below

- d. As to deferred income taxes in respect of the assets acquired and liabilities assumed at the date of the above acquisition, see Note 12e.
- e. The pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisitions taken place at the beginning of 2004, nor is it necessarily indicative of future results.

	<u>2005</u>	<u>2004</u>
	<u>\$ in thousands</u>	
	<u>(except per share data)</u>	
	<u>(Unaudited)</u>	
Revenues	<u>20,057</u>	<u>13,743</u>
Loss	<u>(736)</u>	<u>(8,620)</u>
Loss per share - basic and diluted	<u>(0.03)</u>	<u>(0.36)</u>

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – INVENTORIES

	December 31	
	2006	2005
	\$ in thousands	
Raw materials	1,330	1,566
Spare parts	566	1,057
Work in process	861	209
Finished products*	1,211	1,727
	<u>3,968</u>	<u>4,559</u>

* Mainly systems in trial by customers (see Note 2j).

The balance are net of write-down of \$ 1,467,000 and \$971,000 as of December 31, 2006 and 2005 respectively.

NOTE 5 – OTHER LONG-TERM RECEIVABLES

	December 31	
	2006	2005
	\$ in thousands	
Deposits on leased vehicle (see also Note 10b2))	39	46
Loan to other (1)	61	61
Future proceeds from selling the Yuravision	966	-
	<u>1,066</u>	<u>107</u>

(1) Representing a loan to a company, convertible into 8% of this company's share capital. The loan is denominated in dollars, with no interest. The Company can convert the loan into share capital after December 31, 2003. On July 22, 2004, the Company requested, pursuant to the loan agreement, to convert the loan to 197,217 shares of the company. To date, the conversion of the loan has not yet been executed.

NOTE 6 - PROPERTY AND EQUIPMENT

a. Comprised as follows:

	December 31	
	2006	2005
	\$ in thousands	
Machinery and equipment	2,660	2,335
Leasehold improvements	216	341
Office furniture and equipment	296	339
Vehicles	184	215
	<u>3,356</u>	<u>3,230</u>
Less - accumulated depreciation and amortization	2,901	2,695
	<u>455</u>	<u>535</u>

b. Depreciation and amortization expenses totaled \$ 191,000, \$ 254,000, and \$225,000, in the years ended December 31, 2006, 2005 and 2004, respectively.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7- OTHER INTANGIBLE ASSETS

	Gross carrying amount		Accumulated amortization	
	December 31		December 31	
	2006	2005	2006	2005
	U.S. dollars in thousands		U.S. dollars in thousands	
Technology	2,828	1,803	625	240
Customer relations	1,599	1,110	357	148
Distribution network	338	338	79	45
Brand name	489	489	95	55
Backlog	414	414	414	414
	<u>5,668</u>	<u>4,154</u>	<u>1,570</u>	<u>902</u>

Amortization expenses totaled \$ 669,000 \$ 436,000, and \$ 1,048,000, in the years ended December 31, 2006, 2005, and 2004, respectively.

Estimated amortization expense for the following years, subsequent to December 31, 2006:

	<u>\$ in thousands</u>
Year ended December 31:	
2007	669
2008	669
2009	669
2010	669
2011	366

NOTE 8- ACCRUED SEVERANCE PAY, NET

- a. The Company's liability for severance pay is calculated in accordance with Israeli law based on the latest salary paid to employees and the length of employment in the Company. Part of the liability is funded through individual insurance policies. The policies are assets of the company and, under labor agreement subject to certain limitation, they may be transferred to ownership of the beneficiary employees.
- b. A U.S. subsidiary provides defined contribution plan for the benefit of its employees. Under these plans, contributions are based on specific percentages of pay.
- c. Severance pay and defined contribution plan expenses were \$ 165,000, \$ 291,000, and \$ 255,000 in the years ended December 31, 2006, 2005, and 2004, respectively. The earnings on the amounts funded were \$ 102,000, \$ 54,000, and \$ 80,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 – LONG-TERM LIABILITIES – LOANS AND OTHER

a. Composed as follows:

	December 31	
	2006	2005
	\$ in thousands	
Loans from banks(1)	2,015	1,500
Other liabilities:		
Loans from shareholders(2),(3)	769	396
	2,784	1,896
Less – current maturities:		
From banks	2,015	-
From shareholder (2)	160	160
	2,175	160
	609	1,736

(1) On August 2004 The Company and ScanMaster entered into an agreement with bank Mizrahi, pursuant to which both the Company and ScanMaster received in 2005 a credit line for the aggregate amount of \$ 2,000,000. The credit line is secured by a first ranking floating charge on all the Company's assets and all the assets of ScanMaster (see Note 11d).

(2) During 2003, the Company and Elbit Ltd. (a shareholder), reached an agreement, whereby the Company's debt to Elbit of \$ 400,000 and accrued interest thereon that was due in 2003, will have the following terms:

- a. The loan will bear annual interest of Libor+2% (formerly Libor+0.5%) payable quarterly.
- b. The loan is repayable in quarterly installments of \$ 40,000 each, commencing in the third quarter of 2003, but only if the cash flows provided by Company's operating activities in the quarter preceding the payment exceeds \$ 50,000.
During the reported years \$ 80,000 were repaid in respect of the said loan.

For more information, see Note 18.

(3) In February 2006, the Company issued notes to Mivtach Shamir Holdings Ltd. ("Mivtach") for \$3 million (half of which will be held in escrow until the occurrence of certain events). The notes are convertible at the option of Mivtach into 6,000,000 ordinary shares of EVS, at a price per share of \$0.50. Repayment of the notes will be in 30 equal monthly installments commencing two years after the notes issuance or on the date that Mivtach decides not to convert the notes, whichever is sooner. The Company also granted to Mivtach a two-year warrant to purchase 4,000,000 of the Company's ordinary shares at an exercise price of \$0.50 per share, exercisable only if Mivtach converts the notes.

The Company allocated the proceeds received based on the respective fair values to the notes and the warrants. Consistent with provisions of EITF 98-5 and 00-27, the Company evaluated whether the notes contain a beneficial conversion feature ("BCF") and determined that the BCF amount exceeded the amount initially allocated to notes and as a result the notes initially recorded at nil and are to be amortized over the term of notes.

As of December 31, 2006 the company recorded in its financial reports a long term loan of \$ 342,000, representing the amortized discount to date.

During June 2007 the loan was converted, see Note 18.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 – LONG-TERM LIABILITIES – LOANS AND OTHER(cont.)

- b. The liabilities (net of current maturities) mature in the following years after the balance sheet dates:

	December 31	
	2006	2005
	\$ in thousands	
2007	160	1,660
2008	107	76
2009	-	-
2010 and thereafter	342	-
	<u>609</u>	<u>1,736</u>

NOTE 10 - COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalties

- 1) The Company is committed to pay royalties to the Government of Israel based on proceeds from sales of products in the research and development of which the Government participates by way of grants. At the time the grants were received, successful development of the related projects was not assured.

In the case of failure of a project that was partly financed as above, the Company is not obligated to pay any such royalties.

Under the terms of the Company's funding from the Israeli Government, royalties of 3%-5% are payable on sales of products developed from a project so funded, up to 100% of the amount of the grant received by the Company (dollar linked); as from January 1, 2001 - with the addition of an annual interest rate based on Libor.

Royalty expenses to the Government of Israel totaled \$ 259,000, \$ 286,000 and \$ 583,000 in the years ended December 31, 2006, 2005 and 2004 respectively and are included in the statements of operations among cost of revenues.

During December 2005 the Company reached a settlement with the OCS ("office chief scientist") according to which the OCS would withdraw its request to extend the royalties payment from 3.5% to 4.5% on part of the received grants. As a result of the settlement the Company reversed the OCS allowance by \$ 822,000.

- 2) The Company and ScanMaster Ltd. are committed to pay royalties to the Government of Israel in respect of marketing expenses in which the Government participated by way of grants. At the time the grants were received, successful development of the related projects was not assured. In the case of failure of a project that was partly financed as above, the Company is not obligated to pay any such royalties. The royalties are payable at the rate of 4% of the increase in export sales, up to the amount of the dollar-linked grant received. No royalties were paid in the reported years to the Government of Israel.

The maximum royalty amount payable by the Company to the Government of Israel at December 31, 2006 is approximately \$ 948,000 (see 1) and 2) above).

- 3) Effective upon its initial public offering on July 3, 1997, the Company agreed to pay Elbit Ltd. ("Elbit") royalties in an amount dependent upon the sales of the Company's vision system products in the textile, automotive and food industries.

The royalties will in turn be paid in full by Elbit to the original developer of certain elements of the technology licensed by the Company from Elbit.

In 2002, the Company and Elbit amended the abovementioned agreement, effective as of July 1, 2001; pursuant to the agreement the royalties would be paid directly to the developer, twice a year, at a rate of 0.9375%-1.5% of sales of certain products in the immediately preceding six months.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

a. Royalties (Cont.)

3) (Cont.)

The royalty expenses totaled \$ 20,600 and \$ 46,000 in the years ended December 31, 2006 and 2005, respectively, and are included in the statements of operations in cost of revenues.

- 4) ScanMaster Ltd. signed an agreement with a supplier, whereunder the supplier assisted Scanmaster Ltd. to complete a development of one of the Company's products. The supplier is also entitled to receive royalties from the product's sales. The royalty expenses in respect of royalties paid to the said supplier amounted to totaled \$ 28,000 and \$ 25,000 in the years ended December 31, 2006 and 2005, respectively, were included in the statements of operations in cost of revenues.
- 5) As part of acquisition of Panoptes Ltd. (see Note 3c.), the Company, subject to certain instances, will pay cash royalties equaling 3.5% of sales of EVS's optical inspection systems between January 2006 and the end of December 2008 to Ma'aragim Panoptes' controlling shareholder. Through 31 December 2006, the Company paid royalties \$ 109,000 to Ma'aragim.

b. Lease commitments

- 1) The premises occupied by the Company and certain subsidiaries are rented under various operating lease agreements. The lease agreements for the premises expire in 2009 with extended options for another 3 years.

Minimum lease commitments of the Company and the subsidiaries under the above leases, at rates in effect as of December 31, 2006, are as follows:

	<u>\$ in thousands</u>
Year ending December 31:	
2007	423
2008	435
2009	447
	<u>1,305</u>

The rental payments for the premises in Israel, which constitute most of the above amounts, are payable in Israeli currency linked to the Israeli CPI.

Rental expenses totaled \$ 514,000, \$ 540,000, and \$ 240,000 in the years ended December 31, 2006, 2005 and 2004, respectively.

- 2) The Company leases motor vehicles under long-term operating lease agreements. The lease agreements expire on various dates ending in 2007 – 2009 (with prior notice of cancellation clauses).

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

b. Lease commitments (Cont.)

Minimum lease commitments of the Company under the above leases, at rates in effect on December 31, 2006, are as follows:

	<u>\$ in thousands</u>
2007	277
2008	247
2009	149
	<u>673</u>

To secure the amounts due to the lessor, the Company has deposited a total of U.S. \$ 33,200. The deposits are unlinked and presented among other receivables and long-term receivables.

Lease expenses in 2006, 2005 and 2004, amounted to \$ 299,000, \$ 298,000, and \$ 194,000 respectively.

c. Guarantees

To secure the Company's commitment under its sales agreements, the Company provided guarantees in the amounts \$ 913,000 to its customers. The guarantees are usually secured by cash advances received from the said customers.

NOTE 11 - SHAREHOLDER' EQUITY

a. Authorized, issued and outstanding shares

- 1) The Company's Ordinary Shares are traded in the United States on the OTC Bulletin Board over the counter market under the symbol EVSNF.OB.
- 2) In March 2001, Mr. Alon, the Company's chairman, as from March 2001 until February 2006, purchased 1,500,000 of its ordinary shares at a price per share of \$1.00. At that time, Mr. Alon also agreed to complete a second investment in which he would purchase by no later than March 15, 2002, an additional 1,500,000 shares at a price per share of \$1.00; provided that the Company's financial results for 2001 met certain minimum thresholds. In March 2002, the Company agreed to permit Altro Warenhandelsgesmbh (hereafter – Altro), an Austrian company controlled by Mr. Alon, to complete the second investment in nine equal monthly installments commencing March 2002. In May 2002, the Company deferred payment of the first four of these installments until no later than June 30, 2002. This investment was not done by Altro.

Under a plan of arrangement (hereafter – the arrangement) between the Company, its shareholders and Altro, approved by the Company's shareholders in October 2003 and the District Court of Haifa in November 2003, the Company agreed to cancel Altro's prior commitment to invest in the Company and replace it with new investment terms, and at the same time grant warrant to purchase shares to the other shareholders. According to the plan of arrangement, Altro will purchase 2,000,000 of the Company's ordinary shares for a purchase price of \$0.35 per share, payable in up to five quarterly installments to be completed by November 2004.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

a. Authorized, issued and outstanding shares (Cont.)

2) (Cont.)

Through December 31, 2004, the Company received from Altro an amount of \$564,000 (net of issuance costs amounting to \$ 30,000) in respect of 1,500,000 shares issued to Altro.

In April 2005, the Company received \$ 106,000 in respect of the completion of the transaction.

Also, pursuant to the arrangement, in 2004, the Company distributed, without consideration, warrants to purchase 4,183,950 of its ordinary shares to all of its shareholders on a pro rata basis (other than Altro, Mr. Alon and a group of investors which purchased the Company's shares in private placements which occurred in December 2003 and January 2004 (see 3) and 4) below). Each warrant is exercisable for a period of four years following the grant date 14 May , 2004, at a price of \$0.35 per share.

The fair value of the said warrants granted was \$ 0.1 per warrant . The fair value was determined in accordance with the Black & Scholes model, based on the following assumptions: dividend yield – 0%, expected volatility – 137%, risk free interest 1.91%, expected life – 2 years.

Through December 31, 2006, warrants to purchase 400,418 shares were exercised by one of the said shareholders.

3) In December 2003 and in January 2004, the Company entered into shares and warrants purchase agreements with several private investors. Under these agreements, the Company issued to the said investors 3,569,299 shares of NIS 1 par value at a price of \$0.68 per share and 1,067,325 warrants. Each warrant entitles its holder to purchase one ordinary share of NIS 1 par value at the exercise price, payable in cash, of \$ 0.85; the warrants are exercisable for a period of 24 months from date of issuance, which was further extended to June 30, 2006. All of the said warrant expired unexercised.

Under this agreement, the Company received \$ 2,276,360 (net of issuance costs of \$ 150,640), in respect of the shares and warrants, issued as above (of which \$ 1,765,000 – net of issuance costs of \$ 150,640 – were received through December 31, 2003).

The said private investors participating in the issuance of shares and warrants as above, did not participate in the warrant distribution Arrangement mentioned in 2) above.

As part of the issuance, the Company issued 293,300 warrants to consultants and providers of financial services (245,300 warrants were issued in December 2003 and 48,000 warrants were issued in January 2004). The said warrants were issued to consultants and service providers in respect of their assistance in the said capital raising. 51,500 warrants have the same terms as the warrants issued to the investors as above, and 241,800 warrants are exercisable at a price of \$ 0.68 per share, for a period of 24 months from date of issuance, which was further extended to June 30, 2006. All of the said warrant expired unexercised.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

a. Authorized, issued and outstanding shares (Cont.)

(3) (Cont.)

The Company has divided the amount raised from issuance, as above, between shareholders' equity components: share capital, additional paid-in capital and warrants. The warrants granted to the said private investors were recorded in shareholders' equity at their fair value. Also, the value of the warrants issued to consultants and providers of financial services was offset from the premium component. The weighted average fair value of warrants granted was \$ 0.25. The said weighted average fair value of all warrants was determined in accordance with the Black & Scholes model, based on the following assumptions: dividend yield – 0%, expected volatility - 137%, risk free interest rate 1.31%, expected life - 1 year.

In May 2004, warrants to purchase 156,000 shares at an exercise price of \$0.68 were exercised by one of the said consultants.

- 4) In January and February 2004, the Company issued to several private investors 1,530,612 shares at a price of \$0.98 per share and 382,653 warrants for a total consideration of \$ 1,330,000 (net of issuance costs amounting to \$ 170,000). Each warrant is exercisable to one ordinary share of NIS 1 par value, at an exercise price of \$ 1.40 per share. The warrants are exercisable for a period of 24 months, commencing in the date of issuance, which was further extended to June 30, 2006. All of the said warrant expired unexercised.

As part of the issuance as above, the Company issued 100,816 warrants to consultants and providers of financial services. The said warrants were issued to consultants and service providers in respect of their assistance in the said capital raising.

The said warrants are exercisable at a price of \$ 0.98 per share for a period of 24 months from the date of issuance, which was further extended to June 30, 2006.

The Company has divided the amount raised from issuance, as above, between shareholders' equity components: share capital, additional paid-in capital and warrants. The warrants granted to the said private investors were recorded in shareholders' equity at their fair value. Also, the value of the warrants issued to consultants and providers of financial services was offset from the premium component. The weighted average fair value of warrants granted was \$ 0.42. The said weighted average fair value of all warrants was determined in accordance with the Black & Scholes model, based on the following assumptions: dividend yield – 0%, expected volatility - 137%, risk free interest rate 1.31%, expected life - 1 year.

In May 2004, warrants to purchase 85,714 shares at an exercise price of \$ 0.98 were exercised by one of the said consultants. The remaining warrants expired unexercised.

- 5) In March 2004, the Company entered into a Standby Equity Distribution Agreement with Cornell. Pursuant to this agreement, the Company will be entitled to issue Cornell with put notices requiring it to purchase, six days following each put notice, a number of Company's ordinary shares with a value of up to \$ 300,000 per put notice and up to an aggregate value of \$ 10,000,000 over two years.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

a. Authorized, issued and outstanding shares (Cont.)

(5) (Cont.)

The price per share payable by Cornell will be determined based on the minimum price of Company's shares during the five days period following Company's put notice to Cornell to purchase Company's shares. Under the said agreement, the Company agrees to pay Cornell commitment fees, which were defined as follows:

- a) For each notice, Cornell will deduct 5% from the price payable for Company's ordinary shares, as a commitment fee.
- b) Upon execution of the Agreement, the Company issued Cornell with 148,438 of its ordinary shares in an amount equal to \$ 190,000.
- c) Upon the first to occur of (i) receipt by the Company of an aggregate of more than \$5,000,000 from Cornell pursuant to the Agreement; and (ii) the first put notice to be provided by the Company following the first anniversary of the execution of the Agreement, the Company will issue to Cornell a number of its ordinary shares with a value of \$ 150,000, calculated in accordance with the minimum closing bid price of Company shares on the public market on which its shares shall be traded at such time, on the day on which the Company is required to issue the ordinary shares.

In a registration statement, which was declared effective on July 7, 2004, or the Initial Registration Statement, the Company registered 5,555,555 of its ordinary shares for future issuance to Cornell.

On August 26, 2004, the Company signed a short-term Promissory Note with Cornell whereby Cornell agreed to advance the sum of \$4,000,000 to the Company as a loan for the acquisitions of ScanMaster and Yuravision (see Note 3). This amount is repayable by no later than May 9, 2005, or immediately following an event of default, as defined in the agreement. According to the terms of the note, interest shall commence accruing from the 121st day following the execution of the note at a rate equal to one percent (1%) per month. From the 211th day following the execution of the note, interest shall accrue at a rate equal to two percent (2%) per month. Under the terms of the Promissory Note, the Company has agreed to repay the note either in cash or through the net proceeds to be received by it under the Standby Equity Distribution Agreement.

In May 2005, the Company signed an amendment to the Promissory Note, under the new term the balance of loan will be paid in monthly installments through December 2006, at an interest rate of Prime+2%.

The Company has included in its accounts interest costs pertaining to the Promissory Note, based on a computation of the weighted interest in respect of the Promissory Note.

The Company paid Cornell a commitment fee of five percent (5%) of the principal amount of the Promissory Note, and a further \$ 30,000 to an affiliate of Cornell and other party. When used for the repayment of the note, proceeds received under the Standby Equity Distribution Agreement, will not be subject to the 5% commitment fee.

The Company records in its books of accounts the commitment fees over the period of the Promissory Note.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

a. Authorized, issued and outstanding shares (Cont.)

(5) (Cont.)

As securities for repayment of the advance and the Promissory Note, the Company has: (i) granted Cornell a second ranking floating charge on all of Company's assets (to the extent permitted under Israeli law) and on the assets of ScanMaster; (ii) issued to a trustee, 5,555,555 of its ordinary shares which are registered (see above), and (iii) Issued to Trustee an additional 2,500,000 of Company's restricted ordinary shares.

It has also been agreed to reserve an additional 14,444,445 of Company's ordinary shares for issuance to Cornell pursuant to the Standby Equity Distribution Agreement, and have agreed to file the registration statement covering these shares.

As part of the transaction with Cornell, the Company also retained the services of Newbridge Securities Corporation (hereafter – Newbridge), an unaffiliated broker-dealer, as a placement agent in connection with the Standby Equity Distribution Agreement. The Company issued Newbridge 7,812 ordinary shares as a placement fee.

The fair value of the said shares is app. \$ 10,000. The said costs are included in company's accounts as deferred share issuance costs.

Through December 31, 2005, the Company repaid \$ 2,129,000 of the Note in cash and \$ 433,000 by the issuance of 869,946 shares to Cornell, as stipulated in the said agreement.

Through June 2006, the Company issued Cornell with 1,433,527 of its ordinary shares in an amount equal to \$ 569,000.

On February 17, 2006, the Company repaid all outstanding amounts owed to Cornell, and have thus fulfilled all of it obligations toward them under the Promissory Note. Following repayment of the Promissory Note, all ordinary shares and advance notices held in trust to guarantee the loan were returned to the Company, and the floating charge on its assets was removed.

- 6) As to shares issued in consideration, and as contingent consideration, for the purchase of the shareholding in ScanMaster and Panoptes, see Note 3b and Note 3c, respectively.

b. Share option plans:

1) The plans:

- (a) In February 1996, the Company's board of directors adopted the Company's Employee Share Option Plan (1996) (hereafter – The 1996 Plan). Under the 1996 plan, 565,720 options can be granted to directors, employees and consultants of the Company and its subsidiaries. Each option can be exercised into one ordinary share of the Company. The 1996 plans is valid for ten years and expired on February 2006, except for option awards outstanding on that date.

Under the 1996 Plan, options usually vest as follows: 50% - two years after the effective date of grant; 75% - after three years; and 100% - after four years.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

b. Share option plans: (Cont.)

1) The plans: (Cont.)

- (b) In April 2000, the board of directors of the Company adopted the Employee Share Option Plan (2000) (hereafter – The 2000 Plan).

Under the 2000 plan, options to purchase an aggregate of 4,500,000 ordinary shares are available to be awarded to employees, directors or consultants of the Company or any of its subsidiaries.

Under the 2000 plan, options usually vest over a period of three or four years from the date of grant, in equal parts each year.

The 2000 Plan is valid for ten years and will expire on April 3, 2010, except for options outstanding on that date.

- (c) In November 2003, the Board of Directors of the Company adopted the Employee Share Option Plan (2003) (hereafter – The 2003 Plan).

Under the 2003 plan, options to purchase an aggregate of 2,000,000 ordinary shares are available to be awarded to employees, directors or consultants of the Company or any of its subsidiaries.

Under the 2003 plan, options usually vest over a period of four years from the date of grant, in equal parts each year.

The 2003 Plan is valid for ten years and will expire on November 30, 2013, except for options outstanding on that date.

- (d) In March 2006, the Board of Directors of the Company adopted the Employee Share Option Plan (2006) (hereafter – The 2006 Plan).

Under the 2006 plan, options to purchase an aggregate of 2,000,000 ordinary shares are available to be awarded to employees, directors or consultants of the Company or any of its subsidiaries.

Under the 2006 plan, options usually vest over a period up to ten years following the date of grant, if not exercised earlier, or 6 months after termination of the employee, will generally vest as to 25-33% commencing the beginning of the second year after the grant and as to an additional 25-33% in each of the remaining years thereafter, assuming continuous employment with the Company through such periods.

The 2006 Plan is valid for ten years and will expire on March, 2016, except for options outstanding on that date.

The exercise price of options granted under the 1996, 2000 and 2003 plans is to be not less than 85% of the fair market value of the ordinary share on the date of grant. All of the outstanding options from the 1996, 2000 and 2003 plan are to expire no later than 10 years following the date of grant.

Through December 31, 2005, options to purchase 474,848 shares were exercised. The proceeds from the exercise amounted to \$ 102 thousands.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

b. Share option plans: (Cont.)

1) The plans: (Cont.)

(d) (Cont.)

Through December 31, 2006, options to purchase 181,797 shares were exercised. The proceeds from the exercise amounted to \$ 43 thousands.

The 2000, 2003 and 2006 plans are subject to the terms stipulated by Section 102 of the Israeli Income Tax Ordinance. Inter alia, these terms provide that the Company will be allowed to claim, as an expense for tax purposes, the amounts credited to the employees as a benefit in respect of shares or options granted under the plan.

The amount allowed as an expense for tax purposes, at the time the employee utilizes such benefit, is limited to the amount of the benefit that is liable to tax as labor income, in the hands of the employee; all being subject to the restrictions specified in Section 102 of the Income Tax Ordinance.

The aforementioned expense will be recognized in the tax year that the benefit is credited to the employee.

2) Options granted to employees:

(a) A summary of the status of the above plans in respect of options granted to employees and directors of the Company and its subsidiaries as of December 31, 2006, 2005 and 2004, and changes during the years ended on those dates, is presented below:

	Year ended December 31					
	2006		2005		2004	
	Number	Weighted average exercise price	Number	Weighted average exercise price	Number	Weighted average exercise price
Options outstanding at beginning of year	4,551,596	\$ 0.86	4,406,138	\$ 0.88	3,157,086	\$ 0.72
Changes during the year:						
Granted (1)	777,500	0.69	625,000	0.51	1,796,000	0.99
Exercised	(183,797)	0.21	(82,250)	0.21	(392,598)	0.22
Forfeited	(256,613)	1.21	(397,292)	0.69	(154,350)	0.56
Options outstanding at end of year	4,888,686	0.83	4,551,596	0.86	4,406,138	0.88
Options exercisable at year end	3,663,176	\$ 0.9	3,147,401	\$ 0.97	2,335,380	\$ 0.94
Weighted average fair value of options granted during the year (2)	\$ 0.64		\$ 0.37		\$ 0.7	

(1) 777,500 options granted in 2006 (weighted average exercise price of \$0.69 and fair value of \$ 0.64), 625,000 options granted in 2005 (weighted average exercise price of 0.51 and fair value of \$ 0.37) and 521,000 options, granted in 2004 (weighted average exercise price of \$ 0.83 and fair value of \$ 0.38), were granted with exercise price that was at market value or above.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

b. Share option plans: (Cont.)

2) Options granted to employees: (Cont.)

(a) (Cont.)

- (2) The fair value of each option granted is estimated on the date of grant using the Binomial lattice model in 2006 and the Black-Scholes option-pricing model in 2005 and 2004, with the following weighted average assumptions:

	Year ended December 31		
	2006	2005	2004
Dividend yield	<u>0%</u>	<u>0%</u>	<u>0%</u>
Expected volatility	<u>102%</u>	<u>70%</u>	<u>133%</u>
Risk-free interest rate	<u>4.7%</u>	<u>4.84%</u>	<u>3.1%</u>
Expected life - in years	<u>6</u>	<u>4</u>	<u>3.3</u>

Dividend yield - Management used an expected dividend yield based primarily on past experience applicable as of the grant date.

Expected volatility - Management estimated volatility based on the historical volatility of the Company's ordinary shares, being the only traded financial instrument of the Company, using in most cases daily observations of the Company's price share to determine the standard deviation.

Risk free interest rate - The risk-free interest rate is based on the implied yield in effect at the time of each option grant, based on U.S. Treasury zero-coupon bond issued with equivalent remaining terms.

Management estimates forfeiture rates at the date of grant, which are adjusted in subsequent periods if the actual forfeiture rates differ from those initially estimated. Management uses historical data to estimate pre-vesting option forfeiture rates and records share-based compensation expense only for those awards that are expected to vest.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - SHAREHOLDERS' EQUITY (Cont.)

b. Share option plans: (Cont.)

2) Options granted to employees: (Cont.)

(b) The following table summarizes certain information about options granted to employees and directors of the Company which were outstanding and exercisable under the above plans as of December 31, 2006:

Exercise prices	Options outstanding		Options exercisable	
	Number outstanding at December 31, 2006	Weighted average remaining contractual life	Number exercisable at December 31, 2006	Weighted average remaining contractual life
\$		Years		Years
3.00	44,668	0.34	44,668	0.34
1.68	110,000	2	110,000	2
1.169	523,639	3.39	523,639	3.39
0.36	272,750	4.07	272,750	4.07
0.48	295,100	5.21	295,100	5.21
0.15	20,852	5.58	20,852	5.58
1	166,027	5.58	166,027	5.58
0.2	125,453	6.64	95,203	6.64
0.85	136,500	6.9	136,500	6.9
0.68	153,197	6.9	153,197	6.9
0.83	20,000	6.96	15,000	6.96
1.25	727,500	7.24	727,500	7.24
0.75	100,000	6.91	100,000	6.91
0.75	525,000	7.57	495,000	7.57
0.8	334,000	7.78	246,834	7.78
0.78	515,000	9.16	-	-
0.4	30,000	9.25	8,572	9.25
0.28	120,000	9.97	-	-
1.2	44,000	7.95	44,000	7.95
0.7	25,000	8.98	8,334	8.98
0.5	600,000	8.98	200,000	8.98
	<u>4,888,686</u>	6.82	<u>3,663,176</u>	6.1

c. Dividends

In the event the Company declares cash dividends, such dividends will be paid in Israeli currency. Under current Israeli regulations, any cash dividend in Israeli currency paid in respect of ordinary shares purchased by non-residents of Israel with non-Israeli currency may be freely repatriated in such non-Israeli currency, at the rate of exchange prevailing at the time of conversion.

d. Options issued to consultants

In May 2005, the Company issued to advisors 50,000 warrants, fully vested with an exercise price of \$1 and 125,000 with vesting period of three years and an exercise price of \$0.8.

In September 2005, the Company issue 571,429 warrants, fully vested to bank Mizrahi with an exercise price of \$0.77 and immediate vesting in favor of loan agreement (see also Note 9). During November 2006, the Company's board of directors approve to change the exercise price to \$0.5.

All those warrants were granted above market value and the Company recorded expenses according to SFAS 123.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 - TAXES ON INCOME

a. Corporate taxation in Israel

- 1) Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985 (the "Inflationary Adjustments Law")

Under the Inflationary Adjustments Law, results for tax purposes are measured in real terms, having regard to the changes in the Israeli Consumer Price Index (hereafter – CPI). The Company and ScanMaster Ltd. are taxed under this law.

As explained in Note 2, the financial statements are measured in dollars. The difference between the changes in the Israeli CPI and in the exchange rate of the dollar relative to Israeli currency, both on annual and cumulative bases, creates a difference between taxable income and income reflected in these financial statements.

Paragraph 9(f) of FAS 109, "Accounting for Income Taxes", prohibits the recognition of deferred tax liabilities or assets that arise from differences between the financial reporting and tax bases of assets and liabilities that are measured from the local currency into dollars using historical exchange rates, and that result from changes in exchange rates or indexing for tax purposes. Consequently, the abovementioned differences were not reflected in the computation of deferred tax assets and liabilities.

- 2) Tax rates

- a) The income of the Company and ScanMaster Ltd. (other than income from "approved enterprises", see b. below) are taxed at the regular rate. Through to December 31, 2006, the corporate tax was 31% and it will gradually decrease from 29% in 2007 through 25% in 2010.

- b) Subsidiaries outside Israel

Subsidiaries that are incorporated outside of Israel are assessed for tax under the tax laws in their countries of residence. The principal tax rates applicable to subsidiaries outside Israel are as follows:

Company incorporated in the USA – tax rate of 39%.

Company incorporated in the Netherlands – tax rate of 29 %.

b. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (hereinafter – the law)

Under the law, by virtue of the "approved enterprise" status granted to investments in certain assets the Company and ScanMaster Ltd. are entitled to various tax benefits.

- 1) The main tax benefits available to the Company and ScanMaster Ltd. are:

- (a) Reduced tax rates:

- (i) The Company

Tax exemption during the period of benefits – 10 years – commencing in the first year in which the Company earns taxable income from the approved enterprises (provided that the maximum period to which it is restricted by the law has not elapsed).

The Company has four approved enterprises; the benefit periods commenced in 1994, 1995, 1997 and 2004, respectively.

The periods of benefits for the first, second and third approved enterprise expired in 2003, 2004 and 2006 respectively.

In the event of distribution of cash dividends from income, which was tax exempt as above, the Company would have to pay 25% tax in respect of the amount distributed. The amount distributed for this purpose includes the amount of the tax that applies as a result of the distribution.

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 - TAXES ON INCOME (Cont.)

b. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (hereinafter – the law) (Cont.)

(ii) ScanMaster Ltd.

Tax exemption during the period of benefits – 7 years – commencing in the first year in which the Company earns taxable income from the approved enterprises (provided that the maximum period to which it is restricted by the law has not elapsed).

Tax exemption on income from approved enterprises in respect of which the companies have elected the “alternative benefits” (involving waiver of investment grants); the length of the exemption period is four years, after which the income from these enterprises is taxable at the rate of 25% for three years.

ScanMaster Ltd. has three approved enterprises; the benefit periods in respect of the first and second enterprises commenced in 1994 and 1997, respectively. The period of tax benefits in respect of the first approved enterprise has expired.

The period of tax benefits in respect of the second approved enterprise will expire in 2008. The third approved enterprise has not yet been activated.

In March 2004 ScanMaster Ltd. received a warning from the Investment Center that the instrument of approval of the second approved enterprise might be cancelled. ScanMaster Ltd. plans to appeal the Investment Center’s decision in the near future. ScanMaster Ltd. has not utilized its tax benefits in respect of this enterprise. In case that the said approved enterprise will be cancelled, the Company estimates that it will not be required to be subject to penalties.

(b) Accelerated depreciation

The Company is entitled to claim accelerated depreciation in respect of equipment used by the approved enterprises during five tax years.

(c) Conditions for entitlement of the benefits

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above law, regulations published there under and the certificate of approval for the specific investments in approved enterprises. In the event of failure to comply with these conditions, the benefits may be canceled, and ScanMaster Ltd. and the Company may be required to refund the amount of the benefits, in whole or in part, with the addition of linkage differences to the Israeli CPI and interest.

In the event of distribution of cash dividends out of income, which was tax exempt as above, the companies would have to pay the 25% tax in respect of the amount distributed. For this purpose, the amount distributed includes the amount of the tax that applies as a result of the distribution.

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

The Company and ScanMaster Ltd. are “industrial companies” as defined by this law and as such are entitled to certain tax benefits, consisting mainly of accelerated depreciation as prescribed by regulations published under the Inflationary Adjustments Law, amortization of patents and certain other intangible property, and the right to claim public issuance expenses.

d. Taxes on income:

1) Income (loss) before taxes on income is composed as follows:

	2006	2005	2004
	\$ in thousands		
Israeli companies	(5,063)	1,588	(5,699)
Subsidiaries abroad	(294)	(821)	44
	(5,357)	767	(5,655)

ELBIT VISION SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 - TAXES ON INCOME (Cont.)

2) Reconciliation of Income Taxes

Following is a reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory corporate tax rate applicable to Israeli corporations (see d1 above), and the actual expense:

	Year ended December 31		
	2006	2005	2004
	S in thousands		
Income (Loss) before taxes on income	(5,357)	767	(5,655)
Theoretical tax benefit on the above amount	(1,661)	261	(1,979)
Increase in taxes in respect of tax losses incurred in the reported year for which deferred taxes were not recorded (see f. below)	1,661	(261)	1,979
Other	5	4	6
Actual tax expense	5	4	6

Taxes on income included in the statement of operations relate to Company's subsidiaries.

e. Deferred Taxes

1) The Company has unutilized carryforward tax losses from prior years. Therefore, no current tax liability has been provided in 2006, 2005, and 2004.

Virtually all the Company's temporary differences are in respect of carryforward tax losses. The Company expects that during the period in which its tax losses are utilized, its income would be tax exempt, as described in b1) (a) above. Accordingly, no deferred tax assets have been included in these financial statements in respect of the Company's carryforward tax losses.

2) ScanMaster has unutilized carryforward tax losses from prior years, exceeding other temporary differences. Valuation allowance has been provided in full, for all deferred taxes relating to the above tax losses and temporary differences; Accordingly no tax benefits have been included in these financial statements, as follows:

	December 31, 2006	December 31, 2005
	S in thousands	S in thousands
Provision for vacation pay	94	111
Accrued severance pay	14	116
Carryforward tax losses	1,362	881
Research and development costs	218	384
Less – valuation allowance	(1,688)	(1,492)
	-	-

The deferred taxes are computed at the average tax rate of 25% - 39%.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 - TAXES ON INCOME (Cont.)

f. Carryforward tax losses

Carryforward tax losses of the Company and its subsidiaries aggregate approximately \$ 30 million at December 31, 2006.

g. Tax assessments

Final tax assessments have been received by the Company through the tax year 2002. ScanMaster Ltd received final tax assessments through the tax year 2001.

NOTE 13 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

a. General

The Company operates internationally, which gives rise to exposure to market risks, mainly from changes in foreign exchange rates.

b. Fair value of financial instruments

The fair value of financial instruments included in working capital is usually identical or close to their carrying amount. The fair value of long-term receivables also approximate the carrying amounts, since they bear interest at rates close to prevailing market rates.

NOTE 14 – LIABILITIES SECURED BY PLEDGES AND RESTRICTION PLACED IN RESPECT OF LIABILITIES

- a.** The Group has registered fixed charge on bank deposits in favor of certain banks. The bank deposits are used to secure a credit line granted to the Company by the banks, and as collateral for guarantees provided to its customers (see Note 2r).

As of December 31, 2006, the bank deposits amount to \$ 688 thousands, out of which \$ 576 thousands are linked to the dollar and \$ 112 thousands are linked to the Euro;The deposits are for a period of one Month.

- b.** The Company and Scanmaster have registered floating charges on all of their assets in favor of banks (see Notes 9, 15c).

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 – SUPPLEMENTARY INFORMATION:

		December 31	
		2006	2005
		\$ in thousands	
a. Accounts receivable			
1) Trade – allowance for doubtful accounts:			
Balance at beginning of year		774	1,407
Charged to general and administrative expenses		174	-
Write-off of uncollectible amounts		(12)	(633)
Balance at end of year		936	774
2) Other:			
Employees		50	44
Prepaid expenses		181	548
Israeli Government departments and agencies		362	324
Advance to suppliers		-	199
Sundry		10	32
		603	1,147
		December 31	
		2006	2005
		\$ in thousands	
b. Accounts payable and accruals – other:			
Employees and employee institutions		645	465
Israeli Government departments and agencies		998	1,025
Provision for vacation and recreation pay		592	537
Provision for product warranty		259	243
Liability for commissions to agents		394	794
Customer advances		-	908
Accrued expenses and sundry		695	698
		3,583	4,670

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 – SUPPLEMENTARY INFORMATION (Cont.)

c. Credit from banks

Composed as follows:

	% interest rate as of December 31, 2006	December 31	
		2006	2005
		\$ in thousands	
Unlinked credit from bank	9	528	127
Short-term loans from banks:			
Linked to the dollar	8	3,223	1,346
Linked to the Euro	6	962	640
		<u>4,713</u>	<u>2,113</u>

In 2003, the Company entered into agreements for bank credit facilities, pursuant to which the Company may, from time to time, borrow an aggregate amount of up to \$ 3,430,000; to secure the credit facilities, the Company registered a floating fixed charge on certain bank deposits in favor of the said banks (see Note 14).

d. Cost of revenues

	Year ended December 31		
	2006	2005	2004
\$ in thousands			
Industrial operations:			
Materials consumed	5,636	7,178	2,167
Payroll and related expenses	2,745	2,569	1,720
Subcontracted work	253	135	170
Depreciation and amortization	579	457	1,095
Other production expenses	2,267	1,736	1,097
Royalties (see Note 10a)	287	(490)	624
Decrease (increase) in inventories:			
Finished products	469	(1,074)	667
Products in process	-	1,122	500
	<u>12,236</u>	<u>11,633</u>	<u>8,040</u>
e. Research and development expenses:			
Total expenses	2,707	2,193	2,616
Less – grants and participations, see Note 10a1).	<u>(145)</u>	<u>(154)</u>	<u>(160)</u>
	<u>2,562</u>	<u>2,039</u>	<u>2,456</u>

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 – SUPPLEMENTARY INFORMATION (cont.):

f. Financial income (expenses)

	Year ended December 31		
	2006	2005	2004
	\$ in thousands		
Income:			
Interest in respect of bank			
Deposits and securities	44	46	10
Exchange differences	-	99	17
Other	9	-	-
	53	145	27
Expenses:			
Interest			
In respect of liability to related parties	460	22	2
In respect of credit from banks	695	170	75
In respect of credit from Cornell	-	79	222
Exchange differences	215	124	-
Other	15	187	93
	1,385	582	392
	(1,332)	(437)	(365)

NOTE 16 – RELATED PARTIES

	2006	2005	2004
	\$ in thousands		
Marketing and selling	92	-	-
General and administrative	322	184	149
Financing expenses on long-term loan granted by shareholder - see Note 9a.	29	22	2

NOTE 17 - BUSINESS AND GEOGRAPHICAL SEGMENTS

a. General information:

- 1) Factors management used to identify the enterprise's reportable segments

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Most of the businesses were acquired as a unit, and the management at the time of the acquisition was retained.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 - BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont.)

- 2) Description of the types of products and services from which each reportable segment derives its revenues

Due to the acquisition in 2004, the internal organizational structure changed; consequently, the company has two reportable segments:

- (a) Automatic Vision Inspection segment - design, develop, manufacture and marketing automatic vision inspection and quality monitoring systems, and rendering services related to those systems.
- (b) Non-destructive Automated Inspection segment - develop, manufacture and market equipment for the ultrasonic inspection of industrial parts and components for the automotive and transportation industries, the metal industry as well as applications for aircraft and jet engine inspection.

Prior to June 2004, the Company operated only in one segment - the Automatic Vision Inspection segment.

b. Information about reported segment income or loss and assets:

Measurement of segment income or loss and segment assets

The accounting policies of the segments are the same as those described in the significant accounting policies. The Company evaluates performance based on profit or loss from operations before income taxes, not including non-recurring gains and losses and foreign exchange gains and losses.

The Company accounts for inter-segment sales and transfers as if the sales or transfers were to third parties, that is - at current market prices.

	Automatic Vision Inspection	Non- Destructive Automated Inspection	Total
	\$ in thousands		
Year ended December 31, 2006:			
Revenues from unaffiliated customers	7,573	9,424	16,997
Total Consolidated revenues			<u>16,997</u>
Segment Operating loss	(1,742)	(1,938)	(3,680)
Unallocated corporate expenses			(340)
Operating loss			<u>(4,020)</u>
Segment assets	7,149	12,237	19,386
Other unallocated amounts			4
Consolidated assets at the year end			<u>19,390</u>
Expenditures for segment assets	1,643	60	1,703
Total depreciation and amortization	399	461	<u>860</u>

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 - BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont.)

c. Geographic information

- 1) The Company's revenues by geographic areas (based on location of customers) are as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	<u>\$ in thousands</u>		
U.S.A.	4,178	6,163	2,888
Europe	7,370	4,389	4,877
Other (mainly Japan and China)	5,449	9,027	2,634
	<u>16,997</u>	<u>19,579</u>	<u>10,399</u>

- 2) The Company's long-lived assets by geographic areas are as follows:

	<u>2006</u>	<u>2005</u>
	<u>\$ in thousands</u>	
Israel	6,887	6,119
U.S.A.	27	28
	<u>6,914</u>	<u>6,147</u>

d. Major customers

The following customers accounted for 10% or more of the Company's sales:

	<u>2006</u>	<u>2005</u>
Customer A	-	12%

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 - SUBSEQUENT EVENTS

a. Private placement with Israeli investors

In June 2007 the Company completed the April Investment with a group of Israeli institutional investors, or the Israeli Investors, for the purchase of its 6,290,941 ordinary shares for \$0.315 per share, of an aggregate price of \$1,981,646. Pursuant to the transaction, the investors were also issued warrants to purchase 3,145,472 of the Company's ordinary shares at an exercise price per share of \$0.45, exercisable for a period of 4 years. The Company has undertaken to file a registration statement covering all of its ordinary shares and ordinary shares underlying the warrants issuable under the April Investment by no later than July 31, 2007. Additionally, the Company agreed to pay the Israeli Investors a penalty in the event that they (i) fail to comply with their registration obligations as described in this paragraph; (ii) fail to respond to any comments on a registration statement by the SEC within 30-days or (iii) fail to maintain a registration statement covering the shares underlying the April Investment. The penalty will be an amount in cash equal to 1% of the product of the number of shares required to be covered by the registration statement which is the subject of the failure, multiplied by US\$0.315, for each month during which the failure continues or a prorated daily amount for a period of less than a month.

b. Agreement with Elbit

On June 21, 2007, following the approval of the board of directors and the audit committee, the Company executed an agreement with Elbit, or the Elbit Agreement, the consummation of which is subject to the approval of the shareholders. Pursuant to this agreement Elbit will (i) convert an existing loan to the Company in the amount of \$470,000 (including accrued interest) into 1,492,063 ordinary shares, at a price of \$0.315 per share; and (ii) invest in the Company \$250,000 in consideration for 793,651 ordinary shares at a price of \$0.315 per share and will receive a 4 year warrant to purchase 396,825 ordinary shares at an exercise price of \$0.45 per share.

Within the framework of the Elbit Agreement, the Company has, by way of a registration rights agreement, undertaken to file a registration statement covering all of its ordinary shares and ordinary shares underlying the warrants issued pursuant to the Elbit Agreement with the Securities and Exchange Commission by no later that July 31, 2007, or the Registration Statement.

c. Amendment to Convertible Loan Agreement with Mivtach Shamir

In February 2006, the Company issued notes to Mivtach Shamir Holdings Ltd. ("Mivtach") for \$3 million (half of which will be held in escrow until the occurrence of certain events). The notes are convertible at the option of Mivtach into 6,000,000 ordinary shares of EVS, at a price per share of \$0.50. Repayment of the notes will be in 30 equal monthly installments commencing two years after the notes issuance or on the date that Mivtach decides not to convert the notes, whichever is sooner. The Company also granted to Mivtach a two-year warrant to purchase 4,000,000 of the Company's ordinary shares at an exercise price of \$0.50 per share, exercisable only if Mivtach converts the notes. . On June 21, 2007 the Company executed an agreement with M.S.N.D. pursuant to which, the Mivtach Agreement will be amended, subject to shareholder approval.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 - SUBSEQUENT EVENTS (Cont.)

c. Amendment to Convertible Loan Agreement with Mivtach Shamir(Cont.)

Pursuant to the Amendment Agreement, the terms of the Mivtach Agreement and the notes therein, are amended, such that in consideration for M.S.N.D.'s undertaking to convert the full amount by no later than August 1, 2007 (a) Mivtach will be issued with 9,523,810 of the Company's ordinary shares; and (b) Mivtach will receive a 4 year warrant to purchase 2,380,952 of the Company's ordinary shares at an exercise price of \$0.45 per share.

Mivtach also agreed to waive its rights under the warrants to exercise at least 3,000,000 ordinary shares, agreeing to exercise no more than 1,000,000 ordinary shares issuable under the Amendment Agreement. Following consummation the Amendment Agreement M.S.N.D, will become a holder of more than 25% of the Company's issued and outstanding share capital. The Company also entered into a Registration Rights Agreement with M.S.N.D., undertaking to file a registration statement covering all of the ordinary shares and ordinary shares underlying the warrants under the Amendment Agreement, which have not previously been registered, by no later than July 31, 2007.

M.S.N.D. also completed the purchase of 2,939,192 of the Company's ordinary shares from three of the founders of ScanMaster, in accordance with the provisions of a share purchase agreement.

M.S.N.D. currently holds approximately 26.2% of the Company's issued and outstanding share capital.