



## **Unitronics (1989)(R" G) LTD.**

### **Quarterly Report as of September 30, 2006**

**Financial Statements included in this report have been prepared  
in accordance with Israeli GAAP (Generally Accepted Accounting Principles)**

**Note:** The Company's accounts are administered in NIS. All figures for all periods specified in this report were translated for convenience at the same exchange rate of the EUR against the NIS (New Israeli Shekel) as of September 30, 2006 (1 EUR = 5.4552 NIS).

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This Report contains forward-looking information within the meaning of Section 32A of the Israeli Securities Law, 5728-1968, including forecasts, estimations, assessments, expectations or other information pertaining to future events or issues, the occurrence of which is uncertain and not solely under the Company's control, if at all. This information is identified as such where it is used herein. Although such information is based on data available to the Company as of the date of the Report, and reflects the Company's intents and estimates as of such date, the actual occurrences and/or results may vary substantially from those presented in the Report or implied therefrom as projected or anticipated since their occurrence is subject, *inter alia*, to uncertainties and other factors beyond the Company's control as set out in this Report below.

## CHAPTER A – PREFACE

### 1. General

Company's Name: Unitronics (1989) (R"G) Ltd.  
(hereinafter: the "Company" or "Unitronics")  
Company No.: 520044199  
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Israel 70100  
Email Address: [investors@unitronics.com](mailto:investors@unitronics.com)  
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### 2. Description of the Company and its business environment

Unitronics is engaged through its Products Department in design, development, production, marketing, sale and support of industrial automation products, mainly programmable logic controllers (hereinafter: "**controllers**" or "**PLCs**"). Controllers are computer based electronic products (hardware and software) which serve for control and supervision of machines performing automatic tasks such as industrial manufacturing, storage, retrieval and logistics systems and machines. The Company is also engaged, through its Systems Department, in design, construction and maintenance services in the framework of projects for automation, computerization and integration of computerized production and/or logistic systems, mainly automatic warehouses and automated distribution centers.

The Company's PLCs are distributed through over one hundred and forty distributors (and a wholly-owned US subsidiary) in about fifty countries throughout Europe, Asia, America and Africa, and the services of the Systems Department are provided mainly to customers in Israel, and in a few cases, also outside Israel.

The Company operates from facilities at "Unitronics Building", an offices and industrial building part of which is leased by the Company. Unitronics Building is located at Airport City which is adjacent to Israel's Ben-Gurion Airport, and the offices of the Company and all its other facilities in Israel are located there.

Since May 2004, the shares of the Company are traded on the Tel Aviv stock exchange and since September 1999 in Brussels, Belgium, (first on the EuroNM Stock Exchange and since year 2000 on the EuroNext Stock Exchange).

### **3. Main Events in the Period of the Report and prior to its Publishing**

#### **3.1 Public Offering and listing for trade**

The Company published in Israel a prospectus dated August 16, 2006 (the "2006 Prospectus"), whereby it offered the public to purchase units comprising of the Company's Debentures (Series 2), and Option Deeds (Series 2) exercisable into Ordinary Shares of the Company, in 100,000 units (the "Units"), by way of a tender with respect to each Unit's price.

The Units' price and composition was as follows:

NIS 340 nominal value Debentures (Series 2)	
at an aggregate price per Unit of	NIS 319.6 (about EUR 58.6)
6 Option Deeds (Series 2) with nil purchase price	NIS 0.0 (EUR 0)
Minimum price per Unit	NIS 319.6 (about EUR 58.6)
Maximum price per Unit	NIS 331.5 (about EUR 60.8)

In the tender, which was conducted on August 24, 2006, the Company received 68 orders to purchase 102,938 Units (including orders from Institutional Investors to purchase 80,000 Units in an aggregate amount of NIS 25,352,000 (about EUR 4,647,309)).

The tender's outcome was as follows:

- The price per Unit was determined as NIS 319.60 (about EUR 58.6) (the "Price Per Unit") and the allocation of Units was as follows:
  - 12 orders to purchase 2,117 Units, which stipulated a price per Unit higher than the Price Per Unit, were fully accepted.
  - 33 orders to purchase 20,821 Units, which stipulated the Price Per Unit, were partly accepted so that each such applicant received 85.74 % of its order (rounded up to the nearest full Unit).
  - 23 orders of Institutional Investors to purchase 80,000 Units were fully accepted at the Price Per Unit.
- The immediate gross proceeds received by the Company for the securities offered pursuant to the 2006 Prospectus was NIS 31,960,000 (about EUR 5,847,632).

## **CHAPTER B – BOARD OF DIRECTORS REPORT**

### **1. The Financial Status**

#### **Assets**

The total assets according to the consolidated balance sheet of the Company as of September 30, 2006 amounted to approximately NIS 125,774 thousand (about EUR 23,056 thousand) as compared to approximately NIS 97,739 thousand (about EUR 14,917 thousand) as of December 31, 2005. This increase is mainly attributable to the increase in cash and cash equivalents as specified below.

In the total of the cash, cash equivalents and marketable securities items, an increase was registered, amounting to approximately NIS 74,652 thousand (about EUR 13,685 thousand) as of September 30, 2006 compared to approximately NIS 51,205 thousand (about EUR 9,386 thousand) as of December 31, 2005. The increase is mainly attributable to the capital-raising by issuance of the Company's debentures (series 2) pursuant to the 2006 Prospectus, as detailed in section 3.1 above.

In the accounts receivable (trade) item, an increase was registered from approximately NIS 10,103 thousand (about EUR 1,852 thousand) as of December 31, 2005 to approximately NIS 11,708 thousand (about EUR 2,146 thousand) as of September 30, 2006. The increase is mainly attributable to the growth in revenues from sales, as specified below.

An increase of about 64% was registered in the inventory, from an amount of approximately NIS 9,451 thousand (about EUR 1,732 thousand) as of December 31, 2005 to approximately NIS 15,486 thousand (about EUR 2,839 thousand) as of September 30, 2006. The increase is mainly attributable to the growth of the sales of the products sector, procurement with respect to commencing production and sales of the new Jazz™ PLC series, arrangements made in respect to temporary shortage and supply lead-time prolongation of certain electronic components occurring from time to time (known as "allocations" – for more information see item 1.24.1 in the Annual Report for year 2005), as well as to the initiated increase in the inventory levels of the Company's US subsidiary according to the Company's policy to support its distributors and customers and facilitate the availability of the Company's products (for more information on the Company's policy see item 1.24.1 in the Annual Report for year 2005).

The Other Assets item as of September 30, 2006 amounted to approximately NIS 179 thousand (about EUR 33 thousand), as compared to NIS 3,279 thousand (about EUR 601 thousand) as of December 31, 2005. The change is mainly attributable to the reclassification of deferred issuance expenses in connection with the convertible debentures (issued to the public in accordance with the Company's prospectus from May 2004) to the long term liabilities convertible debentures item, in accordance with Accounting Standard No.22 of the Israeli institute of accounting standards, applicable to financial statements for periods commencing January 1<sup>st</sup> 2006.

## Liabilities

The aggregate short term credit amounted to approximately NIS 9,950 thousand (about EUR 1,824 thousand) as of September 30, 2006, as compared to NIS 1,103 thousand (about EUR 202 thousand) as of December 31, 2005, and is mainly attributable to current maturities of convertible debentures (series 1) payable commencing May 2007, current maturities of convertible debentures denominated in Euro and payable commencing May 2006 until September of 2008, as well as current maturities of long-term loans.

Accounts payable (trade) amounted as of September 30, 2006 to NIS 13,367 thousand (about EUR 2,450 thousand) as compared to NIS 13,146 thousand (about EUR 2,410 thousand) as of December 31, 2005. A decrease was registered in comparison to the previous quarter, from approximately NIS 16,122 thousand (about EUR 2,955 thousand), resulting from payments made to suppliers. The increase registered in previous quarters resulted mainly from the increase in the accounts payable in connection with the Company's increase in inventory explained above, and from the increase in sales (and in required purchases thereof) in the products sector as detailed below.

Accounts payable (other) amounted as of September 30, 2006 to NIS 10,771 thousand (about EUR 1,974 thousand) as compared to NIS 12,305 thousand (about EUR 2,256 thousand) as of December 31, 2005. The decrease is mainly attributable to the decrease in the down payments item in connection to the system's sector activity, resulting mainly from the pace of the actual progress of work performed in connection with logistic systems projects by the Company's systems division, and from the decrease in the down payments item in connection to the products' sector activity (in the ordinary course of Company's business).

In the aggregate long-term liabilities as of September 30, 2006 a decrease was recorded and they amounted to NIS 68,701 thousand (about EUR 12,594 thousand) as compared to NIS 50,520 thousand (about EUR 9,261 thousand) as of December 31, 2005. This change results mainly from the issuance of debentures (series 2) pursuant to the 2006 Prospectus, deducting current liabilities of convertible debentures (series 1) payable commencing May 2007 which are recorded - as of the previous periodic report - in the framework of the short term credit instead of the long-term liabilities, and from reclassification of deferred issuance expenses in connection with the convertible debentures as explained above.

The working capital of the Company amounted to approximately NIS 68,874 thousand (about EUR 12,625 thousand) as of September 30, 2006 as compared to approximately NIS 45,234 thousand (about EUR 8,292 thousand) as of December 31, 2005. This increase results mainly from the increase in cash and cash equivalents item, following the capital raising issuance of the debentures (serie2) pursuant to the 2006 Prospectus.

The Company's shareholders equity as of September 30, 2006 increased to approximately NIS 22,985 thousand (about EUR 4,213 thousand), as compared to approximately NIS 20,665 thousand (about EUR 3,788 thousand) as of December 31, 2005. This increase arises mainly from the net profit of the Company in the reported period and from remunerations for option deeds within the framework of the fund raising pursuant to the 2006 Prospectus, after deducting the purchase of the Company's shares by the Company as described below and from the allocation of the capital component of the convertible debentures to shareholders' equity, resulting from the implementation of Standard 22 .

## **2. Operating Results**

### Revenues

The Company's revenues in the three months period ended September 30, 2006 amounted to approximately NIS 23,734 thousand (about EUR 4,351 thousand) as compared to approximately NIS 22,927 thousand (about EUR 4,203 thousand) in the previous quarter (an increase of approximately 3.5%) and as compared to approximately NIS 20,388 thousand (about EUR 3,737 thousand) in the corresponding period of 2005 (an increase of approximately 16%), reflecting a continued increase in revenues in the last twenty quarters. The Company's revenues in the first nine months of 2006 amounted to approximately NIS 67,401 thousand (about EUR 12,355 thousand) as compared to approximately NIS 60,228 thousand (about EUR 11,040 thousand) in the first nine months of 2005 (an increase of approximately 12%).

The revenues from the Company products' activities in the three months period ended September 30, 2006 amounted to approximately NIS 14,084 thousand (about EUR 2,582 thousand) an increase of about 47% as compared to the corresponding period of 2005, and of about 1% as compared to the previous quarter. The moderate growth in revenues from products' activities in the reported quarter results from:

- Appreciation of the New Israeli Shekel against the main selling currencies (US Dollar and Euro)
- The effect, estimated to be temporary, of the Israeli security climate on sales in Israel during the outbreaks of hostilities in mid 2006 in the northern part of Israel.

The revenues from the Company products' activities in the first nine months of 2006 amounted to approximately NIS 40,882 thousand (about EUR 7,494 thousand) an increase of about 52% as compared to the first nine months of 2005. The increase in revenues from the Company products' activities results mainly from the following factors:

- Continued market recognition of the Company's new generation products. The majority of these products have been developed during the course of the last few years and new models have been released every year.
- Marketing efforts primarily in the United States, intended to enhance the market penetration and the products recognition.

The revenues from the Company systems' activities in the three months period ended September 30, 2006 amounted to approximately NIS 9,435 thousand (about EUR 1,730 thousand) a decrease of about 10% as compared to the corresponding period of 2005, and an increase of about 7% as compared to the previous quarter. The revenues from the Company systems' activities in the first nine months of 2006 amounted to approximately NIS 25,981 thousand (about EUR 4,736 thousand), a decrease of about 20% as compared to the first nine months of 2005. The fluctuations between the quarters results mainly from the pace of the actual progress of work of logistic systems projects performed by the Company's systems division (in the ordinary course of Company's business). The Company estimates that during the outbreaks of hostilities in mid 2006 in the north part of Israel, a temporary influence of such security climate affected sales and project progress. Nevertheless, since the beginning of the year the Company reported the execution of a number of agreements for installation and upgrade of logistic systems.

The revenues from the Company products' activities in the three months period ended September 30, 2006 constituted approximately 59% of the total revenues of the Company in this quarter whereas the revenues from its systems' activities in the same period constituted approximately 40% of the total revenues (another 1% is attributable to other revenues).

In the contemporaneous quarter in the year 2005, the revenues from products' activities constituted about 47% of the total revenues of the Company in such quarter whilst the revenues from systems' activities in the same period constituted approximately 52% of the total revenues. In the annual aggregate for the year 2005, the revenues from the Company's products' activities

constituted approximately 46% of the revenues whereas the revenues from the Company's systems' activities constituted approximately 53% of the revenues.

### Gross Profit

The gross profit for the three months period ended September 30, 2006 amounted to approximately NIS 7,831 thousand (about EUR 1,436 thousand) (approximately 33% of the revenues for the period) as compared to approximately NIS 6,263 thousand (about EUR 1,148 thousand) in the contemporaneous period in the year 2005 (approximately 31% of the revenues in the period). The gross profit for the first nine months of 2006 amounted to approximately NIS 23,924 thousand (about EUR 4,386 thousand) (approximately 35% of the revenues for the period) as compared to approximately NIS 18,597 thousand (about EUR 3,409 thousand) in the contemporaneous period in the year 2005 (approximately 31% of the revenues in the period).

It should be noted that the gross margin in the products sector activities is higher than the gross margin of the systems sector activities. The fluctuations in the Company's rates of gross profit, result from the fluctuations in the percentage of revenues generated from the different activities.

### Research and Development Expenses, Net

The net research and development expenses (R&D) in the three months period ended September 30, 2006 amounted to approximately NIS 2,093 thousand (about EUR 384 thousand) (approximately 9% of the revenues) as compared to approximately NIS 1,409 thousand (about EUR 258 thousand) in the corresponding period of 2005 (approximately 7% of the revenues). No significant change was recorded from the previous quarter. The net R&D expenses in the first nine months of 2006 amounted to approximately NIS 6,116 thousand (about EUR 1121 thousand) (approximately 9% of the revenues) as compared to approximately NIS 4,135 thousand (about EUR 758 thousand) in the first nine months of 2005 (approximately 7% of the revenues).

The R&D expenses in the reported quarter reflect the continued development activity of new technologies and new products, required to support the Company's continued growth and to support the adaptation of Company's products to certain regulatory changes in certain areas of the word.

### Sale and Marketing Expenses

The sales and marketing expenses in the three months period ended September 30, 2006 amounted to approximately NIS 2,593 thousand (about EUR 475 thousand) (about 11% of revenues), in comparison to approximately NIS 2,549 thousand (about EUR 467 thousand) (about 12.5% of revenues) in the corresponding period of 2005. The sales and marketing expenses in the first nine months of 2006 amounted to approximately NIS 8,214 thousand (about EUR 1,506 thousand) (about 12.2% of revenues), in comparison to approximately NIS 6,891 thousand (about EUR 1,263 thousand) (about 11.4% of revenues) in the first nine months of 2005.

Adaptations were registered in the sales and marketing expenses in previous quarters, required to support the continued growth, conforming with the increased revenues, in accordance with the Company's policy, and resulting mainly from recruitment of additional personnel to the marketing teams, attendance and participation in trade shows, and additional marketing activities in Israel and worldwide.

## General and Administrative Expenses

The general and administrative expenses for the three months period ended September 30, 2006 amounted to approximately NIS 1,499 thousand (about EUR 275 thousand) as compared to approximately NIS 1,401 thousand (about EUR 257 thousand) in the corresponding quarter of 2005. No significant change was recorded from the previous quarter. The general and administrative expenses for the first nine months of 2006 amounted to approximately NIS 4,502 thousand (about EUR 825 thousand) as compared to approximately NIS 4,971 thousand (about EUR 1,095 thousand) in the first nine months of 2005.

The general and administrative expenses in the reported period reflect the expenses required for managing the increasing activity of the Company.

## Operating Profit

An increase of about 82% was registered in the operating profit for the three months period ended September 30, 2006, and it amounted to approximately NIS 1,646 thousand (about EUR 302 thousand) as compared to an operating profit of approximately NIS 904 thousand (about EUR 166 thousand) for the corresponding period of 2005. An increase of approximately 5.8% was registered in this item as compared to the previous quarter. An increase of about 96% was registered in the operating profit for the first nine months of 2006, and it amounted to approximately NIS 5,092 thousand (about EUR 933 thousand) as compared to an operating profit of approximately NIS 2,600 thousand (about EUR 477 thousand) for the first nine months of 2005.

The increase in operating profit results mainly from the increase in gross profit, after deducting adaptations made in the reported period mainly in R&D items as explained above.

## Financing Expenses, Net

The financing expenses for the three months period ended September 30, 2006 amounted to approximately NIS 1,236 thousand (about EUR 227 thousand) as compared to approximately NIS 154 thousand (about EUR 28 thousand) for the corresponding quarter of 2005, and as compared to approximately NIS 1,053 thousand (about EUR 193 thousand) in the previous quarter. The financing expenses for the first nine months of 2006 amounted to approximately NIS 3,359 thousand (about EUR 616 thousand) as compared to approximately NIS 722 thousand (about EUR 132 thousand) for the first nine months of 2005. The financing expenses are mainly attributable to fluctuations of currency exchange rates as explained below, current expenses in connection with the interest on the debentures and from current depreciation of discount in connection with convertible debentures (series 1) and debentures (series 2), after deducting financial income from investment activities intended to protect the Company's monetary balances, within the framework of the Company's risk management policy detailed below.

As of May 2004, the Company's exposure to exchange rate fluctuations of the NIS against the US Dollar increased as a result of the issuance of Dollar linked convertible debentures (series 1). In addition, such public offering also introduced an 'interest' factor and consequently exposed the Company to interest-rate related exposures. As of August 2006, the Company's exposure to fluctuations of the Israeli Consumer-Price Index increased as a result of the issuance of index linked debentures (series 2).

## Net Profit

In the reported quarter, the Company reports a net profit which amounts to approximately NIS 413 thousand (about EUR 76 thousand) (about 1.7% of the revenues), a decrease of about 46% in comparison to a net profit of approximately NIS 769 thousand (about EUR 141 thousand) in the corresponding period of 2005 (about 3.8% of the revenues), and an decrease of about 38% in comparison to a net profit of approximately NIS 665 thousand (about EUR 122 thousand) in the previous quarter (about 3% of the revenues). In the first nine months of 2006, the Company reports a net profit which amounts to approximately NIS 1,679 thousand (about EUR 308 thousand) (about 2.5% of the revenues), a decrease of about 12% in comparison to a net profit of approximately NIS 1,908 thousand (about EUR 350 thousand) in the first nine months of 2005 (about 3.2% of the revenues), mainly due to the increased financial expenses explained above.

## Analysis of Business Results by Sectors of Operations

As stated above, the Company's main commercial activities are performed through two business Divisions, the Products Division and the Systems Division. For details of the Income of each - see below.

### The Products Sector

The Products sector's results for the reported quarter, amounted to approx. NIS 5,097 thousand (about EUR 934 thousand), as compared to approx. NIS 2,879 thousand (about EUR 528 thousand) for the corresponding quarter of 2005. The Products sector's results for the first nine months of 2006, amounted to approx. NIS 13,697 thousand (about EUR 2,511 thousand), as compared to approx. NIS 7,774 thousand (about EUR 1,425 thousand) for the first nine months of 2005. The increase in the results of this sector in the reported period is mainly attributable to the growth in revenues from sales in the Products sector as explained above.

### The Systems Sector

The Systems sector's results for the reported quarter, amounted to approx. NIS 151 thousand (about EUR 28 thousand), as compared to approx. NIS 809 thousand (about EUR 148 thousand) for the corresponding quarter of 2005. The Systems sector's results for the first nine months of 2006, amounted to approx. NIS 2,044 thousand (about EUR 375 thousand), as compared to approx. NIS 3,824 thousand (about EUR 701 thousand) for the first nine months of 2005. The decrease in the sector's results for the reported period is mainly attributable to the decrease in revenues from this sector in the reported period. Such decrease results mainly, as previously explained, from the pace of the actual progress of work performed in connection with logistic systems projects by the Company's systems division (in the ordinary course of Company's business), and from a certain decrease of profit margins of projects due to market conditions and penetration efforts to new markets (such as the USA), and due to the strengthening of the New Israel Shekel against the main selling currencies (US Dollar and Euro).

### **3. Liquidity and Financial Sources**

The cash and cash equivalents and marketable securities of the Company as of September 30, 2006 amounted to approximately NIS 74,652 thousand (about EUR 13,685 thousand), as compared to approximately NIS 51,205 thousand (about EUR 9,386 thousand) as of December 31, 2005. This increase is mainly attributable to the positive cash flow from financing activities as described below.

The cash flow from operating activities for the three months period ended September 30, 2006, amounted to a negative flow of approximately NIS 1,067 thousand (about EUR 196 thousand), which is mainly attributable to the decrease in the accounts payable trade items resulting from payments to suppliers, deducting the net profit of the Company in such period as explained above.

The cash flow from investment activities for the three months period ended September 30, 2006, amounted to a negative cash flow of approximately NIS 662 thousand (about EUR 121 thousand), mainly as a result of the investments and purchase of fixed assets and marketable securities in the reported quarter.

The cash flow from financing activities for the three months period ended September 30, 2006, amounted to a positive cash flow of approximately NIS 29,724 thousand (about EUR 5,449 thousand). The positive cash flow resulted mainly from the public offer of debentures pursuant to the 2006 Prospectus.

As of September 30, 2006, the aggregate credit framework available to the Company amounted to approximately NIS 12.5 million (about EUR 2.3 million), of which, on the date of the report, approximately NIS 5.7 million (about EUR 1 million) has been exploited mainly for guarantees to secure the Company's obligations in certain projects performed by its systems' division.

#### **4. Qualitative report Re: Exposure to Market Risks and Risk Management Handling**

The persons in charge of handling of the market risks are the chief executive officer of the Company and its chief financial officer.

##### **Exposure to Exchange Rate Fluctuations**

The Company is exposed to exchange rate fluctuations, particularly fluctuations in the rate of the US Dollar against the New Israel Shekel and the Euro, for the following reasons:

In May 2004, the Company issued convertible Debentures (Series 1) pursuant to the 2004 Prospectus. The principal and interest on these debentures are linked to the representative NIS-US Dollar exchange rate, but not less than the base rate of NIS 4.59 per US Dollar. Until either the full conversion or the full repayment of the debentures by May 2010, the Company is exposed to changes in the Shekel-Dollar exchange rate.

In February 2001, the Company issued convertible debentures denominated in Euros. In December 2003, 75% of the principal sum of these debentures was converted into shares of the Company. Until either the full conversion or the full repayment of the debentures, commencing May 2006 through September 2008, the Company is exposed to changes in the Shekel-Euro exchange rate.

The assets of the Company are exposed to exchange rate fluctuations, most importantly, deposits in various currencies (mainly in Euros and U.S. Dollars), and also including debts of customers denominated in various currencies, according to the customer, and which do not bear interest, and marketable securities linked to foreign currencies.

Current liabilities items, which are exposed to exchange rate fluctuations, include credits from banks and others linked partly to foreign currencies, and debts to suppliers in foreign currencies, mainly in Euros. Long-term liabilities include long-term loans for continued financing of the purchase of rights in the Company's facilities at Airport City, 50% of which are denominated in U.S. Dollars, and 50%, are in Euros.

Most of the Company's operations are carried out in foreign currency or in New Israel Shekels linked to foreign currency. In the Products sector, most of the revenues are denominated in U.S. Dollar or linked to the U.S. Dollar exchange rate, with the exception of revenues generated from sales in Europe, which are mostly denominated in Euros. In the Systems sector, most of the revenues are denominated in Euros or linked to the Euro exchange rate.

Raw materials required for the production of the Company's products mainly include various electronic and mechanical components, the prices of which are mostly denominated in foreign currency – mainly the U.S Dollar and Euro.

##### **Exposure to Israeli Consumer Price Index Fluctuations**

As detailed in section 3.1 above, during the reported period the Company issued, debentures (series 2), pursuant to the 2006 Prospectus. These debentures are linked to the Israeli Consumer Price Index. Developments and changes in Israel's economy including depreciation and inflation, may cause changes in the consumer-price index, and may therefore affect the financial expenses and/or revenues of the Company.

### Risks Related to Marketable Securities

Part of the Company's financial resources are invested in marketable securities. Extraordinary developments in the capital markets in Israel and around the world may cause fluctuations in the rates of marketable securities on the stock exchange, and, consequently, could affect the Company's financial income/expenses.

### Interest Related Risks

The Company has various loans relating to the acquisition of its rights in the Company's facilities in Airport City, convertible debentures (Series 1) and debentures (Series 2) issued by the Company pursuant to the 2004 and 2006 Prospectuses, and other credit facilities bearing various interest rates, and exposed to potential changes in the prime and/or LIBOR interest rates

### Company's Policy for Managing Market Risks

The policy of the Company is to try to reduce, for each contract, the exposure to changes in the exchange rate by adjusting the income currency to the main expenses currency. In the Systems sector, the Company usually links the payment terms (periods / foreign currencies) of the different customers to the terms of the payment to the subcontractors.

The Company's investments allocation policy derives from the Company's intention to reduce its exposure to US Dollar obligations (mainly the principal and interest payment of the US Dollar linked Debentures (Series 1)).

To such end, the Company reviewed, in consultation with professional entities in the capital market shortly after the 2004 Prospectus (and receiving the proceeds of such offering), a number of investment alternatives, including: US Dollar-linked deposits, derivatives and other financial tools and NIS-linked investment programs.

The Company estimates that, due to its undertakings pursuant to the Debentures (Series 1) issued pursuant to the 2004 Prospectus which are linked to the US Dollar rate if exchange (and not less than a base rate of NIS 4.59 per Dollar), using US Dollar-linked deposits alone cannot secure the Company's obligations according to the Debentures (Series 1), mainly in the event of a decrease of the US Dollar exchange rate below the aforementioned base rate.

The Company found that using derivatives and other financial tools to secure changes in the US Dollar exchange rate in order to comply with its undertakings according to the Debentures (Series 1), is not beneficial due to the extent of expenses involved therein.

Considering the aforementioned and the fact that most of the Company's revenues are in foreign currency, the Company chose, after completing the fund raising under the 2004 Prospectus, to allocate approximately 60% of its investments to US Dollar-linked investment programs (partially protecting its exposure to the increase in the US Dollar exchange rate) and approximately 40% of its investments, to NIS programs, which at the time produced a higher yield, and thus partially protect from a decrease in the US Dollar exchange rate below the base rate.

The Company's investment committee (established thereafter) continues to currently examine the allocation method. After the reported period, the investment committee decided to change the allocation method following the capital-raising in August 2006 and the issuance of the consumer-price index-linked debentures (Series 2), to the effect that approximately 35% of the Company's investments will be allocated to US Dollar-linked investment programs (partially protecting its exposure to the increase in the US Dollar exchange rate) and approximately 65% of its investments, to NIS programs (partially protecting its exposure to an increase in the Israeli Consumer-Price Index).

**Monetary Assets and Liabilities Classified by Linkage Basis**

September 30, 2006							
Israeli currency			Other currencies				
Not linked	Linked to the Israeli CPI	EURO			Other Currencies	Non monetary assets and liabilities	Total
		USD					
NIS in thousands							
<b>Assets</b>							
Cash and cash equivalents	31,802	-	7,678	3,302	-	-	42,782
Marketable securities	3,409	16,951	-	11,510	-	-	31,870
Accounts receivable - Trade	7,577	-	1,995	2,121	15	-	11,708
Accounts receivable - Other	440	600	-	-	-	76	1,116
Inventory	-	-	-	-	-	15,486	15,486
Inventory - work in progress	-	-	-	-	-	-	-
Long-term deposits	-	-	-	-	-	292	292
Property and equipment	-	-	-	-	-	22,341	22,341
Other assets	-	-	-	-	-	179	179
<b>Total assets</b>	<b>43,228</b>	<b>17,551</b>	<b>9,673</b>	<b>16,933</b>	<b>15</b>	<b>38,374</b>	<b>125,774</b>
<b>Liabilities</b>							
Credit from banks and others	-	143	1,988	7,819	-	-	9,950
Accounts payable - Trade	11,185	-	1,964	197	21	-	13,367
Accounts payable - Other	10,017	-	-	184	-	570	10,771
Long-term debt	-	263	5,161	4,811	-	-	10,235
Convertible debentures	-	-	2,358	24,416	-	-	26,774
Debentures	-	29,675	-	-	-	-	29,675
Accrued severance pay, net	2,017	-	-	-	-	-	2,017
Deferred taxes	-	-	-	-	-	-	-
<b>Total liabilities</b>	<b>23,219</b>	<b>30,081</b>	<b>11,471</b>	<b>37,427</b>	<b>21</b>	<b>570</b>	<b>102,789</b>
Net Balance	20,009	(12,530)	(1,798)	(20,494)	(6)	37,804	22,985

Tzvi Livne  
Director

Haim Shani  
Chairman & CEO

Date: November 27<sup>th</sup>, 2006

**UNITRONICS (1989) (R"G) LTD.**

**Financial Statements  
As of September 30, 2006**

**(Unaudited)**

**Unitronics (1989) (R"G) Ltd.**

**Financial Statements**

**As of September 30, 2006**

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**To the Board of Directors of Unitronics (1989) (R"G) Ltd.**

**Re: Review of the Interim Financial Statements**

At your request, we have reviewed the interim consolidated balance sheet of Unitronics (1989) (R"G) Ltd. as of September 30, 2006, and the related interim consolidated statements of operations, changes in shareholders' equity and cash flows for the nine and the three months then ended.

Our review was made in accordance with procedures established by the Institute of Certified Public Accountants in Israel. These procedures included reading the above mentioned interim consolidated financial statements, reading minutes of meetings of the shareholders and of the board of directors and its committees, and making inquiries of persons responsible for financial and accounting matters.

We did not review the Interim Financial Statements of a subsidiary, which were reviewed by other auditors. We have been furnished with reports of other auditors in respect of the review of the Interim Financial Statements of the subsidiary whose assets as at September 30, 2006 represent approximately 3% of the total assets included in the Consolidated Interim Balance Sheet and whose income for the nine month period ending September 30, 2006 represents approximately 13% of the total income included in the Consolidated Interim Statement of Operations.

Since the review performed is limited in scope and does not constitute an examination in accordance with acceptable auditing standards, we do not give an opinion on the above Interim Financial Statements.

Based on our review and the reports of other auditors, we are not aware of any material modifications that should be made to the interim consolidated financial statements in order for them to be in conformity with generally accepted accounting principles in Israel and with chapter D to the Securities Regulations (Periodic and Immediate Reports) - 1970.

Amit, Halfon  
Certified Public Accountants (Israel)

November 27, 2006

Unitronics (1989) (R"G) Ltd. Consolidated Balance Sheets	<u>September 30, 2006</u>	<u>September 30, 2006</u>	<u>September 30, 2005</u>	<u>December 31, 2005</u>
	<u>(unaudited)</u>	<u>(unaudited)</u>		<u>(audited)</u>
	<u>(in thousands)</u>			
	<u>Convenience translation into Euro(1)</u>	<u>Reported NIS</u>		
Cash and cash equivalents	7,842	42,782	13,991	15,542
Restricted cash	-	-	-	2,300
Marketable securities	5,842	31,870	32,953	33,363
Accounts receivable -				
Trade	2,146	11,708	9,736	10,103
Other	205	1,116	728	1,029
Inventory	2,838	15,486	8,478	9,451
Inventory - work in progress	-	-	130	-
<i>Current assets</i>	<u>18,873</u>	<u>102,962</u>	<u>66,016</u>	<u>71,788</u>
<i>Long-term deposits</i>	54	292	199	201
<i>Property and equipment, net</i>	4,095	22,341	22,377	22,471
<i>Other assets and deferred expenses, net</i>	33	179	3,557	3,279
<b>Total assets</b>	<b><u>23,055</u></b>	<b><u>125,774</u></b>	<b><u>92,149</u></b>	<b><u>97,739</u></b>
Credit from banks and others	1,824	9,950	7,144	1,103
Accounts payable -				
Trade	2,450	13,367	10,348	13,146
Other	1,957	10,678	7,880	12,305
<i>Current liabilities</i>	<u>6,232</u>	<u>33,995</u>	<u>25,372</u>	<u>26,554</u>
Long-term debt	1,876	10,235	5,052	11,411
Convertible bonds	4,908	26,774	37,742	37,512
Bonds	5,440	29,675	-	-
Accrued severance pay, net	370	2,017	1,575	1,346
Deferred taxes	-	-	224	251
<i>Long-term liabilities</i>	<u>12,594</u>	<u>68,701</u>	<u>44,593</u>	<u>50,520</u>
<i>Shareholders' equity</i>	<u>4,230</u>	<u>23,078</u>	<u>22,184</u>	<u>20,665</u>
<b>Total liabilities and shareholders' equity</b>	<b><u>23,055</u></b>	<b><u>125,774</u></b>	<b><u>92,149</u></b>	<b><u>97,739</u></b>

Haim Shani  
Chairman of the Board of Directors  
and Chief Executive Officer

Tzvi Livne  
Director

Yair Itscovich  
Chief Financial Officer

Approved: November 27, 2006.

(1) See note 2D.

The notes to the financial statements form an integral part thereof.

Unitronics (1989) (R"G) Ltd. Consolidated Statements of Operations	<i>For the nine months period ended September 30,</i>		<i>For the nine months period ended September 30,</i>		<i>For the three months period ended September 30,</i>		<i>For the three months period ended September 30,</i>		<i>For the year ended December 31,</i>
	2006		2006		2006		2006		2005
	<u>(unaudited)</u>		<u>(unaudited)</u>		<u>(unaudited)</u>		<u>(unaudited)</u>		<u>(audited)</u>
	Convenience translation into Euro (1)		Reported NIS		Convenience translation into Euro (1)		Reported NIS		
	<u>(in thousands)</u>								
Revenues	12,355	67,401	60,228	4,351	23,734	20,388	80,774		
Cost of revenues	7,970	43,477	41,631 (*)	2,915	15,903	14,125 (*)	55,888		
<i>Gross profit</i>	<u>4,385</u>	<u>23,924</u>	<u>18,597</u>	<u>1,436</u>	<u>7,831</u>	<u>6,263</u>	<u>24,886</u>		
Research & development expenses, net	1,121	6,116	4,135 (*)	384	2,093	1,409 (*)	5,753		
Selling & marketing expenses	1,506	8,214	6,891 (*)	475	2,593	2,549 (*)	9,659		
General & administrative expenses	810	4,420	4,971 (*)	260	1,417	1,401 (*)	6,302		
<i>Operating profit</i>	<u>948</u>	<u>5,174</u>	<u>2,600</u>	<u>317</u>	<u>1,728</u>	<u>904</u>	<u>3,172</u>		
Financing expenses, net	614	3,348	722	225	1,225	154	2,511		
<i>Operating profit after financing expenses, net</i>	<u>334</u>	<u>1,826</u>	<u>1,878</u>	<u>92</u>	<u>503</u>	<u>750</u>	<u>661</u>		
Other income, net	6	33	-	-	-	-	-		
<i>Profit before taxes on income</i>	<u>341</u>	<u>1,859</u>	<u>1,878</u>	<u>92</u>	<u>503</u>	<u>750</u>	<u>661</u>		
Tax benefits (taxes on income)	16	(87)	30	1	3	19	(37)		
<i>Profit for the period</i>	<u>325</u>	<u>1,772</u>	<u>1,908</u>	<u>93</u>	<u>506</u>	<u>769</u>	<u>624</u>		
<i>Profit per ordinary share</i> NIS 0.02 par value	<u>0.028</u>	<u>0.153</u>	<u>0.164 (**)</u>	<u>0.008</u>	<u>0.044</u>	<u>0.066 (**)</u>	<u>0.054</u>		

(\*) Reclassified.

(\*\*) Restated, see Note 2E5.

(1) See note 2D.

The notes to the financial statements form an integral part thereof.

<b>Unitronics (1989) (R"G) Ltd. Statements of Shareholders' Equity</b>	<b>Share capital</b>	<b>Capital reserves</b>	<b>Share premium</b>	<b>Receipts on account of warrants and conversion option</b>	<b>Company shares held by the company</b>	<b>Accumulated Loss</b>	<b>Total</b>
<b>Reported NIS in thousands</b>							
Balance at January 1, 2005 (audited)	352	-	48,442	676	-	(28,855)	20,615
Purchase of company shares by the company	-	-	-	-	(574)	-	(574)
Profit for the year	-	-	-	-	-	624	624
Balance at December 31, 2005 (audited)	352	-	48,442	676	(574)	(28,231)	20,665
Purchase of company shares by the company	-	-	-	-	(67)	-	(67)
Split of conversion option from convertible bonds, net	-	-	-	235	-	-	235
Benefit arising from warrants granted	-	11	-	-	-	-	11
Receipts on account of warrants	-	-	-	462	-	-	462
Profit for the period	-	-	-	-	-	1,722	1,722
Balance at September 30, 2006 (unaudited)	<u>352</u>	<u>11</u>	<u>48,442</u>	<u>1,373</u>	<u>(641)</u>	<u>(26,459)</u>	<u>23,078</u>
Balance at January 1, 2005 (audited)	352	-	48,442	676	-	(28,855)	20,615
Purchase of company shares by the company	-	-	-	-	(339)	-	(339)
Profit for the period	-	-	-	-	-	1,908	1,908
Balance at September 30, 2005 (unaudited)	<u>352</u>	<u>-</u>	<u>48,442</u>	<u>676</u>	<u>(339)</u>	<u>(26,947)</u>	<u>22,184</u>
Balance at July 1, 2006 (unaudited)	352	11	48,442	911	(641)	(26,965)	22,110
Receipts on account of warrants	-	-	-	462	-	-	462
Profit for the period	-	-	-	-	-	506	506
Balance at September 30, 2006 (unaudited)	<u>352</u>	<u>11</u>	<u>48,442</u>	<u>1,373</u>	<u>(641)</u>	<u>(26,459)</u>	<u>23,078</u>
Balance at July 1, 2005 (unaudited)	352	-	48,442	676	-	(27,716)	21,754
Purchase of company shares by the company	-	-	-	-	(339)	-	(339)
Profit for the period	-	-	-	-	-	769	769
Balance at September 30, 2005 (unaudited)	<u>352</u>	<u>-</u>	<u>48,442</u>	<u>676</u>	<u>(339)</u>	<u>(26,947)</u>	<u>22,184</u>

The notes to the financial statements form an integral part thereof.

<b>Unitronics (1989) (R"G) Ltd. Statements of Shareholders' Equity</b>	<u>Share capital</u>	<u>Capital reserves</u>	<u>Share premium</u>	<u>Receipts on account of warrants and conversion option</u>	<u>Company shares held by the company</u>	<u>Accumulated Loss</u>	<u>Total</u>
<b><u>Convenience translation into Euro in thousands (unaudited) (1)</u></b>							
Balance at January 1, 2006	65	-	8,880	124	(106)	(5,176)	3,787
Purchase of company shares by the company	-	-	-	-	(12)	-	(12)
Split of conversion option from convertible bonds, net	-	-	-	43	-	-	43
Benefit arising from warrants granted	-	2	-	-	-	-	2
Receipts on account of warrants	-	-	-	85	-	-	85
Profit for the period	-	-	-	-	-	325	325
Balance at September 30, 2006	<u>65</u>	<u>2</u>	<u>8,880</u>	<u>252</u>	<u>(118)</u>	<u>(4,851)</u>	<u>4,230</u>
<b><u>Convenience translation into Euro in thousands (unaudited) (1)</u></b>							
Balance at July 1, 2006	65	2	8,880	167	(118)	(4,944)	4,052
Receipts on account of warrants	-	-	-	85	-	-	(85)
Profit for the period	-	-	-	-	-	93	93
Balance at September 30, 2006	<u>65</u>	<u>2</u>	<u>8,880</u>	<u>252</u>	<u>(118)</u>	<u>(4,851)</u>	<u>4,230</u>

(1) See note 2D.

The notes to the financial statements form an integral part thereof.

Unitronics (1989) (R"G) Ltd. Consolidated Statements of Cash Flows	<i>For the nine months period ended September 30,</i>		<i>For the nine months period ended September 30,</i>		<i>For the three months period ended September 30,</i>		<i>For the three months period ended September 30,</i>		<i>For the year ended December 31,</i>
	2006	2006	2005	2006	2006	2005	2005	2005	
	(unaudited)	(unaudited)		(unaudited)	(unaudited)		(audited)		
	Convenience translation into Euro (1)	Reported NIS		Convenience translation into Euro (1)	Reported NIS				
Profit for the period	325	1,772	1,908	93	506	769	624		
Adjustments necessary to show the cash flows from operations (Appendix A)	(1,240)	(6,775)	(3,262)	(288)	(1,573)	(719)	2,453		
<i>Cash flows provided by (used in) operating activities</i>	<i>(917)</i>	<i>(5,003)</i>	<i>(1,354)</i>	<i>(196)</i>	<i>(1,067)</i>	<i>50</i>	<i>3,077</i>		
Investment in marketable securities, net	362	1,976	(3,030)	(23)	(126)	(22)	2,802		
Investment in restricted cash, net	422	2,300	-	-	-	-	2,300		
Purchase of property and equipment	(210)	(1,143)	(1,140)	(95)	(517)	(648)	(1,637)		
Sale of equipment	6	33	-	-	-	-	-		
Investment in long-term deposits	(18)	(97)	(91)	(4)	(23)	(66)	(94)		
Repayment of long-term deposits	1	6	25	1	4	14	26		
Investment in other assets	(20)	(110)	(67)	-	-	-	(110)		
<i>Cash flows provided by (used in) investing activities</i>	<i>543</i>	<i>2,965</i>	<i>(4,303)</i>	<i>121</i>	<i>(662)</i>	<i>(722)</i>	<i>(6,917)</i>		
Long-term loan received from bank	-	-	-	-	-	-	11,063		
Repayment of long-term loans from bank	-	-	(450)	-	-	(210)	(11,506)		
Repayment of long-term loans from others	(18)	(100)	(497)	(5)	(30)	(159)	(536)		
Short-term credit from banks, net	-	(1)	(13)	-	(1)	-	(12)		
Purchase of company shares by the company	(12)	(67)	(339)	-	-	(339)	(574)		
Repayment of convertible bonds	(114)	(622)	-	(57)	(313)	-	-		
Receipts on account of warrants	85	462	-	85	462	-	-		
Bonds issue	5,427	29,606	-	5,427	29,606	-	-		
<i>Cash flows provided by (used in) financing activities</i>	<i>5,368</i>	<i>29,278</i>	<i>(1,299)</i>	<i>5,450</i>	<i>29,724</i>	<i>(708)</i>	<i>(1,565)</i>		
<i>Increase (decrease) in cash and cash equivalents</i>	<i>4,993</i>	<i>27,240</i>	<i>(6,956)</i>	<i>5,132</i>	<i>27,995</i>	<i>(1,380)</i>	<i>(5,405)</i>		
Cash and cash equivalents at beginning of period	2,849	15,542	20,947	2,712	14,787	15,371	20,947		
Cash and cash equivalents at end of period	<u>7,842</u>	<u>42,782</u>	<u>13,991</u>	<u>7,842</u>	<u>42,782</u>	<u>13,991</u>	<u>15,542</u>		

(1) See note 2D.

The notes to the financial statements form an integral part thereof.

Unitronics (1989) (R" G) Ltd. Consolidated Statements of Cash Flows	<i>For the nine months period ended September 30,</i>			<i>For the three months period ended September 30,</i>			<i>For the three months period ended September 30,</i>			<i>For the year ended December 31,</i>
	2006	2006		2005	2006	2006		2005	2005	
	(unaudited)	(unaudited)			(unaudited)	(unaudited)			(audited)	
	Convenience translation into Euro (1)	Reported NIS			(in thousands) Convenience translation into Euro (1)	Reported NIS				
<i>Appendix A</i> - Adjustments necessary to show the cash flows from operations										
Depreciation and amortization	468	2,551	2,218	198	1,079	756	3,004			
Profit from marketable securities, net	(89)	(483)	(1,787)	(19)	(105)	(1,043)	(2,425)			
Benefit arising from warrants granted	2	11	-	-	-	-	-			
Capital gain	(6)	(33)	-	-	-	-	-			
Change in accrued severance pay, net	123	671	435	37	204	184	206			
Deferred taxes, net	16	85	(50)	-	-	(28)	35			
Exchange rate differences on long- term debt and convertible bonds	(81)	(444)	98	(106)	(577)	80	97			
Decrease (increase) in accounts receivable - trade	(294)	(1,605)	(2,874)	91	491	(3,974)	(3,241)			
Decrease (increase) in accounts receivable - other	(16)	(87)	175	(10)	(56)	467	(126)			
Decrease (increase) in inventory	(1,106)	(6,035)	1,307	(57)	(310)	(929)	334			
Decrease in inventory - work in progress	-	-	313	3	19	1,038	443			
Increase (decrease) in accounts payable - trade	41	221	(3,082)	(505)	(2,755)	543	(284)			
Increase (decrease) in accounts payable - other	(298)	(1,627)	(15)	80	437	2,187	4,410			
	<u>(1,240)</u>	<u>(6,775)</u>	<u>(3,262)</u>	<u>(288)</u>	<u>(1,573)</u>	<u>(719)</u>	<u>2,453</u>			

(1) See note 2D.

The notes to the financial statements form an integral part thereof.

**Notes to the Financial Statements of Unitronics (1989) (R"G) Ltd.**

**Note 1 - General**

These financial statements have been prepared in a condensed format as of September 30, 2005, and for the nine and the three months then ended ("interim financial statements"). These financial statements should be read in conjunction with the Company's audited annual financial statements and accompanying notes as of December 31, 2005 and for the year then ended.

**Note 2 - Significant Accounting Policies**

- A. The interim financial statements have been prepared in accordance with generally accepted accounting principles for the preparation of financial statements for interim periods, as prescribed in Accounting Standard No. 14 of the Israel Accounting Standards Board.

The significant accounting policies and methods of computation followed in the preparation of the interim financial statements are identical to those followed in the preparation of the latest annual financial statements, except as explained in Note E.

- B. The company prepares its financial statements according to chapter D to the Securities Regulations (Periodic and Immediate Reports) - 1970.
- C. Following are data regarding the Israeli CPI and the exchange rate of the U.S. dollar and the Euro:

<b>As of</b>	<b>Israeli CPI Points (*)</b>	<b>Exchange rate of One U.S. dollar NIS</b>	<b>Exchange rate of One Euro NIS</b>
September 30, 2006	186.48	4.302	5.4552
September 30, 2005	184.15	4.598	5.5275
December 31, 2005	185.05	4.603	5.4465
<b>Change during the period</b>	<b>%</b>	<b>%</b>	<b>%</b>
September 2006 (nine months)	0.77	(6.54)	0.16
September 2005 (nine months)	1.89	6.73	(5.94)
September 2006 (three months)	(0.77)	(3.11)	(3.34)
September 2005 (three months)	1.38	0.52	0.01
December 2005 (12 months)	2.38	6.85	(7.32)

(\*) The index on an average basis of 1993 = 100.

## **Note 2 - Significant Accounting Policies (cont')**

### **D. Convenience translation in EURO**

For the convenience of the reader, the reported NIS amounts for the last reported period have been translated in EURO by dividing each reported NIS amount by the representative rate of exchange of the EURO as at September 30, 2006 (EURO 1 = NIS 5.4552).

The translated EURO amounts presented in these financial statements should not be construed as representing amounts receivable or payable in EURO unless otherwise indicated.

### **E. Initial application of new Accounting Standards**

1. Since January 1, 2006 the company implements Accounting Standard No.22 - "Financial Instruments: Disclosure and Presentation" ("the standard"). The Standard prescribes principles for the presentation of financial instruments and identifies the information that should be disclosed about them in the financial statements and cancels Opinions No. 48 and No. 53 of the Institute of Certified Public Accountants in Israel.

The application of the standard was 'from now on'. Comparative data for prior periods were not restated.

As a result of the initial application of the standard, the equity has been increased against a decrease in liabilities due to charge of the equity component of the financial instruments to the equity at the amount of NIS 235 thousands. In addition, issue expenses related to the convertible bonds have been deducted from the liabilities and were taken in account in the effective interest calculation. This issue expenses of NIS 2,796 thousand as at December 31, 2005 were deducted on January 1, 2006, from the liabilities presented in the balance sheet at December 31, 2005.

2. Since January 1, 2006 the company implements Accounting Standard No. 24, "Share-Based Payment" ("the Standard"). The Standard prescribes principles of measurement and specifically requires for three types of share-based payment transactions:
  - a. Share-based payment transactions which will be settled in equity instruments.
  - b. Share-based payment transactions which will be settled in cash.
  - c. Share-based payment transactions which the entity or the other party can determine the way it will be settled.

The initial application of the new Standard had no material effect on the financial statements of the company.

3. Since January 1, 2006 the company implements Accounting Standard No. 25, "Revenues" ("the Standard"). The Standard deals with the recognition of revenue from three types of transactions: sale of goods, rendering of services and revenue from interest, royalties and dividends and prescribes the criteria for recognition, measurement, presentation and disclosure for each type of revenue.

The initial application of the new Standard had no material effect on the financial statements of the company.

4. Since January 1, 2006 the company implements Accounting Standard No. 20 (Revised), "Accounting for Goodwill and Intangible Assets upon Acquisition of Investee" ("the Standard"). The standard deals with goodwill and intangible assets upon acquisition of subsidiary, affiliated company or a company under common control.

The initial application of the new Standard had no material effect on the financial statements of the company.

## **Note 2 - Significant Accounting Policies (cont')**

### **E. Initial application of new Accounting Standards (cont')**

5. Since January 1, 2006 the company implements Accounting Standard No. 21, "Earnings per Share" ("the Standard"), which prescribes the principles for the computation and presentation of earnings (loss) per share in the financial statements and supersedes Opinion No. 55 of the Institute of Certified Public Accountants in Israel.

According to the Standard, earnings per share are to be computed based on the number of ordinary shares (and not per NIS 1 par value of the shares as computed until the effective date). Basic earnings per share are to include only shares which are outstanding during the period whereas convertible securities (such as convertible debentures and options) are to be included in the computation of diluted earnings per share, in contrast to the principles applied until the effective date according to which in cases where a convertible security is likely to be converted, it is included in the computation of basic earnings per share.

In addition, convertible securities which had been converted during the period, are to be included in diluted earnings per share up to the date of conversion and are to be included in basic earnings per share from that date. Pursuant to the Standard, options will be included in diluted earnings where their exercise results in the issuance of shares for a consideration which is less than the market price of the shares. The amount of dilution is the market price of the shares less the amount that would have been received as a result of the conversion of the options into shares. This is in contrast to the method of computation prescribed by Opinion No. 55, which also includes adjustments to earnings.

In the event that the Company has various types of ordinary shares with different rights, earnings per share are to be presented separately for each type of share, in accordance with the method of calculation prescribed by the Standard. The company's share of earnings of an investee is to be included based on the company's share in the earnings per share of the investee multiplied by the number of shares held by the company.

As a result of the initial application of this Standard the comparative data for earnings per share were retrospectively restated. The comparative data, before the restatement, were basic profit - NIS 8.18 (fully diluted - NIS 7.89) and basic profit - NIS 3.30 (fully diluted - NIS 3.03) for the nine and three month periods ended September 30, 2005, respectively and NIS 2.68 for the year ended December 31, 2005.

### **F. Disclosure of the effects of new Accounting Standards prior to their adoption**

1. Accounting Standard No. 29 - "Adoption of International Financial Reporting Standards (IFRS)"

In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)" ("the Standard").

International Financial Reporting Standards comprise standards and interpretations adopted by the International Accounting Standards Board, and include:

- a) International Financial Reporting Standards (IFRS)
- b) International Accounting Standards (IAS)
- c) Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and by its predecessor, the Standing Interpretations Committee (SIC).

Pursuant to the Standard, companies that are subject to the provisions of the Securities Law, 1968, and that are required to report according to the regulations published thereunder, will be required to prepare their financial statements in accordance with IFRS starting from the period commencing on January 1, 2008. These companies, as well as other companies, may adopt IFRS early and prepare their financial statements in accordance with IFRS starting with financial statements that are issued subsequent to July 31, 2006.

For transition purposes, companies that prepare their financial statements in accordance with IFRS will be required to adopt the provisions of IFRS 1, "First-time Adoption of IFRS".

## **Note 2 - Significant Accounting Policies (cont')**

### F. Disclosure of the effects of new Accounting Standards prior to their adoption (cont')

#### 1. Accounting Standard No. 29 - "Adoption of International Financial Reporting Standards (IFRS)" (cont')

A company that adopts IFRS commencing from January 1, 2008, and that has elected to include comparative data for only one year (2007) will be required to prepare an opening balance sheet as of January 1, 2007 ("Opening IFRS Balance Sheet"). The Opening IFRS Balance Sheet will require the following:

- Recognition of all assets and liabilities whose recognition is required by IFRS.
- De-recognition of assets and liabilities if IFRS do not permit such recognition.
- Classification of assets, liabilities and components of equity according to IFRS.
- Application of IFRS in the measurement of all recognized assets and liabilities.

In order to ease first-time adoption, a number of exemptions from IFRS have been granted in respect of the Opening IFRS Balance Sheet, which exemptions may be elected, in whole or in part. Exceptions have also been established which prohibit retrospective application of certain aspects of IFRS.

According to the Standard, the Company is required to include in a note to the annual financial statements as of December 31, 2007, a balance sheet as of December 31, 2007, and a statement of income for the year then ended, that have been prepared based on the recognition, measurement and presentation criteria of IFRS.

There are differences between IFRS and generally accepted accounting principles in Israel in the recognition and measurement of assets and liabilities and in reporting and disclosure requirements. These differences could have a material impact on the Company's financial position and results of operations. The first-time adoption of IFRS will require the Company to identify such differences, a process that will entail a significant amount of time and resources.

The Company is evaluating the implications of the transition to IFRS but is presently unable to estimate the effect of the adoption of IFRS on its financial statements.

#### 2. Accounting standard No.26 - "Inventories"

In August 2006, the Israel Accounting Standards Board published Accounting Standard No. 26, "Inventories" ("the Standard").

The Standard applies to all types of inventories, excluding work in progress arising from construction contracts, which is subject to the provisions of Accounting Standard No. 4, "Construction-type Contracts", inventory of buildings for sale, which is subject to the provisions of Accounting Standard No. 2, "Construction of Buildings for Sale" and financial instruments.

The Standard prescribes that inventories should be measured at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and costs necessary to make the sale. The cost of inventories should be determined based on the "first in - first out" (FIFO) method or using weighted average cost, provided that the same method is applied in respect of inventories having a similar nature and use. Measurement of the cost of inventories based on the "last in - first out" (LIFO) method is not permitted.

In accordance with the Standard, when inventories are purchased under credit terms whereby the arrangement involves a financing element, the inventories should be presented at cost reflecting the cash purchase price and the financing element should be recognized as a financial expense over the period of the financing.

## **Note 2 - Significant Accounting Policies (cont')**

### F. Disclosure of the effects of new Accounting Standards prior to their adoption (cont')

#### 2. Accounting standard No.26 - "Inventories" (cont')

In respect of the allocation of conversion costs to inventories, the Standard prescribes that if in a particular period, production is not at normal capacity, then the cost of inventories should not include allocation of fixed overhead costs in excess of that allocated based on normal capacity. Such unallocated overhead costs should be recognized as an expense in the statement of income in the period in which they are incurred. Furthermore, cost of inventories should not include abnormal amounts of materials, labor and other costs resulting from inefficiency.

When a write-down of inventories has been recognized and subsequently there is an increase in their value, the amount of the write-down is reversed. The amount of the write-down or its reversal should be recorded in cost of sales in the statement of income.

The Standard will be applicable to financial statements for periods beginning January 1, 2007 and thereafter. The provisions of the Standard are to be applied retrospectively, by restating comparative amounts relating to prior periods.

The company is currently assessing the implications of the standard on its financial statements.

#### 3. Accounting standard No. 27 - "Fixed Assets"

In September 2006, the Israel Accounting Standards Board published Accounting Standard No. 27, "Fixed Assets" ("the Standard"). The Standard is applicable to financial statements for periods commencing on January 1, 2007 ("the effective date") or thereafter.

Initial recognition of fixed assets will be based on the cost of purchase. After the initial recognition, the Standard enables choosing between the cost method or the reevaluation method as the accounting policy and to apply it consistently with regard to a group of fixed asset items of a similar nature and usage. According to the reevaluation method, fixed assets are to be presented at an amount revalued based on the fair value upon the date of reevaluation less accumulated depreciation and subsequent impairment losses. The revaluation of fixed assets will be carried to capital reserve in shareholders' equity with the deduction of the tax effect. This capital reserve will be carried directly to retained earnings once the asset has been disposed of or during the use of the asset (according to the rate of depreciation). Revalued assets will be depreciated based on the revalued amount.

According to the Standard, each component of fixed assets with a different life and cost that is material in relation to total cost of fixed assets is to be depreciated separately. The asset's depreciation shall be based on its useful life for the Company, which will be tested at year end, and will be discontinued at the earlier of the date of the asset's classification as held for sale or the date of the asset's disposal. An asset held for sale is an asset which is available for immediate sale as is, which the Company has an obligation to sell and in respect of which the sale is expected to be completed within a year from classification. Furthermore, upon the adoption of the Standard, a change in the method of depreciation will be accounted for as a change in accounting estimate, prospectively rather than by way of cumulative effect, as customary prior to the effective date.

The cost of fixed assets obtained in a swap transaction will be measured at fair value unless the transaction is commercially immaterial or if the fair value of the fixed assets obtained or delivered cannot be reliably measured. The Standard actually replaces the restriction for the measurement of similar assets at fair value with a restriction regarding commercially immaterial transactions. A transaction is commercially material if it leads to a change in amount, timing and risk of future cash flows from the asset.

The cost of fixed assets will also include an initial evaluation of costs of the asset's liquidation and evacuation and restoration of the site on which the asset is located which are undertaken by the Company. The evaluation will be recorded at its present value while using a discount rate reflecting the Company's risk.

The company is currently assessing the implications of the standard on its financial statements.

**Note 3 - Business segments**

**Unitronics (1989) (R"G) Ltd.  
Consolidated**

	<i>For the Nine months period ended September 30, 2006</i>	<i>For the nine months period ended September 30,</i>		<i>For the three months period ended September 30, 2006</i>	<i>For the three months period ended September 30,</i>		<i>For the year ended December 31, 2005</i>
		2006	2005	2006	2006	2005	2005
	(unaudited)	(unaudited)		(unaudited)	(unaudited)		(audited)
				(in thousands)			
	Convenience translation into Euro	Reported NIS		Convenience translation into Euro	Reported NIS		
<b>A. Revenues</b>							
Products	7,494	40,882	26,952	2,582	14,084	9,603	37,201
System integration projects	4,762	25,981	32,722	1,730	9,435	10,574	42,802
Other	99	538	554	39	215	211	711
Total revenues	<u>12,355</u>	<u>67,401</u>	<u>60,228</u>	<u>4,351</u>	<u>23,734</u>	<u>20,388</u>	<u>80,744</u>
<b>B. Segment results</b>							
Products	2,511	13,697	7,774	934	5,097	2,879	10,498
System integration projects	374	2,044	3,824	28	151	809	4,591
Other	14	75	78	4	23	46	73
Unallocated corporate expenses	<u>(1,951)</u>	<u>(10,642)</u>	<u>(9,076)</u>	<u>(649)</u>	<u>(3,543)</u>	<u>(2,830)</u>	<u>(11,990)</u>
Operating profit (loss)	<u>948</u>	<u>5,174</u>	<u>2,600</u>	<u>317</u>	<u>1,728</u>	<u>904</u>	<u>3,172</u>

#### **Note 4 - Events in the reported period**

- A. On May 9, 2006 the annual general meeting of the Company's shareholders (the "AGM") has approved the indemnification and exemption of the Company's Office Holders as may be appointed from time to time, and/or those serving in Other Companies (excluding Office Holders which are Controlling Shareholders of the Company) pursuant to the provisions of the Indemnity Letter and the granting of Indemnity Letters to such Office Holders.

In addition, the AGM has approved the indemnification and exemption of Mr. Haim Shani and Mrs. Bareket Shani, the Controlling Shareholder in the Company and his wife, pursuant to the provisions of the Indemnity Letter and the granting of Indemnity Letters to Messrs. Shani.

On May 18, 2006, the Company has granted Indemnity Letters to the Company's Office Holders, including Mr. Haim Shani and Mrs. Bareket Shani, the Controlling Shareholder in the Company and his wife.

Further more, the AGM has ratified the Company's shareholders general meeting's resolution dated December 15, 2005, to grant options to purchase 10,000 Ordinary Shares of the Company, to Mr. Ron Mishael, who serves as an External Director of the Company. On May 18, 2006, such options were granted to Mr. Mishael. These options exercisable at respective price of EURO 1 from the day of grant till May, 2009. The benefit component from the options granted at the amount of NIS 11 thousands was included in the statements of operations according to Accounting Standard No. 24.

- B. On August, 2006 the company issued a series of bonds at the amount of NIS 34 million (in exchange for 94% of their par value) payable in 5 equal payments starting at August 25, 2009. The bonds are linked to the Israeli CPI and bear fixed interest of 6.1% per annum.

In addition the company issued a series of 600 thousands warrants, which can be exercised to ordinary shares of 0.02 NIS in a way that any warrant can be exercised to one ordinary share at respective price of NIS 5.00, the amount is linked to the Israeli CPI. The warrants can be exercised since the day it was listed to trade until August 24, 2010.

The gross amount raised amounted to approximately NIS 32 million.