

MEDIVISION MEDICAL IMAGING LTD.
CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2005

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INDEPENDENT AUDITORS' REPORT
TO THE SHAREHOLDERS OF
MEDIVISION MEDICAL IMAGING LTD.

We have audited the accompanying consolidated balance sheets of Medivision Medical Imaging Ltd. and its subsidiaries (the "Group") as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We did not audit the financial statements of a subsidiary whose assets constitute approximately 4% and 6% of total consolidated assets as of December 31, 2005 and 2004, respectively, and whose revenues constitute approximately 8% and 7% of total consolidated revenues for the year ended December 31, 2005 and 2004, respectively. The financial statements of this subsidiary were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for this subsidiary, is based on the report of the other auditors.

We conducted our audits in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above give a true and fair view of the financial position of the Group as of December 31, 2005 and 2004, and the consolidated results of operations and cash flows for the years then ended, in accordance with International Financial Reporting Standards.

KOST FORER GABBAY & KASIERER
A member of Ernst & Young Global

Haifa, Israel
March 7, 2006

MEDIVISION MEDICAL IMAGING LTD

CONSOLIDATED BALANCE SHEETS

U.S. Dollars in thousands

	<u>Note</u>	<u>December 31,</u>	
		<u>2005</u>	<u>2004</u>
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents		5,005	2,311
Restricted cash		150	150
Trade receivables, net	3a	3,201	2,395
Other accounts receivable and prepaid expenses	3b	427	227
Inventories	4	642	945
<u>Total current assets</u>		<u>9,425</u>	<u>6,028</u>
PROPERTY AND EQUIPMENT			
Cost	5	879	830
Less – accumulated depreciation		661	546
Property and equipment, net		<u>218</u>	<u>284</u>
DEFERRED TAX ASSETS	13e	<u>1,124</u>	<u>1,029</u>
GOODWILL AND OTHER ASSETS	6	<u>3,712</u>	<u>4,125</u>
<u>Total assets</u>		<u>14,479</u>	<u>11,466</u>

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

MEDIVISION MEDICAL IMAGING LTD

CONSOLIDATED BALANCE SHEETS

U.S. Dollars in thousands (except share data)

		December 31,	
	Note	2005	2004
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Short-term bank credit and current maturities	7	1,525	1,913
Trade payables		738	592
Other accounts payable and accrued expenses	8	4,368	3,683
<u>Total current liabilities</u>		6,631	6,188
LONG-TERM LIABILITIES			
Long-term loans, net of current maturities	9	1,996	1,506
Other liabilities		157	144
<u>Total long-term liabilities</u>		2,153	1,650
COMMITMENTS AND CONTINGENT LIABILITIES			
	10		
<u>Total liabilities</u>		8,784	7,838
EQUITY:			
	11		
Equity attributable to equity holders of the parent:			
Ordinary shares of NIS 0.1 par value each:			
Authorized: 10,000,000 shares as of December 31, 2005 and 2004;			
Issued and outstanding: 6,807,299 and 6,804,675 shares as of			
December 31, 2005 and December 31, 2004 respectively.			
		165	165
Additional paid-in capital		8,506	8,391
Capital reserve		(311)	(311)
Accumulated deficit		(4,346)	(5,389)
		4,014	2,856
Minority interest		1,681	772
<u>Total equity</u>		5,695	3,628
<u>Total liabilities and equity</u>		14,479	11,466

March 7, 2006
Date of Approval

Gabriel Bouganim
Director of Finance

Noam Allon
Director and
Chief Executive Officer

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

MEDIVISION MEDICAL IMAGING LTD

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. Dollars (in thousands - except per share data)

	<u>Note</u>	<u>Year ended December 31,</u>	
		<u>2005</u>	<u>2004</u>
Sales	12a	15,386	12,792*
Cost of sales	12b	<u>6,459</u>	<u>5,494*</u>
Gross profit		----- 8,927	----- 7,298
Operating expenses:			
Research and development expenses	12c	1,548	961
Selling and marketing expenses	12d	3,887	3,404*
General and administrative expenses	12e	<u>2,064</u>	<u>1,895</u>
Total operating expenses		----- 7,499	----- 6,260
Operating income		<u>1,428</u>	<u>1,038</u>
Financial expenses, net	12f	<u>465</u>	<u>387</u>
Profit before other income		963	651
Other income, net	12g	<u>574</u>	<u>1,293</u>
Profit before taxes on income		1,537	1,944
Income tax expense (benefit)	13, 12h	<u>13</u>	<u>(490)</u>
Net Profit for the year		<u><u>1,524</u></u>	<u><u>2,434</u></u>
Attributed to:			
Equity holders of the parent		1,043	1,985
Minority interest		<u>481</u>	<u>449</u>
		<u><u>1,524</u></u>	<u><u>2,434</u></u>
Basic earnings per share (in Dollars)	12i	<u>0.15</u>	<u>0.29</u>
Diluted earnings per share (in Dollars)	12i	<u>0.13</u>	<u>0.29</u>

*Reclassified - see note 2v.

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

U.S. Dollars in thousands

	Attributable to equity holders of the parent				Total	Minority interests	Total equity
	Share capital	Additional paid-in capital	Capital reserve	Accumulated deficit			
Balance at January 1, 2004	165	8,391	(311)	(7,374)	871	4	875
Net profit	-	-	-	1,985	1,985	768	2,753
Balance at January 1, 2005	165	8,391	(311)	(5,389)	2,856	772	3,628
Exercise of options	*-	-	-	-	-	-	-
Conversion of a note and exercise of options into common stock of a subsidiary	-	-	-	-	-	366	366
Cost of share-based payment	-	31	-	-	31	62	93
Modification of terms of warrants (Note 11a)	-	84	-	-	84	-	84
Net profit	-	-	-	1,043	1,043	481	1,524
Balance at December 31, 2005	165	8,506	(311)	(4,346)	4,014	1,681	5,695

* Represents an amount of less than \$1.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. Dollars in thousands

	Note	Year ended December 31,	
		2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net profit for the year		1,524	2,434
Adjustments for:			
Depreciation and amortization		214	376
Gain on the sale and issuance of shares of a subsidiary		(678)	(1,308)
Deferred taxes, net		(95)	(529)
Cost of share-based payment		93	-
Non cash payment of interest		10	36
Other		21	4
		<u>1,089</u>	<u>1,013</u>
Changes in operating assets and liabilities:			
Increase in trade receivables		(806)	(545)
Decrease (increase) in other accounts receivable and prepaid expenses		(200)	201
Decrease (increase) in inventories		303	(228)
Increase (decrease) in trade payables		146	(1)
Increase in other accounts payable and accrued expenses		764	143
Net cash provided by operating activities		<u>1,296</u>	<u>583</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of a subsidiary (Note 6c)		(1)	(570)
Purchase of property and equipment		(55)	(101)
Proceeds from the sale of shares of subsidiary		919	1,364
Proceeds from the sale of property and equipment		-	1
Payment of short-term credit for purchase of subsidiary		(74)	-
Net cash provided by investing activities		<u>789</u>	<u>694</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Receipt of long-term loans		2,000	1,099
Repayment of long-term loans		(1,304)	(1,098)
Proceeds from exercise of options by the minority shareholders of a subsidiary		49	49
Deferred debt issuance costs		-	(71)
Decrease in short-term loans, net		(113)	(318)
Net cash provided by (used in) financing activities		<u>632</u>	<u>(339)</u>
Increase (decrease) in cash and cash equivalents		2,717	938
Cash and cash equivalents at beginning of the year	15	<u>2,247</u>	<u>1,309</u>
Cash and cash equivalents at the end of the year	15	<u>4,964</u>	<u>2,247</u>

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

	Year ended December 31,	
	2005	2004
SUPPLEMENTARY INFORMATION:		
Cash paid during the year for interest	170	151
Income taxes	60	70
Supplemental schedule of non-cash activities:		
Repayment of notes payable and interest through conversion into common stock of a subsidiary	411	617
Short-term credit for purchase of subsidiary	-	74
Purchase of CCS in consideration of shares of OIS	-	32
Modification of terms of warrants in connection with receipt of bank loan	84	-

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 1:- GENERAL

- a. Medivision Medical Imaging Ltd. ("the Company"), an Israeli corporation located in Yokneam, was incorporated and commenced business operations in June 1993. The Group is primarily engaged in the business of designing, developing, manufacturing and marketing digital imaging systems, image enhancements and analysis software and related products and services for use by practitioners in the ocular healthcare field. The principal markets of the Company are located in the United States and Europe (see Note 12a).

The average head count of employees of the company and its subsidiaries during the year was 67, of which 17 were in production, 30 were in sales, 9 were in research and development and 11 were in administration functions.

The Company's shares are traded on the EURO.NM market in Belgium.

b. **Definitions:**

- "The Company"** - Medivision Medical Imaging Ltd.
- "Subsidiaries"** - Companies whose financial statements are fully consolidated with those of the Company.
- "The Group"** - The Company and its subsidiaries.
- "OIS"** - Ophthalmic Imaging Systems.
OIS is a company incorporated in Sacramento, California, U. S. A. whose shares are traded over the counter in NASDAQ (OISI.OB). As of December 31, 2005, the Company owns 67% of OIS's outstanding common stock. (See also note 16).
- "CCS"** - Effective as of July 1, 2004, the Company acquired 54% of the voting shares of CCS Pawlowski GmbH. (CCS), a company incorporated in Jena, Germany. CCS designs, develops, manufactures and markets ophthalmic digital imaging and image enhancement systems. The Company currently owns 63% of CCS's outstanding common stock. (See Note 6c).
- "C.P.I."** - The Consumer Price Index as published by the Central Bureau of statistics in Israel.
- "NIS"** - New Israeli Shekels.
- "Dollar" or "\$"** - U.S. Dollar.
- "EURO" or "€"** - European currency.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS).

The consolidated financial statements have been prepared on an historical cost basis.

a. Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except that the Group has adopted new or revised standards mandatory for financial years beginning on or after 1 January 2005 as follows:

- IFRS 2 Share-Based Payment
- IFRS 3 Business Combinations, IAS 36 (revised) Impairment of Assets and IAS 38 (revised) Intangible Assets

The principal effects of these changes in policies are discussed below.

IFRS 2 – SHARE-BASED PAYMENT

IFRS 2, 'Share-Based Payment' requires an expense to be recognized when goods or services are acquired in exchange for shares or rights to shares ('equity-settled transactions'), or in exchange for other assets equivalent in value to a given number of shares or rights to shares ('cash-settled transactions'). The main impact of IFRS 2 on the Group is the recognition of an expense for options granted to employees and directors. The expense is measured by reference to the fair value of the options on the grant date by using an option-pricing model. The initial application of IFRS 2 relates primarily to approximately 360,000 options granted in December 2004 for which the effect in 2004 was immaterial.

IFRS 3 – BUSINESS COMBINATIONS

In accordance with the transitional provisions of IFRS 3, the Group has ceased amortizing goodwill commencing on January 1, 2005. IFRS 3 requires the Group to test goodwill for impairment annually at the cash generating unit level (unless an event occurs during the year which requires the goodwill to be tested more frequently). In the year ended December 31, 2004 amortization of goodwill amounted to \$222.

IAS 1- PRESENTATION OF FINANCIAL STATEMENTS (amended 2004)

The Group has adopted the revised Standard as of January 1, 2005. The principal impact is in the presentation of minority interests in the financial statements. Comparative data have been reclassified.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (continued)**b. Use of Estimates**

The preparation of financial statements in accordance with IFRS requires estimates and assumptions by the Company's management. Management is not presently aware of any significant uncertainty in applying these estimates that might result in material changes in the carrying amounts of assets and liabilities within the next financial year.

c. Financial statements in U.S. Dollars:

1. The majority of the Group's sales are denominated in Dollars and the majority of the Group's costs are incurred in Dollars or linked thereto. Accordingly, the Company has determined the Dollar as the currency of its primary economic environment, and thus as its functional and presentation currency in accordance with IAS 21.
2. Transactions and balances originally denominated in Dollars are presented at their original amounts. Balances in non-Dollar currencies are translated into Dollars using historical and current exchange rates for non-monetary and monetary balances respectively. For non-Dollar transactions reflected in the statement of operations, the exchange rates prevailing at the date of the transaction are used. Depreciation and changes in inventories deriving from non-monetary items are based on historical exchange rates.

All transaction gains and losses from the above translation are reflected in the statement of operations in financial expenses, net.

3. Data regarding the representative exchange rates of the NIS in relation to the Dollar on balance sheet date and the changes therein during the reported periods are as follows:

	Exchange rate of the NIS
	<hr/>
December 31, 2005	4.603
December 31, 2004	4.308
Change during the year ended:	%
	<hr/>
December 31, 2005	6.85
December 31, 2004	(1.62)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (continued)**d. Principles of consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiaries. Inter-company transactions and balances, including profits from inter-company sales not yet realized outside the Group, have been eliminated upon consolidation.

Acquisitions of subsidiaries are included in the financial statements using the purchase method of accounting. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the group. The financial statements of subsidiaries are prepared for the same reporting periods as the Company, using consistent accounting policies. Adjustments are made to conform to any dissimilar accounting policies that may exist.

e. Cash and cash equivalents

The Company considers all highly liquid investments readily convertible into cash, originally purchased with maturities of three months or less, to be cash equivalents.

For the purposes of the consolidated cash flows statements, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

f. Restricted cash

Restricted cash is primarily invested in certificates of deposits, which mature within one year and is used as security for a line of credit of OIS.

g. Trade receivables

Trade receivables include amounts billed to customers from transactions arising in the ordinary course of business. Management periodically evaluates the collectibility of these receivables. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified

h. Inventories

Inventories are valued at the lower of cost or net realizable value. Cost is determined as follows:

Raw materials	- on a first-in, first-out basis.
Work-in-progress and finished products	- cost of direct materials and labor and a proportion of manufacturing overheads based on normal operating activities.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (continued)**i. Property and equipment**

Property and equipment are stated at cost, less accumulated depreciation and any impairment in value.

Depreciation is computed by the straight-line method, on the basis of the estimated useful lives of the assets.

Annual depreciation rates are:	%
Machinery and equipment	15 – 25
Office furniture and equipment	6 – 15
Computers and peripheral equipment	20 – 33
Vehicles	16.67
Leasehold improvements	Over the term of the lease

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

j. Goodwill

Goodwill represents the excess of the cost of the acquisition over the fair value of identifiable net assets of a subsidiary at the date of acquisition. Goodwill arising from the purchase of OIS (for which the agreement date was prior to March 31, 2004) was amortized on a straight-line basis over its useful economic life of 20 years. Goodwill is stated at cost less accumulated amortization at December 31, 2004, and any impairment in value. As of January 1, 2005 the Company ceased amortizing goodwill – see a above.

k. Leases

Financing leases, which effectively transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the present value of the minimum lease payments at the inception of the lease term and disclosed as leased property and equipment. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (continued)**l. Warranty provision**

The Group generally offers a one-year warranty to its customers. The warranty requires repair or replacement of defective products during the warranty period. At the time product revenue is recognized, The Group records a provision for estimated costs that may be incurred under these warranties. The costs are estimated based on historical experience and any specific warranty issues that have been identified. (Although historical warranty costs have been within expectations, there can be no assurance that future warranty costs will not exceed historical amounts). The Group periodically assesses the adequacy of the recorded warranty liability and adjusts the balance as necessary.

m. Borrowing costs

Borrowing costs are recognized as an expense when incurred in accordance with the benchmark accounting treatment under IAS 23.

n. Convertible debt

The component parts (liability and equity elements) of convertible debt are measured and reported separately in the balance sheet. Upon the issuance of convertible debt, the fair value of the liability component is determined using a market rate for an equivalent non-convertible debt. This amount is shown as a long-term liability on the amortized cost basis until conversion or repayment. The remainder, if any, of the proceeds received upon the issuance of the convertible debt is allocated to the equity component (option) and included in shareholders' equity. The value of the option is not changed in subsequent periods.

Issuance costs are allocated between the liability and equity components of the convertible debt based on the allocation of the proceeds to those components when they are first recognized.

Issuance costs allocated to liability were presented as deferred issuance costs included in other assets.

o. Income taxes

The Company accounts for income taxes under the liability method of accounting for income taxes as prescribed by IAS 12.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry forward of unused tax assets, and unused tax losses can be utilized.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (continued)

o. Income taxes (continued)

In respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognized to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

p. Revenue recognition

Revenue is recognized when the significant risks and rewards of ownership have passed to the buyer and the amount of revenue can be measured reliably.

Revenues from sales of products are recognized upon shipment to customers, provided that no significant vendor obligations remain, acceptance has occurred and the collection of the related receivable is probable. Revenues from installation and training services are generally recognized when such services are performed. The Group generally provides a one year warranty covering materials and workmanship. Cost of sales includes the anticipated expenses associated with the warranty.

Customers may purchase extended warranty coverage for additional one or two year periods. Revenues from the sale of these extended warranties are deferred and recognized as revenue on a straight-line basis over the term of the extended warranty contract.

q. Research and development costs

Research costs are expensed as incurred. Development costs are also expensed as incurred, if the development costs do not meet the criteria for capitalization as set forth in IAS 38 "Intangible Assets"

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (continued)**r. Royalty bearing grants**

Royalty bearing grants from the Chief Scientist and BIRD-F for funding certain approved research projects are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred and are presented as a reduction of research and development expenses.

s. Earnings per share

The Group calculates basic and diluted earnings per share in accordance with IAS 33, Earnings per Share. Basic earnings per share are computed using the weighted average number of shares outstanding during the period. Diluted earnings per share are computed using the weighted average number of shares outstanding during the period plus the dilutive effect of stock options outstanding during the period.

t. Fair value of financial instruments

The carrying values of cash and cash equivalents, restricted cash, trade and other receivables, short-term bank credit, trade and other payables, and long-term loans reported in the balance sheet approximate their fair values.

u. Concentrations of credit risk

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash, cash equivalents and trade receivables.

Cash and cash equivalents are deposited with high credit quality banks and financial institutions in Israel, Germany and U.S.A. Management believes that the financial institutions that hold the Group's investments are financially sound, and, accordingly, minimal credit risk exists with respect to these investments.

The Group has adopted credit policies and standards intended to accommodate industry growth and inherent risk. The Group performs ongoing credit evaluations of its customers' financial condition and has limited the risk due to the policy to require deposits from customers, the number of customers and their geographic dispersion. The Group includes provisions in the financial statements, which in the opinion of management are adequate to cover doubtful accounts.

v. Reclassification

The Company reports installation revenue within sales, and installation expenses within cost of sales. Prior to 2004 such amounts were immaterial, and were presented, net, in selling and marketing expenses. These amounts increased with the increase in sales of software in 2004. Installation revenue and expenses in 2004 were \$475,200 and \$503,250 respectively. These amounts were reclassified.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 3:- ACCOUNTS RECEIVABLE

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
a. Trade receivables		
Open accounts	3,487	2,697
Less - allowance for doubtful accounts	286	302
	<u>3,201</u>	<u>2,395</u>
b. Other accounts receivable and prepaid expenses		
Prepaid expenses	315	217
Other	112	10
	<u>427</u>	<u>227</u>

NOTE 4:- INVENTORIES

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Composition:		
Raw materials	222	330
Work in progress	71	120
Finished products	349	495
	<u>642</u>	<u>945</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 5:- PROPERTY AND EQUIPMENT

	<u>Machinery and equipment</u>	<u>Office furniture and equipment</u>	<u>Computers and peripheral equipment</u>	<u>Vehicles</u>	<u>Leasehold improvements</u>	<u>Total</u>
Cost:						
Balance as of January 1, 2005	319	302	139	42	28	830
Changes during the year:						
Additions	5	36	13	-	1	55
Disposals	-	(6)	-	-	-	(6)
Balance as of December 31, 2005	<u>324</u>	<u>332</u>	<u>152</u>	<u>42</u>	<u>29</u>	<u>879</u>
Accumulated depreciation:						
Balance as of January 1, 2005	209	185	126	8	18	546
Provision	43	53	8	7	10	121
Disposals	-	(6)	-	-	-	(6)
Balance as of December 31, 2005	<u>252</u>	<u>232</u>	<u>134</u>	<u>15</u>	<u>28</u>	<u>661</u>
Depreciated cost:						
Balance as of December 31, 2004	<u>110</u>	<u>117</u>	<u>13</u>	<u>34</u>	<u>10</u>	<u>284</u>
Balance as of December 31, 2005	<u>72</u>	<u>100</u>	<u>18</u>	<u>27</u>	<u>1</u>	<u>218</u>

Includes assets under capital lease agreements, whose cost is \$ 83 as of December 31, 2005.

Depreciation expense amounted to \$121 and \$99 for the years ended December 31, 2005 and 2004, respectively.

As for Liens - see Note 10d.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 6:- GOODWILL AND OTHER ASSETS

a. Intangible assets:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Original amounts:		
Goodwill (See b and c)	4,691	5,025
Deferred debt issuance costs (See Note 9a)	222	190
	<u>4,913</u>	<u>5,215</u>
Accumulated amortization:		
Goodwill	1,025	1,025
Deferred debt issuance costs	176	65
	<u>1,201</u>	<u>1,090</u>
	<u>3,712</u>	<u>4,125</u>

Amortization of goodwill, which is included in general and administrative expenses, amounted to \$222 for the year ended December 31, 2004. Deferred debt issuance costs which are included in financial expenses amounted to \$46.

- b. On August 18, 2000, the Company acquired 73% of the voting shares of OIS. The consideration for the acquisition, paid in cash, was \$2,575. Goodwill arising on the acquisition amounted to \$4,819. In June 2003, the Company's investment in OIS increased to 85% due to the conversion of a convertible promissory note (see Note 16a). Since then, the Company's investment in OIS decreased to 67% due to sales of shares and options exercised by the minority interest (see Note 16b). A proportionate share of goodwill amounting to \$863 was also realized.
- c. Effectively as of July 1, 2004, the Company acquired 54% of the voting shares of CCS, a Company incorporated in Jena, Germany. CCS designs, develops, manufactures and markets ophthalmic digital imaging and image enhancement systems. The consideration for the acquisition was \$845 of which \$813 was paid in cash and balance of \$32 by transfer of shares of Medivision's US subsidiary, Ophthalmic Imaging Systems, Inc. ("OIS").

In July 2005, the Company increased its holdings in CCS by an additional 9% in consideration of Euro 1 thousand and reached 63% holdings in CCS. The Company has an option to reach up to 80% holdings in CCS until January 2007.

The agreement also provides for additional financing, if it shall be required for funding CCS' activities. Each of the shareholders of CCS shall provide cash financing (shareholders' loans) or a security (such as guarantee, pledge or similar security) in an amount pro-rata to its respective nominal holdings of CCS's shares on such date. The additional amount to be potentially provided for financing by both parties will be limited up to €100 thousand.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 6:- GOODWILL AND OTHER ASSETS (continued)

The cost of the acquisition was allocated to the fair value of the assets and liabilities of CCS as of July 1, 2004 as follows:

	U. S. Dollars (in thousands)
Cash and cash equivalents	169
Fixed and other assets, net	20
Trade receivables	115
Other accounts receivable	189
Inventories	196
	689
Short-term loans	(2)
Trade payables	(2)
Other accounts payable	(473)
Long-term loans	(8)
	204
Fair value of net tangible assets	204
Minority interests	(94)
Goodwill arising on acquisition	735
	845
	U. S. Dollars (in thousands)
Net cash acquired with subsidiary	169
Cash paid	(739)
Net cash outflow	(570)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 7:- SHORT-TERM CREDIT AND CURRENT MATURITIES OF LONG-TERM LOANS

	Interest rate in 2005	December 31,	
	%	2005	2004
Short-term bank credit in NIS	6	41	13
Short-term bank credit in Dollars		-	51
Short-term loans in Dollars		-	113
Current maturities of long-term loans (see Note 9)	LIBOR + 2.75	1,484	1,736
		<u>1,525</u>	<u>1,913</u>

Collateral - see Note 10d.

Line of credit- In May 2003, OIS entered into a line of credit agreement with a bank of up to \$150. The line is secured by a pledged investment with the bank at the amount of \$150. Advances on the line bear interest at prime (5.25% at December 31, 2005) and are due monthly. The line of credit expires on September 10, 2008. As of December 31, 2005 OIS has not drawn any advances against the line of credit.

NOTE 8:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2005	2004
Employees	1,060	842
Accrued expenses to shareholders	191	402
Deferred extended warranty revenue	866	794
Advances from customers	729	227
Warranty provision*	619	506
Accrued expenses and other credit balances	903	912
	<u>4,368</u>	<u>3,683</u>

*Product warranty provision changes consist of the following as of December 31, 2005 and 2004:

	December 31,	
	2005	2004
Warranty balance at beginning of the year	506	438
Net provisions	487	237
Warranty costs incurred	(374)	(169)
Warranty Balance at end of the year	<u>619</u>	<u>506</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 9:- LONG-TERM LOANS (continued)

	Interest rate for	December 31,	
	2005 %	2005	2004
a. Composition:			
Bank loans in Dollars (1,2,5)	LIBOR + 2.75	2,479	1,260
Loans from shareholders' - linked to the Dollar (2)	LIBOR + 5.00	115	293
Loans from minority shareholders of subsidiary - in Euro		-	33
Capitalized lease		53	76
Convertible notes issued by OIS - in Dollars (3,4)		833	1,580
		3,480	3,242
Less-current maturities of long-term loans		1,484	1,736
		1,996	1,506

(1) For loan agreement with United Mizrahi Bank see Note 11a.

(2) The LIBOR rate was 4.83% at December 31, 2005.

(3) On September 25, 2003, OIS entered into a securities purchase agreement with Laurus Master Fund Ltd. #1 ("Laurus 1"). Pursuant to this agreement, OIS sold to Laurus 1 a secured convertible term note in the principal amount of \$1,200 bearing interest at the rate of six and one-half percent (6.5%) per annum, due September 25, 2006, convertible into shares of its common stock at a conversion price of \$1.07 per share at OIS's option. Debt issuance costs of \$119 have been capitalized and are being amortized over the three-year life of the note. Interest is payable, at OIS's option, in cash or in shares of common stock, under certain limitations. OIS granted to Laurus 1 a subordinated second priority security interest in its assets to secure the obligations under the note, pursuant to a security agreement dated September 25, 2003 between it and Laurus 1. See Note 17 regarding early repayment of this note in January 2006.

Additionally, OIS issued a warrant to Laurus 1 to purchase up to 375,000 shares of its common stock at exercise prices ranging between \$1.23 and \$1.61 per share (see Note 16d).

(4) On April 27, 2004, OIS entered into a securities purchase agreement with Laurus Master Fund Ltd. #2 ("Laurus 2"). Pursuant to this agreement, OIS sold to Laurus 2, a secured convertible term note in the principal amount of \$1,000 bearing interest at the rate of six and one-half percent (6.5%) per annum, due April 27, 2007, convertible into shares of its common stock at a conversion price of \$1.22 per share, at OIS's option. Debt issuance costs of \$61 have been capitalized and are being amortized over the three-year life of the note. Interest is payable at OIS's option in cash or shares of common stock. OIS granted to Laurus 2 a subordinated second priority security interest in its assets to secure the obligations under the note. See Note 17 regarding conversion of this note in January 2006. Additionally, OIS issued a warrant to Laurus 2 to purchase up to 313,000 shares of its common stock at exercise prices ranging between \$1.40 and \$1.83 per share (See Note 16e).

(5) According to the loan agreement with Delta Lloyd Bank N.V., dated August 8, 2000, and the first Appendix thereto dated May 28, 2002, the principal amount of \$548 is to be repaid in equal monthly installments of approximately \$61.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 9:- LONG-TERM LOANS (continued)

b. Aggregate maturities of long-term loans are as follows:

	December 31, 2005
First year - current maturities	1,484
Second year	1,349
Third year	602
Loans from shareholders of Company and subsidiary- repayment date not yet determined	45
	1,996
	3,480

c. Collateral - see Note 10d.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands (Except share amount)

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES**a. Equity line of credit**

On December 28, 2004, OIS entered into an investment agreement with Dutchess Private Equities Fund II, LP (Dutchess) providing for an equity line of credit. Pursuant to the investment agreement, Dutchess has agreed to provide OIS with up to \$9,000 of funding during the thirty-month period beginning on the date that a registration statement OIS agreed to file providing for the resale of the shares of common stock issued under the investment agreement is declared effective by the Securities and Exchange Commission. During this thirty-month period, OIS may request a drawdown under the investment agreement by selling shares of its common stock to Dutchess, and Dutchess will be obligated to purchase the shares. OIS is under no obligation to request any drawdowns under the investment agreement.

The amount that OIS can request in any drawdown notice is, at OIS's election, the greater of (A) up to 200% of the average daily volume of OIS's common stock for the ten trading days prior to the date of the drawdown notice multiplied by the average of the three daily closing bid prices for the common stock immediately preceding the date of the drawdown notice or (B) \$100; provided that the OIS may not request more than \$1,000 in any single drawdown.

b. Chief Scientist

The Company is committed, under agreements with the Chief Scientist in respect of certain research and development projects, to pay royalties to the Chief Scientist at the rate of 3.5% of the sales of products resulting from the research and development which resulted with the Angiovision product line, at an amount not to exceed the amount of the grants received by the Company, as participation in the research and development program. The sales of the AngioVision product line have decreased significantly. As of December 31, 2005 the Company had an outstanding contingent obligation to pay royalties in the amount of \$1,804. The obligation to pay these royalties is contingent on actual sales of the AngioVision product and in the absence of such sales no payment is required. Company's management is of the opinion that payment of these royalties is remote.

c. BIRD-F

The Group received grants from BIRD-F. Royalty payments to BIRD-F are due at the rate of 2.5% for the first year and 5% beginning with the second year and thereafter, on revenues derived from research and development projects in which the BIRD-F participated in their financing, up to 150% of the amount received by the Group.

As of December 31, 2005, grants received from BIRD-F amounted to \$769, and the Group has an outstanding contingent obligation to pay royalties to BIRD-F aggregating up to \$1,154. The obligation to pay these royalties is contingent on actual sales of the product and in the absence of such sales no payment is required. Company's management is of the opinion that payment of these royalties is remote.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands (Except share amount)

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (continued)

d. Liens

1. The Company's liabilities to banks are secured by a fixed lien on the Company's share capital, goodwill, patents and insurance rights and a floating lien on all of its assets.
2. To secure its liabilities to Delta Lloyd Bank, the Company pledged 2,131,908 shares of its holdings in the common stock of OIS in favor of Delta Lloyd Bank.
3. OIS granted a security interest in substantially all assets of OIS to United Mizrahi Bank Ltd., as security for amounts borrowed by the Company from the Bank (see Note 11a).

The secured liabilities and guarantees are as follows:

	December 31,	
	2005	2004
Short-term bank loan including current maturities of long-term loans	1,484	1,850
Long-term bank loans	1,951	1,179

e. Lease Agreements

1. OIS leases its facilities under a non-cancelable operating lease that expires in June 2007 with minimum lease payments of approximately \$106 for the year ended December 31, 2006 and \$54 for the year ended December 31, 2007.
2. The Company rents its facilities under a non-cancelable operating lease that expires in September 2010. The lease agreements require minimum lease payments of approximately \$40 per year until 2010.
3. CCS leases its facilities under a six-month cancellation notice operating lease that is unlimited in time with minimum lease payments of approximately \$22 per year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 11:- SHARE CAPITAL

a. Warrants

In July 2005, the Company obtained a long-term bank loan in the amount of \$2,000. The loan with interest at an annual rate of LIBOR+ 2.5% is to be paid in twenty four monthly installments, commencing on August 1, 2006.

In consideration for the loan, the Company modified the terms of the warrants issued to the bank during 2002. The warrants to purchase shares of the Company for a total consideration of up to Euro 348,603 may be exercised at any time, for a period ending at the earlier of 8.5 years after December 9, 2002 or 12 months after the consummation of an exit transaction as described in the agreement with the bank. The exercise price will be the lower of Euro 1.3 or the price per share set at the exit transaction less 40%. The Company calculated the incremental fair value (increase in fair value of the warrants before and after the modification) using an option pricing model. The incremental fair value in the amount of \$84 was recognized as transaction costs and presented as a deduction from the loan with a corresponding credit to equity (additional paid-in capital). These costs will be amortized over the term of the loan using the effective rate interest method.

b. Stock Option Plans

On October 17, 1999, the Board of Directors of the Company adopted a Stock Option Plan (the "1999 Plan") pursuant to which share options in the Company may be granted to employees, officers, directors and consultants of the Company or any subsidiary. An aggregate of 500,000 Ordinary shares of the Company are reserved for issuance under the 1999 Plan. Any options which are canceled or forfeited within the option period will become available for future grants. The 1999 Plan will terminate in 2009, unless previously terminated by the Board of Directors. The plan is under section 102 of the Israeli Tax Ordinance in connection with exemption from tax on the date of issuance of shares (subject to its limitations). As of December 31, 2005, there are 145,912 Ordinary Shares available for issuance under the 1999 Plan.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 11:- SHARE CAPITAL (Continued)

b. Stock Option Plans (Continued)

On November 16, 2004, the Board of Directors of the Company adopted an Israeli Stock Option Plan (the "2004 ISOP") pursuant to which share options in the Company may be granted to employees, officers, directors and consultants of the Company or any subsidiary. An aggregate of 500,000 Ordinary shares of the Company are reserved for issuance under the 2004 ISOP. Any options which are canceled or forfeited within the option period will become available for future grants. The vesting period will be 50% after two years, 25% after three years and 25% after four years from the grant date. The 2004 ISOP will terminate in 2014, unless previously terminated by the Board of Directors. As of December 31, 2005, there are 120,199 Ordinary Shares available for issuance under the 2004 ISOP.

As of December 31, 2005 there are 733,889 options outstanding, of which 334,088 are exercisable into Ordinary shares as follows:

Exercise price per share	December 31, 2005		
	Outstanding		Exercisable
	Number of options	Life**	Number of options
EURO			
0.5-1.5	347,128	4.5	327,128
0.03	6,960	4.5	6,960
0.80	379,801	9	-
	<u>*733,889</u>		<u>334,088</u>

* Including 312,745 options not issued under section 102 of the Israeli Tax Ordinance.

** Weighted average contractual life remaining in years.

	December 31, 2004		December 31, 2005	
	Amount	Weighted average exercise price EURO	Amount	Weighted average exercise price EURO
Outstanding at the beginning of the year	364,712	0.96	724,513	0.88
Granted	359,801	0.80	26,000	1.18
Exercised	-	-	(2,624)	0.03
Forfeited	-	-	(14,000)	0.91
Outstanding at the end of the year	<u>724,513</u>	<u>0.88</u>	<u>733,889</u>	<u>0.89</u>
Exercisable options	<u>344,712</u>	<u>0.93</u>	<u>334,088</u>	<u>0.98</u>

MEDIVISION MEDICAL IMAGING LTD

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 11:- SHARE CAPITAL (Continued)

b. Stock Option Plan (Continued)

The fair value of options grants is estimated at the date of grant using the Black-Scholes option pricing model. The following are the data and assumptions used:

	2004	2005
Dividend yield (%)	0	0
Expected Volatility (%)	57	57
Historical Volatility (%)	57	57
Risk free interest rate (%)	2.5	3
Expected life of options (years)	5	4
Exercise price (Dollars)	1.09	1.34-1.5
Share price (Dollars)	1.09	1.44
Fair value (Dollars)	0.55	0.65-0.70

The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

The Company recorded employee compensation expense of \$31 for the year ended December 31, 2005, with a corresponding increase in equity (additional paid-in capital).

In addition, compensation expense of \$62 was recorded for the year ended December 31, 2005, in connection with grants of options by OIS.

NOTE 12:- SELECTED STATEMENTS OF OPERATIONS DATA

a. Sales

	Year ended December 31,	
	2005	2004**
North America *	12,658	10,556
Europe	2,498	1,853
Other	230	383
	15,386	12,792

* Mainly in the U.S.A.

** Reclassified - see note 2v.

MEDIVISION MEDICAL IMAGING LTD

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 12:- SELECTED STATEMENTS OF OPERATIONS DATA (continued)

b. Cost of sales

	Year ended December 31,	
	2005	2004*
Materials consumed	4,123	4,028
Salaries	1,157	912
Other	983	683
	6,263	5,623
Changes in work in progress and finished products	196	(129)
	6,459	5,494

*Reclassified - see note 2v.

c. Research and development expenses:

	Year ended December 31,	
	2005	2004
Salaries and related expenses	662	539
Subcontractors and consultants	538	133
Materials and supplies	51	41
Depreciation	23	21
Miscellaneous	274	227
	1,548	961

d. Selling and marketing expenses:

	Year ended December 31,	
	2005	2004*
Salaries and related expenses	2,778	2,060
Advertising and exhibitions	342	394
Foreign travel	572	785
Communications	64	57
Miscellaneous	131	108
	3,887	3,404

*Reclassified- see note 2v.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 12:- SELECTED STATEMENTS OF OPERATIONS DATA (continued)

e. General and administrative expenses

	Year ended December 31,	
	2005	2004
Salaries and related expenses	961	884
Professional services	660	336
Rent	177	154
Communications	78	80
Vehicles maintenance	24	26
Doubtful debts	(8)	(59)
Depreciation	80	67
Amortization of goodwill	-	222
Miscellaneous	92	185
	<u>2,064</u>	<u>1,895</u>

f. Financial expenses, net

	Year ended December 31,	
	2005	2004
Bank expenses and interest	283	282
Amortization of financing expenses	121	53
Interest to related party	53	23
Other	8	29
	<u>465</u>	<u>387</u>

g. Other income, net

	Year ended December 31,	
	2005	2004
Gain on issuance of shares by OIS to third parties	156	329
Gain on sale of OIS shares to third parties	522	979
Other	(104)	(15)
	<u>574</u>	<u>1,293</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars (in thousands except for share and per share data)

NOTE 12:- SELECTED STATEMENTS OF OPERATIONS DATA (continued)

h. Income tax expense (benefit)

Income tax expense (benefit) is comprised as follows:

	Year ended December 31,	
	2005	2004
Current taxes	108	39
Deferred taxes	(95)	(529)
	13	(490)

i. Earnings per share

	Year ended December 31,	
	2005	2004
Net profit for the year attributed to equity holders of the parent	1,043	1,985
Weighted average number of shares used in calculation of basic earnings per share	6,807,069	6,804,675
Dilutive effect of share options	999,817	70,649
Adjusted weighted average number of shares used in calculation of diluted earnings per share	7,806,886	6,875,324
Basic earnings per share (in Dollars)	0.15	0.29
Diluted earnings per share (in Dollars)	0.13	0.29

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 13:- TAXES ON INCOME

- a. Tax benefits under the Encouragement of Capital Investments Law:

The Company was granted "approved enterprise" status. The main benefits to which the Company will be entitled, if it implements all the terms of the approved program, are exemption from tax on income from the approved enterprise, and reduced tax rates on dividends originating from this income. The income from the approved enterprise will be exempt from tax for a ten year period, commencing on the date that taxable income is first generated by the approved enterprise (limited to the earlier of a maximum period of 12 years from commencing operations or 14 years from the date the approval letter is received). In August 1999 the Company was granted an additional period of extension, thus extending the period of tax exemption until 2009.

Dividend distributions originating in the income of the approved enterprise will be subject to tax at the rate of 15%, provided that the dividend is distributed during the period stipulated in the law. In the event of a dividend distribution (including withdrawals and charges that are deemed to be dividends) out of the income originating from the approved enterprise, and on which the Company received a tax exemption, income from which the dividend is distributed will be subject to corporate taxes at the rate of 25%.

Tax benefits are conditional upon compliance with the provision of the Law, the regulations that were enacted, and the terms stipulated in the approval letter.

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above law, regulations published hereunder and the instruments 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 the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2005, management believes that the Company is meeting all of the aforementioned conditions.

- b. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985: Results for tax purposes are measured in accordance with the change in the CPI.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 13:- TAXES ON INCOME (continued)

c. Carryforward tax losses:

The Company has accumulated losses for tax purposes as of December 31, 2005, in the amount of approximately \$ 6,396, which may be carried forward and offset against taxable income in the future for an indefinite period.

OIS has at December 31, 2005, a net operating loss carryover of approximately \$3,246 for U.S. Federal income tax purposes which expires between 2007 and 2020, and a net operating loss carry forward of approximately \$284 for California state income tax purposes which expires through 2010. The State of California has suspended the application of net operating losses for the 2002 and 2003 fiscal years and extended the carry forward period two years. Federal tax credit carry forwards of approximately \$175 will begin to expire in 2007. Due to changes in ownership which occurred in prior years, Section 382 of the Internal Revenue Code provides for significant limitations on the utilization of net operating loss carry forwards and tax credits. As a result of these limitations, a portion of these loss and credit carryovers may expire without being utilized.

d. Until December 31, 2003, the regular tax rate applicable to income of companies in Israel (which are not entitled to benefits due to "approved enterprise" as described in a above) was 36%. In June 2004 and July 2005, the Income Tax Ordinance was amended such that the corporate tax rate is to be gradually reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26% and 2010 and thereafter - 25%.

e. A reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to the income of companies in Israel, and the actual tax benefit, is as follows:

	Year ended December 31,	
	2005	2004
Profit before taxes as reported in the consolidated statements of operations	1,537	1,944
Statutory tax rate in Israel	34%	35%
Theoretical tax expense	<u>523</u>	<u>681</u>
Increase (decrease) in taxes resulting from:		
Capital gain exempt from tax	(55)	(486)
Deferred tax benefit in respect of carry forward losses	(404)	(529)
Utilization of carry forward tax losses of OIS in respect of which deferred taxes were previously not recorded	(241)	(369)
Increase in taxes resulting from carry forward tax losses in respect of which deferred tax assets were not recorded	160	189
Other	30	24
Actual tax expense (benefit)	<u><u>13</u></u>	<u><u>(490)</u></u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands

NOTE 13:- TAXES ON INCOME (continued)

- f. Deferred tax assets:
 OIS recorded a tax asset due to carry forward losses and other deductible temporary differences in the amount of \$1,124 as of December 31, 2005 (December 31, 2004 - \$1,029). Due to OIS's limited history of profitable operations and as these carry forward losses may not be used to offset taxable profits elsewhere in the Group, an additional tax asset of \$2,100 was not recorded.
 The Company has not recorded deferred tax assets in respect of carry forward losses in the amount of \$1,599 due to their uncertainty of realization.
- g. Final tax assessments
 The Company has tax assessments that are deemed final through 2001.

NOTE 14:- RELATED PARTIES TRANSACTIONS AND BALANCES

a. Balances:

	December 31,	
	2005	2004
Long-term loans from shareholders	115	293
Accrued expenses to shareholders	191	402
Other liabilities to shareholders	364	366
Other liabilities to directors	32	18
No advances or loans were granted to Directors of the Company.		

b. Transactions:

	Year ended December 31,	
	2005	2004
Interest to related parties	53	23
Salaries to key management personnel of the Company (Shareholders)	232	208
Salaries to key management personnel of a Subsidiary (Shareholders)	462	448
Salaries to directors of the Company	64	47
Salaries to directors of a Subsidiary	72	34

NOTE 15:- CASH AND CASH EQUIVALENTS (For the purpose of the Cash Flow Statements)

Cash and cash equivalents comprise the following:

	December 31,	
	2005	2004
Cash and cash equivalents	5,005	2,311
Short-term bank credit (see Note 7)	(41)	(64)
	4,946	2,247

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**U.S. Dollars in thousands, except per share data****NOTE 16:- MODIFICATION OF SHARE CAPITAL OF OIS**

- a. Pursuant to a Common Stock Purchase Agreement dated June 1, 2004 between the Company and S2 Partners LP, the Company sold 550,000 of OIS's common stock to S2 Partners LP at a price of \$1.35 per share. On June 23, 2004, the Company through Nollenberger Capital Partners Inc. acting as its agent sold an additional 500,000 shares of OIS's common stock at a price of \$1.38 per share. During the years ended December 31, 2004 the consideration received from the sales of these shares amounted to \$1,364 (net of expenses of \$69), and the Company recorded a gain of \$979. The Company also recorded a gain of \$329 resulting from the issuance of shares by OIS upon conversion of the loans and the exercise of options by the minority (see d below). The gains are included in other income. As a result of the foregoing transactions, as of December 31, 2004 the Company owned approximately 74% of OIS's outstanding common stock (see Note 12g).
- b. Pursuant to a Common Stock Purchase Agreement dated as of September 16, 2005 between MediVision and Meadowbrook Opportunity Fund LLC, MediVision sold 400,000 shares of OIS's common stock to Meadowbrook Opportunity Fund LLC at a price of \$1.20 per share. On December 8, 2005, MediVision sold 310,000 shares to the clients of an institutional investor at the price per share of \$1.45. During the year ended December 31, 2005 the consideration received from the sales of these shares amounted to \$919 (net of expenses of \$10), and the Company recorded a gain of \$522. The Company also recorded a gain of \$156 resulting from the issuance of shares by OIS upon conversion of the loans and the exercise of options by the minority (see c below). The gains are included in other income. As a result of the foregoing transactions, as of balance sheet date the Company owns approximately 67% of OIS's outstanding common stock (see Note 12g).
- c. During the years ended December 31, 2005 and 2004 principal and interest of the Laurus loans were converted to 383,985 and 576,322 shares of OIS respectively. In addition, 100,000 and 53,334 options were exercised into OIS shares respectively (see Note 12g).
- d. OIS issued a warrant in September 2003 pursuant to the issuance of a note payable (Note 9a(3)). The warrant permits the holder to purchase up to 375,000 shares of common stock at a price of \$1.23 per share for the first 100,000 shares; \$1.39 per share for the next 125,000 shares and \$1.61 per share for the remaining 150,000 shares. The warrant is exercisable through September 26, 2010.
- e. OIS issued a warrant in April 2004, pursuant to the issuance of a note payable (Note 9a(4)). The warrant permits the holders to purchase up to 313,000 shares of common stock at a price of \$1.40 per share for the first 83,000 shares; \$1.59 per share for the next 105,000 shares and \$1.83 per share for the remaining 125,000 shares. The warrant is exercisable through April 27, 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. Dollars in thousands, except per share data

NOTE 17:- SUBSEQUENT EVENTS

On January 24, 2006, OIS paid off the remainder of the \$1,200,000, three-year, convertible note with Laurus Master Fund, Ltd (“Laurus”) entered into in September 2003.

On January 20, 2006, Laurus converted the balance of the \$1,000,000, three-year convertible note entered into in April 2004.

On February 21, 2006, MediVision sold 1 million shares of OIS’s common stock to Wasatch Advisors, Inc. at the market price of \$1.80 per share.

As a result of the foregoing transactions, the Company expects to record a capital gain. As of February 22, 2006, MediVision owns approximately 59% of OIS's outstanding common stock.