# TAKING DISTRIBUTED TRAINING SIMULATION PERSONALLY

'11

SIMIGON

2011 ANNUAL REPORT


## *About SimiGon*

SimiGon (AIM: SIM) is a leading developer and supplier of distributed simulation solutions for defence and civilian applications. SimiGon is the creator of SIMbox, a leading PC-based platform for creating, managing and deploying simulation-based content across multiple domains. Through its off-the-shelf training solutions for demanding high-skill occupations, SimiGon provides diverse organizations with faster and more cost-effective training. SimiGon's growing client base includes blue-chip training and simulation systems providers as well as over 20 air forces and commercial airlines worldwide. Founded in 1998, SimiGon maintains offices in Israel and the United States.

## *Contents*

# TAKING DISTRIBUTED TRAINING SIMULATION PERSONALLY

***When it comes to distributed simulation solutions, SimiGon technology is the way to go. Leading the industry shift away from inflexible, stationary and expensive training systems, offering personal, portable and cost-effective training solutions optimized for the PC or laptop. Our off-the-shelf platform and products – for air, land, sea and industrial applications – are highly flexible, adaptable and robust. This "personal" approach enables multiple high-skill users to train simultaneously on multiple platforms, saving defence and civilian organizations significant time and money. We offer state-of-the-art simulation solutions for non-training applications, bringing the best of personal simulation to wider audiences.***

## *Operational Highlights*

- Awarded a $5.6 million, five-year contract from Check-6, SimiGon's first major contract outside the aerospace and defence industry
- Moved up the supply chain when selected as prime contractor by the U.S. Air Force Air Education Training Command (AETC) in $2.6 million contract
- Entered the fourth year of supporting Lockheed Martin's F-35 Lightning II Joint Strike Fighter ("JSF") training program. This project made a significant contribution to revenues in 2011 and is expected to continue to do so over the lifespan of the JSF programme
- SimiGon has been successfully meeting project milestones over the past three years for the UK Military Flying Training System ("UKMFTS")
- SimiGon is in the third year of a long-term contract to provide training simulations for a strategic European aircraft manufacturer
- Continued to deliver a complete Live, Virtual and Constructive training solution for Unmanned Aerial Vehicle training program, a leading provider in the small tactical unmanned aircraft systems
- The Company's training and simulation platform, SIMbox, was selected for its in-base driving training system by the U.S Air Force
- Significant improvement of the Company's distribution network as number of strategic partners tripled in 2011 from the number in 2010

## *Financial Highlights*

- Revenues increased by 5% to $5.48 million (2010: $5.21 million)
- Net profit improved by $1.03 million to $0.35 million (2010: Loss of $0.68 million)
- Total operating expenses decreased by 12% to $4.35 million, (2010: $4.95 million)
- Gross margin of 85% (2010: 85%)
- Generated positive cash flow from operations of $2.3 million
- Significant increase in cash and cash equivalents and short term bank deposits at the year end at $4.74 million (31 December 2010: $2.62 million)

# *LEVERAGING GROWING MARKETS FOR PERSONAL TRAINING & SIMULATION*

***There are several factors driving the need for personal, flexible solutions in the fast growing training and simulation market.***

## *Key Trends*

**Operating complexity:** Aircraft, ground vehicles, maritime systems, and control rooms and their subsystems are increasingly complex with more advanced technology inside them. This requires better training tools to enable correct and safe operations. “Digital Natives” don’t learn with user manuals based on a "learning by reading" methodology. They learn with challenging, interactive, “see-it and do-it” training methods. **Customer empowerment:** Organizations are smarter and more demanding than ever and will no longer accept inflexible, expensive solutions provided by large suppliers. They know what type of training solution they need and demand it from their training providers. **Flexible, Off-the-shelf solutions:** Government and commercial customers seek Commercial-Off-The-Shelf (COTS) products to save time and money. **Cost of training:** Instructors, trainees and platforms have limited time and associated rising costs, especially in multifaceted environments. This intensifies the need to maximize preparations and increase the effectiveness of Instructor-led and live training exercises and operations. Leveraging available, cost effective technology to provide continuous individual and collective training ensures mission readiness.

## *Fast Growing Market*

With these market trends and the current global economic state, the industry is turning away from expensive, stationary training systems towards more robust, flexible and reconfigurable cost-effective PC-based or laptop-based COTS training solutions. The interactive, “Learning by doing” methodology championed by SimiGon software systems has become recognized as the most effective way to train users, especially those in demanding high-skill occupations in both military and civilian markets. And while the economy is in turmoil, the training & simulation market is thriving as its cost saving benefits are recognized by government and civilian leaders. Many organizations are using a learning management system (LMS).

In terms of market value, the greater Modelling & Simulation market is valued at more than $20 billion annually and the projection for the global eLearning market is $107.3 billion by the year 2015. The market growth is driven by reduced costs, simplified training and a dispersed workforce.

The biggest driver of the training and simulation market growth is the defence industry. Despite the US defence budget cuts, the US Department of Defence remains the undisputed leader in seeking training and simulation solutions for military preparedness and readiness for symmetric and asymmetric warfare. The market anticipates increased usage of simulation based training for these purposes as the DoD seeks more ways to reduce costs. While the Iraq and Afghanistan-Pakistan front pushed the industry to rapidly develop and field innovative training solutions, future force planning is underway to keep military personnel trained after wartime using more simulation based training and less real assets. In the military pilot training market, Forecast International projects 1,600 new fixed wing military training aircraft over the next ten years and the market for fighter aircraft will be worth nearly $194.5 billion as approximately 3,150 fighters will be manufactured. Another important market segment, Airborne Intelligence, Surveillance and Reconnaissance (ISR), estimated at $17.3 in 2011, will continue to grow globally. The US market is the largest Commercial and Military Flight Simulation segment while the Asia-Pacific region is the fastest growing market. The Civilian aviation market continues to be a driver in the simulation market with more than 11,850 large commercial jets forecast to be produced by 2021, valued at $1.4 trillion.

Since the global economy is affecting how governments spend, training and simulation technologies are playing a larger role to offset the decrease in live training exercises. Significant business potential also exists in areas such as commercial flight training, air traffic control, homeland security, maritime operations, nuclear and electric power plants operator training, crane operations, driving and medical care. Operators working in these domains are requiring advanced, holistic training solutions, such as Simulation Based Training and Learning Management Systems to reach and maintain high levels of operational skill.

# *GETTING PERSONAL*
# *WITH DISTRIBUTED SIMULATION SOLUTIONS*

***SimiGon's comprehensive portfolio of off-the-shelf solutions – including a state-of-the-art simulation platform and range of compelling products – "closes the knowledge gap" for professional users. At the same time, SimiGon's flexible solutions are easily integrated either by customer organizations or third-party systems integrators for both military and civilian applications.***

## *SIMbox*

SimiGon is the creator of SIMbox, a leading PC-based platform for creating, managing and deploying simulation based content across multiple domains including training, mission debriefing, homeland security and entertainment. SIMbox is a flexible, off-the-shelf 3D simulation engine comprised of a wide array of software modules that empowers users to create an unlimited range of new products and content. Built from the ground up as a robust and flexible platform, SIMbox has been deployed successfully by large training and simulation systems providers, leading military contractors, and over 20 air forces and commercial airlines worldwide. SIMbox is comprised of three main environments:

- SIMbox Toolkit development environment: SIMbox Toolkit is an easy-to-use development suite, empowering non-programmers to create, reuse and control simulation-based applications.
- SIMbox Server management environment: SIMbox Server which serves as the Learning Management System (LMS), contains various software modules used for configuration management of developed content, control over content distribution, data gathering from end users, and data analysis and report generation.
- SIMbox Runtime delivery environment: SIMbox Runtime provides hi-fidelity 3D distributed simulations that place the user in a virtual or constructive environment with numerous viewpoints for both military and civilian applications.

## *KnowBook™ Family*

KnowBook is a family of PC-based COTS training applications used by leading organisations for training professional users. KnowBook provides a common platform for learning, training, planning and debriefing.

The key members of the KnowBook family are:

- **AirBook™**: the family's flagship application that enables aircrew and organisations to remain completely updated with the rapidly changing demands of the military and civilian aviation world.

**GroundBook, MarineBook and CarBook:** the newest members of the KnowBook family designed for ground, maritime and driving training scenarios.

## *AirTrack™*

AirTrack represents the next generation of passenger in-flight entertainment (IFE) solutions. Successfully installed and operational on airlines worldwide, AirTrack is a cost-effective, rapidly deployable solution for airlines seeking to upgrade their IFE systems. Based on advanced SIMbox technology, the system's capabilities include hi-fidelity 360º 3D simulation views, moving maps, external plane views, dynamic media, and real-time flight data and news. AirTrack is provided with an easy-to-use, PC-based software configuration tool that enables airlines to independently and rapidly customize and upload in-flight content based on specific needs.

## *Debriefing Systems*

SimiGon offers advanced post-mission debriefing applications that provide critical feedback and improve operational readiness. Utilizing a standard Windows graphical user interface (GUI), the PC-based systems can be deployed at any location and are extremely simple to operate. SimiGon's debriefing systems include **D-Brief PC** and **MDDS Pro**. Operated from a server connected to multiple client workstations, the systems analyse flight data stored on the aircraft's PMC or RMM cartridge. D-Brief PC is used to support real-time air combat debriefing. MDDS Pro is a digital debriefing solution incorporating video with 3D simulation.

## *Air Traffic Control*

SimiGon's successfully deployed Air Traffic Control training solution includes instructor operator stations, virtual pilots, voice recognition and the ability for instructors to modify training sessions in real time. The systems are used by ATC instructors to train new controllers in guiding aircraft through take-off and landing procedures as well as for recurrent and operational training. The Company aims to leverage its success in this market to compete for additional military and civilian ATC training contracts.

# *Sharing Personal Messages From Corporate Leadership*

## *Chairman & CEO Reviews*

### *Chairman's Statement*

I am pleased to report a significant year of progress in 2011 for SimiGon, marking a turnaround in the operations of the business and a return to revenue growth and profit .

In 2011, SimiGon successfully executed its strategy to build a foundation for long term growth as the Company continued to set the standard for training and simulation programmes for large aerospace and defence training programmes. Added to our strong position in the aerospace and defence sector, 2011 saw a further milestone for SimiGon as the Company moved into the oil and gas sector, opening up further opportunities for growth.

Looking ahead, the Company's strategy is to focus on driving growth through its existing presence in the aerospace and defense market and also to leverage that position to access new and growing markets for SimiGon's simulation technology. There is now an increasing awareness and market acceptance that SimiGon's training solutions help customers significantly reduce costs, improve trainee pass rates and increase safety levels .

As a result of the success in 2011, SimiGon enters 2012 in stronger position than previous years and I am confident the business will continue to progress and grow over the coming years .

I look forward to working with fellow board members on behalf of our shareholders, customers and workforce as we embark on this new and exciting phase for the Company. I would also like to take this opportunity to thank the management, employees and all those involved and associated with SimiGon for the hard work and the tremendous support we have received over the last year.

Alistair Rae

**Alistair Rae**
Chairman

### *Chief Executive's Review*

#### *Overview*

We are pleased to announce a return to revenue growth and profit in a year of significant progress as we successfully implemented our strategic growth plan. We were able to foresee the potential market challenges, plan for it and improve our positioning and market reach. As a result, SimiGon has cemented its market leading position in the aerospace and defence industry while also achieving its growth plans to expand into lucrative new markets and move up the supply chain to become a prime contractor for training programmes. With a larger and more diverse customer base, major new contracts secured and the expected ramp up in sales of our long term defense training programmes, the Board looks forward to 2012 and beyond with confidence.

SimiGon is pleased to report a return to revenue growth and profit in 2011. Revenues increased 5% to $5.48 million (2010: $5.21 million) with a $0.35 million profit from a loss of $0.68 million in 2010. The positive results in 2011 are the result of a patient strategy implemented by management to position SimiGon with strategically valuable partners and build a foundation for long term growth. SimiGon's software is now the preferred supplier of training and simulation technologies for four of the world's largest military flight training programmes including the JSF and UKMFTS, which is a reflection of SimiGon's leading position in the market of PC-based training and simulation solutions.

#### *Operational Overview*

SimiGon entered 2011 with a set of strategic goals to build a foundation for long term growth. These were: to expand into new markets outside the aerospace and defense industry; to increase the number of strategic partners; and to move up the supply chain and be a direct supplier of training programmes. It is pleasing to report that all of the above targets were achieved.

### *Major contract wins*

In October 2011, SimiGon was awarded a $5.6 million contract from Check-6 in a five-year agreement, the Company's first major contract outside the aerospace and defence industry and the first step in the Company's growth strategy to diversify its product offering and increase its addressable market. SimiGon will bring the type of training and skill development required for survival by fighter pilots and astronauts, to oil and gas workers, preserving lives and protecting profits. Check-6 has worldwide operations and its clients include industry leaders such as Chevron, Diamond Offshore, BP, Hess and others.

This development diversifies SimiGon's customer base and leaves the Company less reliant on the defence sector. Non-military sales accounted for 23% of revenues in 2011 as opposed to 16% in 2010.

SimiGon achieved a further significant milestone when selected as prime contractor for AETC for the delivery of SIMbox based T-6A Modular Training Devices (MTD). The SIMbox MTD simulators will be used to train undergraduate, Remotely Piloted Aircraft (RPA) students for Pilot Instrument Qualification training. With this agreement SimiGon moved up the supply chain and to become a direct supplier to AETC. This agreement positions SimiGon for similar opportunities globally as the T-6A is also used as a basic trainer by the Canadian Forces, the Luftwaffe of Germany, the Greek Air Force, the Israeli Air Force, and others.

In addition, the Company's training and simulation platform, SIMbox, was selected for its in-base driving training system by the U.S Air Force. This agreement opens another door for SimiGon and could lead to further new business opportunities in the future.

### *Increased partnerships*

As part of the Company's long term strategy, SimiGon constantly surveys the potential to increase its number of strategic partners and penetrate additional commercial markets, offering other industries learning and training simulations using its advanced technological infrastructure.

In 2011 the number of strategic partners tripled from the number in 2010. New partners secured in 2011 include Check-6, AETC and TAISR Group to add to SimiGon's established, long term partnerships with the likes of Lockheed Martin, BAE and Boeing. As a result, SimiGon is not as dependent on a single client or country for its sales and now has a more diverse and global presence.

### *Update on long-term contracts*

The Company entered the third year of supporting Lockheed Martin's F-35 Lightning II Joint Strike Fighter ("JSF") training program. The company expects increased license delivery as the JSF program enters its regular production and delivery phase.

SimiGon has been successfully meeting project milestones over the past three years for the UK Military Flying Training System ("UKMFTS"). This substantiates SimiGon's product capabilities allowing the company to showcase its product capabilities and increase probability of future sales.

SimiGon is in the third year of a long-term contract to provide training simulations for a strategic European aircraft manufacturer. This partnership was further strengthened in 2011 as agreement was reached for additional licenses as part of future projects expected to be delivered in 2012 and 2013.

The Company continued to deliver a complete Live, Virtual and Constructive training solution for Unmanned Aerial Vehicle training program for a leading provider in the small tactical unmanned aircraft systems. The first training center was launched in 2011 with additional systems expected to be delivered to US and international clients in 2012.

### ***Financial Performance***

Revenue for the year ended 31 December 2011 was $5.48 million, compared to $5.21 million in 2010, reflecting increase of 5%. In terms of regional breakdown, 71% of SimiGon's revenues came from North America (2010: 67%), 27% from Europe and the Middle East (2010: 27%) and 2% from the Far East (2010: 6%).

# SHARING PERSONAL MESSAGES FROM CORPORATE LEADERSHIP (CONT.)

Net profit for the fiscal year improved by $1.03 million to $0.35 million (2010: loss of $0.68 million).

Total operating expenses for the year decreased by 12% to $4.35 million (2010: $4.95 million), the research and development expenses decreased to $1.68 million (2010: $1.76 million) mainly due to salary expenses and cost management. Sales and marketing expenses were $1.70 million (2010: $1.71 million). General and administration expenses decreased to $0.98 million (2010: $1.48 million) mainly due to doubtful debt provision recorded in year 2010, share-based compensation and reduced professional fees.

The operating profit therefore is $0.31 million (2010: operating loss $0.55 million) and the net profit is $0.35 million in 2011 compared to net loss of $0.68 million in 2010. This resulted in a net basic and diluted earnings per share of $0.01 (2010: Basic and diluted loss per share of $0.02).

SimiGon generated positive cash flow from operations of $2.3 million in 2011. As at 31 December 2011, SimiGon had cash, cash equivalent and deposits in the amount of $4.74 million (31 December 2010: $2.62 million).

### *Outlook*

SimiGon has made a solid start to 2012 with revenue visibility improving as sales to the Company's long-term partners and recent contract wins continue to ramp up.

With a strong order book in place and new markets now opening up alongside the Company's established leading position in the aerospace and defence industry, the Board expects year-on-year sales growth and looks forward to the future with confidence.

**Amos Vizer**
President & CEO

## *Displaying Personal Commitment To Organizational Success*

### *Board of Directors*

**Alistair Rae, Non-Executive Chairman**
Alistair is currently chief executive of LTG Technologies Plc, an AIM traded company, having been a non-executive director from 2002 to 2005. He was the group finance director of Jarvis Plc from 2004 to 2005, guiding the company through a period of reconstruction. Prior to this he was a director in the corporate finance department of HSBC Investment Bank from 1996 to 2002, and before that he worked in corporate finance at Cazenove for ten years in the UK and the Far East. Alistair qualified as a chartered accountant with KPMG.

**Eitan Cohen, Non-Executive Director**
Eitan Cohen is a Co-Founder and Chief Executive Officer of ASIC Depot OOD an EDA and Semiconductor design centre. Eitan previously held positions as CEO and Country manager for Semiconductor and EDA companies, in which he led to the award of multi-million dollar deals with tier-one companies and managed business development activities with potential partners worldwide.

**Amos Vizer, President & CEO**
Prior to founding SimiGon, Amos founded Logi-Cali, a software development house specializing in data storage applications. He previously served as marketing and business development manager of ISYS Operational Management Systems, an international IT company. Amos also previously worked for the missiles division of RAFAEL Armament Development Authority Ltd. Additionally, he served ten years in the Israeli Air Force (IAF) as an F-4 Phantom Fighter navigator, a flight school course commander, and a Popeye missile weapons officer. With extensive training in advanced software development, Amos holds a BA in business administration.

**Nevat Simon, Independent Non-Executive Director**
Nevat has practiced as a certified public accountant in his own accounting firm since 1991, providing both accounting and other financial services to the firm's clients. He has previously served on the board of Sprint Investments Ltd. and Multimetrics Ltd., both publicly listed companies on the Tel Aviv Stock Exchange, and on the board of a number of private companies. Nevat has a BA in accounting and marketing from the Business College of Management in Tel Aviv and has been a member of the Certified Public Accountant Council in the Justice Department of the State of Israel since 1991.

**Efraim Manea, CFO**
Mr Manea joined the Company as its finance controller in June 2008, managing its financial aspects including financial reporting, corporation accounting and tax preparation, budget and forecasting and risk management. He has more than seven years of accounting and management experience and before joining SimiGon served for approximately four years as an Audit Team Manager at Ernst & Young's High-Technology sector. Mr Manea is a Certified Public Accountant and holds a BA in Accounting and Business Administration from the College for Management in Israel.

**Dr. Vered Shany, Independent Non-Executive Director**
Since March 2002, Vered has managed Tashik Consultants, providing strategic consulting and corporate analysis in the life sciences sector. Previously, Vered served as managing director of Up-Tech Ventures Ltd., as a member of the board of directors of the Weizmann Science Park Incubator, and as vice president of marketing for Arad Technological Incubator. Prior to that, she was business and marketing manager of Medun Ltd., a medical start-up company, from 1995 to 1998. Vered received her masters' degree in business administration from Heriot–Watt University, Edinburgh Business School, and gained her doctorate of medical dentistry and her B.Med.Sc. from the Hebrew University of Jerusalem.

# *DISPLAYING PERSONAL COMMITMENT TO ORGANIZATIONAL SUCCESS (CONT.)*

## *Management*

**Amos Vizer, President & CEO**
Prior to founding SimiGon, Amos founded Logi-Cali, a software development house specializing in data storage applications. He previously served as marketing and business development manager of ISYS Operational Management Systems, an international IT company. Amos also previously worked for the missiles division of RAFAEL Armament Development Authority Ltd. Additionally, he served ten years in the Israeli Air Force (IAF) as an F-4 Phantom Fighter navigator, a flight school course commander, and a Popeye missile weapons officer. With extensive training in advanced software development, Amos holds a BA in business administration.

**Efraim Manea, CFO**
Mr Manea joined the Company as its finance controller in June 2008, managing its financial aspects including financial reporting, corporation accounting and tax preparation, budget and forecasting and risk management. He has more than seven years of accounting and management experience and before joining SimiGon served for approximately four years as an Audit Team Manager at Ernst & Young's High-Technology sector. Mr Manea is a Certified Public Accountant and holds a BA in Accounting and Business Administration from the College for Management in Israel.

**John Schverak, VP Programs**
Mr. Schverak, is a results-oriented, certified Project Management Professional (PMP) with over 20 years of experience in Program Management, Project Management, Product Management, and Operations Management. Mr. Schverak has a proven track record of successfully developing, managing, and executing project plans to meet customer and product requirements, including product features, technical performance, quality standards, and supportability. He has directed all phases of programs with responsibility for cost, schedule, technical performance, and quality. Mr. Schverak has a MBA in MIS and BS in Operations Management and Procurement Management.

**Alon Shavit, VP Business Development**
Before joining SimiGon, Alon served 15 years in the Israeli Air Force (IAF), having flown F-16s for the past 20 years. He was an instructor in the Operational Training Unit (OTU) on A-4s for two years and a commander of the F-16 OTU for 18 months. His last role in the IAF was managing the planning, coordination, synchronization, and monitoring of the training program. Alon holds an MBA and bachelor's degrees in economics and psychology.

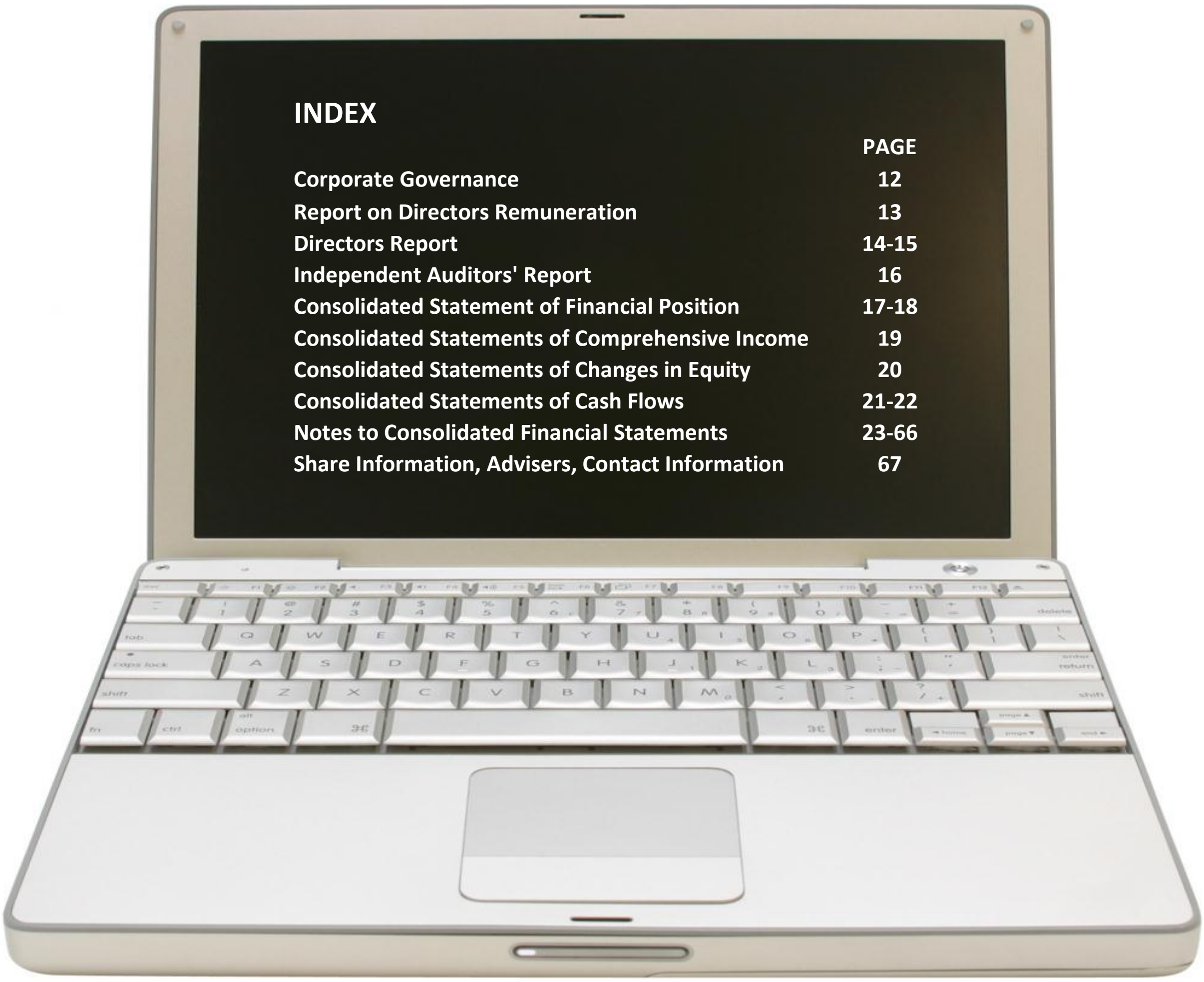
**Koby Ben Yakar, VP Product**
Koby, has a distinguished record as an experienced manager with extensive technical skills and knowledge. Mr. Ben Yakar has led a wide range of projects with cross-functional teams, including serving as SimiGon's Information Technology team leader and overseeing the architecture, design and development of the SIMbox LCMS Server infrastructure. Mr. Ben Yakar has over 10 years of experience in large training and simulation technologies enterprise projects with a proven ability to manage business and technical relationships for large-scale projects.

**Jeff Annis, VP Sales & Marketing**
Mr Annis, joined SimiGon in 2011 and has a career in the Sales & Marketing of simulation, training, and software development technology, primarily in the Aerospace/Defense and Automotive sectors. Before joining SimiGon he held Director positions at Adacel Systems, Advanced Rotorcraft Technology, and Engenuity Technologies each specializing in high-tech, advanced pilot training software systems. Prior to this Mr. Annis founded American Data-Pro, a company specializing in the development of database and network systems. Mr. Annis has a Bachelor degree in Management and Marketing from Troy University in Alabama.

**Merav Nachmani, Director of Human Resources**
Ms. Nachmani, joined SimiGon in November 2005 and has been managing SimiGon's HR Department since July 2009. Ms. Nachmani has more than ten years of experience in financial aspects including payroll controlling, accounts payable, accounts receivable , cash flow and tax reporting. Before joining SimiGon Ms. Nachmani served as a bookkeeping & salary controller in several High-Technology companies. Ms. Nachmani has a Bookkeeping&Salary controller diploma.

# FINANCIALS

## SIMIGON LTD. AND ITS SUBSIDIARIES
## CONSOLIDATED FINANCIAL STATEMENTS
## AS OF DECEMBER 31, 2011 (U.S DOLLARS IN THOUSANDS)



## *CORPORATE GOVERNANCE FOR THE PERIOD ENDED 31 DECEMBER 2011*

### *Introduction*
SimiGon Ltd. commenced trading on the AIM Market operated by the London Stock Exchange on 2 November 2006. Although the rules of AIM do not require the Company to comply with the Combined Code on corporate governance ("the Code") published by the Financial Reporting Council, the Company fully supports the principles set out in the Code and will attempt to comply with them wherever appropriate, given the Company's size, the constitution of the Board and the resources available to the Company. Details are provided below of how the Company applies those parts of the Code, which it believes to be appropriate.

### *Directors*
The Board comprises two executive Directors, two Non- Executive Directors and two independent Non-Executive Directors nominated by the majority shareholders of the Company. The Board generally meets a minimum five times a year and receives a Board pack comprising a report from senior management together with any other material deemed necessary for the Board to discharge its duties. It is the Board's responsibility for formulating, reviewing and approving the Group's strategy, budgets, major items of expenditure and acquisitions.

### *Audit Committee*
The audit committee consists of Eitan Cohen, Dr. Vered Shany and Nevat Simon and meets at least twice a year. The role of the audit committee is to review the management and systems of internal control of the company, including in consultation with the internal auditor and the company's independent auditor and to recommend any remedial action. In addition, the approval of the audit committee is required to effect certain related-party transactions.

### *Remuneration Committee*
The remuneration committee consists of Alistair Rae, Dr. Vered Shany and Nevat Simon. The Remuneration Committee has a primary responsibility to review the performance of the Company's executive directors and the senior employees and to recommend their remuneration and other terms of employment.

### *Shareholder Relations*
The Company meets with its shareholders and analysts periodically to encourage communication with shareholders. In addition, the Company intends to facilitate communication with shareholders through the annual report and accounts, interim statement, press releases as required during the ordinary course of business and the Company website (www.simigon.com).

### *Going Concern*
The directors have satisfied themselves that the Company has adequate resources to continue in operational existence for the foreseeable future, and for this reason the financial statements are prepared on a going concern basis.

### *Internal Control*
The Board is responsible for the system of internal control and for reviewing its effectiveness. Such systems are designed to manage rather than eliminate risks and can provide only reasonable and not absolute assurance against material misstatement or loss. Each year, on behalf of the Board, the audit committee reviews the effectiveness of these systems. This is achieved primarily by considering risks potentially affecting the Group and from discussions with the external auditors. Each year, the Group is subject to internal audit, the results of which are presented to the audit committee.

A comprehensive budgeting process is completed once a year and is reviewed and approved by the Board. The Group's results, as compared against budget, are reported to the Board on a quarterly basis and discussed in detail at each meeting of the Board. The Group maintains appropriate insurance cover in respect of any legal actions against the Directors as well as against material loss or claims against the Group and reviews the adequacy of the cover regularly. To comply with AIM rules, the Company has adopted a code for dealings in its shares by directors and employees.

# REPORT ON DIRECTORS REMUNERATION

### *Remuneration Policy*

The remuneration packages for non-executive directors are based principally on annual salaries. The remuneration packages for independent non-executive directors are based on an annual fixed fee and till October 2009 were including payment for each Board or Board committee meeting attended. The remuneration packages for executives are based on annual salaries and benefits.

| | **Total 2011** | **Total 2010** |
|---|---|---|
| **Executive** | **$** | **$** |
| Ami Vizer * | 402,251 | 382,247 |
| Haim Yatim** | - | 96,189 |
| Efraim Manea*** | 107,038 | 39,679 |
| **Non-Executive** | | |
| Alistair Rae | 48,080 | 45,465 |
| Eitan Cohen | 22,440 | 22,440 |
| Nevat Simon | 24,000 | 24,000 |
| Dr. Vered Shany | 2,000 | 24,000 |
| Total | 605,809 | 634,020 |

*) Year 2011 amount does not include $39,150 paid in respect of vacation days and does not include $31,107 paid in respect of transfer of severance allocation. Year 2010 amount does not include $26,100 paid in respect of vacation days and does not include $48,977 paid in respect of transfer of severance allocation.

**) Till July 2010

***) From August 2010

Please see the Directors Report below for details of options and shares granted to directors.

# DIRECTORS REPORT

The directors submit their report and the financial statements of the Group for the period ended 31 December 2011.

### *Incorporation and Admission onto the AIM Market*

The Company was incorporated on 1 October 1998. On November 2006 the Company commenced trading on AIM and issued 6,076,811 new Ordinary Shares of NIS 0.01 at price of £0.88 per share. The number of Ordinary Shares issued immediately following the admission were 37,250,666.

### *Shares*

As of December 31, 2011 the total numbers of Ordinary Shares Issued were 44,134,769.

### *Share Options*

As of 31 December 2011, the outstanding balance of options granted to certain employees of SimiGon is approximately 4.5 percent of the Company's issued and outstanding shares at an average exercise price of $0.315. The majority of the options vest in four years from the date of grant. The options expire in ten years from the date of grant.

### *Review of Business and Future Developments*

The business review is given within the Chief Executive Officer's statement.

### *Dividends*

The Company has not declared a dividend in respect of the relevant period.

### *Suppliers Payment Policy*

The Group does not operate a standard code in respect of payment to suppliers. It has due regard to the payment terms of suppliers and generally settles all undisputed accounts within 60 days of the date of invoice, except where different arrangements have been arranged with suppliers.

### *Directors*

The following directors have held office during the year:

- Amos Vizer has been an executive director of the Company since 4 November 1998.
- Efraim Manea was appointed as an executive director on July 30, 2010.
- Alistair Rae, appointed as a director and Chairman of the Board on 27 October 2006.
- Nevat Simon, appointed as an independent director on 27 October 2006.
- Dr. Vered Shany, appointed as an independent director on 27 October 2006.
- Mr. Eitan Cohen was appointed a non-executive director on June 3, 2008.

### Directors Interest in Shares and Share Options

The interest of directors in the issued share capital of the company at 31, December 2011 were as follows.

| Directors | Number of Ordinary Shares Capital | Percentage of Ordinary shares | Options |
|---|---|---|---|
| Alistair Rae*) | 70,454 | 0.17 | 0 |
| Eitan Cohen *) | 24,000 | 0.06 | 0 |
| Dr. Vered Shany *) | 24,000 | 0.06 | 0 |
| Nevat Simon *) | 24,000 | 0.06 | 0 |
| Ami Vizer **) | 5,838,628 | 13.23 | 410,000 |
| Efraim Manea ***) | 167,155 | 0.38 | 132,500 |

### Substantial Shareholdings

At 31, December 2011 the Company was informed of the following interests of 3% or more in its ordinary shares issued at that date:

| Shareholder | Number Of Ordinary Shares | Percentage of issued |
|---|---|---|
| Jeffrey Braun | 6,543,039 | 14.83 |
| Packet Science Rami Weitz | 6,244,944 | 14.15 |
| A. Vizer Holdings A. Vizer **) | 5,838,628 | 13.23 |
| G. Poran Holding Ltd | 3,778,444 | 8.56 |
| Green Venture Capital Ltd. | 3,067,848 | 6.95 |
| Israel Aircraft Industries Ltd | 2,624,310 | 5.95 |
| Moldavski High-tech Ltd | 1,750,297 | 3.97 |
| Shroder Euroclear Nominees Limited | 1,711,070 | 3.88 |

*) On January 2010 the Non-Executive Board members were granted a total of 119,727 Ordinary shares of the Company as part of a yearly 15% salary reduction, with an equivalent fair value on date of grant of $ 0.165. Messrs. Alistair Rae, Nevat Simon, Vered Shany and Eitan Cohen, Non-Executive Directors of the Company, were granted 47,727, 24,000, 24,000 and 24,000 Ordinary Shares, respectively; The shares were vested in 12 equal monthly instalments, and as of December 31, 2011 were fully vested.

The salary reduction of 15% for the Non-Executive Board members remains in effect for additional 2 years. As of December 31, 2011, Messrs. Alistair Rae, Nevat Simon, Vered Shany and Eitan Cohen, Non-Executive Directors of the Company, are to be granted 47,727, 24,000, 24,000 and 24,000 Ordinary Shares, respectively, in return for the second year salary reduction; this will represent in aggregate 119,727 Ordinary Shares and 0.27% of the total issued share capital of the Company. Following this transaction, Messrs. Alistair Rae, Nevat Simon, Vered Shany and Eitan Cohen shall have a beneficial interest of • Ordinary Shares (0.27%), • Ordinary Shares (0.11%), • Ordinary Shares (0.11%) and • Ordinary Shares (0.11%), respectively.

**) Not Including 5,415,686 Ordinary shares and Options over Ordinary shares to be granted, under the Share Bonus Plan as mentioned in Note 10e under the Company's Annual report for year 2011.

***) Not Including 59,691 Ordinary shares and Options over Ordinary shares to be granted, under the Share Bonus Plan as mentioned in Note 10e under the Company's Annual report for year 2011.

### Auditors

Kost Forer Gabbay & Kasierer
A member of Ernst & Young Global
3 Aminadav St.
Tel Aviv 67067
Israel

Ernst & Young

Kost Forer Gabbay & Kasierer
3 Aminadav St.
Tel-Aviv 67067, Israel

Tel: 972 (3)6232525
Fax: 972 (3)5622555
www.ey.com

**INDEPENDENT AUDITORS' REPORT**

**To the Shareholders of**

**SIMIGON LTD.**

We have audited the accompanying consolidated financial statements of SimiGon Ltd. and its subsidiaries ("the Group"), which comprise the consolidated statements of financial position as of December 31, 2011 and 2010, and the consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statement of cash flows for each of the years ended December 31, 2011, 2010 and 2009, and a summary of significant accounting policies and other explanatory information.

**Management's Responsibility for the consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditors' Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of December 31, 2011 and 2010, and of its financial performance and cash flows for each of the years then ended December 31, 2011, 2010 and 2009, in accordance with International Financial Reporting Standards.

Kost, Forer Gabbay & Kasierer

April 3, 2012
Tel-Aviv, Israel

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

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| | | December 31, | |
|---|---|---|---|
| | | **2011** | **2010** |
| | **Note** | **U.S. dollars in thousands** | |
| ASSETS | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | | 4,231 | 2,110 |
| Short-term bank deposits | 3 | 508 | 507 |
| Trade receivables | 4 | 1,240 | 3,377 |
| Other accounts receivable and prepaid expenses | | 410 | 181 |
| Total current assets | | 6,389 | 6,175 |
| NON-CURRENT ASSETS: | | | |
| Long-term prepaid expenses | | 23 | 25 |
| Fixed assets, net | 5 | 87 | 85 |
| Intangible assets, net | 6 | 1,324 | 1,374 |
| Total non-current assets | | 1,434 | 1,484 |
| Total assets | | 7,823 | 7,659 |

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

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

| | | December 31, | |
|---|---|---|---|
| | | **2011** | **2010** |
| | **Note** | **U.S. dollars in thousands** | |
| EQUITY AND LIABILITIES | | | |
| CURRENT LIABILITIES: | | | |
| Current maturities of loan | 9 | 188 | 562 |
| Trade payables | | 174 | 205 |
| Deferred revenues | | 113 | 409 |
| Other accounts payable and accrued expenses | 7 | 762 | 691 |
| Total current liabilities | | 1,237 | 1,867 |
| NON-CURRENT LIABILITIES: | | | |
| Employee benefit liabilities, net | 8 | 108 | 122 |
| Long-term loan | 9 | - | 188 |
| Other non-current liabilities | 12a | 746 | 460 |
| Total non-current liabilities | | 854 | 770 |
| Total liabilities | | 2,091 | 2,637 |
| EQUITY: | 10 | | |
| Share capital | | 105 | 98 |
| Additional paid-in capital | | 15,997 | 15,644 |
| Accumulated deficit | | (10,370) | (10,720) |
| Total equity | | 5,732 | 5,022 |
| Total liabilities and equity | | 7,823 | 7,659 |

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

| | | | |
|---|---|---|---|
| April 3, 2012 | | | |
| Date of approval of the financial statements | Alistair Rae<br>Non-Executive Chairman | Ami Vizer<br>Chief Executive Officer | Efi Mena<br>Chief Financial Officer |

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Note | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| | | Year ended December 31, | | |
| | | U.S. dollars in thousands (except share and per share amounts) | | |
| Revenues | 14 | 5,484 | 5,207 | 6,057 |
| Cost of revenues | 13a | 826 | 804 | 977 |
| Gross profit | | 4,658 | 4,403 | 5,080 |
| Operating expenses: | | | | |
| Research and development | 13b | 1,675 | 1,760 | 1,833 |
| Selling and marketing | 13c | 1,696 | 1,711 | 1,610 |
| General and administrative | 13d | 975 | 1,478 | 1,566 |
| Total operating expenses | | 4,346 | 4,949 | 5,009 |
| Operating profit (loss) | | 312 | (546) | 71 |
| Finance income | 13e | 305 | 75 | 230 |
| Finance cost | 13f | (267) | (207) | (229) |
| Net income (loss) and total comprehensive income (loss) | | 350 | (678) | 72 |
| Basic and diluted earnings (loss) per share in U.S. dollars | 15 | 0.01 | (0.02) | 0.00 |
| Weighted average number of shares used in computing basic earnings (loss) per share (in thousands) | 15 | 42,867 | 41,361 | 40,204 |
| Weighted average number of shares used in computing diluted earnings (loss) per share (in thousands) | 15 | 42,932 | 41,361 | 40,660 |

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

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| | Number of shares | Share capital | Additional paid-in capital | Treasury shares | Accumulated deficit | Total equity |
|---|---|---|---|---|---|---|
| | | U .S. dollars in thousands (except share amounts) | | | | |
| Balance as of January 1, 2009 | 37,798,194 | 90 | 14,904 | - | (10,114) | 4,880 |
| Total comprehensive income | - | - | - | - | 72 | 72 |
| Issuance of shares (Note 10b) | 2,263,383 | 5 | (5) | *) - | - | - |
| Share-based compensation | - | - | 396 | - | - | 396 |
| Treasury shares | - | - | - | (3) | - | (3) |
| Exercise of stock options | 1,460,979 | 3 | - | - | - | 3 |
| Balance as of December 31, 2009 | 41,522,556 | 98 | 15,295 | (3) | (10,042) | 5,348 |
| Total comprehensive loss | - | - | - | - | (678) | (678) |
| Issuance of shares (Note 10b) | 119,727 | *) - | *) - | - | - | *) - |
| Share-based compensation | - | - | 320 | - | - | 320 |
| Issuance of Treasury shares | - | - | 29 | 3 | - | 32 |
| Balance as of December 31, 2010 | 41,642,283 | 98 | 15,644 | - | (10,720) | 5,022 |
| Total comprehensive income | - | - | - | - | 350 | 350 |
| Issuance of shares (Note 10c) | 2,444,984 | 7 | - | - | - | 7 |
| Share-based compensation | - | - | 353 | - | - | 353 |
| Exercise of stock options (Note 10d) | 47,502 | *) - | - | - | - | *) - |
| Balance as of December 31, 2011 | 44,134,769 | 105 | 15,997 | - | (10,370) | 5,732 |

*) Represents an amount lower than $ 1 thousand.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| | **U.S. dollars in thousands** | | |
| Cash flows from operating activities: | | | |
| Net income (loss) | 350 | (678) | 72 |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | | |
| Adjustments to the profit or loss items: | | | |
| Depreciation and amortization | 85 | 110 | 125 |
| Finance cost | 16 | 22 | 26 |
| Share-based compensation | 353 | 320 | 396 |
| Accrued interest on long-term loan and non-current liabilities | (124) | (33) | 26 |
| Change in employee benefit liabilities, net | (14) | 21 | (205) |
| Changes in asset and liability items: | | | |
| Decrease (increase) in trade receivables | 2,137 | (76) | (1,421) |
| Decrease (increase) in other accounts receivable and prepaid expenses (including long-term) | (222) | 34 | (33) |
| Increase (decrease) in trade payables | (31) | 48 | 10 |
| Increase (decrease) in deferred revenues | (296) | 204 | (131) |
| Increase (decrease) in other accounts payable and accrued expenses | 72 | (39) | 93 |
| Cash paid and received during the year for: | 1,976 | 611 | (1,114) |
| Interest paid | (24) | (33) | (50) |
| Interest received | 9 | 7 | 20 |
| | (15) | (26) | (30) |
| Net cash provided by (used in) operating activities | 2,311 | (93) | (1,072) |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| Cash flows from investing activities: | | | |
| Purchase of fixed assets | (37) | (40) | (23) |
| Net cash used in investing activities | (37) | (40) | (23) |
| Cash flows from financing activities: | | | |
| Proceeds from treasury shares | - | 32 | - |
| Exercise of stock options | *) - | - | 3 |
| Repayment of bank loan | (563) | (919) | (81) |
| Proceeds from refundable grants | 410 | 327 | 89 |
| Proceeds from long-term bank loans, net | - | 750 | - |
| Net cash provided by (used) financing activities | (153) | 190 | 11 |
| Increase (decrease) in cash and cash equivalents | 2,121 | 57 | (1,084) |
| Cash and cash equivalents at beginning of year | 2,110 | 2,053 | 3,137 |
| Cash and cash equivalents at end of year | 4,231 | 2,110 | 2,053 |

| | | | |
|---|---|---|---|
| (a) Supplemental disclosure of non-cash financing activities: | | | |
| Other Account Receivables Issuance of shares | 6 | - | - |

*) Represents an amount lower than $ 1 thousand.

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

## NOTE 1:- GENERAL

a. The Company commenced its operations on October 1, 1998, and is engaged in developing advanced learning, training and simulation technologies and applications for use in professional communities. The Company's registered office is in Herzlia, Israel.

b. The Company has two wholly-owned subsidiaries in the United States, SimiGon Inc., which is engaged in the marketing of the Company's products in the United States and National Simulation Services Inc., which is engaged in marketing of the Company's products in the United States.

c. On November 2, 2006, the Company completed its Initial Public Offering ("IPO") on the Alternative Investment Market ("the AIM") on the London Stock Exchange, by issuing 6,076,811 Ordinary shares of NIS 0.01 par value each at a price of £ 0.88 ($ 1.65) per share for a total net consideration of $ 8.4 million.

d. Definitions:

In these financial statements:

| | | |
|---|---|---|
| The Group | - | SimiGon Ltd. and its subsidiaries. |
| The Company | - | SimiGon Ltd. |
| Subsidiaries | - | Companies that are controlled by the Company. |
| Related parties | - | As defined in IAS 24. |

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. Measurement basis:

The Company's financial statements have been prepared on a cost basis, except for the following:

Employee benefit obligations;

Provisions;

Other non-current liabilities;

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

b. Basis of preparation of the financial statements:

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These Standards comprise:

a) International Financial Reporting Standards (IFRS).
b) International Accounting Standards (IAS).
c) Interpretations issued by the IFRIC and by the SIC.

c. Consistent accounting policies:

The accounting policies adopted in the financial statements are consistent with those of all periods presented.

d. Changes in accounting policies in view of the adoption of new standards:

*IAS 24 - Related Party Disclosures:*

The amendment to IAS 24 ("the Amendment") clarifies the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised Standard introduces a partial exemption of disclosure requirements for government-related entities. The Amendment has been applied retrospectively from January 1, 2011.

The retrospective application of the Amendment did not have a material effect on the Company's financial statements.

*IAS 32 - Financial Instruments: Presentation - Classification of Rights Issues:*

The amendment to IAS 32 ("the Amendment") provides that rights, options or warrants to acquire a fixed number of the Company's equity instruments for a fixed amount of any currency are classified as equity instruments if the Company offers the rights, options or warrants pro rata to all of its existing owners of the same class of its non-derivative equity instruments. The Amendment has been applied retrospectively from January 1, 2011.

The retrospective application of the Amendment did not have any effect on the Company's financial statements.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

*IFRS 7 - Financial Instruments: Disclosure:*

The amendment to IFRS 7 ("the Amendment") clarifies the Standard's disclosure requirements. In this context, emphasis is placed on the interaction between the quantitative disclosures and the qualitative disclosures and the nature and extent of risks arising from financial instruments. The Amendment also reduces the disclosure requirements for collateral held by the Company and revises the disclosure requirements for credit risk. The Amendment has been applied retrospectively commencing from the financial statements for periods beginning on January 1, 2011.

The retrospective application of the Amendment did not have any effect on the Company's financial statements.

*IFRIC 14 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction:*

The amendment to IFRIC 14 ("the Amendment") provides guidance on measuring the economic benefit available from a defined benefit plan asset. It allows companies to account for prepayments of minimum funding requirements as an asset. The Amendment has been applied retrospectively commencing from the financial statements for periods beginning on January 1, 2011.

The retrospective application of the Amendment did not have any effect on the Company's financial statements.

*IFRIC 19 - Extinguishing Financial Liabilities with Equity Instruments:*

IFRIC 19 ("the Interpretation") prescribes the accounting treatment of transactions in which financial liabilities are settled by issuing equity instruments. According to the Interpretation, equity instruments issued as a replacement of a debt instrument are measured at fair value of the equity instruments issued if their fair value can be reliably measured. If the fair value of the equity instruments issued cannot be reliably measured, then the equity instruments are measured based on the fair value of the financial liability when extinguished. The difference between the carrying amount of the financial liability extinguished and the fair value of the equity instruments issued is recognized in profit or loss. The Interpretation has been applied retrospectively from January 1, 2011.

The retrospective application of the Interpretation did not have any effect on the Company's financial statements.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

e. Significant accounting estimates and assumptions used in the preparation of the financial statements:

Estimates and assumptions:

The preparation of the financial statements requires management to make estimates and assumptions that have an effect on the application of the accounting policies and on the reported amounts of assets, liabilities, revenues and expenses. These estimates and underlying assumptions are reviewed regularly. Changes in accounting estimates are reported in the period of the change in estimate.

The key assumptions made in the financial statements concerning uncertainties at the end of the reporting period and the critical estimates computed by the Group that may result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Chief Scientist grants:

Government grants received from the Office of the Chief Scientist at the Ministry of Industry, Trade and Labor ("OCI") are recognized as a liability if future economic benefits are expected from the research and development activity that will result in royalty-bearing sales. There is uncertainty regarding the estimated future cash flows and the estimated discount rate used to measure the amount of the liability. As for the accounting treatment of grants received from the OCI, see also Note 12.

Impairment of goodwill:

The Group reviews goodwill for impairment at least once a year. This requires management to make an estimate of the projected future cash flows from the continuing use of the cash-generating unit to which the goodwill has been allocated and also to choose a suitable discount rate for those cash flows. Further details are given in Note 6.

Pensions and other post-employment benefits:

The liability in respect of post-employment defined benefit plans is determined using actuarial valuations. The actuarial valuation involves making assumptions about, among others, discount rates, expected rates of return on assets, future salary increases and mortality rates. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Further details are given in Note 8.

Determining the fair value of share-based payment transactions:

The fair value of share-based payment transactions is determined using an option-pricing model. The model's assumptions consist of the share price, exercise price, expected volatility, expected life, expected dividend and risk-free interest rate.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Functional currency, presentation currency and foreign currency:

The consolidated financial statements are presented in U.S. dollars, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the statement of comprehensive income.

Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Transactions, assets and liabilities in foreign currency:

Transactions denominated in foreign currency (other than the functional currency) are recorded on initial recognition at the exchange rate at the date of the transaction. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at the end of each reporting period into the functional currency at the exchange rate at that date. Exchange differences, other than those capitalized to qualifying assets or recorded in equity in hedging transactions, are recognized in profit or loss. Non-monetary assets and liabilities measured at cost in a foreign currency are translated at the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currency and measured at fair value are translated into the functional currency using the exchange rate prevailing at the date when the fair value was determined.

g. Consolidated financial statements:

The consolidated financial statements comprise the financial statements of companies that are controlled by the Company (subsidiaries). Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity. The consolidation of the financial statements commences on the date on which control is obtained and ends when such control ceases.

Significant intragroup balances and transactions and gains or losses resulting from intragroup transactions are eliminated in full in the consolidated financial statements.

The financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods. The consolidated financial statements are prepared using uniform accounting policies by all companies in the Group.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

h. Cash equivalents:

Cash equivalents are considered as highly liquid investments, including unrestricted short-term bank deposits with an original maturity of three months or less from the date of acquisition.

i. Short-term deposits:

Short-term bank deposits are deposits with an original maturity of more than three months from the date of acquisition. The deposits are presented according to their terms of deposit.

j. Allowance for doubtful accounts:

The allowance for doubtful accounts is determined in respect of specific debts whose collection, in the opinion of the Company's management, is doubtful. Impaired debts are derecognized when they are assessed as uncollectible.

k. Financial instruments:

Financial assets:

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs, except for financial assets measured at fair value through profit or loss in respect of which transaction costs are recorded in profit or loss.

After initial recognition, the accounting treatment of investments in financial assets is based on their classification into one of the following four categories:

- financial assets at fair value through profit or loss;
- held-to-maturity investments;
- loans and receivables; and
- available-for-sale financial assets.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Receivables:

The Group receivables that are financial assets (non-derivative) with fixed or determinable payments, that are not quoted in an active market. After initial recognition, loans are measured based on their terms at amortized cost using the effective interest method taking into account directly attributable transaction costs. Short-term receivables (such as trade and other receivables) are measured based on their terms, normally at face value. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the systematic amortization process.

Interest-bearing loans:

All loans and borrowings are initially recognized at fair value less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method.

Financial liabilities:

A financial liability is derecognized when it is extinguished, that is when the obligation is discharged or cancelled or expires. A financial liability is extinguished when the debtor (the Group):

- discharges the liability by paying in cash, other financial assets, goods or services; or
- is legally released from the liability.

Where an existing financial liability is exchanged with another liability from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is accounted for as an extinguishment of the original liability and the recognition of a new liability. The difference between the carrying amount of the above liabilities is recognized in profit or loss. If the exchange or modification is not substantial, it is accounted for as a change in the terms of the original liability and no gain or loss is recognized on the exchange.

l. Treasury shares:

Company shares held by the Company are recognized at cost and deducted from equity. Any gain or loss arising from a purchase, sale, issuance or cancellation of treasury shares is recognized directly in equity. Voting rights attached to treasury shares are revoked.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

m. Presentation of statement of comprehensive income:

The Company has elected to present a single statement of comprehensive income which includes both the items of the statement of income and the items of other comprehensive income.

n. Leases:

The criteria for classifying leases as finance or operating leases depend on the substance of the agreements and are made at the inception of the lease in accordance with the following principles as set out in IAS 17.

The Group as leases:

Operating leases:

Lease agreements are classified as an operating lease if they do not transfer substantially all the risks and benefits incidental to ownership of the leased asset. Lease payments are recognized as an expense in profit or loss on a straight-line basis over the lease term.

o. Property, plant and equipment:

Property, plant and equipment are measured at cost, including directly attributable costs, less accumulated depreciation, accumulated impairment losses and any related investment grants and excluding day-to-day servicing expenses.

Depreciation is calculated on a straight-line basis over the useful life of the assets at annual rates as follows:

| | % |
|---|---|
| Computers and peripheral equipment | 33 |
| Office furniture and equipment | 7 - 15 (mainly 15%) |
| Leasehold improvements | Over the term of the lease or the expected life, whichever is shorter |

The useful life, depreciation method and residual value of an asset are reviewed at least each year-end and any changes are accounted for prospectively as a change in accounting estimate.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. An asset is derecognized on disposal or when no further economic benefits are expected from its use. The gain or loss arising from the derecognition of the asset (determined as the difference between the net disposal proceeds and the carrying amount in the financial statements) is included in profit or loss when the asset is derecognized.

p. Intangible assets:

Intangible assets acquired in a business combination are included at fair value at the acquisition date (see Note 6). After initial recognition, intangible assets are carried at their cost less any accumulated amortization and any accumulated impairment losses.

According to management's assessment, intangible assets have a finite useful life. The assets are amortized over their useful life using the straight-line method and reviewed for impairment whenever there is an indication that the asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for prospectively as changes in accounting estimates. The amortization of intangible assets with finite useful lives is recognized in the profit or loss.

| | **Backlog** | **Technology** |
|---|---|---|
| Useful lives | 1 year | 10 years |
| Amortization method used | straight-line basis | straight-line basis |

q. Research and development:

Research and development costs are charged to profit or loss as incurred as development costs do not meet the criteria for recognition as an intangible asset.

r. Impairment of non-financial assets:

The Company evaluates the need to record an impairment of the carrying amount of non-financial assets whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of fair value less costs of sale and value in use. In measuring value in use, the expected future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in profit or loss.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The following criteria are applied in assessing impairment of these specific assets:

1. Goodwill in respect of business combination:

For the purpose of impairment testing, goodwill acquired in a business combination is allocated, at the acquisition date, to each of the Group's cash-generating units that is expected to benefit from the synergies of the combination.

The Company reviews goodwill for impairment once a year as of December 31 or more frequently if events or changes in circumstances indicate that there is impairment.

Goodwill is tested for impairment by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units) to which the goodwill has been allocated. An impairment loss is recognized if the recoverable amount of the cash-generating unit (or group of cash-generating units) to which goodwill has been allocated is less than the carrying amount of the cash-generating unit (or group of cash-generating units). Any impairment loss is allocated first to goodwill. Impairment losses recognized for goodwill cannot be reversed in subsequent periods.

Effective from January 1, 2010, each unit or group of units to which the goodwill is allocated shall not be larger than an operating segment determined in accordance with IFRS 8, "Operating Segments", prior to aggregation for reporting purposes.

s. Government grants:

Government grants are recognized where there is reasonable assurance that the grant will be received and the Company will comply with the attached conditions.

Government grants received from the Office of the Chief Scientist ("OCS") and the Korea Israel Industrial R&D Foundation as support for research and development projects which grants include an obligation to pay royalties that are conditional on future sales arising from the project, are recognized upon receipt as a liability if future economic benefits are expected from the project that will result in royalty-bearing sales. If no such economic benefits are expected, the grants are recognized as a reduction of the related research and development expenses. In that event, the royalty obligation is treated as contingent liability in accordance with IAS 37.

At the end of each reporting period, the Company evaluates, based on its best estimate of future sales, whether there is reasonable assurance that the liability recognized, in whole or in part, will not be repaid (since the Company will not be required to pay royalties). If there is such reasonable assurance, the appropriate amount of the liability is derecognized and recorded in profit or loss as a reduction of research and development expenses. If the estimate of future sales indicates that there is no such reasonable assurance, the appropriate amount of the liability that reflects expected future royalty payments is recognized with a corresponding adjustment to research and development expenses.

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Grants received after January 1, 2009, which are recognized as a liability, are accounted for as forgivable loans, in accordance with IAS 20 (Revised), pursuant to the provisions of IAS 39, "Financial Instruments: Recognition and Measurement". Accordingly, when the liability for the loan is first recognized, it is measured at fair value using a discount rate that reflects a market rate of interest. The difference between the amount of the grants received and the fair value of the liability is accounted for upon recognition of the liability as a government grant and recognized as a reduction of research and development expenses. After initial recognition, the liability is measured at amortized cost using the effective interest method. Changes in the projected cash flows are discounted using the original effective interest and recorded in profit or loss in accordance with the provisions of IAS 39.AG8.
Royalty payments are treated as a reduction of the liability.

t. Revenue recognition:

Revenues are recognized in profit or loss to the extent that it is probable that the economic benefits will flow to the Company and the revenues can be reliably measured. Revenues are measured at the fair value of the consideration received less any trade discounts, volume rebates and returns.

The Company generates revenues mainly from licensing the software products and sales of software licenses that require significant customization. The Company also generates revenues from maintenance, support and training. The resellers usually add an additional component to the package sold or include the Company's products as part of a broader package.

Revenues from software licensing that requires significant customization are recognized by reference to the stage of completion of the transaction at the end of the reporting period. When the outcome of the transaction cannot be estimated reliably, revenues are recognized only to the extent of the costs recognized that are recoverable. A provision for estimated losses on uncompleted contracts is recorded in the period in which such losses are first identified. As of December 31, 2011, no provision for such losses has been identified.

Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement. The fair value of the undelivered elements (maintenance and support services) is determined based on the price charged for the undelivered element when sold separately.

Deferred revenue includes unearned amounts received under maintenance and support contracts, and amounts received from customers but not recognized as revenues.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from software arrangements:

Software arrangements contain multiple elements (software, integration, installation, upgrades, support, training, consultation etc.). The Company evaluates the arrangement's elements, including those delivered on a "when and if available basis", in order to determine if the elements can be separately identified.

The Company recognizes revenues from the sale of software only after the significant risks and rewards of ownership of the software have been transferred to the buyer for which a necessary, but not sufficient condition, is delivery of the software, either physically or electronically, or providing the right to use or permission to make copies, of the software. The Company recognizes revenues from providing software related services when the outcome can be measured reliably by reference to the stage of completion of the transaction at the end of the reporting period. If the services consist of a number of activities that are not defined over a specified period of time, revenues are recognized on a straight-line basis over the specified period, unless there is evidence that some other method better represents the stage of completion.

u. Earnings (loss) per share:

Earnings per share are calculated by dividing the net income attributable to equity holders of the Company by the weighted number of Ordinary shares outstanding during the period. Basic earnings per share only include shares that were actually outstanding during the period. Potential Ordinary shares are only included in the computation of diluted earnings per share when their conversion decreases earnings per share or increases loss per share from continuing operations. Further, potential Ordinary shares that are converted during the period are included in diluted earnings per share only until the conversion date and from that date in basic earnings per share. The Company's share of earnings of investees is included based on the earnings per share of the investees multiplied by the number of shares held by the Company.

v. Provisions:

A provision in accordance with IAS 37 is recognized when the Company has a present (legal or constructive) obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are measured according to the estimated future cash flows discounted using a pre-tax interest rate that reflects the market assessments of the time value of money and, where appropriate, those risks specific to the liability.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Following are the types of provisions included in the financial statements:

Legal claims:

A provision for claims is recognized when the Group has a present legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources embodying economic benefits will be required by the Group to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the effect of the time value of money is material, a provision is measured at its present value.

w. Employees benefit liabilities:

The Company's liability for severance pay pursuant to the Israel's Severance Pay Law (for those who elected not to be fully included under section 14 of the Severance Pay Law, 1963) is based on the last monthly salary of the employee multiplied by the number of years of employment, as of the date of severance.

The cost of providing severance pay is determined using an independent actuary. Actuarial gains and losses are recognized immediately in the statements of comprehensive income in the period in which they occur.

Pursuant to Section 14 of the Severance Pay Law, which covers 75% of most of the employees' severance pay, monthly deposits with insurance companies release the Company from any future severance obligations in respect of those employees (defined contribution). Deposits under Section 14 are recorded as an expense in the Company's statements of comprehensive income.

x. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, short-term bank deposits, trade receivables, other accounts receivable, short-term bank loans, trade payables and other accounts payable approximate their fair value due to the short-term maturity of such instruments.

y. Share-based payment transactions:

The Company applies the provisions of IFRS 2, "Share-Based Payment". IFRS 2 requires an expense to be recognized where the Company buys goods or services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares of rights over shares ("cash-settled transactions"). The main impact of IFRS 2 on the Company is the expensing of employees' and directors' share options (equity-settled transactions).

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The cost of equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date on which they are granted. The fair value is determined by using the Black-Scholes option-pricing model taking into account the terms and conditions upon which the instruments were granted. The fair values of Ordinary shares for the purpose of calculating the fair values of options and warrants were determined by management based on a number of factors.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest.

The Company's employees/other service providers are entitled to remuneration in the form of equity-settled share-based payment.

z. Finance income and expenses:

Finance income includes interest income on amounts invested and exchange rate gains.

Finance expenses comprise interest expense on bank loan fees and exchange rate loss.

Gain an losses on exchange rate differences are reported on a net basis.

aa. Disclosure of new IFRSs in the period prior to their adoption:

*IFRS 10, IFRS 11, IFRS 12, IFRS 13 - Consolidated Financial Statements, Joint Arrangements, Disclosure of Interests in Other Entities, Fair Value Measurement:*

In May 2011, the IASB issued four new Standards: IFRS 10, "*Consolidated Financial Statements*", IFRS 11, "*Joint Arrangements*", IFRS 12, "*Disclosure of Interests in Other Entities*" ("the new Standards") and IFRS 13, "*Fair Value Measurement*", and amended two existing Standards, IAS 27R (Revised 2011), "*Separate Financial Statements*", and IAS 28R (Revised 2011), "*Investments in Associates and Joint Ventures*".

The new Standards are to be applied retrospectively in financial statements for annual periods commencing on January 1, 2013 or thereafter. Earlier application is permitted. However, if the Company chooses earlier application, it must adopt all the new Standards as a package (excluding the disclosure requirements of IFRS 12 which may be adopted separately). The Standards prescribe transition provisions with certain modifications upon initial adoption.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The main provisions of the Standards and their expected effects on the Company are as follows:

*IFRS 10 - Consolidated Financial Statements:*

IFRS 10 supersedes IAS 27 regarding the accounting treatment of consolidated financial statements and includes the accounting treatment for the consolidation of structured entities previously accounted for under SIC 12, "*Consolidation - Special Purpose Entities*".

IFRS 10 does not prescribe changes to the consolidation procedures but rather modifies the definition of control for the purpose of consolidation and introduces a single consolidation model. According to IFRS 10, in order for an investor to control an investee, the investor must have power over the investee and exposure, or rights, to variable returns from the investee. Power is defined as the ability to influence and direct the investee's activities that significantly affect the investor's return.

According to IFRS 10, when assessing the existence of control, potential voting rights should be considered only if they are substantive, as opposed to the provisions of IAS 27 prior to its amendment which required consideration of potential voting rights only if they could be exercised immediately while disregarding management's intentions and financial ability to exercise such rights.

IFRS 10 also prescribes that an investor may have control even if it holds less than a majority of the investee's voting rights (de facto control), as opposed to the provisions of the existing IAS 27 which permits a choice between two consolidation models - the de facto control model and the legal control model.

IFRS 10 is to be applied retrospectively in financial statements for annual periods commencing on January 1, 2013, or thereafter.

The Company believes that the adoption of IFRS 10 is not expected to have a material effect on the financial statements.

*IFRS 11 - Joint Arrangements:*

IFRS 11 supersedes IAS 31 regarding the accounting treatment of interests in joint ventures and SIC 13 regarding the interpretation of the accounting treatment of non-monetary contributions by venturers.

IFRS 11 defines joint arrangements as contractual arrangements over which two or more parties have joint control.

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

IFRS 11 distinguishes between two types of joint arrangements:

- Joint ventures in which the parties that have joint control of the arrangement have rights to the net assets of the arrangement. IFRS 11 requires joint ventures to be accounted for solely by using the equity method, as opposed to the provisions of IAS 31 which allowed the Company to make an accounting policy choice whether to apply proportionate consolidation or the equity method for entities under joint control.

- Joint operations in which the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. IFRS 11 requires the joint operator to recognize a joint operation's assets, liabilities, revenues and expenses in proportion to its relative share of the joint operation as determined in the joint arrangement, similar to the current accounting treatment for proportionate consolidation.

IFRS 11 is to be applied retrospectively in financial statements for annual periods commencing on January 1, 2013, or thereafter.

The Company believes that the adoption of IFRS 11 is not expected to have a material effect on the financial statements.

*IFRS 13 - Fair Value Measurement:*

IFRS 13 establishes guidance for the measurement of fair value, to the extent that such measurement is required according to IFRS. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. IFRS 13 also specifies the characteristics of market participants and determines that fair value is based on the assumptions that would have been used by market participants. According to IFRS 13, fair value measurement is based on the assumption that the transaction will take place in the asset's or the liability's principal market, or in the absence of a principal market, in the most advantageous market.

IFRS 13 requires an entity to maximize the use of relevant observable inputs and minimize the use of unobservable inputs. IFRS 13 also includes a fair value hierarchy based on the inputs used to determine fair value as follows:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - unobservable inputs (valuation techniques that do not make use of observable inputs).

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

IFRS 13 also prescribes certain specific disclosure requirements.

The new disclosures, and the measurement of assets and liabilities pursuant to IFRS 13, are to be applied prospectively for periods commencing after the Standard's effective date, in financial statements for annual periods commencing on January 1, 2013 or thereafter. Earlier application is permitted. The new disclosures will not be required for comparative data.

The appropriate disclosures will be included in the Company's financial statements upon initial adoption of IFRS 13.

As for the effect on the financial statements, the Company believes that IFRS 13 is not expected to have a material impact on its financial statements.

**NOTE 3:- SHORT-TERM BANK DEPOSITS**

The short-term bank deposits (between three months and a year) as of December 31, 2011 and 2010 (in a total of $ 508 thousand and $ 507 thousand, respectively) bear an annual interest rate of 0.3% and 0.35%, respectively.

**NOTE 4: - TRADE RECEIVABLES**

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Trade receivables (1) | 1,240 | 3,377 |
| (1) Net of allowance for doubtful debts | 394 | 412 |

Trade receivables are non-interest bearing and are generally on 30 - 90 days' terms.

The aging analysis of trade receivables is as follows:

| | | Past due but not impaired | | | | |
|---|---|---|---|---|---|---|
| | Neither past due nor impaired | < 30 days | 30 - 60 days | 60 - 90 day | > 90 days | Total |
| | U.S. dollars in thousands | | | | | |
| 2011 | 947 | 293 | - | *) - | *) - | 1,240 |
| 2010 | 3,018 | 299 | - | 24 | 36 | 3,377 |

*) Represents an amount lower than $ 1 thousands.

## NOTE 5:- FIXED ASSETS, NET

Composition and movement:

| | Computers and peripheral equipment | Office furniture and equipment | Leasehold improvements | Total |
|---|---|---|---|---|
| | U.S. dollars in thousands | | | |
| **Cost:** | | | | |
| Balance as of January 1, 2010 | 733 | 165 | 54 | 952 |
| Acquisitions during the year | 40 | *) - | - | 40 |
| Balance as of December 31, 2010 | 773 | 165 | 54 | 992 |
| Disposal during the year | (111) | (17) | - | (128) |
| Acquisitions during the year | 24 | 13 | - | 37 |
| Balance as of December 31, 2011 | 686 | 161 | 54 | 901 |
| **Accumulated depreciation:** | | | | |
| Balance as of January 1, 2010 | 681 | 118 | 49 | 848 |
| Depreciation during the year | 47 | 8 | 4 | 59 |
| Balance as of December 31, 2010 | 728 | 126 | 53 | 907 |
| Disposal during the year | (111) | (17) | - | (128) |
| Depreciation during the year | 26 | 9 | - | 35 |
| Balance as of December 31, 2011 | 643 | 118 | 53 | 814 |
| Depreciated cost as of December 31, 2011 | 43 | 43 | 1 | 87 |
| Depreciated cost as of December 31, 2010 | 45 | 39 | 1 | 85 |

*) Represents an amount lower than $ 1 thousands.

## NOTE 6:- GOODWILL AND AN INTANGIBLE ASSET

The carrying amount of intangible assets acquired as of December 31, 2011 and 2010 in the accounts of the Company was as follows:

| | Carrying amount as of December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Technology **) | 256 | 306 |
| Goodwill | 1,068 | 1,068 |
| Total | 1,324 | 1,374 |

As the activities of VTSG have been fully integrated into those of the Company, the goodwill arising in the acquisition of VTSG is evaluated for impairment purposes as part of the cash generating unit representing the Company. As of December 31, 2011, the recoverable amount determined based on the value in use exceeded the carrying amount of the Company's net assets (equity).

**) During the years ended December 31, 2011, 2010 and 2009, the Company recorded amortization in the amount of $ 50 thousand, $ 51 thousand and $ 51 thousand, respectively, which was recorded in cost of revenues.

## NOTE 7:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Employees and payroll accruals | 351 | 341 |
| Accrued expenses | 411 | 350 |
| | 762 | 691 |

## NOTE 8:- EMPLOYEE BENEFIT LIABILITIES, NET

Employee benefits consist of short-term benefits, post-employment benefits, other long-term benefits and termination benefits.

a. Post-employment benefits:

According to the labor laws and Severance Pay Law in Israel, the Company is required to pay compensation to an employee upon dismissal or retirement or to make current contributions in defined contribution plans pursuant to Section 14 to the Severance Pay Law, as specified below. The Company's liability is accounted for as a post-employment benefit. The computation of the Company's employee benefit liability is made in accordance with a valid employment contract based on the employee's salary and employment term which establish the entitlement to receive the compensation.

b. The amounts recognized in the balance sheet are as follows:

| | December 31, | |
|---|---|---|
| | **2011** | **2010** |
| | **U.S. dollars in thousands** | |
| Liability at the beginning of the year | 122 | 101 |
| Expense (income) recognized in the profit or loss | (52) | 31 |
| Benefits paid | 38 | (10) |
| Liability at the end of the year | 108 | 122 |

b. Amounts recognized in the statements of comprehensive income are as follows:

| | December 31, | |
|---|---|---|
| | **2011** | **2010** |
| | **U.S. dollars in thousands** | |
| Current service cost | 2 | 26 |
| Interest cost | *) - | 6 |
| Net actuarial gain recognized in the year | (54) | (1) |
| Total expense included in profit or loss | (52) | 31 |

*) Represents an amount lower than $ 1 thousand.

**NOTE 8:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)**

c. Changes in the present value of defined benefit obligation:

Composition:

| | December 31, | |
|---|---|---|
| | **2011** | **2010** |
| | **U.S. dollars in thousands** | |
| Balance at January 1 | 122 | 101 |
| Interest cost | *) - | 6 |
| Current service cost | 2 | 26 |
| Benefits paid | 38 | (10) |
| Net actuarial gain | (54) | (1) |
| Balance at December 31 | 108 | 122 |

*) Represents an amount lower than $ 1 thousand.

d. The actuarial assumptions used are as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| Discount rate | 4.83% | 5.10% | 4.66% |
| Expected rate of return on plan assets | 5.10% | 5.39% | 4.96% |
| Future salary increases | 2% | 2% | 2% |
| Average expected remaining working years | 6.38 | 6.44 | 6.21 |

## NOTE 9:- LONG-TERM LOAN

a. Comprised as follows:

| | Linkage terms | Interest rate as of December 31, | | December 31, | |
|---|---|---|---|---|---|
| | | 2011 | 2010 | 2011 | 2010 |
| | | | | U.S. dollars in thousands | |
| Long-term loan from bank (c) | LIBOR +4% | 4.28% | 4.26% | - | 750 |
| Less - current maturities | | | | - | 562 |
| | | | | - | 188 |

b. The aggregate annual maturities of the long-term loan are as follows:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| First year (current maturities) | 188 | 562 |
| Second year | - | 188 |
| | 188 | 750 |

c. On November 16, 2008, the Company signed a loan agreement ("the Loan Agreement") with Bank Mizrahi Ltd. ("Mizrahi"), according to which Mizrahi provided a loan to the Company in the amount of $ 1 million. The loan bears an annual interest rate of LIBOR+4% and is repayable in 12 equal monthly payments commencing December 25, 2009. As part of the Loan Agreement, the Company issued to Mizrahi 374,240 Ordinary shares, which were recorded as transaction costs, based on the market price of the shares on the date of issuance. In addition, the Company paid loan origination fees of $ 10,000. As of December 31, 2009, the fair value of the loan approximates its carrying amount.

According to the Loan Agreement, the Company is obligated to maintain cash, cash equivalents and trade receivables at more than 125% of the loan value. The Company complied with those obligations.

**NOTE 9:- LONG-TERM LOAN (Cont.)**

On May 24, 2010, the Company signed a refinance loan agreement ("Refinance Loan") with Bank Mizrahi Ltd. ("Mizrahi"), according to which the Company will repay Mizrahi the initial Loan Agreement in a total of $ 590 thousand and Mizrahi will provide the Company with a Refinance Loan in a total amount of $ 750 thousand. The Refinance Loan bears an annual interest rate of LIBOR+4% and is repayable in 12 equal monthly payments commencing April 26, 2011. In addition, the Company paid loan commission of $ 20 thousand. According to the Loan Agreement, the Company is obligated to maintain cash, cash equivalents and trade receivables at more than 150% of the loan value and to maintain a cash and cash equivalent balance of $ 500 thousand under Mizrahi. As of December 31, 2011, the Company is in compliance with this obligation.

As of December 31, 2011, the fair value of the loan approximates its carrying amount.

**NOTE 10:- EQUITY**

a. On November 2, 2006, the Company completed its Initial Public Offering ("IPO") on the Alternative Investment Market ("the AIM") on the London Stock Exchange, by issuing 6,076,811 Ordinary shares of NIS 0.01 par value each at a price of £ 0.88 ($ 1.65) per share for a total net consideration of $ 8,411 thousand.

b. On April 23, 2009, the Board of Directors approved the implementation of a one-year plan for salary reduction of 15% for senior management and other employees ("the Reduction Plan"). According to the Reduction Plan, the individuals, in exchange for the reduction on salary, are to be granted 2,263,383 Ordinary shares of the Company with an equivalent fair value on date of grant of $ 0.15. The shares which have been issued and are being held by a trustee will vest in 12 equal monthly installments. Out of the issued shares, a total of 380,313 Ordinary shares were returned to the Company due to departure of employees and recorded as treasury shares ("the Treasury Shares"). On November 30, 2010, Mr. Ami Vizer, the Chief Executive Officer of the Company and also a Director of the Company, acquired the Treasury Shares at a price of £ 0.0512 ($ 0.7979) per share, reflecting the fair market value of the stock on the purchase date.

Further to the Reduction Plan, on July 27, 2009, the Non-Executive Board members also decided to implement a one-year salary reduction of 15% and instead will be granted 119,727 Ordinary shares of the Company, with an equivalent fair value on date of grant of $ 0.165, which will vest in 12 equal monthly installments. The shares were issued to the trustee in January 2010.

The salary reduction of 15% for the Non-Executive Board members will be effective for additional 2 years, and the Non-Executive Board members will be granted additional Ordinary shares of the Company.

## NOTE 10:- EQUITY (Cont.)

c. On November 2, 2010, the Board of Directors approved the implementation of a share bonus plan ("the Share Bonus Plan").

According to the Share Bonus Plan, the Bonus Compensation will be granted with an equivalent value of Ordinary shares based on the quoted fair market price of the shares as of November 2, 2010, which is equal to $ 0.0821 per Ordinary share ("the Bonus Shares"). The Bonus Shares will vest upon receiving actual payment from the customer under the relevant PO ("the Bonus Shares Vested Date").
The fair value on date of grant equal to $ 0.08 per Ordinary Share

On July 4, 2011 the Company issued a total of 2,444,984 ordinary shares of 0.01 NIS each ("Ordinary Shares") to its senior management and other employees. Out of the shares issued, 1,984,530 and 103,703 Ordinary Shares were issued to the Company's Chief Executive Officer and Chief Finance Officer, who are also Directors of the Company, respectively.

As of December 31, 2010, the Company recorded share-based compensation expenses of $ 212 thousand, in respect of the bonus compensation.

d. On August 10, 2011, a total of 47,502 options were exercise under the company's Stock Option Plan at an exercise price of NIS 0.01.

e. On September 12, 2011, the Board of Directors approved the implementation of a share bonus plan ("the Share Bonus Plan") for year 2011.

According to the Share Bonus Plan, the Bonus Compensation will be granted with an equivalent value of Ordinary shares based on the quoted fair market price of the shares as of September 12, 2011, which is equal to $ 0.0812 per Ordinary share ("the Bonus Shares"). The Bonus Shares will vest upon receiving actual payment from the customer under the relevant PO ("the Bonus Shares Vested Date").
The fair value on date of grant equal to $ 0.08 per Ordinary Share

As of December 31, 2011 and based on full vesting, the Company's senior management and other employees are to be granted a total of 6,040,580 Ordinary shares and Options at an exercise price of NIS 0.01 per share of the Company. Out of the shares issued, 5,415,686 and 59,691 Ordinary Shares and Options are expected to be issued, based on a full vesting, to the Company's Chief Executive Officer and Chief Finance Officer, who are also Directors of the Company, respectively.

**NOTE 10:- EQUITY (Cont.)**

f. Composition of share capital:

| | December 31, 2011, 2010 and 2009 | December 31, | | |
|---|---|---|---|---|
| | | 2011 | 2010 | 2009 |
| | Authorized | Issued and outstanding | | |
| | | Number of shares | | |
| Ordinary shares of NIS 0.01 par value each | 100,000,000 | 44,134,769 | 41,642,283 | 41,522,556 |

g. Stock option plan:

In August 2000, the Company's Board of Directors authorized an incentive share option plan ("the Option Plan") and has since granted options to purchase Ordinary shares to employees and consultants. Under the Option Plan, options generally vest ratably over a period of four years, commencing with the date of grant. The exercise price of the options granted under the Option Plan may not be less than the par value of the shares. The options generally expire no later than 10 years from the date of the grant, and are non-transferable, except under the laws of succession. On November 2, 2010, the Company decided to increase its Option Plan reserves by 8,000,000 options to accumulate a total of 17,500,000. As of December 31, 2011, an aggregate of 2,519,264 Ordinary shares of the Company are still available for future grant.

The fair value of share options is measured at the grant date using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. The following are the inputs to the model used for each of the three years in the period ended December 31, 2011: risk-free interest rates ranging from 1.27%-5.09%; a dividend yield of 0%; volatility factor of the expected market price of the Company's Ordinary shares of 80%; and a weighted average expected life of the options of 6.5 years.

The weighted average fair values of the options granted in 2011, 2010 and 2009 were $ 0.15, $ 0.03 and $ 0.09, respectively.

## NOTE 10:- EQUITY (Cont.)

A summary of the activity in options to employees, consultants, and directors (including the senior management, see j. below) for the years 2011, 2010 and 2009 is as follows:

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2009 | |
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding at beginning of year | 2,673,444 | $ 0.371 | 2,207,822 | $ 0.693 | 2,408,069 | $ 0.706 |
| Granted | 315,000 | $ 0.148 | 1,234,000 | $ 0.031 | 477,500 | $ 0.089 |
| Exercised | (47,502) | $ 0.002 | - | - | (442,125) | $ 0.002 |
| Expired | (110,245) | $ 0.617 | (110,245) | $ 0.461 | | |
| Forfeited | (837,449) | $ 0.453 | (658,133) | $ 0.741 | (235,622) | $ 0.886 |
| Outstanding at end of year | 1,993,248 | $ 0.315 | 2,673,444 | $ 0.371 | 2,207,822 | $ 0.693 |
| Exercisable options | 648,683 | $ 0.834 | 1,192,198 | $ 0.781 | 1,575,944 | $ 0.736 |

The options outstanding as of December 31, 2011, have been separated into ranges of exercise price as follows:

| Exercise price | Options outstanding as of December 31, 2011 | Weighted average remaining contractual life (years) | Options exercisable as of December 31, 2011 |
|---|---|---|---|
| $ 0.003-0.127 | 1,190,500 | 9.69 | 156,241 |
| $ 0.129-0.630 | 592,748 | 5.37 | 282,442 |
| $ 1.330-2.170 | 210,000 | 4.98 | 210,000 |
| | 1,993,248 | | 648,683 |

**NOTE 10:- EQUITY (Cont.)**

h. Options to the CEO and senior employees:

1. On March 26, 2009, a total of 80,000 options at an exercise price of $ 0.08 per share were exercised by the Company's senior employees.

2. On March 29, 2009, a total of 32,978 options at an exercise price of NIS 0.01 per share were exercised by the Company's senior employees.

3. On January 27, 2010, the Board of Directors granted 1,249,000 options as follows:

a) A total of 360,000 options were granted to the CEO at an exercise price of NIS 0.01 per share.

b) A total of 312,000 options were granted to senior employees at an exercise price of NIS 0.01 per share.

c) A total of 132,000 options were granted to employees at an exercise price of NIS 0.01 per share.

d) A total of 304,000 options were granted to employees at an exercise price of $ 0.13 per share.

e) A total of 141,000 options were granted to the former CFO at an exercise price of NIS 0.01 per share.

The options will vest over 3 years in equal annual amounts commencing as of January 1, 2010 and will be conditional upon the following:

a) Employee being employed by the Company.

b) The EBIDTA of the Company (on a consolidated basis) for the relevant fiscal year shall increase by more than 20% compared to the previous year.

Vesting will be fully accelerated in the event of any of the following:

a) Merger, acquisition or reorganization of the Company with one or more other entities;

b) A sale of all or substantially all of the assets or shares of the Company;

c) An investment in the Company of at least $ 2 million.

As of December 31, 2011, no options have been vested and the Company did not record share-based compensation expenses.

**NOTE 10:- EQUITY (Cont.)**

4. On July 28, 2010, the Board of Directors approved that all vested options granted to the former CFO in total amount of 319,388 options at the date of termination of his engagement by the Company will be exercisable until December 31, 2011, or an M&A event (whichever is sooner).

   On September 27, 2010, the Board of Directors approved that all vested options granted to a former senior employee in total amount of 90,171 options at the date of termination of her engagement by the Company will be exercisable until December 31, 2011, or an M&A event (whichever is sooner).

   The effect of the modification in terms of the options was an increase in their fair value in the amount of $49 thousand which was recorded as share based compensation expense in 2010.

5. On June 29, 2011 the Company’s Board of Directors approved. the extension in terms of options granted to former senior employee according to which, options in a total of 75,000 will be exercisable until June 10, 2012 only in case of a Transaction (as defined in the Company's Share Option Plan). All other vested options in a total of 85,400 will be exercisable until December 7, 2012 only in case of a Transaction (as defined in the Company's Share Option Plan).

6. On November 28, 2011 the Annual General meeting of the Company’s approved the grant of 40,000 options to purchase ordinary shares of the Company to Mr. Efraim Manea, a director of the Company and its CFO. Such options are granted to Mr. Manea in accordance with the Company's Employees' Stock Option Plan (the “ISOP”) and in the same terms that similar options are granted to the employees of the Company. The options will be vested over 36 months commencing September 2012 at an exercise price of US$0.08. The Vested Options are exercisable only in an event of an Transaction as defined under the ISOP.

i. Shares to the CEO and senior employees:

1. The Reduction Plan as mentioned under Note 10b above includes a total of 342,717 and 435,495 Ordinary shares of the Company which were granted to the CEO and senior management; respectively, with an equivalent fair value on date of grant of $ 0.15. The shares which have been issued and are being held by the Company's trustee, will vest in 12 equal installments.

2. The Share Bonus Plan as mentioned under Note 10c includes a total of 1,984,530 and 339,691 Ordinary shares of the Company that were granted to the CEO and senior management, respectively, with an equivalent fair value on date of grant equal to $ 0.0821 per Ordinary Share.

   As of the date the financial statements were approved 2,318,131and 333,601 Ordinary shares, which were granted to the CEO and the senior management respectively, are due.

**NOTE 10:- EQUITY (Cont.)**

As of December 31, 2010, the Company recorded share-based compensation expenses in a total of $ 163 thousand and $ 28 thousand in respect to the CEO and senior management, respectively.

3. The Share Bonus Plan as mentioned under Note 10e includes a total of 5,415,686 and 558,545 Ordinary shares and Options at an exercise price of NIS 0.01 per share of the Company that are expected to be issued, based on full vesting, to the CEO and senior management, respectively, with an equivalent fair value on date of grant equal to $ 0.0812 per Ordinary Share.

   As of the date the financial statements were approved 1,725,545 and 66,291 shares, which are expected to be granted to the CEO and the senior management, respectively; are due.

   As of December 31, 2011, the Company recorded share-based compensation expenses in a total of $ 248 thousand and $ 45 thousand in respect to the CEO and senior management, respectively.

**NOTE 11:- INCOME TAXES**

a. Tax benefits under the Law for the Encouragement of Capital Investments, 1959:

The Company has been granted an "Approved Enterprise" status for an original program and an additional expansion program, ("the programs") under the Law for the Encouragement of Capital Investments, 1959 ("the Law"). According to the provisions of the Law, the Company has elected to enjoy the "alternative benefits track" - a waiver of grants in return for tax holidays. The "Approved Enterprise" status will allow the Company a tax holiday on undistributed income derived from the "Approved Enterprise" program. The income derived from this "Approved Enterprise" will be tax-exempt for a period of two years, and may enjoy a reduced tax rate of 10% to 25% (based on percentage of foreign ownership) for an additional five years. The seven-year period of benefits will commence with the first year in which the Company earns taxable income.

The Company completed the implementation of its original and expansion programs.

The period of tax benefits, detailed above, is subject to limits of the earlier of 12 years from the commencement of production, or 14 years from receiving the approval. The period of benefits has not yet commenced, and will expire in the year 2016.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the above Law, regulations published thereunder and the letters 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.

Should the Company derive income from sources other than the "Approved Enterprise" during the period of benefits, such income shall be taxable at the regular corporate tax rate.

**NOTE 11:- INCOME TAXES (Cont.)**

If tax-exempt profits are distributed to shareholders, they would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative system of benefits, currently between 10%-25% for an "Approved Enterprise".

An amendment to the Law, which became effective in 2005 ("the Amendment") changed certain provisions of the Law. As a result of the Amendment, a company is no longer obliged to implement an "Approved Enterprise" status in order to receive the tax benefits previously available under the alternative benefits provisions, and therefore there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authorities for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of the company's business income from export. In order to receive the tax benefits, the Amendment states that a company must make an investment in the beneficiary enterprise exceeding a minimum amount specified in the Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the beneficiary enterprise ("the Year of Election"). Where a company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a beneficiary enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a beneficiary enterprise is required to exceed a certain percentage of the company's production assets before the expansion. The duration of tax benefits is subject to a limitation of the earlier of 7 years from the Commencement Year, or 12 years from the first day of the Year of Election.

*Amendments to the Law for the Encouragement of Capital Investments, 1959:*

In December 2010, the "Knesset" (Israeli Parliament) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011 ("the Amendment"), which prescribes, among others, amendments in the Law for the Encouragement of Capital Investments, 1959 ("the Law"). The Amendment became effective as of January 1, 2011. According to the Amendment, the benefit tracks in the Law were modified and a flat tax rate applies to the Company's entire preferred income. Commencing from the 2011 tax year, the Company will be able to opt to apply (the waiver is non-recourse) the Amendment and from the elected tax year and onwards, it will be subject to the amended tax rates that are: 2011 and 2011 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%).

## NOTE 11:- INCOME TAXES (Cont.)

b. Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2d, the financial statements are presented in U.S. dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a difference between taxable income or loss and the income or loss before taxes reflected in the financial statements.

c. Tax reconciliation:

In 2011, 2010 and 2009, the main reconciling item between the statutory tax rate of the Company and the effective tax rate (0%) is carryforward tax losses and tax exemption for which no deferred taxes were provided.

d. Carryforward losses:

Domestic:

As of December 31, 2011, 2010 and 2009, the Company had accumulated losses for Israeli tax purposes of approximately $ 6.5 million, $ 6.8 million and $ 5.2 million, respectively, which may be carried forward, in order to offset taxable income in the future, for an indefinite period.

Foreign:

As of December 31, 2011, 2010 and 2009, the federal tax loss carryforwards of the U.S. subsidiaries amounted to approximately $ 5.5 million, $ 5.9 million and $ 5.7 million, respectively. Such losses are available for offset against future U.S. taxable income of the subsidiaries and will expire in the years 2023-2026.

Due to the uncertainty of the utilization of these carryforward losses, no deferred tax assets have been recorded.

e. Tax rates applicable to the income of the Company and its subsidiaries:

Domestic:

The Israeli corporate tax rate was 26% in 2009, 25% in 2010 and 24% in 2011.

A company is taxable on its real (non-inflationary) capital gains at the corporate tax rate in the year of sale. A temporary provision for 2006-2009 stipulates that the sale of an asset other than a quoted security (excluding goodwill that was not acquired) that had been purchased prior to January 1, 2003, and sold by December 31, 2009, is subject to corporate tax as follows: the part of the real capital gain that is linearly attributed to the period prior to December 31, 2002 is subject to the corporate tax rate in the year of sale as set forth in the Israeli Income Tax Ordinance, and the part of the real capital gain that is linearly attributed to the period from January 1, 2003, through December 31, 2009, is subject to tax at a rate of 25%.

**NOTE 11:- INCOME TAXES (Cont.)**

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

Foreign:

The subsidiaries were incorporated in Orlando, Florida, U.S.A., and are taxed according to U.S. tax laws. The statutory federal tax rate is 35%.

f. Tax assessments:

The Company's tax assessments in Israel for the years until and including 2006 are considered final, subject to the powers vested with the director of the Tax Authority pursuant to sections 145, 147 and 152 to the Income Tax Ordinance.

g. Deferred taxes:

On December 31, 2011, there was no recognized deferred tax liability for taxes that would be payable on unremitted earnings of the Company and its subsidiaries.

**NOTE 12:- CONTINGENT LIABILITIES AND COMMITMENTS**

a. Royalty commitments:

1. In June 2001, the Company and a third party signed a Cooperation and Project Funding Agreement with Britech, which is an establishment of the United Kingdom-Israel Industrial Research and Development Fund.

   According to the agreement, Britech agreed to fund, by conditional grant, the implementation of the proposal submitted by the Company and the third party for a research and development project in the maximum amount of £ 227 thousand.

   The Company shall make repayments to Britech, based on gross sales derived from the sale, leasing or other marketing or commercial exploitation of the innovation, including service or maintenance contracts, commencing with the first commercial transaction. Such payments shall be repaid in Pounds Sterling at the rate of 2.5% of the first year's gross sales and, in succeeding years, at the rate of 5% of the gross sales until 100%-150% of the conditional grant and other sums have been repaid (incremental 50% based upon agreed milestone which was not fulfilled).

   The Company received a total amount of $ 324 thousand, of which $ 150 thousand and $ 174 thousand were deducted from the research and development expenses in 2001 and 2003, respectively.

## NOTE 12:- CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

Although the development of technology had been completed by the third party and the Company, the Company has never received the third party's portion of the developed technology upon completion of the project although it requested it from both the third party and Britech. Therefore, since the Company cannot utilize the developed technology without the essential portion developed by the third party, the Company has not paid any royalties to Britech and the Company's management believes that it will not be required to pay royalties in the future for the abovementioned project. In addition, the Company did not submit any patent applications in connection with the Britech grant.

2. On September 1, 2009, the Company and a third party signed a Cooperation and Project Funding Agreement with KORIL ("the Agreement"), which is an establishment of the Korea-Israel Industrial Research and Development Fund. According to the agreement, KORIL agreed to fund, by conditional grant, the implementation of the proposal submitted by the Company ("the proposal") and the third party for a research and development project in the maximum amount of $ 273 thousand.

   As of December 31, 2011, the Company received a total amount of $ 191 thousand.

   The Company shall make repayments to KORIL, based on gross sales derived from the gross invoiced sales value of the products, processes, inventions, technology, discoveries, improvements, modifications, methods, software, specifications, or any form of technical information developed or arising from the proposal (gross sales). Such payments shall be repaid in U.S. dollars at the rate of 2.5% of the first year's gross sales until 100% of the conditional grant and other sums have been repaid.

   The total non-current liability for the years ended December 31, 2011 and 2010 was $ 208 thousand and $ 168 thousand, respectively.

   As of the financial statement approval date, the Company has not paid any royalties to KORIL as no related gross sales were recorded.

3. On September 16, 2010, the Company signed a Project Funding Agreement ("the Agreement") with the Israeli Chief Scientist ("the OCS"). According to the Agreement, the OCS agreed to fund, by conditional grant, the implementation of the proposal submitted by the Company for a research and development project in the maximum amount of $ 365 thousand.

   On March 29, 2011, the Company signed on a supplement to the Agreement ("the Supplement"). According to the Supplement, the OCS agreed to fund, by conditional grant, the implementation of the proposal submitted by the Company for a research and development continued project in the maximum amount of $ 278 thousand.

   As of December 31, 2011, the Company received total amount of $ 571 thousand.

**NOTE 12:- CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)**

The Company shall make repayments to the OCS, based on gross sales derived from the gross invoiced sales value of the products, processes, inventions, technology, discoveries, improvements, modifications, methods, software, specifications, or any form of technical information developed or arising from the proposals (gross sales). Such payments shall be repaid in NIS at the rate of 3% of the first year's gross sales until 100% of the conditional grant and other sums have been repaid.

The total non-current liability for the years ended December 31, 2011 and 2010 was $ 479 thousand and $ 292 thousand, respectively.

4. On April 7, 2011, the Company and a third party signed a Cooperation and Project Funding Agreement with the Israeli Chief Scientist ("the OCS"), which is an establishment of the Italian-Israel Industrial Research and Development Fund. According to the agreement, the OCS agreed to fund, by conditional grant, the implementation of the proposal submitted by the Company (“the proposal”) and the third party for a research and development project in the maximum amount of $ 90 thousand.

   As of December 31, 2011, the Company received a total amount of $ 77 thousand.

   The Company shall make repayments to the OCS, based on gross sales derived from the gross invoiced sales value of the products, processes, inventions, technology, discoveries, improvements, modifications, methods, software, specifications, or any form of technical information developed or arising from the proposal (gross sales). Such payments shall be repaid in NIS at the rate of 3% of the first year's gross sales until 100% of the conditional grant and other sums have been repaid.

   The total non-current liability for the year ended December 31, 2011 was $ 59 thousand.

   As of the financial statement approval date, the Company has not paid any royalties to the OCS as no related gross sales were recorded.

b. Lease commitments:

1. Premises occupied by the Company are rented under various non-cancelable lease agreements until March 2012. As mentioned under Note 18, the lease was extended until December 31, 2014.

2. The Company has leased various motor vehicles under cancelable operating lease agreements, which expire on various dates, the latest of which is in 2014.

3. Premises occupied by the subsidiaries are rented under non-cancelable lease agreements. The latest rental agreement for the premises expires in March 2016 as determined under the new lease agreement signed on December 14, 2011 by SimiGon Inc.

**NOTE 12:- CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)**

4. Future minimum rental payments under non cancellable operating leases are as follows:

| Year ended December 31, | U.S. dollars in thousands |
|---|---|
| 2012 | 144 |
| 2013 | 66 |
| 2014 | 69 |
| 2015 | 69 |
| 2016 | 69 |
| | 417 |

The total expense for the years ended December 31, 2011, 2010 and 2009 was $ 367 thousand, $ 350 thousand and $ 341 thousand, respectively.

c. Floating charge:

The Company recorded a first priority unlimited floating charge on all of its assets, in favor of a bank, in consideration of the loan agreement as described in Note 9.

**NOTE 13:- SUPPLEMENTARY INFORMATION TO THE STATEMENT OF COMPREHENSIVE INCOME**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| | **U.S. dollars in thousands** | | |
| a. Cost of revenues: | | | |
| Salaries and related benefits | 602 | 406 | 581 |
| Lease and office maintenance | 124 | 132 | 147 |
| Travel expenses, net | (50) | 35 | 23 |
| Depreciation and amortization | 59 | 61 | 62 |
| Share-based compensation | 8 | 6 | 64 |
| Subcontractors | 83 | 164 | 100 |
| | 826 | 804 | 977 |
| b. Research and development expenses: | | | |
| Salaries and related benefits | 1,433 | 1,466 | 1,400 |
| Lease and office maintenance | 245 | 297 | 214 |
| Depreciation and amortization | 16 | 32 | 38 |
| Share-based compensation | 21 | 22 | 185 |
| Other | 1 | 4 | 15 |
| Government grants | (41) | (61) | (19) |
| | 1,675 | 1,760 | 1,833 |
| c. Selling and marketing expenses: | | | |
| Salaries and related benefits | 965 | 919 | 882 |
| Lease and office maintenance | 105 | 132 | 125 |
| Consultant fees | 141 | 241 | 258 |
| Advertising and sales promotion | 54 | 45 | 58 |
| Travel expenses | 106 | 142 | 111 |
| Depreciation | 6 | 10 | 12 |
| Share-based compensation | 296 | 219 | 67 |
| Commission | 23 | 3 | 97 |
| | 1,696 | 1,711 | 1,610 |

**NOTE 13:- SUPPLEMENTARY INFORMATION TO THE STATEMENT OF COMPREHENSIVE INCOME (Cont.)**

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| | U.S. dollars in thousands | | |
| d. General and administrative expenses: | | | |
| Salaries and related benefits | 539 | 547 | 716 |
| Lease and office maintenance | 67 | 95 | 149 |
| Consultant fees | - | 10 | 122 |
| Travel expenses | 21 | 22 | 31 |
| Professional fees and public company expenses | 327 | 436 | 405 |
| Depreciation | 4 | 7 | 13 |
| Share-based compensation | 28 | 73 | 80 |
| Doubtful debt provision | (18) | 282 | - |
| Other | 7 | 6 | 50 |
| | 975 | 1,478 | 1,566 |
| e. Finance income: | | | |
| Exchange rate differences | 296 | 68 | 210 |
| Interest income from banks | 9 | 7 | 20 |
| | 305 | 75 | 230 |
| f. Finance cost: | | | |
| Exchange rate differences | 231 | 131 | 150 |
| Government grants interest | 3 | - | - |
| Bank loans and fees | 33 | 76 | 79 |
| | 267 | 207 | 229 |

**NOTE 14:- REVENUES**

The Company manages its business on the basis of one reportable segment.

a. Revenues:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| Software licenses | 3,954 | 3,666 | 4,093 |
| Software licenses that require significant customization | 553 | 1,161 | 1,226 |
| Maintenance | 910 | 296 | 738 |
| Training | 67 | 84 | - |
| | 5,484 | 5,207 | 6,057 |

b. Geographical information:

Revenues classified by geographical destinations based on the customer location:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| EMEA (1) | 1,475 | 1,388 | 2,693 |
| North America | 3,892 | 3,509 | 3,201 |
| Asia Pacific | 117 | 310 | 163 |
| | 5,484 | 5,207 | 6,057 |

(1) Europe, Middle East, Australia and Africa.

The carrying amounts of non-current assets (fixed assets, investment property and intangible assets) in the Company's country of domicile (Israel) and in foreign countries, based on the location of the assets, are as follows:

| | December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| EMEA | 54 | 60 | 82 |
| North America | 1,357 | 1,399 | 1,447 |
| | 1,411 | 1,459 | 1,529 |

## NOTE 14:- REVENUES (Cont.)

c. Information about major customers:

Revenues from major customers, each of whom amount to 10% or more of total revenues reported in the financial statements:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| Customer A | 49% | 48% | 30% |
| Customer B | 12% | 13% | 17% |
| Customer C | 13% | 2% | 3% |

## NOTE 15:- EARNINGS (LOSS) PER SHARE

The following reflects the income (loss) and share data used in the basic and diluted earnings (loss) per share computations:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| | **U.S. dollars in thousands** | | |
| Income (loss) for the year | 350 | (678) | 72 |

| | **2011** | **2010** | **2009** |
|---|---|---|---|
| Weighted average number of Ordinary shares for computing basic earnings (loss) per share | 42,867 | 41,361 | 40,204 |
| Effect of dilution: | | | |
| Share options | 65 | - | 456 |
| Weighted average number of Ordinary shares adjusted for the effect of dilution | 42,932 | 41,361 | 40,660 |

There have been no significant transactions involving Ordinary shares or potential Ordinary shares between the balance sheet date and the date of approval of these financial statements.

Share options and warrants (see Note 10) were not included in the 2010 earnings (loss) per share calculation due to their antidilutive effect.

## NOTE 16:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| b. Compensation of key management personnel of the Company: | | | |
| Employee benefits *) | 1,281 | 1,200 | 1,300 |
| Share-based payments **) | 314 | 256 | 216 |
| | 1,595 | 1,456 | 1,516 |

*) Includes increase in long-term employee benefits due to change in provision for severance pay in a total amount of $ 37 thousand, $ 43 thousand and $ 150 thousand for the years ended December 31, 2011, 2010 and 2009, respectively.

Year 2011 and 2010 include the provision for sales bonus in a total of $ 10 thousand and $ 7 thousand to the VP of Business Development, respectively. Year 2009 includes the provision for sales bonus in a total of $ 75 thousand and $ 11 thousand to the CEO and to the VP of Business Development, respectively. It also includes the provision for the CEO severance pay in a total of $ 30 thousand due to the salary increase approved by the Company's Board of Directors on January 27, 2010 (see Note 16c).

**) Year 2011 includes share-based compensation in a total of $ 248 thousand and $ 45 thousand due the Share Bonus Plan as described under Note 10e, in respect to the CEO and senior management, respectively.
Year 2010 includes share-based compensation in a total of $ 163 thousand and $ 28 thousand due the Share Bonus Plan as described under Note 10c, in respect to the CEO and senior management, respectively.

**NOTE 16:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)**

c. Significant agreements with shareholders:

1. On September 21, 2006, the Company signed an agreement with Mr. Ami Vizer, the Chief Executive Officer of the Company, according to which Mr. Ami Vizer is engaged with a current salary of $ 313 thousand per annum (excluding bonuses and benefits), terminable by either party on nine months' notice. In addition, pursuant to this agreement, Mr. Vizer received options.

   On April 23, 2009, the Board of Directors approved the implementation of a one-year plan for salary reduction of 15% for senior management and other employees ("the Reduction Plan"). According to the Reduction Plan, Mr. Ami Vizer, in exchange for the reduction on salary, was granted 342,717 Ordinary shares of the Company with an equivalent fair value on date of grant of $ 0.15. The shares which have been issued and are being held by a trustee will vest in 12 equal monthly installments.

   On January 27, 2010, the Board of Directors approved an increase of 10% in his salary effective January 1, 2010.

   Total salary (excluding bonuses mentioned under Note 10e) of Mr. Ami Vizer during year 2011 amounted to an annual salary of $ 344 thousand. Related benefits include annual social benefits of $ 43 thousands (12.5% out of his annual salary), severance pay of $28 thousands, vacation days of $39 thousands and health insurance of $28 thousands. In addition, the Company has made a provision for family travel expense of $ 21 thousands and for tax consultancy services related to his agreement of $ 15 thousands.

2. On September 27, 2006, the Company signed an agreement with Mr. Simi Efrati, pursuant to which Mr. Efrati receives a fee of $ 122 thousand per annum for consulting services. The agreement may be terminated by either party on six months' written notice. In addition, pursuant to this agreement Mr. Efrati received options (see Note 10g). Prior to this agreement, Mr. Simi Efrati had been a Non-Executive director of the Company. The agreement was terminated effective February 1, 2010.

3. On September 27, 2006, the Company entered into an agreement with Mr. Rami Weitz, pursuant to which Mr. Weitz receives a fee of $ 122 thousand per annum in consideration of consulting services. The agreement may be terminated by either party by at least six months' written notice. In addition, pursuant to this agreement, Mr. Weitz received options. Prior to this agreement, Mr. Rami Weitz had been the Chairman of the Board of Directors of the Company.

## NOTE 17:- FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

Capital management:

The primary objective of the Company's capital management is to ensure that it maintains a strong credit rating and sufficient capital in order to support its business and maximize shareholder value.

The Company manages its capital structure and makes adjustments to it, in light of changes in economic conditions.

Financial risks factors:

The Company's activities expose it to various financial risks such as market risk (including foreign exchange risk), credit risk and liquidity risk.

a. Foreign exchange risk:

The Company operates in a number of countries and is exposed to foreign exchange risk resulting from the exposure to different currencies, mainly the NIS. As of December 31, 2011, balances in foreign currency are immaterial.

b. Credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term bank deposits, trade receivables, current maturities and long-term loan.

Cash and cash equivalents and short-term bank deposits are invested in major banks in Israel and the United States. Management believes that the financial institutions that hold investments of the Company and its subsidiaries are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The Company trades only with creditworthy customers. The Company performs ongoing credit evaluation of its customer's financial condition and requires collateral as deemed necessary.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

The Company has no significant concentrations of credit risk. The Company has a policy to ensure collection through sales of its products to wholesalers with an appropriate credit history and through retail sales in cash or by credit card.

**NOTE 17:- FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Cont.)**

Credit risk may arise from the exposure of holding several financial instruments with a single entity or from entering into transactions with several groups of debtors with similar economic characteristics whose ability to discharge their obligations will be similarly affected by changes in economic or other conditions. Factors that have the potential of creating concentrations of risks consist of the nature of the debtors' activities, such as their business sector, the geographical area of their operations and the financial strength of groups of borrowers.

The Company regularly monitors the credit extended to its customers and requires collateral as security for these receivables. The Company provides an allowance for doubtful accounts based on the factors that affect the credit risk of certain customers, past experience and other information.

The Company maintains cash and cash equivalents, and other financial instruments in various financial institutions. These financial institutions are located in different geographical areas around the world. The Company's policy is to diversify its investments among the various institutions. According to the Company's policy, the relative credit stability of the various financial institutions is evaluated on a regular basis.

As of December 31, 2011, cash and cash equivalents totaled $ 4,739 thousand.

c. Liquidity risk:

The Company is required to maintain cash, cash equivalents and trade receivables equal to at least 150% of the carrying amount of the loan (as described in Note 9c).

The table below presents the maturity profile of the Company's financial liabilities based on contractual undiscounted payments:

December 31, 2011:

| | Less than one year | 3 to 4 years | Total |
|---|---|---|---|
| | U.S. dollars in thousands | | |
| Current maturities | 188 | - | 188 |
| Government grants | 49 | 746 | 795 |
| Trade payables | 174 | - | 174 |
| Other accounts payable and accrued expenses | 697 | - | 697 |
| | 1,108 | 746 | 1,854 |

## NOTE 17:- FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Cont.)

December 31, 2010:

| | Less than one year | 3 to 4 years | Total |
|---|---|---|---|
| | U.S. dollars in thousands | | |
| Current maturities | 586 | - | 586 |
| Government grants | 33 | 460 | 493 |
| Trade payables | 205 | - | 205 |
| Other accounts payable and accrued expenses | 658 | - | 658 |
| | 1,482 | 460 | 1,942 |

d. Interest rate risk:

The Company has a loan which bears interest at a variable rate. The Company estimates that any reasonably possible changes in the interest rate in the coming year would not have a material effect on the profit of the Company.

## NOTE 18:- SUBSEQUENT EVENT

On March 1, 2012 the Company extended its lease agreement for its Premises occupied in Israel until December 31, 2014.

- - - - - - - - - - - - - - - - -

## SHARE INFORMATION

SimiGon is listed on the AIM. The shares of the Company are available through the Crest settlement system, enabling immediate, secured electronic trading and registration of shareholders' assets. Symbol: SIM Financial Year End: 31 December

## ADVISERS

### *Nominated Adviser and Broker*

finnCap
60 New Broad St
London, EC2M 1JJ

### *Registrar*

Computershare Investor Services (Jersey) Limited
Queensway House
Hilgrove Street
St Helier
Jersey
JE1 1ES

### *Auditors and Reporting Accountants*

Kost Forer Gabbay & Kasierer
A member of Ernst & Young Global
3 Aminadav Street
Tel Aviv 67067
Israel

### *Solicitor to the Company as to English law*

Halliwells LLP
1 Threadneedle Street
London
EC2R 8AW

### *Counsel of the Company as to Israeli law*

Amit, Pollak, Matalon & Co. Advocates and Notary
Nitsba Tower, 19th Floor, 17 Yitzhak Sadeh St.,
Tel Aviv 67775
Israel

## CONTACT INFORMATION

To request additional information about SimiGon and our products, please contact us by telephone, fax or e-mail:

### *SimiGon Ltd.*

1 Sapir St.
PO Box 12050
Herzliya, Israel 46733
Tel: +972-9-956-1777
Fax: +972-9-951-3566

### *SimiGon Inc.*

12001 Research Parkway
Suite 236
Orlando, FL, USA 32826-3009
Tel: +1 407 737-7722
Fax: +1 321 251-7692
For more information:
info@simigon.com

# WWW.SIMIGON.COM