

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**

**Periodic Report for 2010**

Contents

Chapter A – The Company's Business Environment

Chapter B – Board of Directors' Report on the Company's State Of Affairs

Chapter C – Financial Statements as at December 31, 2010

Chapter D – Additional Information on the Company

Chapter E – Effectiveness of the Internal Auditing on Financial Reporting and Disclosure

## Description of the Company's Business – Contents

### **Chapter A – The Company's Business Environment**

The Company's operations and business development	A – 1
The Company's fields of operation	A – 4
Investments in the Company's share capital	A – 4
Distribution of dividends	A – 12

### **Chapter B – Other information**

Financial information concerning the Company's areas of activity	A – 12
The economic environment and the impact of external factors on the Company's activities	A – 12

### **Chapter C – Description of the Company's business**

General information on the Company's area of activities	A – 15
The Company's products	A – 26
Income distribution of the product groups and the product profitability	A – 28
New products under development	A – 30
Customers and distributors	A – 32
Marketing and distribution	A – 36
Backlog orders	A – 38
Competitors and competition	A – 38
Production capacity	A – 40
Fixed assets, land and facilities	A – 41
Research and development	A – 41
The Company's intangible assets	A – 43

Human capital	A – 44
Raw materials and suppliers	A – 47
Working capital	A – 49
Investments	A – 50
Financing	A – 50
Taxation	A – 53
The environment	A – 54
Restrictions and supervision of the corporation	A – 54
Material agreements	A – 60
Cooperation agreements	A – 60
Legal proceedings	A – 60
Business goals and strategies	A – 60
Development expectations in the forthcoming year	A – 62
Exceptional changes in the Company's business	A – 60
Events or matters beyond the Company's regular business	A – 62
Financial information on geographical segments	A – 62
Risk factors	A – 62

## Chapter A – The Company’s Business Environment

### 1.1 The Company's operations and business development

#### 1.1.1 General

MCS was founded in Israel as a private company and registered on December 18, 1997. In May 2006, it completed its initial public offering and became a public company.

#### 1.1.2 Incorporation of the Company and its main operations

The Company was established by Mr. Adi Dagan (who serves as its CEO) (**Mr. Dagan**), Dr. Jacob Barak (who serves as its CTO and is the major force behind the concept that the Company’s technology is based on) (**Dr. Barak**), and Nissan Holdings (T.R) Ltd. (**Nissan**), for the purpose of research, development, production and marketing of non-invasive, non-drug solutions to enhance blood flow processes using a pneumatic device which applies pressure to the limbs by means of air compression. The technology developed by the Company reduces the risk of blood clot formation in traumatic events, surgery and vascular diseases.

The Company is currently involved in the development, production and marketing of devices and products which it developed in recent years, *inter alia* following its research. In 2002, the Company completed the development of a pneumatic device to prevent the formation of deep vein thrombosis (**DVT**) resulting from trauma or surgical intervention, called ActiveCare® DVT (**the first generation device**). In June 2006, the Company completed the development of its second generation device, the ActiveCare+SFT® (**the SFT device**).

The Company also focuses on furthering the research and development of other products, including a DVT detection device to treat fractures and ulcers (diabetic or venal), as described extensively below.

The principal advantage of the pneumatic device which the Company developed in the DVT prevention field, is the blood flow profile that it induces, and its minute size that enables users to carry it. The clinical trials conducted by the Company prove that the device induces especially efficient blood flow. These two devices allow the Company to provide effective protection against DVT during the patient’s entire risk period.

As at December 31, 2010, some 9,000 first generation devices manufactured by the Company were installed in medical centers, 5,600 of which in the US, with the rest in

Japan, Brazil and Israel. The Company sells its first generation devices (pump unit) as well as disposable sleeves (that apply pressure to the limb), which are adapted to the Company's devices and designed for single-patient treatment. For further information, see Section 1.9 of this report.

As at December 31, 2010, the Company has deployed 1,716 SFT devices in medical centers and with its sales agents (DME providers) in the US (through which patients released from hospital are treated using the STF devices). In 2010, some 6,800 treatments with the STF device were performed on hospitalized patients and 5,300 on out-patients for usage fees. For further information, see Section 1.9 of this report.

In June 2008, the Company completed a clinical trial, with the participation of 9 leading US orthopedic centers. As part of the trial, the efficacy and safety of the SFT device was compared to that of the leading drug in the field (Lovenox) produced by Sanofi-Aventis. The trial was conducted in the hip replacement surgery field, which is considered one of the fields where the risk of DVT is especially high. The trial was successfully completed, and the device and drug were found to have the same success rate in preventing DVT. Moreover, the device was proven to be even safer. Patients using it did not suffer from complications of substantial hemorrhaging, while 5.2% of those using the drug suffered from significant hemorrhaging (the drug used to prevent DVT is an anticoagulant and the hemorrhaging side-effects of treatment have been documented in medical literature and practice for decades) (**the multicenter trial**).

Following the success of the multicenter trial, the Company is focusing its operations on marketing SFT devices as an alternative to drug therapy, primarily in orthopedics. The first generation devices, which were marketed as complementary treatments to drug therapy at substantially lower prices than those of the SFT device, are no longer actively marketed, and the Company provides support only to the existing first generation device users. In 2009, the Company began relating to the SFT as a separate field of operations.

### 1.1.3 Principal milestones in the Company's operations

Details of the principal milestones in the Company's operations to date, as well as the key milestones for its future development which, in the Company's opinion, are essential for its success, are as follows:

- A. As noted in Section 1.1.2 above, in June 2006, the Company successfully completed the development of the SFT device. The Company has received all approvals required to commercially market the device, including FDA and CE Mark approval.
- B. In June 2008, the Company successfully completed its US multicenter trial, as discussed in Section 1.1.2 of this report.
- C. Upon completion of the multicenter trial, the Company signed SFT distribution agreements with leading orthopedic rehabilitation sales agents. Sales efforts are geared towards medical centers and private hospitals in the US.
- D. The Company is taking steps through its US subsidiary to expand its US SFT device marketing and distribution set-up, with the goal of marketing, distributing and providing support for the Company's products.
- E. During 2010, the Company expanded entry into US medical centers, which began using the SFT device as an alternative to the existing, customary post-surgical DVT prevention drug therapy.
- F. During 2010, the Company strengthened its presence in the US, *inter alia*, by expanding its sales and marketing array and accessing new medical centers.
- G. Patents - protecting its intellectual property rights, and registering patents for the technology and products developed by the Company is a vital component for its success. For information on the Company's registered patents, see Section 1.18 below.
- H. In January 2010, the Company announced that it received approval from the US Patent and Trademark Office (PTO) for a patent that covers the device and the method to enhance venal blood flow using external pressure on the limb by synchronizing the creation of pressure with the maximal natural blood flow of limb outwards.
- I. In March 2010, the leading US orthopedic journal, "Journal of Bone and Joint Surgery"<sup>1</sup>, published an article reviewing the clinical trial which the Company conducted to compare the SFT device with Lovenox, the market's leading drug therapy for DVT prevention. Based on the trial findings, the SFT device is preferable

---

<sup>1</sup> Method And Apparatus For Assisting Vascular Flow Through External Compression Synchronized With Venous Phasic Flow. Patent No.: US 7,637,879 B2 Patent Date: Dec. 29, 2009

to using this drug primarily because of its safety and capacity to prevent DVT without risk of significant hemorrhaging, a common side effect from using the drug, as discussed in Section 1.1.2. Publication in this leading journal is known to be highly important in providing a scientific and medical seal of approval for doctors to use the product and helps with its marketing.

#### 1.1.4 **Structure of the Company's holdings**

As at report date, the Company owns and controls (100%) Medical Compression System Inc. (**the subsidiary**), a US subsidiary consolidated in June 2001.

The subsidiary was founded to market and sell the Company's products in the US. At present, it is engaged in marketing and distributing SFT devices in the US, as well as marketing, distributing and providing support for sales of the first generation product to most US customers. As at report date, the subsidiary employs ten staff members and/or consultants who focus on marketing and selling the SFT product in the US.

#### 1.2 **The Company's fields of operation**

Since 2009, the Company operates in two fields. One is to provide support and selling the first generation device (**field of operation A**) and the other is manufacturing and marketing the SFT device (**field of operation B**).

The Company's existing technology is also used for the development of new products. For further information, see Section 1.10 of this report.

#### 1.3 **Investments in the Company's share capital**

Below are particulars of the Investments in the Company's share capital in the last two years, as well as all material transactions carried out by interested parties:

##### 1.3.1 **Signing a credit line agreement, and the allocation of securities to a financial institution - January 2009**

Under a credit line agreement dated January 2009, the Company allocated 1,165,380 options exercisable for 1,165,380 ordinary Company shares of NIS 0.01 par value each (which on allocation date comprised 4.99% of the Company's issued share capital and 3.82% fully diluted), to an Israeli financial institution. Provisions with respect to possible adjustments, including the distribution of a dividend or bonus shares, as well as provisions to protect the financial institution during the exercise period were set out in the option documents. For information on the allocation of options against the credit facility,

see section 1.23.4 of this report. On February 14, 2010, the financial institution converted 291,345 options into 231,151 ordinary Company shares of NIS 0.01 par value each.

### 1.3.2 Allocation to consultants - January 2009

In January 2009, the Company allocated options exercisable for 224,215 ordinary Company shares of NIS 0.01 par value each to consultants, under terms of their engagement, as part of an agreement under which the consultants provide the Company with fundraising services and related consultancy services. In February 2010, at the consultants' request, the Company's board of directors approved the transfer of these options to a third party, which to the best of the Company's knowledge, is not and did not become an interested party as a result of this transfer. On February 23, 2010, the third party converted the options into 224,214 ordinary Company shares of NIS 0.01 par value in consideration of USD 50 thousand.

### 1.3.3 June 2009 investment agreement with Accelmed

On August 3, 2009 the Company signed an investment agreement with A.M. Accelmed, a limited partnership that is registered in Israel (**Accelmed**) (which was approved by the Company's Audit Committee and Board of Directors on June 10, 2009 and by the general meeting on July 29, 2009), under which the Company allocated Accelmed 9,124,088 ordinary Company shares of NIS 0.01 par value each (which at the time of allocation comprised 28.08% of the Company's voting rights and issued and paid up share capital, and 21.82% fully diluted) in consideration of an investment of NIS 10 million (the allocation reflects a price of NIS 1.096 per share).

Concurrently, a shareholders' agreement was signed between Accelmed; Nissan; Aviv Ventures I, L.P and Aviv Parallel Fund I, L.P, (hereinafter together: **the Aviv Fund**); Mr. Dagan and Dr. Barak<sup>2</sup> (**the shareholders' agreement**) under which the parties will, *inter alia*, coordinate their voting with respect to appointing the Company's Board of Directors, such that the number of directors (excluding outside directors) and their identity will be as follows: (A) two directors at Nissan's recommendation; (B) two directors at Accelmed's recommendation; (C) one director at the Aviv Fund's recommendation and (D) one director at the joint recommendation of Mr. Dagan and Dr.

---

<sup>2</sup> Accelmed, Nissan and the Aviv Fund are controlling shareholders of the Company, and cumulatively hold approximately 57.13% of the Company's share capital, as at financial statement publication date.

Barak. A right of first refusal was also prescribed for the shareholders in the agreement. The shareholders' agreement cancelled any previous shareholders' agreements, and will remain in force either until a general meeting in which one or more directors recommended by any of the parties entitled to do so under the shareholders' agreement, will not be appointed, not as the result of a breach of the agreement by any of the parties thereto, or until the rate of holding of any of the parties in the Company's issued and paid up share capital falls below 5%, at which time the agreement will be cancelled in respect of the party whose share of the Company's issued and paid up share capital has fallen below 5%. In June 2010, following the off-exchange sale of shares by Mr. Dagan, his holdings in the Company dropped below 5% and thus he is no longer party to the shareholders' agreement. In addition, following the sale of Company shares by Mr. Dagan, Dr. Barak also ceased being party to the shareholders' agreement.

For additional details on the terms of the investment and the shareholders' agreements, see the immediate report on the exceptional private allocation, which the Company published on July 23, 2009 (Document Number 178056-01-2009).

#### 1.3.4 September 2009 allocation to Company directors

In September 2009, the Company allocated 120,000 options to four directors (30,000 each). The options can be converted into 120,000 ordinary shares of NIS 0.01 par value each. .

#### 1.3.5 October 2009 shelf offering memorandum

On October 28, 2009, the Company published a shelf offering memorandum under the shelf prospectus dated November 27, 2008, as part of which the Company made an offer in a uniform public offering of 850,000 units by way of a tender on the unit price, whereby each unit comprises four ordinary Company shares of NIS 0.01 par value each (at a price of NIS 2.35 per share) and one option (Series 1) (at no cost) exercisable for one ordinary Company share of NIS 0.01 par value each. In accordance with the results of the public offering, the Company allocated 801,343 units at a price of NIS 9.40 per unit, which comprised 3,205,372 ordinary Company shares of NIS 0.01 par value each and 801,343 of the Company's options (Series 1) for an overall consideration of NIS 7,533 thousand (gross).

#### 1.3.6 Allocation to consultants - October 2009

In October 2009, the Company allocated three options exercisable for a total of 456,204 ordinary Company shares of NIS 0.01 par value to three consultants under the terms of engagement with them, as part of an agreement whereby the consultants provide the Company with fundraising services for the Company as well as related consultancy services. In February 2010, at the request of two of the consultants, the Company's Board of Directors gave approval for two options relating to 205,292 ordinary shares each to be allocated to a private Company owned by the two consultants.

1.3.7 Allocation to the subsidiary's VP Marketing – October 2009

In October 2009, the Company allocated 150,000 options exercisable for a total of 150,000 ordinary Company shares of NIS 0.01 par value each to the subsidiary's VP Sales.

1.3.8 Allocation to the subsidiary's VP Sales – October 2009

In October 2009, the Company allocated 100,000 options exercisable for a total of 100,000 ordinary Company shares of NIS 0.01 par value each to the subsidiary's VP Marketing

1.3.9 Allocation to a Company employee – October 2009

In October 2009, the Company allocated 10,000 options exercisable for a total of 10,000 ordinary Company shares of NIS 0.01 par value each to a Company employee.

1.3.10 Allocation to the Company CFO – November 2009

In November 2009, the Company allocated 130,000 options exercisable for 130,000 ordinary Company shares of par value NIS 0.01 each to the Company CFO.

1.3.11 Allocation to a consultant – December 2009

In December 2009, the Company allocated 94,276 options (Series 1) exercisable for a total of 94,276 ordinary Company shares of NIS 0.01 par value each to Poalim I.B.I. Underwriting and Issues Ltd. as part of the consultancy and distribution fees with respect to the public offering under the shelf offering memorandum of October 2009.

1.3.12 Allocation to a consultant of the subsidiary – December 2009

In December 2009, the Company allocated 100,000 options exercisable for a total of 100,000 ordinary Company shares of NIS 0.01 par value each to a consultant of the subsidiary.

1.3.13 Allocation to a consultant of the subsidiary – December 2009

In December 2009, the Company allocated 130,000 options exercisable for a total of 130,000 ordinary Company shares of NIS 0.01 par value each to consultant of the subsidiary.

1.3.14 Allocation to a consultant – December 2009

In December 2009, the Company allocated 25,000 options exercisable for a total of 25,000 ordinary Company shares of NIS 0.01 par value each to a consultant of Company.

1.3.15 Allocation to the president of the subsidiary – March 2010

In December 2009, the Company allocated 350,000 options exercisable for 350,000 ordinary Company shares of NIS 0.01 par value each to the president of the subsidiary under the terms of engagement with him.

1.3.16 Allocation to a consultant – March 2010

In March 2010, the Company allocated 70,000 options exercisable for 70,000 ordinary Company shares of NIS 0.01 par value each to the subsidiary's consultant.

1.3.17 Allocation to the Company's Chairman of the Board – March 2010

The terms of Mr. Eitan Nahun's tenure as the Company's Chairman of the Board and consultant were approved by the Audit Committee on March 7, 2010 and by the Company Board of Directors on March 8, 2010 and June 13, 2010, including the allocation of 350,000 options exercisable for 350,000 ordinary Company shares of NIS 0.01 par value each. The terms of his tenure, including the allocation of options, were approved by the general meeting held on July 26, 2010.

1.3.18 Allocation to the VP Commercial Operations – May 2010

In May 2010, the Company allocated 350,000 options exercisable for 350,000 ordinary Company shares of NIS 0.01 par value each to the VP Commercial Operations.

1.3.19 Off-exchange sale of Company shares by the Company CEO – June 2010

In June 2010, the Company CEO, Mr. Dagan, sold 199,999 ordinary Company shares of NIS 0.01 par value each off-exchange.

1.3.20 Allocation to the Company VP – June 2010

On June 20, 2010, the Company Board of Directors approved the terms of Mr. Dagan's tenure as Company CEO and as consultant after the end of the tenure, including the allocation of 420,000 options exercisable for 420,000 ordinary Company shares of NIS 0.01 par value each.

1.3.21 Allocation to the Company CTO – June 2010

On July 20, 2010, the Company Board of Directors approved allocating 350,000 options exercisable for 350,000 ordinary Company shares of NIS 0.01 par value each to the Company CTO, Dr. Barak.

1.3.22 Shelf offering memorandum of July 2010

On July 14, 2010, the Company published a shelf offering memorandum as part of which it offered its shareholders between 1,507,606 and 1,657,216 ordinary Company shares of NIS 0.01 par value each, by means of rights to them, whereby each holder of 24 ordinary Company shares was entitled to acquire one unit of rights consisting of one ordinary Company share of NIS 0.01 par value at an exercise price of NIS 3. Based on the results of the rights offering, exercise notices of a total of 1,258,104 rights to acquire 1,258,104 ordinary Company shares of NIS 0.01 par value each were received for a total consideration of NIS 3,774 thousand (gross).

1.3.23 Signing of a credit line agreement and allocation of securities to a financial institution of September 2010

Based on a credit line agreement dated September 2010, the Company undertook to allocate options to an Israeli financial institution to acquire 183,000 options exercisable during a period of six years from their allocation date for 183,000 ordinary Company shares of NIS 0.01 par value each (which at the allocation date comprised 0.49% of the Company's issued share capital and 0.42% fully diluted) at an exercise price of NIS 3.1 per share, if the Company exercises the credit line and pro rata to utilization of the credit line. On December 29, 2010, the Company utilized the credit line in full and allocated 183,000 to the banking institution accordingly. For information concerning the allocation of options against the credit facility, see Section 1.23.10 of this report.

1.3.24 Signing of an investment agreement with the Company's controlling shareholders, Accelmed and Nissan – October 2010

On October 20, 2010, the general meeting approved an immaterial private allocation to the Company's controlling shareholders, Accelmed and Nissan, which was approved by the Audit Committee on August 12, 2010 and by the Board of Directors on September 6, 2010. Under the investment agreement 400,000 ordinary Company shares of NIS 0.01 par value each were allocated (which at the time of allocation comprised 1.06% of the

Company's voting rights and the issued and paid-up capital) for a total consideration of NIS 1.2 million, which reflects a price of NIS 3 per share.

1.3.25 Signing of a private investment agreement – October 2010

On October 11, 2010, the Company Board of Directors approved an immaterial private allocation of 606,061 ordinary Company shares of NIS 0.01 par value each (which on the allocation date comprised 1.59% of the Company's voting rights and issued and paid-up capital and 1.37% fully diluted) to an offeree that is not a controlling shareholder or interested party in the Company in consideration for a total of NIS 2 million, which reflects a price per share of NIS 3.3.

1.3.26 Off-exchange sale of Company shares by the Company CEO – December 2010

On December 2, 2010, the Company CEO, Mr. Dagan, sold 500,000 ordinary Company shares of NIS 0.01 par value each off-exchange.

1.3.27 Allocation to the Company CFO – December 2010

In December 2010, the Company allocated 70,000 options to the Company CFO, Mr. Uri Mor, which are exercisable for 70,000 ordinary Company shares of NIS 0.01 par value each.

1.3.28 Allocation to Company employees and an officer – January 2011

On January 27, 2011, the Company Board of Directors approved an insignificant private allocation of 144,000 options exercisable for 144,000 ordinary Company shares of NIS 0.01 par value each, of which 109,000 to 13 of the Company's Israeli employees (including one offeree who is not an officer in the Company for whom the transaction is not extraordinary) and 35,000 options to an American employee of the subsidiary.

1.3.29 On March 24, 2011, the Company Board of directors approved an insignificant private allocation of 1,046,667 ordinary Company shares of NIS 0.01 par value each to several offerees that are not controlling shareholders or interested parties in the Company, except for Yelin Lapidot -- Mutual Funds Management Ltd. which is an interested party in the Company by virtue of holdings, in consideration of a NIS 3,925 thousand, which reflects a price per share of NIS 3.75.

1.3.30 Exercise of employees', directors' and officers' options

In 2010, the Company allocated 1,960,000 options exercisable for 1,960,000 ordinary Company shares of NIS 0.01 par value each.

During 2010, 241,135 options were exercised for 241,135 ordinary Company shares of NIS 0.01 par value each.

On December 31, 2010, following the exercise and expiry of some of the options, 3,447,052 (non-marketable), 3,447,052 options are held by former and present Company employees, consultants and directors, which are exercisable for 1,960,000 ordinary Company shares of NIS 0.01 par value each, which comprise 7.68% of the Company's capital, assuming full dilution.

For information with respect to the options allocated by the Company to officers and interested parties, see Regulations 21 and 22 in Chapter D of this report.

#### **1.4 Distribution of dividends**

The Company has not declared or distributed a cash dividend to its shareholders during the course of the past two years. With respect to the Company's undertaking to the bank to avoid distributing dividends, see section 1.23 of this report.

The Company's Board of Directors has not adopted a dividend distribution policy.

#### **1.5 Financial information concerning the Company's fields of operation**

Below are financial data in respect of the Company's fields of operation, in USD thousands:

##### **Field of operation A – the first generation device**

<b><u>Period</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
<b>Income</b>	3,849	3,074
<b>Costs</b>	3,300	2,905
<b>Operating profit</b>	549	169
<b>Total assets</b>	2,670	4,754

**Field of operation B – the SFT device**

<b><u>Period</u></b>	<b>2010</b>	<b>2009</b>
<b>Income</b>	1,877	253
<b>Costs</b>	5,086	2,143
<b>Operating loss</b>	(3,209)	(1,891)
<b>Total assets</b>	8,130	4,952

The Company does not have significant revenues from other operations and/or investee companies that are not in the field of operation, and therefore, the above figures reflect the Company's consolidated balance sheet and statement of income.

For explanations of the changes that have occurred in the Company's financial data, see the Board of Directors' report, attached as Chapter B of this report.

**1.6 The economic environment and the impact of external factors on the Company's activities**

Below are details of the trends, events and developments in the Company's macroeconomic environment, which have had or may have a significant impact on the Company's operating results in its fields of operation:

- 1.6.1 Exchange rate changes: The Company is exposed to changes in the exchange rate of the US Dollar against other currencies (primarily NIS). Most of the Company's sales are denoted in USD, whereas some of its expenses are incurred in other currencies (primarily in NIS and also to a lesser extent in Euro). Since there is no full overlap between the currencies in which the Company produces its revenues and those in which it incurs its expenses, a change in the exchange rates could affect the Company's profitability. Moreover, a considerable portion of the Company's financial liabilities are denoted in NIS. The Company partially hedges this exposure by investing a considerable portion of its cash balances in NIS denoted investments and forward transaction hedging of the USD rate (future USD sales and NIS purchases). There was no significant change in the USD/NIS exchange rate at the end of 2010 compared to that of 2009 and its fluctuations did not materially impact the Company's profitability.

1.6.2 Interest rate fluctuations: The Company has liabilities to banks for USD loans that are dependent on the Libor rate. As a result thereof, changes in the Libor interest rate affect the Company's financing expenses.

1.6.3 The global financial crisis: In 2008 and 2009, a financial crisis broke out in the global markets. Due to this crisis, several extremely large banks in the US and other countries collapsed, bringing about substantial reductions and fluctuations in the prices of securities in Israel and worldwide, as well as a credit crisis. Following these events, several countries took various steps to stabilize and prevent financial market fluctuations, including the injection of funds into financial institutions, fiscal expansion and decreasing of interest rates. Along with the above global financial crisis, several other developments occurred in the Israeli economy, including *inter alia*, material fluctuations in the exchange rates of principal foreign currencies versus the NIS and a rise of the inflation rate in the local economy. Therefore, there is uncertainty in the macroeconomic environment where the Company operates. Nevertheless, relatively speaking, the Israeli economy displayed real power.

The Company is unable to evaluate the impact of the credit crisis on the Company, the state of its business, the results of its operations, its financial position, its liquidity and its financial stability, as detailed below. Despite the above, if the global financial crisis spreads to the Israeli economy as well, this could have a significant impact on the Company's operations, results and financial situation, as the result of a possible decline in its revenues, and could also make it difficult for the Company to raise additional financing, in so far as any is required for the continuation of its future operations.

1.6.4 Regulatory requirements: The medical equipment industry is characterized by an environment that is subject to stringent regulatory requirements. The various products and manufacturers must comply with standards and permits for the use and application. Therefore, a considerable portion of the Company's investment in the research and development of its products is used to receive the approvals required to be able to sell them in markets which are subject to regulatory supervision (primarily in the USA). The stringent regulation adds time to the development and launching procedures of the various products in the medical equipment industry, increases the operating and

production expenses and adds a significant cost component to receive and maintain the approvals.

Nevertheless, in the Company's opinion, the experience accumulated to date by the Company in obtaining the regulatory approvals for the existing product and the fact that the planned new products are based on the technology used to develop the existing product, may help the Company in the procedures involved in obtaining regulatory approvals for the planned new products and may even lead to shortening the time required to receive them. With respect to the Company's activities concerning compliance with the said regulatory requirements, see section 1.26 of this report.

1.6.5 Time required for development and introduction of products based on the Company's technology into the market and the costs involved:

The average time required to develop the Company's products and receive the various regulatory permits in the Company's field of operation is approximately two to three years. Thereafter, another period of approximately three years is required to introduce the Company's products into the market, *inter alia*, by conducting clinical trials to prove the advantages of the product over the existing ones. Due the long time period from starting the development of the Company's products until they are introduced into the market (approximately six years), the Company is exposed to the risk that by the end of this process, an alternative product similar to the Company's will be found in the market, which could harm its profitability considerably.

1.6.6 Strikes at the airport: A vast majority of the Company's sales are exported by air transport. Extended strikes and/or sanctions at the airports in Israel and/or across the globe could cause significant delays in supplying the products manufactured in Israel, resulting in higher costs associated with alternative, more expensive means of shipment, and in extreme cases could even lead to loss of customers. Moreover, extended strikes and/or sanctions at airports could cause difficulties in receiving raw materials, which could lead to significant slowdown in product production in Israel. Nevertheless, in the light of the Company's capacity to make arrangements to manufacture the products overseas in a relatively short time period without incurring any significant additional cost, this factor is not a long-term risk factor for the Company.

The information above with respect to the economic environment and external factors affecting the Company's operations is based on the Company's subjective evaluations, considering past experience. This information described above is an evaluation only and is possibly incomplete. However, in the Company's opinion, it provides a general picture, even if not accurate, concerning the nature of its business operations. In view of the above, the actual results could be different from the evaluations published in the Company's report with respect to the external factors affecting its operations.

## **1.7 General information on the Company's field of operation**

### **1.7.1 General**

As aforesaid, as from 2009, the Company has been operating in two fields of operation, one of which is selling and supporting the first generation devices and the other is the production and marketing of the SFT device. As long as not indicated otherwise, that set forth below in this section 1.7 applies to both of the Company's above fields of operation. The first generation device competes with other deep vein thrombosis (**DVT**) prevention devices in the market as a supplementary treatment to drug therapy. The SFT device, as has been proved in the US multicenter trial, is an alternative to the customary drug therapy (see section 1.7.5). The Company's products constitute preventative treatment against the formation of DVT.

The Company's products are based on technology which it developed to enhance the blood flow by means of a pneumatic device that applies pressure to the limbs.

In August 2003, the Company began marketing the first generation device in the USA and is currently focusing on marketing the SFT device there. The devices are the first of their kind and unique in the medical market, because of the blood flow profile that they induce, their small size and because they are portable and enable full mobility during treatment. See section 1.8 of this report for details of the characteristics of the devices.

DVT prevention is a routine procedure in most surgical operations (except for children), and this is generally the Company's target market. In particular, the Company is focusing immediately on orthopedics, which is the area with the highest risk of developing DVT. In the Company's opinion, the target market is not affected by genetic characteristics and/or sex of the patient.

1.7.2 General information about DVT and the DVT medical product market

There are two types of blood clots in the body's vascular system. The first type is formed in and typical of the venous system, and among its most common causes is a swift slowdown in the blood flow (for example during surgery or in the absence of physical activity). Most cases where this type of clot is formed originate in the lower limbs and are called DVT. One of the immediate risks associated with this type of blood clot is that they can be swept into the lungs, which is a real life-threatening event for the patient. The Company's products are designed to prevent this type of blood clots. The second type of blood clot is formed and characterized by their location in the artery system and generally the causes do not include a slowdown in the blood flow. The Company's product is not designed to prevent the second type of blood clots (known as arterial thrombosis).

1.7.3 DVT formation has a number of possible serious implications

- A. Death – This is caused as the result of the blood clots being swept into the lungs (a phenomena called a pulmonary embolism – PE), and resulting in labored breathing. Pulmonary embolisms can cause immediate death.
- B. Disease – Thrombosis damages the venous system in the lower limbs making it more difficult for blood to flow and, as a result, damaging the veins. Over time, the venous system suffers from various diseases, which can range from esthetic faults and may include blocked veins and wounds that are difficult to heal.
- C. Costs – The costs incurred for treating DVT are estimated at some USD 10,000 per patient, and for treating pulmonary embolism, they can reach USD 20,000 per patient (according to the US medical treatment cost evaluation committee, which was appointed by the Agency for Healthcare Research and Quality [AHRQ])<sup>3</sup>.

1.7.4 DVT is caused by three main factors:

- A. Internal damage to the vein wall.
- B. Changes in the clotting system - The human body has two clotting systems:
  1. The blood clotting system – the system responsible for the transformation of blood from a liquid state to a solid state to block bleeding from injured veins and arteries.

---

<sup>3</sup> The figures are taken from Maynard G, Stein J. Preventing Hospital-Acquired Venous Thromboembolism: A Guide for Effective Quality Improvement. AHRQ Publication No. 08-0075, August 2008. <http://www.ahrq.gov/qual/vtguide/vtguideapa.htm>

2. The fibrinolytic system – the system responsible for regulating the absorption of blood clots and/or preventing their formation.

These two systems work in delicate balance by regulating the quantities of chemical components in the blood system.

- C. Stagnancy in the blood flow – blood is a very dense liquid and as such can change into a solid state relatively easily. It is kept in a liquid state by being moved around the venous system. The speed of blood flow in the venous system is directly linked to the functioning of the fibrinolytic system. If there is increased friction on the walls of the venous system, they discharge fibrinolytes into the blood system.

All of the above three factors that can lead to DVT occur in the event of a traumatic injury or when a surgical procedure is performed. DVT resulting from surgical intervention and traumatic events is commonplace and ranges between 20% and 70%, based on the nature of the surgical procedure or trauma. In addition, for various reasons, part of the population is at permanent risk of DVT not resulting from surgical intervention and/or traumatic events. At this stage, the Company does not designate its devices for DVT prevention among this at-risk population, but rather focuses on preventing DVT factors resulting from surgical procedures or trauma.

Preventative treatment may be carried out for all of the above three factors causing DVT, and thus the various products focus on the DVT prevention market.

Due to the above risks stemming from the formation of DVT, DVT prevention has become standard treatment in hospitals across the globe (Gold Standard) for patients at risk

1.7.5 Preventative treatments for DVT include the following two methods:

- A. Drug therapy – The use of drugs is intended to regulate the manifestation of blood clots and reduce the risks involved by stemming the body's natural clotting mechanism. Drug therapy is used as treatment for two types of clotting in the body's blood system (to prevent both DVT as well as arterial blood clots). The main disadvantage of using drugs is the risk of complications resulting from severe and local hemorrhaging. The use of drugs also affects all of the body's organs and induces side effects such that a minor injuries that could have been healed by the body naturally may develop into severe hemorrhaging, which can often lead to the need for

new surgical procedures, blood transfusions and in extreme cases even death. Furthermore, some patients are allergic to some of the drug ingredients and the drugs also have negative side effects, primarily in adults. Another disadvantage of using drugs is the risk of hemorrhaging when used in parallel with pain killers administered intravenously or epidurally. As a result, there are also restrictions on using local anesthetics and so patient must be submitted to full anaesthetization, which increases the risks of DVT and lengthens the surgery and recovery times. Reducing the use of pain killers after surgery also slightly reduces recovery time and increases the pain felt by the patient.

Moreover, there is a financial disadvantage stemming from the high cost of using drugs, which the Company estimates at more than USD 50 a day for an inpatient, and over USD 30 per day for an outpatient (in the USA). It should be noted that cheaper drugs are available, but these are less effective and using them increases the frequency of DVT cases relative to the leading drugs. Therefore, this significantly increases the overall cost of treatment per patient (in some cases high additional costs are incurred from treating a larger number of patients suffering from DVT)<sup>4</sup>.

- B. Mechanical treatment – which is carried out using pneumatic devices (Intermittent Pneumatic Compression Devices [IPCs]) (the IPC devices) and elastic stockings (Elastic Socks – ES). The IPC devices include an inflatable sleeve placed over the limb and a pump that intermittently inflates the sleeve. Inflating the sleeve creates external pressure on the limb, which leads to compression of the blood in the veins, prevents blood flow stagnation and contributes to the continued operation of the fibrinolytic system. Unlike the Company’s devices, the pump in the IPC devices is fixed, cumbersome and requires an external power source. The sleeves are also clumsy and require a large amount of air to create pressure, and as a result they generate heat and cause the patient to sweat.

---

<sup>4</sup> Source of the information: Chest 2001; 141S-145S, Chest 2001; 119:132S-175S. D. Bergqvist, B. Lindgren and T. Matzsch. Comparison of the cost of preventing postoperative deep vein thrombosis with either unfractionated or Low Molecular Weight Heparin. British Journal of Surgery 1996, 83, 1548-1552. M.F. Botteman. Results of an Economic Model to Assess the Cost-Effectiveness of Enoxaparin, a Low-Molecular-Weight Heparin, Versus Warfarin for the Prophylaxis of Deep Vein Thrombosis and Associated Long-Term Complications in total Hip Replacements Surgery in the US. Clinical Therapeutics/ Vol.24, No. 11, 2002 p. 1960.

The elastic stockings create fixed pressure on the leg and veins. This pressure prevents expansion of the vein and thus helps maintain the blood flow profile. However, the socks do not actively induce blood flow. A great deal of research has shown that the elastic stockings are a relatively low factor affecting the chemical composition of the blood and preventing DVT. Therefore, the IPC devices and the elastic stockings on the market are not an alternative to drug therapy, but are rather used simultaneously in accordance with the Gold Standard in the USA alone (in the rest of the world, in most cases, it is customary to employ either drug therapy alone or drug therapy together with elastic stockings).

The main disadvantage of the mechanical methods described above compared to the Company's devices stems from the low response rate<sup>5</sup> of the patients using them and the sub-optimal blood flow profile that they induce. The size, the weight and the dependency on a power source restrict the use of the devices, so they can only be used when the patients are in bed. It should be noted that breaks in treatment using the device explicitly contradict the existing recommendations for the treatment of DVT. Three leading research in the field have proven that the response of the device users, the treatment length and the blood flow profile induced are directly linked to the device's capacity to prevent DVT<sup>6</sup>. Consequently, when there are faults in these factors, the effectiveness of treating the patient is compromised.

#### 1.7.6 The use of drugs and devices does not entirely prevent DVT

In orthopedics, drugs have been proven to reduce the risk of DVT cases by 44% - 70%<sup>7</sup> and devices have achieved less or at best slightly less impressive results than those of drugs. Therefore, the existing Gold Standard relies on drug therapy with the possibility of adding treatment with IPCs and/or elastic stockings.

---

<sup>5</sup> Response rate is taken as meaning the length of the continuous treatment of patients using the device.

<sup>6</sup> See footnote no. 6 of this report.

<sup>7</sup> The figures are taken from Westrich GH, Sculco TP. Prophylaxis against deep venous thrombosis after total knee arthroplasty. Pneumatic plantar compression and aspirin compared with aspirin alone. *Journal of Bone and Joint Surgery* 78(6), 826-834 1996. Daniel Clarke-Pearson. Prevention of Postoperative Venous Thromboembolism by External Pneumatic Calf Compression in Panties with Gynecologic Malignancy. *Obstetrics & Gynecology* vol. 63, 92-98 1984. Daniel Clarke-Pearson. Perioperative External Pneumatic Calf Compression as Thromboembolism Prophylaxis in Gynecologic Oncology: Report of a Randomized Controlled Trial. *Gynecologic Oncology* vol. 18, 226-232 1984.

At the report date, the standard practice of DVT prevention in hospitals across the globe is as follows:

In the USA: using drugs throughout the patient's entire high-risk period (when the patient is hospitalized and for around one week after being released) and also using a device and/or elastic stockings during hospitalization.

Following the successful conclusion of the Company's multicenter clinical trial conducted in the USA and its marketing efforts there, in the subsequent years, the Company has started receiving orders for the SFT product for use as an alternative to drug therapy, as described in section 1.1.2 and 1.7.11 of this report.

In the rest of the world: using drugs alone during the high-risk period with or without elastic stockings.

The difference between the practices stems from the level of strictness about the quality of medical care in the USA (*inter alia*, due to the high risk of legal action in the USA). In financial terms, the use of DVT prevention drugs globally is estimated at approximately USD 4 billion per annum, half of which is used for surgical patients and the mechanical market (including the elastic stocking market of USD 100 million per annum), which is estimated at approximately USD 300 million per annum (or approximately one tenth of the drug market)<sup>8</sup>.

1.7.7 As at report, and to the best of the Company's knowledge, its SFT device is the only therapy that allows continuous patient treatment to enhance the blood flow in the legs both in hospital and at the patient's home. It is also the only treatment that is proven, from the research perspective, as an equivalent alternative in terms of efficiency and preferential in terms of safety compared to drug therapy in hospitals and after patient release (in the case of patients who have undergone hip replacement surgery).

#### 1.7.8 Regulation

The DVT prevention product market is subject to stringent regulation (standardization) primarily with respect to drugs. The regulation is relatively stricter in the USA (by the FDA), the European Union (by the EMA) to obtain a CE Mark (a permit to market the product in Europe), Israel (the Ministry of Health) and South Korea (by the KFDA). The

---

<sup>8</sup> The figures are taken from: Treatment Algorithms 2001: venous thromboembolism prophylaxis, Datamonitor (published 10/2001). The Market for new anticoagulant therapies, Kalorama information, a division of MarketResearch.com, 2004.

strict regulatory requirements vary from country to country and it is not necessarily true that if one country approves the product, so will another. However, receiving approval from one of the countries which are considered stricter (for example the USA or the EU) generally makes it easier to obtain regulatory approvals in other countries. Moreover, approval from the EMA applies in all its member states. The regulations in the different countries and the need to obtain the various approvals involve substantial expenses, *inter alia*, because of the relatively long period required to obtain the approvals as well as the need to appoint local representatives and employ skilled staff. However, in countries with lenient regulatory requirement, time required is relatively shorter (for further details, see section 1.26 of this report).

#### 1.7.9 Technological changes that may significantly impact the fields of operation

As aforesaid, as at report date, and to the best of the Company's knowledge, the medical DVT prevention market is controlled by drugs as a requisite means of treatment, while in parallel to the drugs IPC devices and/or elastic stockings are used voluntarily. Technological changes, such as the first generation device, may significantly impact the medical market in this sector, whether by increasing the market share of the device at the expense of stationary machines, which require the patient to stay in bed, or at the expenses of the existing drugs.

To the best of the Company's knowledge, its competitors are working to improve the standard of their devices that compete with the first generation device, primarily to improve the mobility of the device users. Technological success of the competitors in this field could negatively impact the competitive advantage of the first generation device. As at the time of this report, the Company is not aware of the marketing of a device with the advantages of full portability and/or medical efficiency of the first generation device.

The SFT device is an alternative to drug therapy and as such competes with the alternative drug therapies on the market. The SFT device's relative advantage lies in allowing optimal blood flow synchronization. Success of competitors in developing similar capacities could impair the SFT device's competitive advantage. As at report date, to the best of the Company's knowledge, there are no advanced developments on the part of its competitors which allow this synchronization capacity.

In the Company's opinion, the following factors could reduce the risk of technological change on the part of the competitors in relation to both of the Company's devices: A) the patents registered in the Company's name (even though they cannot prevent competitors from developing other technologies not covered by the patent); B) the extended time needed to develop a new medical product and introduce it into the market (about two to three years from the beginning of development until regulatory marketing approvals are obtained and approximately another three years to introduce it into the market).

1.7.10 Insurance coverage for DVT prevention

A key factor to the success of a medical product is its recognition as medical therapy for the purposes of insurance coverage and/or inclusion in a basket of drugs.

In practice, since DVT prevention has been the generally accepted global practice during surgery in hospitals for a long time, this subject is routinely budgeted by the hospitals and in effect insurance financing for all matters linked to DVT prevention already exists. Therefore, the Company is actually competing for an existing budget, which is currently directed towards purchasing drugs, IPC devices and elastic stockings, as aforesaid. The Company is not required to carry out any further actions to create insurance coverage for use of the first generation devices in the various hospitals or the SFT device in hospitals. In the light of the expansion of the Company's operations and marketing the SFT device to private users outside the hospitals, the Company must expand the insurance coverage to include use outside hospitals as well. At present, some of the private insurance companies cover use of the SFT device outside hospitals<sup>9</sup>. However, the government insurance company, Medicare, which is responsible for insuring some 50% of the patients, does not yet recognize coverage of this expense. The Company is working to expand the existing coverage so it will be provided by other insurance companies and Medicare as well.

1.7.11 Critical success factors

The following factors, among others, are critical for the Company's success in its fields of operation (see also section 1.1.2 of this report):

1.7.11 Clinical trials for continued marketing support of the products

---

<sup>9</sup> There are practically no mechanical devices for DVT prevention outside the hospital and most of the insurance companies do not approve using these machines for DVT prevention, but rather for other fields (primarily for vein and lymphatic system diseases).

Over and above the trials that were conducted with the aim of proving the various clinical applications of the Company's products, the Company also intends to continue supporting clinical trials also while marketing its products and services. For information in this matter, see section 1.17 of this report. The findings of the clinical trials and their publication in the professional literature and the leading scientific periodicals are critical for the Company's capacity to convince the medical community of the quality and efficiency of its products and their capacity to constitute alternatives to the existing drug therapy and significantly increase the target market which the Company's devices are aimed at, which is to approach the drug therapy market as well.

The research findings are also important in proving the efficiency of the Company's products over other DVT prevention devices, which could improve the Company's competitive edge in the global device market.

A precondition for the conducting trials by the Company is receiving prior approval from the entities authorized to approve medical trials on humans. The trials must comply with the principles of the Helsinki Declaration (for information about the Helsinki Declaration, see section 1.26.6 of this report), receive the approval of the ethics committee of the hospital where the trials are to be conducted, and work according to the hospital's rules.

It should be noted that, although the clinic trials is funded by the Company ordering them, they are carried out by professional third parties who are committed to publicizing the findings of their research, even if they do not meet the expectations of the Company that ordered them.

#### 1.7.11 Marketing, creating a market and customer relations

Based on currently accepted medical practice worldwide, the customary DVT prevention treatment is drug therapy using anti-coagulant drugs. Therefore, marketing the SFT product as an alternative to drug therapy involves convincing customers that the product is an alternative therapy, as aforesaid. The Company believes that the positive results achieved in the multicenter trials and the Company's success in introducing use of SFT product to leading US medical centers is of central importance in assimilating the product.

The Company also worked to expand its marketing and distribution array and today it is based on the Company's sales staff and an line-up of leading independent distributors in

the field of orthopedics who have been trained by the Company, in order to increase the awareness of and the demand for the Company's products and also to ensure their availability to the various users.

As part of the above, the Company's central goal is introducing its products into the US market, the leading and largest DVT prevention market, because for the most part the global market acts according to the generally accepted medical practice in this market.

1.7.11 Innovation and development of new products

As aforesaid, the Company has developed the SFT device, which is an innovative product with proven advantages over other devices and drugs for the same purpose (DVT prevention). The Company sees the innovation factor as one of the central keys to introducing its products into the market and a condition for its success. Thus, it is perpetually strives to develop new products to provide solutions for a variety of medical complaints in various fields based on the unique technology that it has developed, including its diagnostic product which is designed to identify the development of DVT. For further information, see section 1.10 of this report.

1.7.11 Protecting intellectual property rights

The Company owns unique intellectual property that is protected by registration of patents, as described in section 1.18 of this report, which integrate potential developments and the development of materials and manufacturing processes, providing it with a relative advantage over the competitors in its fields of operation.

1.7.11 Stringency about quality

The Company invests resources and funds in perpetually improving the quality of its products and positioning itself as a Company with a top-quality, cutting-edge line of products. The Company operates according to the international quality standards relevant to its field of operation, such as FDA, CE, KFDA and ISO 13485. In addition, its products are developed and produced in accordance with additional relevant international standards in the area of the product safety, quality, reliability, transport and so on.

The Company develops and manufactures its products using controlled processes with full cooperation, coordination and control over all the QA activities carried out inside the Company as well as by its suppliers and subcontractors. The Company is also in constant

contact with its customers to examine their needs, and expectations, and to receive feedback so as to improve the quality of the products and processes.

1.7.11 Completion of new products development

Another success factor for the Company's growth is developing additional products based on the Company's technology. As at report date, the Company is focusing on developing the diagnostic product as well as other products to treat fractures and ulcers (diabetic or venous), see section 1.10 of this report.

1.7.11 Regulation, licensing and permits

The Company is committed to comply with regulations and obtain the permits and licenses necessary to manufacture, market and use its products. For information of the permits and licenses which the Company is committed to, see section 1.26 of this report.

1.7.12 Entry barriers

In the Company's assessment, the factors described as follows are entry barriers for the Company's field of operation: (1) the development of intellectual property that is relevant to the production of competing products; (2) the existence of know-how and expertise in the medical and technological fields; (3) the relatively long period of time required to develop and introduce the products into the medical market (approximately 6 years); and (4) the need for suitable marketing and distribution channels to handle institutional entities that can compete with large companies operating in the DVT prevention field.

For additional information of the competition in the Company's field of operation and the risk factors relevant to the Company's operations, see sections 1.14 and 1.35 of this report.

1.7.13 Significant developments and changes in the fields of operation

For information about significant developments and changes in the fields of operation, see sections 1.1.2 and 1.1.3 of this report.

**1.8 The Company's products**

The Company's products are as follows:

1.8.1 First generation device used as complementary treatment for the generally accepted drug therapy

The device is marketed in the USA under the ActiveCare<sup>®</sup> DVT trademark, and in Israel and Japan under the WizAir<sup>®</sup> trademark. As at report date, the Company is not actively marketing the product, but rather supporting the medical centers using it.

#### 1.8.2 The SFT Device used as an alternative to drug therapy

The SFT device is innovative in the medical market compared to the competing devices, because of the blood flow profile induced when it is used, while maintaining the special advantages of the Company's devices by being small in size (palm-sized), portable (allowing the user full mobility while using it), and battery operated.

Based on these unique characteristics, the SFT device enables providing continual medical treatment without the patient being forced to stay in bed or be hospitalized at a medical center, while creating an optimal blood flow profile. To the best of the Company's knowledge, its competitors have not yet been able to commercially market devices capable of providing the advantages of full portability, creating a similar blood flow profile and the clinical efficiency of its SFT product.

The device allows preventing hemorrhaging complications caused by drug therapy as well as the low treatment response problems of the other devices on the market, in and out of hospital. In view of the capacity to prevent the hemorrhaging complications by using the SFT device allows administering painkillers intravenously simultaneously to the treatment without the risk of hemorrhaging. This reduces the risk of death and morbidity and the associated costs, and increases the speed of the patient's recovery, especially in orthopedic procedures.

Based on the findings of the clinical research conducted to date in Israel and in the USA, the SFT device is, to the best of the Company's knowledge and understanding, the best DVT prevention solution<sup>10</sup> in patients who undergo hip replacement surgery.

Research conducted at Cleveland Clinic in the USA, which compared standard drug therapy in conjunction with the first generation device to standard drug therapy with another device (which was not the Company's) shows that treatment with the Company's

---

<sup>10</sup> The Company's knowledge and understanding is based, *inter alia*, on research that was published in Killewich, LA, Prophylaxis in trauma, improved compliance with a novel miniaturized compression device, Journal of vascular surgery, Nov 2003. Kahn, M, DVT Prophylaxis in gynecologic surgery, improved compliance with a novel miniaturized compression device, Journal of pelvic medicine and surgery 2003;9.

device reduces the risk of DVT by 70% and shortens the average patient hospitalization time by one day (20%)<sup>11</sup>.

A prospective randomized controlled trial (RCT) conducted by Scripps Clinic in the USA, which compared standard drug therapy in combination with the first generation device to drug therapy alone, shows that adding the Company's device reduces the risk of DVT by 68%.

Moreover, according to a scientific publication concerning the leading drug in the market, Low Molecular Weight Heparin (LMWH), the first generation device in conjunction with 100 milligrams of Aspirin<sup>12</sup> is 6.5 times more effective in preventing DVT than LMWH, by reducing the DVT rate in patients from 28.3% to 6.6% (a risk decrease of 77%)<sup>13</sup>. For further information, see section 1.17 of this report.

In a trial comparing the efficiency and the safety of the SFT device with that of the leading drug in the field (Lovenox) in patients undergoing hip replacement surgery, it was proven that the efficiency of the SFT device is identical to that of the drug, and the percentage of substantial hemorrhaging complications was significantly reduced in the group that used the SFT device.

The SFT device is characterized primarily by enhanced blood flow induced by the device and improved user interfaces. It enables the doctor, patient or nursing staff to receive an indication of the patient's response to treatment (the time period that the patient receives treatment) and thus it enables the doctor to exercise judgment concerning the necessity to use drug treatment or not.

The Company's evaluations in all matters linked to its growth potential and capacity to compete compared to the more expensive drug solutions offered by its competitors is forward looking information, based on the Company's familiarity with the market and the competition therein. It is uncertain whether the Company's evaluations will materialize,

---

<sup>11</sup> M. Froimson, research that was presented at the Mid American Orthopedic Association. Similarly, the research that was published in the leading orthopedic journal in the USA, *The Journal of Arthroplasty*, 2009; 24 (2): 310-316.

<sup>12</sup> Adding 100 milligrams of Aspirin is not recommended for DVT prevention. Giving the Aspirin is intended primarily to protect against arterial diseases, which are diseases of the arterial blood vessels, and not DVT. Since a considerable portion of the participants in the trial use 100 milligrams of Aspirin to prevent arterial diseases, in order to create a homogenous trial group without discontinuing the treatment of those patients with Aspirin, it was given to all of the participants in the trial.

<sup>13</sup> Gelfer, Y, DVT Prevention in joint Arthroplasties, C.E.C.T Therapy vs LMWH, *The Journal of Arthroplasty*, Vol. 21 No.2 2006.

since this depends on the general market conditions and the response of its competitors. The actual results may be significantly different from these estimates.

### 1.8.3 Sleeves

The Company manufactures three types of sleeves, which are used in peripheral accessories for the Company's devices: shin, thigh and foot sleeves (which are designed to bandage the shin, thigh and foot, respectively). The sleeves are sold in pairs.

The shin and thigh sleeves are available in various sizes (between 3 to 5 different sizes), whereas the foot sleeve is available in one uniform size. The sleeves are inflated over the bandaged area (distal to proximal) and the correct venous blood flow directions are induced, from the limb to the heart.

## 1.9 Income distribution of the product groups and product profitability

Below are data concerning the amount and percentage of the Company's overall revenue of each product group (in USD thousands), which constitute 10% or more of the Company's total revenue as well as the amount and the rate of the gross profit for each of the above product groups:

### Field of operation A

	<b>Product group</b>	<b>Sales</b>	<b>% of revenue</b>	<b>Gross profit (loss)</b>	<b>Gross profit (loss) %</b>
<b>2010</b>	Devices *	494	9%	231	47%
	Sleeves **	3,355	59%	1,455	43%
<b>2009</b>	Devices *	483	15%	159	33%
	Sleeves **	2,591	77%	1,085	42%

\* The device segment also includes the sale of ancillary products such as batteries and chargers.

\*\* These sales reflect the Company's sales to distributors and customers (see section 1.11 of this report), and thus do not necessarily reflect the sales figures to the final customers actually achieved by the distributors.

In 2010, there was a significant rise in the gross profit in the devices segment. This stems, *inter alia*, from an increase in profit margins in trade with Japan, which is a central

purchaser of the first generation product. In 2010, there was an increase in the volume of sleeve sales mainly to the various customers in the USA. There was no significant change in the gross profit in this field.

### **Field of operation B**

The Company began marketing the SFT devices at the end of 2008, and the pace at which they were marketed increased substantially during 2010. Below are details of this field:

	<b>Product group</b>	<b>Sales</b>	<b>% of revenue</b>	<b>Gross profit (loss)</b>	<b>Gross profit (loss) %</b>
<b>2010</b>	Procedures inside and outside medical centers	1,877	33%	1,514	81%
<b>2009</b>	Procedures inside and outside medical centers	253	8%	199	79%

### **1.10 New products under development**

As of the report date, the Company is developing other devices in addition to the first generation and SFT devices based on the technology currently existing in the Company, as follows:

#### **1.10.1 Active Care SFT+Diagnostic**

A device, which in addition to its proven capacity to prevent DVT, will also have the capacity for early diagnosis of the formation of DVT. The Company has developed a prototype of the device and is planning to complete the product development and begin clinical trials on a wider scale. In the Company's opinion, the anticipated time span until the development and the clinical trials are completed is approximately three to four years. The initial target market for this product is DVT prevention and the Company hopes it will increase its market share in this field.

#### **1.10.2 ActiveCast®**

A new device designated for active treatment of limb fractures, which will be placed on the injured limb before and during the traditional process of setting the fracture (such as a plaster cast).

The device significantly increases the blood flow even when the limb has been set (when setting a limb the flow blood rate slows down significantly both because of the setting and the diminished physical movement of the limb. This situation slows down the healing process and could cause secondary damage such as edemas and the restriction of movement in the joints). Treatment using ActiveCast® increases and activates the body's natural healing processes and improves formation of the components needed for growth and knitting of the bone, the supply of oxygen to the injured area, the reduction of edemas and DVT prevention.

The initial target market for this product is the fractured lower limbs market (over 8 million sufferers in the USA annually), especially among elderly patients (approximately half a million injuries a year), in cases where the healing is delayed (approximately half a million injuries per annum), and in cases where the fractured bone has not knit (approximately a quarter of a million injuries a year)<sup>14</sup>. The Company has developed a prototype of the device and has completed a feasibility study of its safety. The Company plans completing the product development in the future, and subject to its successful completion, intends to start clinical trials. In the Company's assessment, the anticipated time span to complete the development and clinical trials is approximately three to four years. At this stage, the Company has a prototype, but is not investing significant resources to continue the development. As at report, the Company has no expected date for completing the development of this application.

#### 1.10.3 ActiveCare® Vascular

A new device designed for the treatment of chronic wounds that are not healing due to chronic vein insufficiency, ulcers stemming from venous insufficiency, diabetic ulcers and fibrillar blood vessel diseases.

This device is intended to increase and stimulate the body's natural healing mechanisms, whose capacity to operate is damaged by these diseases, without the need to use drug or invasive therapy, which cause side effects.

---

<sup>14</sup> The figures are taken from: The Ortho Fact Book, US.

The target market is estimated at over 33 million patients in the USA<sup>15</sup>.

The Company has developed a prototype of the device and has obtained approval for it from the FDA (in the USA) and the CE (the European Union). The preliminary clinical indications show that the device is successful in healing wounds that have not been healed by other treatments over prolonged time periods. As at report, the Company has a prototype, but is not investing significant resources to continue the development. The Company plans completing the product development in the future. As at report date, the Company has no expected date for completing the development of this device. In the Company's opinion, a time span of two to three years is expected to complete the development.

1.10.4 Although the Company has not invested significant resources in developing the above products until now due to focusing on the DVT field, to the best of its knowledge, the solutions offered to the population requiring these products has not changed significantly and so the need still exists.

1.10.5 The information in section 1.10 of this report concerning development of the Company's new products and their impact on its business is forward looking information. In the Company's estimation, based on its familiarity with the market and the data in its possession on the report date, if the development processes are completed successfully, these products have great potential due to their advantages described above. However, there can naturally be no certainty that the development processes of any of the above products will be completed successfully and/or in the times specified above, or that any of the above new products will be commercially successful or that any of those that have not yet obtained the regulatory approvals will indeed receive all of them or that the clinical trial will prove the efficiency of the new products for their planned usage.

## **1.11 Customers and distributors**

### **Field of operation A – First generation devices**

1.11.1 The first generation devices are marketed to medical centers.

---

<sup>15</sup> The source of the figure: US compression therapy market , F&S 2005. Becker GJ, McClenny TE, Kovacs ME, et al. The importance of increasing public awareness of peripheral artery disease. Journal of Interventional Radiology, 2002 ; 13:7-11.

- 1.11.2 As of the report date, first generation devices are sold primarily to the USA, Japanese and Israeli markets. For information about geographic segments, see section 1.34 of this report.
- 1.11.3 Since 2009 and after the termination of the contract with Hill- Rom, the Company markets the device directly to its customers, as described in section 1.11.1 above, except for Japan, where the Company markets the device through a local distributor (see section 1.11.5 below).
- 1.11.4 At the beginning of 2008, the Company signed a direct agreement with a US medical center belonging to the Scripps chain (**Scripps**). As part of the agreement, the Company received an order for 1,030 first generation devices from this chain, which has four other hospitals. Based on the "sleeve-based sales" model described in section 1.12.1 of this report, so long as Scripps meets its commitments under the agreement to order a specific quantity of disposable products (sleeves) for each device, it will not be charged for the hiring of the devices. Terms were prescribed in the agreement for the rental of devices over and above the quantity fixed in the agreement.
- If Scripps does not meet its commitments to purchase disposable sleeves in the minimum volume per device fixed in the agreement, it will be liable for hiring fees that was not charged. In addition, the Company will be paid for the difference required or this deficit will be covered by another order of disposable sleeves. As at report, Scripps has not been charged for the devices.
- At the end of the hiring period or if Scripps terminates the contract prior to the agreed date or does not meet the liabilities imposed on it by virtue of the agreement for a period of 30 days, then Scripps will pay the Company an amount based on that fixed in the agreement per day for each device until it meets its commitments and all the units are returned to the Company.
- Under the provisions of the agreement, Scripps undertook to hire up to 1,000 Active Care DVT Pump units from the Company during the agreement period for use in Scripps' facilities. Under the agreement, there is no minimum quantity that Scripps is required to hire from the Company. Currently the Company is negotiating with Scripps to continue extending the agreement.

1.11.5 In 2010, the sales of the first generation products to the Scripps chain increased by 21% and the volume of sales amounted to USD 1,415 thousand compared to USD 1,170 thousand in 2009.

1.11.6 Agreement with Harada Corporation

On April 1, 2005, the Company signed on an exclusive distribution agreement (**the Distribution Agreement**) with Harada Corporation (**the Distributor**) whereby the Company granted the distributor exclusivity to market its products in Japan, based on a list of products set out in the distribution agreement. In return, the distributor undertook not to market and distribute products that compete with those of the Company during the agreement period and for a period of twelve months thereafter.

If at the end of a three-year period from the signing the agreement the parties do not reach agreement with respect to its renewal, it will expire automatically at the end of this period.

It was agreed that if the distributor does not meet the sales targets defined in the distribution agreement, the Company will be entitled, at its election, to cancel the agreement by 90 days prior notice or to cancel the exclusivity granted to the distributor. Even though the distributor did not meet the sales targets in 2005, 2006 and 2007, the Company agreed, at this stage, not to cancel the distribution agreement or the distributor's exclusivity and the agreement was extended under the same terms for another twelve months until April 1, 2009. As of the end of the agreement, the Company has continued selling its products to the distributor under identical terms to those set out in the agreement. A new agreement has not yet been signed between the parties.

In 2010, the sales of the first generation products to Harada decreased by 31%. The volume of the sales to the distributor in 2010 amounted to approximately USD 436 thousand compared to sales of approximately USD 628 thousand in 2009.

1.11.7 Below are details of the Company's revenue from significant customers and distributors in relation to its revenue in the years 2009 and 2010:

		2010	2009
Scripps – first generation	% of the Company's revenue	25%	35%
	Sales	1,415	1,170
Harada	% of the Company's revenue	8%	19%
	Sales	436	628

### **Field of operation B – SFT Devices**

- 1.11.8 The Company began marketing SFT devices at the end of 2008, and the marketing pace of these devices has increased significantly during 2010. The SFT device users are divided into two main groups, namely medical centers (to which the devices are marketed via sales agents and directly by the Company) and patients who are treated in their homes after being released from hospital, through sales agents (DME providers) which the Company has contracted with. Therefore, the Company considers the medical centers and sales agents its customers. The SFT devices are located in medical centers and/or with the sales agents and owned by the Company, while the customers (i.e. the medical centers or sales agents) pay the user fees prescribed in the agreements with them for each DVT prevention treatment performed through them using the device. The user fees paid by the distributors are the fees paid by patients treated through them using the SFT devices.
- 1.11.9 In 2010, the volume of the Company's revenues from treatments using the SFT devices increased by 642%. The revenue in 2010 amounted to USD 1,877 compared to a total of USD 253 in 2009.
- 1.11.10 The Company's agreements with medical centers  
In 2010, 56% of the Company's revenue in field of operation B stemmed from SFT treatments performed at US medical centers, some of which have agreements with the Company, some were carried out through purchase orders, and with respect to the rest, As at report, the Company is negotiating with them to sign agreements as aforesaid. Generally, the Company's agreements with the medical centers prescribe the price and payment terms for the use of SFT devices, the training provided by the Company to the medical centers, and customary provisions in agreements of this type.
- 1.11.11 The Company's agreements with sales agents

The Company's agreements with sales agents generally regulate commissions to the agent (derived from revenue from the sale of treatments using the SFT devices through the agent, as described above), including the terms (payment to the agent is generally subject payment for the treatments from the patients), the SFT device maintenance, and the customary provisions in agreements of this type. Since the end of 2008, the Company has signed agreements with several sales agents (DME providers) to distribute the Company's products to patients who have been released from hospital and are using the SFT products outside the hospitals. As at report date, the Company is not dependent on any of these sales agents.

1.11.12 Below are details of the Company's revenue from medical centers and sales agents in relation to SFT devices, in 2010:

		<b>2010</b>	<b>2009</b>
Hospitals and medical centers	% of the Company's revenue	18%	7%
	Sales	1,056	224
Sales agents	% of the Company's revenue	14%	1%
	Sales	821	29

## 1.12 Marketing and distribution

### Field of operation A – First generation devices

#### 1.12.1 General

During the course of the eighties, with the appearance of the first DVT prevention IPC devices on the USA market, they were marketed and sold primarily to doctors, while the manufacturers enjoyed a percentage of the revenue and high profits from the sale of the pumps and sleeves. With the growth in the US market and the increasing competition, the differences between the various device parts became less distinct and today it is standard practice for the pumps to be given on loan without payment, subject to commitments by the medical centers to purchase the single-patient sleeves in the future. The Company operates two sales models, as follows:

- A. **Sleeve-based sales:** In this model, the Company sells the device to customer at cost and the sleeves at a price that reflects a profit for the Company. The sales in the US are executed using this sales model, since the volume of sleeve purchases for a device there is higher than is customary in Japan and in Israel, *inter alia*, because of the stricter standards for providing medical treatment.
- B. **Device-based sales:** In this model, the Company sells the devices and sleeves at a profit, without any commitment of additional future sleeve purchases. The sales in Japan and in Israel are executed using this sales model, *inter alia*, because the volume of sleeve purchases for the device in Japan and in Israel is relatively low compared to those in the USA.

#### 1.12.2 With respect to the first generation devices, the Company operates marketing and distribution channels, as follows:

- A. All the sales in Japan are executed via Harada Corporation, which purchases the products from the Company under the device-based model.
- B. In Israel the Company distributes the devices through its sales staff, who deal with the marketing and routine handling opposite the customers.
- C. In the US, the Company distributes the devices via both the Company's sales staff, who deal with the support and routine handling opposite the customers, and independent marketers.

1.12.3 As aforesaid, the Company is currently not active in significant volumes in the private market and its primary target population is the institutional market, namely large medical centers, which purchase its products to treat patients.

As described in section 1.11.4 above, the Company signed an agreement with the Scripps chain at the beginning of 2008 for the supply of first generation devices.

**Field of operation B – SFT devices**

1.12.4 The sales of SFT devices are based on a model whereby the Company installs them at the hospitals and the medical centers through sales agents or directly. A sale is made each time a doctor uses the Company's device for DVT prevention treatment. The marketing to distributors (DME) is carried out in a similar manner whereby the marketing by the distributor to the private customers usually stems from treating the patient in hospital and the doctor's recommendation to use the device for continued treatment (see sections 1.11.9 and 1.11.12 above).

1.12.5 In order to implement the model described in section 1.12.4 above, the Company signs agreements with the above sales agents and distributors. The agent coordinates the Company's activities with the medical centers and provides the Company with reports of the quantity of procedures carried out at the relevant medical center during a defined period (generally on a monthly basis). The Company issues an invoice to the medical center based on the report, which is calculated by multiplying the quantity of procedures in the period by the agreed price per treatment, as agreed. The Company credits the agent with commission for this service, as defined in the agent's agreement.

1.12.6 The payment collection from patients who have been released from hospital is carried out by the DME provider that collect the treatment charge from the patients or their insurance Company. The Company charges the agent in multiples of the number of treatments by the sales price to the customers accordingly. The Company credits the agent with commission for this service, as defined in the agent's agreement.

1.12.7 Through its subsidiary, the Company has established a sales and marketing force of ten in the USA. This team focuses on creating interest among doctors and persuading them to demand the SFT device from the administrations at the medical centers. The team is also involved in training the various distributors associated with the Company how to sell and use the product.

1.12.8 The function of the marketing staff is to expose the market (with emphasis on doctors) to the clinical results as well as publicize information about the DVT prevention market. The objective of the marketing specialists is to recruit doctors to press for change in the customary DVT prevention practices so that the Company's devices are recognized as an alternative to drug therapy and/or as products with advantages over other devices and drugs, and thus trigger demand for the Company's products. In the USA, the subsidiary focuses on creating demand for the products through the doctors rather than through the medical center purchasing officers. This is carried out by presenting clinical data showing the clear clinical advantage to be gained by using the Company's devices over the others. It should be noted that naturally it is uncertain whether the marketing team will be successful in meeting its objectives described above.

1.12.9 The Company regularly participates in professional conferences, primarily in the orthopedic field, with the aim of exposing its products and their advantages to as many entities as possible, especially doctors.

1.12.10 Marketing and sales expenses

Below are details of the Company's marketing and sales expenses:

<b>Period</b>	<b>Marketing and sales expenses as a % of the Company's total revenue</b>	<b>Marketing and sales expenses (USD thousands)</b>
<b>2010</b>	62%	3,545
<b>2009</b>	43%	1,422

**1.13 Backlog orders**

The Company has no backlog orders in both fields of operation A and B (the SFT devices).

1.13.1 As a rule, the Company sells all its orders backlog on time

**1.14 Competitors and competition**

**Field of operation A – First generation devices**

1.14.1 As at report date, the Company's first generation devices compete with other mechanical products in the DVT prevention field (IPCs and elastic stockings).

1.14.2 The Company has two main competitors in mechanical DVT prevention devices as follows:

A. Tyco Healthcare (**Tyco**), through its subsidiary Kendall. Tyco is a huge multinational company involved in producing a very wide range of products. It invented and developed the DVT prevention device market in the mid-eighties and is currently the market leader.

As at report date, Tyco markets a new battery-operated device which is three times larger than the first generation device.

B. Huntleigh Technology PLC (**Huntleigh**), a British company that also operates in the USA. According to its advertising, Huntleigh has succeeded in capturing approximately 25% of the market through its low pricing policy. In response to the first generation device, Huntleigh has also developed a battery-operated model, which is six to seven times bigger than the first generation device, but it is not portable and is even less competitive than Tyco's device described above.

It should be emphasized that Tyco and Huntleigh are veteran companies that enjoy a reputation in the market and are familiar with its players.

It should be noted that the Company's competition policy is to position its products as the most qualitative and effective from the medical aspect, and accordingly, the price of its products is higher than that of the competing products.

**Field of operation B – SFT devices**

1.14.3 In view of the success of the multicenter clinical trials and proof of the SFT device's capacity as an alternative to drug therapy, which is common practice today, as detailed in section 1.17.6 of this report, the main competitors for the SFT device are the leading DVT prevention drugs on the market.

1.14.4 In the Company's estimation, the SFT device's largest competitor in the drugs field is the market leader, Lovenox, which is marketed by Sanofi Aventis. It should be noted that this drug is currently administered by daily injections into the abdomen. However, to the best of the Company's knowledge, during the course of the forthcoming year this marketer is expected to launch a new drug with similar characteristics which may be administered orally. The Company continues to observe that its greatest advantage compared to Lovenox is that the SFT device avoids patient exposure to serious hemorrhaging.

Recently, the media reported that Momenta has developed and sells a generic version of Lovenox, which could also be competition for the SFT device.

- 1.14.5 As at the time of this report, the Company's share of the US DVT prevention device market is immaterial. Its estimation, as at report date, it has captured most of the Israeli DVT prevention device market. However, the Company is competing against the drug market in Israel where DVT prevention devices have not been used in parallel with drug therapy and therefore, the Company's share of the overall DVT prevention market in Israel is immaterial. The Company is unable to estimate its market share in Japan.

The above information in this section concerning the growth possibilities of the Company's market share and profitability in the DVT prevention market is forward looking information. The Company's assessment on this matter is based on its familiarity with the relevant market and the agreements signed following the success of the multicenter trials. However, it is naturally uncertain whether the SFT device will actually be commercially successful and whether the Company will in fact increase its market share and profitability.

**1.15 Production capacity**

- 1.15.1 The Company's devices are assembled at its site in Or Akiva. Its production capacity is flexible and dynamic, and can be adjusted to the customers' orders.

The various components required to assemble the devices are purchased from sub-suppliers in Israel, Germany, Japan and the USA. The device's board is manufactured by a sub-supplier in Israel based on the Company's specifications.

- 1.15.2 As at report date, the Company's production capacity is approximately 400 devices per month. The Company can double the device production capacity at short notice of about two months by increasing the number of the production workers.

- 1.15.3 The Company's sleeves are manufactured by a US sub-contractor/supplier based on the Company's development and delivered directly to its customer from the sub-supplier/contractor. As at report date, the Company is working to find another supplier. For additional information, also see section 1.20 of this report

**1.16**      **Fixed assets, land and facilities**

The Company's offices and facilities, covering about 490 sq.m, are located in Or Akiva. It rents the offices from a third party, under a rental agreement dated March 11, 2002, which was extended in April 2008 until May 15, 2011. In July 2009, following the Company's request, the monthly rent were reduced to NIS 12,913. As from February 1, 2011, the rental agreement was expanded to include another area of 18 sq.m for additional monthly rent of NIS 580.

The Company also pays NIS 1,000 a month in respect of management services for the building where its offices are located.

As collateral for the Company's commitments under the rental agreement, it extended a bank guarantee of NIS 45 thousand in favor of the landlord as well as a lien on the Company's rights in a shekel deposit of NIS 21,000.

- 1.16.1      The Company's fixed assets include some of its devices (first generation and SFT), laboratory equipment, devices for rental and office furniture. For further information, see Note 7 to the financial statements attached as Chapter C of this report.

**1.17**      **Research and development**

- 1.17.1      The Company works consistently to develop new products to strengthen its position as a technological leader in its field of operation. For information of the Company's products and the new products under development, see sections 1.8 and 1.10 of this report.
- 1.17.2      The Company's development costs were USD 760 thousand in 2010 and USD 585 thousand in 2009. It did not have any development plans financed by its customers.
- 1.17.3      Until now, the first generation device platform has also served as the platform for developing the Company's future devices. In the Company's estimation, the additional development cost per product is approximately USD 500 thousand until the regulatory marketing approvals are obtained. The Company estimates the additional cost for the clinical trials and research necessary to introduce the product into the market at between USD 1-3 million per product, depending on the efforts required to enter the markets and the preliminary results of the research.
- 1.17.4      As part of the research and development process, when the regulatory approvals are received (FDA, Ministry of Health, CE, KFDA and so on) for medical devices, the

manufacturing companies must provide clinical data about the product. This data is intended to prove the superiority of the product over existing products and thus introduce the product to the medical community. The average time needed from the completion of clinical research until it can be used in practice is about one year.

Therefore, to increase the volume of SFT device sales, the Company must develop new treatment practices that include using SFT devices as the preferred DVT prevention treatment, while overcoming three barriers, as follows:

- A. Clinical proof of the device's advantages is required, and at the same time, the financial advantages need to be supported (lower treatment costs when using the device as compared with the alternatives). Creating a medical infrastructure, as aforesaid, enables introducing the product into the market via the doctors, while reducing the concern of legal action generally involved in the replacing an existing treatment practice with a new treatment mechanism. This clinical proof is the result of the trial detailed in section 1.17.6 of this report.
- B. The Company must employ a clinical marketing team to pass on the message to the medical community, create demand for the device and ensure that the demand is met.
- C. Contending with the anticipated competition by improving the device is necessary.

1.17.5 The Company conducted a clinical trial in Cleveland USA, which was completed in June 2005 and proved the superiority of the first generation device over the IPC device that is widely used in the market. The results of the clinical trial were published in a leading orthopedic journal.

The Company has also conducted clinical research in Israel, which was published in the highly rated orthopedic journal, *The Journal of Arthroplasty (JOA)*<sup>16</sup> and the findings of which show that using the SFT device in conjunction with 100 milligrams of Aspirin (administered primarily to protect against arterial diseases and not DVT. For further information, see the comment in section 1.8.2 of this report) is 6.5 times more effective than using the leading drug in the market, LMWH (for further information, see section 1.8.2 of this report).

---

<sup>16</sup> Gelfer, Y, DVT Prevention in joint Arthroplasties, C.E.C.T Therapy vs LMWH, *The Journal of Arthroplasty*, Vol. 21 No.2 2006.

1.17.6 The Company conducted a multicenter trial in the USA, which was completed in June 2008. The results show that DVT prevention with the Company's SFT device is safer than the leading drug in that market (Lovenox) and has a similar level of effectiveness. For additional details, see section 1.1.2 of this report.

In the Company's estimation, completion of the trial and its findings strengthen the position of its SFT device as having the capacity as an alternative and even preferable to drug therapy. Accordingly, the Company's SFT device has considerable potential. The Company's evaluation, as set out in this section, is forward looking information, based on the device's advantages and the Company's familiarity with the market. However, it is uncertain naturally whether the Company's product will actually be commercially successful.

#### **1.18 The Company's intangible assets**

The Company holds six patents registered in the USA (the Company's primary target market), and one registered in Israel, Europe, Australia and Taiwan. It also has another two patent registration applications under examination in the USA and PCT<sup>17</sup>. The patents afford protection for a period of 20 years each from the submission date. Accordingly, the Company's patents will expire as from 2017 onwards. As at report, the cost of the Company's investment in registering these patents was NIS 37 thousand. The Company did not recognize them as an asset in the financial statements. It attaches great importance to the protection provided from registering the patents, which allows it to maintain the advantages of the first generation and SFT devices over its competitors.

1.18.1 The patents and applications are registered for the device and the method of applying pressure to the limbs, the creation of an optimal blood flow profile, the diagnostic capacity and the device control system.

1.18.2 The Company markets the SFT device under the ActiveCare+SFT® trademark, which is registered in Israel. It also has registered trademarks for the new products under development, under the following brand names: ActiveCast®, and Vascular ActiveCare®.

---

<sup>17</sup> An application under the PCT treaty, by virtue of which it is possible to defer submission of patent applications in various countries across the globe which have signed the treaty, including the EU and the USA, for a period of 30 months from the time of presentation of the first application. A patent that is approved will afford protection in all countries that have signed this treaty.

**1.19 Human capital**

1.19.1 As of the report date, the Company employs 29 employees based on the following breakdown: 7 management employees, 10 marketing and sales staff, 7 research and development employees and 5 production workers.

All of the Company staff are employed under personal employment contracts. In the event of the termination of employment, two of its employees are entitled to 90 days prior notice, two to 60 days prior notice and the others to 30 days prior notice. The Company’s liabilities in respect of the termination of employment are fully covered by routine payments to management insurance policies, provident funds and the provisions recorded in the financial statements (see Note 14 to the Company's financial statements, which form Chapter C of this report).

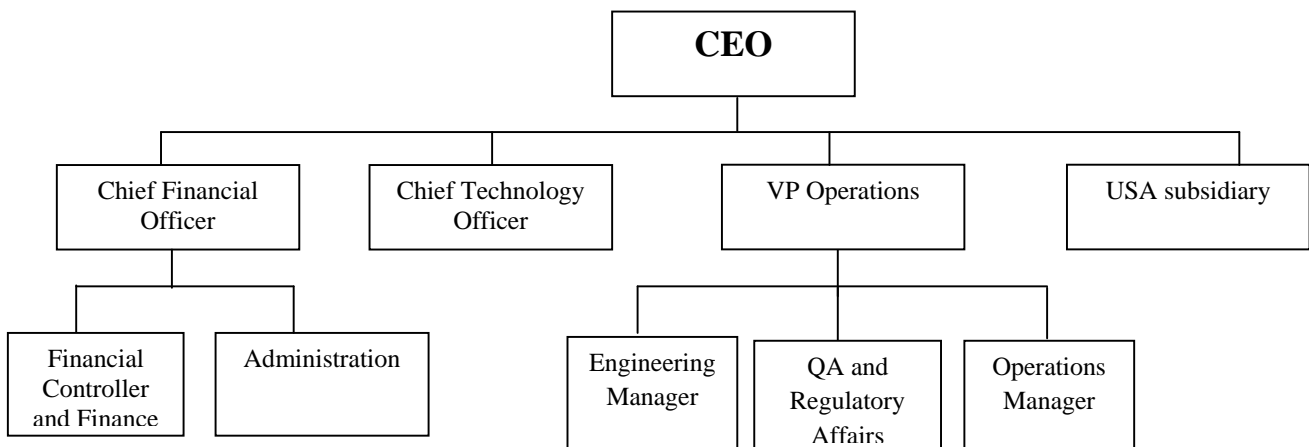
1.19.2 See section 1.19.6 of this report concerning the Company’s dependency on key employees.

1.19.3 The labor relations in the Company are proper. In recent years, there have been no labor disputes or strikes in the Company.

1.19.4 Staff training and education is carried out where the need arises, *inter alia*, by means of the employees' participation at external training courses, study days and conferences. The training is based on the Company’s production file and QA procedures, and in accordance with the QA standards in the medical devices industry. The amounts invested in the above training are immaterial to the Company.

1.19.5 The organizational structure and the Company departments

The following chart details the Company's organizational structure:



Below is additional information concerning the Company's departments and the operations carried out therein:

- A. Finance Department – overall responsibility for the Company's finance (financial management), accounting and administration.
- B. Chief Technology Officer – responsible for product and application development, innovation and scientific advice for both the DVT application (products that are already sold) and the new applications under development. The department guides the engineering and QA departments in defining the specification required and also provides marketing and production support. The department is also engaged in the initiating, managing and monitoring clinical trials, scientific publications and writing patents.
- C. Engineering Department – the department is responsible for the engineering development of the Company's devices (mechanical, hardware and software) based on the characteristics defined by the chief scientist and the marketing department and the specification agreed by all entities involved. The department also leads the engineering development of the disposables (sleeves) and is responsible for solving problems that arise during production or from customer feedback. In developing new products, the department is assisted by sub-contractors, which it employs in the various projects.
- D. The QA and Regulatory Affairs Department – handles the regulatory procedures to register the Company's products in the different countries, product registration maintenance during their lifespan, including managing contacts with the health and QA authorities in the various countries and obtaining all the approvals and standard marks required for production, marketing and distribution. In addition, the department supervises the quality of the raw materials, the production support systems, the Company's products, the logistics array and the development process.
- E. Operations Department – responsible for the entire production array. It manages the work with the sub-contractors (production of disposable sleeves, and electronic and plastic device components), and production planning and supervision. As part of its responsibility for the entire supply chain, the department makes the Company's

purchasing and manages the logistics. The actual device production (pre-assembly and assembly) is carried out at the Company's facilities in Or Akiva.

- F. Marketing in North America – this is carried out at the subsidiary and includes a clinical sales force of experts in marketing medical devices in the USA. The operations include sales promotion among medical staff, medical center administrators, and purchasing departments. This team also participates in professional events (conferences and exhibitions) to promote assimilation of the products and become known among medical professionals.

1.19.6 Dependency on employees

In the Company's estimation, it is dependent on two key employees:

Mr. Dagan – one of the Company's founders and the Company CEO since its incorporation. He is also responsible for the Company's sales, marketing and business development. The Company estimates that its reliance on Mr. Dagan would be expressed in a delay of about six months to a year in development of its business if he were to terminate his position with the Company, until an appropriate replacement is found.

On April 2, 2008, the general meeting approved extending Mr. Dagan's employment agreement retroactively from January 1, 2007 for a three-year period. On June 20, 2010, following the Company Audit Committee's approval of June 13, 2010, the Company Board of Directors decided to sign a new employment agreement and a consultancy agreement with Mr. Dagan. Under the new employment agreement, his tenure as Company CEO was extended for another fifteen months as from January 1, 2010 until March 31, 2011.

Close to the date of this report, the Company Audit Committee and Board of Directors approved extending the employment agreement with Mr. Dagan to June 30, 2011. For further information, see Regulation 21 in Chapter D of this report.

Dr. Barak – one of the Company's founders who serves as the Company Chief Scientist and Chief Technological Officer. Dr. Barak has considerable know-how in the Company's field of operation and coordinates its research and development. The Company estimates that its reliance on Dr. Barak would find expression in a delay of approximately six months to a

year in its research and development if Dr. Barak were to terminate his employment, until an appropriate replacement were found.

On April 2, 2008, the general meeting approved extending Dr. Barak's employment contract retroactively from January 1, 2007 for a three-year period. On June 20, 2010, following the Company Audit Committee's decision of June 13, 2010, the Company Board of Directors approved extending Dr. Barak's employment agreement until December 31, 2012.

1.19.7 The Company's officers and senior management staff

As at report date, the senior management comprises five employees: the CEO, Chief Scientist, CFO, President of the American subsidiary and VP Commercial Operations. The Company's internal auditor is counted among the senior officers although he is not a Company employee. The officers and senior management staff are engaged under personal employment contracts, which include various pension and insurance coverage options, and the customary benefits. For details about the terms of employment of the Company's senior officers as of December 30, 2010, see Regulation 26A, which is attached as Chapter D of this report.

1.19.8 The employee and officer option plan

On March 8, 2010, the Company Board of Directors decided to adopt the 2010 Israeli option plan for the Company's employees and officers. On January 27, 2011, the Company Board of Directors adopted the 2011 American option plan intended for the subsidiary's employees and officers.

For details of the employee and officer option plan and the options allocated by virtue thereof, see section 1.3.29 of this report and Note 18 (C) of the financial statements, attached as Chapter C of this report.

**1.20 Raw materials and suppliers**

1.20.1 The Company purchases all the components required for its devices from sub-suppliers in Israel, Germany, Japan and the USA and assembles them at its facility in Or Akiva. The Company's sleeves are also manufactured by a US sub-supplier/contractor.

1.20.2 The Company is strict about contracting with suppliers which are approved in accordance with the QA standards under which it operates (For further information, see section 1.26.7 of this report). There are no written agreements between the Company and its suppliers, besides the non-disclosure agreements (NDA). The prices are set from time to

time in negotiations between the parties, generally for periods of up to a year. The Company is not committed to purchase minimum quantities. Generally, these supply arrangements do not include collateral from the Company. The Company bears the delivery costs from the manufacturer's plants to the Company's requested destination.

1.20.3 The Company's device contains a unique pump, manufactured for the Company by Gardner Denver Thomas GmbH in accordance with a joint development with the Company. The supplier's warranty for all the pumps is for a period than 5,000 working hours or one year, whichever is shorter. The Company estimates that it is dependent on this supplier as it would take approximately 12 months to find an alternative.

1.20.4 As at report, the Company is dependent on Genesis Manufacturing Inc. (**Genesis**), the supplier which manufacturers the sleeves for the Company in accordance with its specifications. In the Company's estimation, there are other entities around the globe with similar technological capacity to this supplier. The Company is examining contracting with another supplier to reduce the dependence on Genesis. If Genesis were to abstain from supplying the Company with the sleeves, this could affect the Company's business for a period estimated at approximately 6 – 12 months until an alternative supplier is found (as long as there is only one supplier of the sleeves).

1.20.5 The Company purchases all the raw materials required to manufacture its products according to the following distribution (shown as percentages of the overall cost of purchasing the raw materials):

	<b>2010</b>	<b>2009</b>
<b>Israel</b>	36%	21%
<b>USA</b>	45%	71%
<b>Europe</b>	17%	8%
<b>Japan</b>	2%	-
<b>Others</b>	-	-
<b>Total</b>	100%	100%

1.20.6 Below are data about the purchases from suppliers from which the volume of purchases exceeds 10% of the Company's overall raw materials purchases:

	<b>2010</b>	<b>2009</b>
Genesis	36%	64%
AMS Electronics Ltd.	15%	1%
Gardner Denver Thomas GmbH	14%	4%

## **1.21 Working capital**

1.21.1 As a rule, all of the Company's production is carried out according to customer orders and the Company does not produce products for inventory, except for a small inventory of sleeves, as detailed in section 1.21.3 of this report.

1.21.2 At December 31, 2010, the Company has working capital of approximately USD 1,459 thousand and shareholders' equity of approximately USD 5,525 thousand.

1.21.3 The sleeve inventory is maintained by Genesis (including a security inventory). It is clarified that the Company owns this sleeve inventory. Its policy is for this inventory to provide production security of one to two months for the components with an immediate lead-time and up to six months for the key components with an extended lead-time.

### 1.21.4 Supplier and to customer credit

Below are details in respect of the supplier and customer credit (in USD thousands):

	<b>Average credit volume</b>		<b>Average credit days</b>	
	<b>For 2010</b>	<b>For 2009</b>	<b>For 2010</b>	<b>For 2009</b>
<b>Customers</b>	1,049	499	67	55
<b>Suppliers</b>	914	729	58	73

With respect to the first generation devices, the credit terms are an average of 30 days from the invoice date. In relation to SFT devices, the credit terms for the hospitals and the medical centers are an average of 45 days from the invoice date. The credit terms for the distributors (DME) depend, *inter alia*, on the timing of the payment collection from the patient.

The increase in credit from suppliers in 2010 stems from increased purchase volume.

### 1.21.5 Payments to suppliers

As aforesaid, the Company's raw materials are purchased overseas and in Israel. As a rule, the Company is not required to provide collateral for credit from suppliers. The

prices of raw materials are usually denoted in foreign currency. Most of the purchases are made in USD (including those linked to the USD) or in NIS.

1.21.6 Customer payment

As a rule, the Company provides up to 60 days credit to overseas customers. Its customers in Israel are hospitals and medical centers and the credit terms extended to them, as is customary for the supply of products to medical institutions in Israel, are between 60 and 90 days.

Sales to customers are made without collateral.

1.21.7 Customer warranty policy

The Company is legally responsible for the quality of its products and their faults. It also extends full warranty for the proper functioning of its products. The warranty extended to Harada is for 18 months from the dispatch of the product. For information on the Company's direct sales in the US under the sleeve-based model, as aforesaid in section 1.12.1 of this report, the Company maintains ownership of the devices and is responsible for their proper functioning. The warranty for the disposable products (sleeves) is valid until they are used.

The Company's policy is to permit the return of faulty products. Until the date of this report, there has not been a significant volume of returns.

The Company maintains expanded business risks insurance which includes a chapter for product liability. The insurance coverage stands as USD 6 million per event and cumulatively.

**1.22 Investments**

The Company does not have any material investment activity in investee and/or affiliated companies, partnerships and ventures that are not subsidiary companies.

**1.23 Financing**

As a rule, the Company's operations are financed by capital investments via capital raising (*inter alia*, from the public), bank credit (short- and long-term), debt collection from the public and suppliers' credit. For details in respect to the credit drawn by the Company, see Note 12 to the financial statements attached as Chapter C of this report.

For details in respect of the liens created by the Company, see section 1.16.1 and 1.23.7 of this report and Note 16 of the financial statements attached as Chapter C of this report.

For details in respect of the Company's liquidity and cash flows, see section 7 of the Directors' Report attached as Chapter B of this report

1.23.1 Bank loans

In February 2007, the Company took a bank loan of USD 0.5 million at an interest rate of Libor + 2.5%. As part of the credit terms, the Company Board of Directors approved an undertaking not to pay dividends until this credit is repaid. In February 2008, the repayment terms for the loan were amended and the installments rescheduled so that since then, the loan bears interest of Libor +2.7% and is repayable in twelve monthly payments. In June 2008, the loan repayment was deferred so that the Company would begin repaying as from July 2009. In August 2009, the Company repaid this loan.

1.23.2 Change in the credit line terms and provision of another credit line

On January 5, 2009, the Company signed an agreement with an Israeli financial institution (**the lender**) for a credit line whereby the lender will provide the Company with a USD 1 million credit line (**the credit line**). The lender also undertook to provide the Company with an additional credit line of USD 1 million until August 31, 2009, subject to the Company meeting targets set in the agreement in relation to sales, operating profitability, cash flows and the quantity of patients treated with the Company's device (SFT) in the first half of 2009. As at report date, the Company has drawn USD 750 thousand from the credit line (**the original loan**).

On February 17, 2010, following its request, the Company signed an agreement with the lender to change the terms of the credit line and approve an additional credit line of USD 250 thousand, which would remain in force until February 1, 2011 (**the additional credit line**). In August 2010, the Company utilized the additional credit line of USD 250 thousand, which will be repaid in 24 equal installments as from July 29, 2011.

1.23.3 The loan that the Company received from the credit line will bear variable Libor-linked interest per month plus a margin set in the agreement. The original loan and any amount of continuing credit based on the additional credit line (**the new loan**) will be repayable in 24 equal payments starting from March 1, 2011. The Company has been granted early repayment rights for the original loan and new loan without incurring fines.

1.23.4 As at the time of the granting the original credit line in January 2009, the Company allocated options to the lender exercisable during a period of up to six years from the

allocation date for 1,165,380 company shares (subject to adjustments), which when allocated comprised 4.99% of the Company's issued share capital (approximately 3.82% fully diluted) at an exercise price of USD 0.223 per share.

- 1.23.5 In the event of an exit, as defined in the agreement, the Company will pay the lender an amount of USD 200 thousand.
- 1.23.6 Under the agreement with the lender, the Company undertook to comply with the following financial covenants:
- A. To maintain sufficient cash balances for at least three (3) months of activity at all times, based on the average monthly cash flows for the previous three (3) months.
  - B. The ratio between the Company's cash balances and trade receivables as at December 31, 2010 and the amount designated to pay the Company's bonds holders in the year 2011 must be higher than 2, while the cash balance held by the Company at that time must be at least USD 1 million.
  - C. The ratio between the Company's cash balances and the trade receivables (at the end of each calendar quarter) less the debt due to the Company's bonds holders divided by the debt to the lender must be at least 1.2.
- 1.23.7 As collateral for the original and new loan, the lien on all of the Company's property will remain in place in favor of the lender, including various rights also mortgaged by the Company's USA subsidiary in favor of the lender.
- 1.23.8 The collateral terms set in the bonds of the Company and its subsidiary in favor of the lender should not exceed those generally acceptable. The bond terms include cross default clauses.
- 1.23.9 On September 13, 2010, the Company signed an agreement with the lender for a credit line of USD 750 thousand to be utilized no later than December 31, 2010 (**the new credit line**). On December 29, 2010, the Company utilized the new credit line of USD 750 thousand.
- 1.23.10 The amount of the loan which the Company received from the new credit line bears variable Libor-linked interest per month plus a margin set in the agreement. The loan amount will be repaid in four continuous equal monthly installments starting from February 2012. The Company undertook to grant the lender options exercisable during a period of up to six years from the allocation date for 183,000 Company shares (subject to

adjustments), which at their allocation comprised 0.49% of the Company's issued share capital (0.42% fully diluted), at an exercise price of NIS 3.1 per share.

1.23.11 As part of the agreement with the lender, the Company undertook to comply with the financial covenants described in section 1.23.6 above. It also undertook that the ratio between the fixed assets and the loan balance prior to repayment under this agreement will be at least 1.33.

1.23.12 The Company complies with all the terms of its loans described above.

1.23.13 Credit at variable interest

For information about the Company's variable interest loan, see section 1.23 of this report and Note 12 to the financial statements attached as Chapter C of this report.

1.23.14 As at the date of the report, in the Company's estimation, following the capital raising and debt collection that it carried out during 2010 and early 2011, it will not be necessary to raise additional capital in 2011.

**1.24 Taxation**

1.24.1 For information about the tax laws applicable to the Company and its subsidiary, the main benefits thereunder, and the tax laws applicable to the subsidiary, see Note 15 to the Company's financial statements attached as Chapter C of this report.

1.24.2 For information concerning the tax aspects connected to the Company's sales in the American Market, see Note 15 to the Company's financial statements attached as Chapter C of this report.

1.24.3 Until the report date, the Company received approval letters from the Investment Center for an investment program under the alternative plan, in respect to producing devices to enhance blood circulation, treat ulcers and heal chronic wounds. On December 3, 2007, the Company received approval from the Investments Center to implement the program, which determined 2002 as the "year of operation".

1.24.4 Under the confirmation, the Company is entitled to a tax benefit for the investment program expressed as a reduced tax rate (for this program) of 0% for a six-year period and of 25% in the seventh year, starting from the first year in which tax chargeable income is generated, and is limited to 14 years from May 30, 2001.

In May 2006, the Company submitted a request for a pre-ruling to the tax authority for the confirmation of its eligibility if the conditions prescribed in the Law for the

alternative benefit plan comply with Amendment No. 60 to the Law for the Encouragement of Capital Investments. The request is for an expansion program, in which 2006 is the elective year. On February 18, 2007, the Company's request was approved.

1.24.5 For further information, see Note 15 to the financial statements attached as Chapter C of this report.

1.24.6 The Company has transferrable losses for tax purposes of USD 23 million which are unlimited timewise. Deferred tax for the transferrable business losses was not included in the Company's financial statements due to of the lack of a forecast for its utilization in the foreseeable future.

## **1.25 The environment**

The Company is under the routine supervision of the environmental authorities in respect of compliance with the environmental laws related to the Company's activities. The Company complies with these environmental requirements and it does not expect any significant investment in this area.

## **1.26 Restrictions and supervision of the corporation**

### **1.26.1 Licensing requirements for the Company's products and services – general**

The Company's existing products and new products under development fall under the description of medical products. Therefore, their production, sale and marketing are conditional to obtaining a license for each product and service in every country where the Company wishes to sell its products or provide its services. In order to receive these permits, the Company must meet the licensing requirements, including safety stipulations and quality assurance standards, of each country.

The requirements for a license to sell the Company's products and services differ from country to country, as do the duration of the tests carried out by the various authorities to receive the approvals and the costs involved. The lack of a license to the use the Company's products or services in a particular country would prevent them from being sold there, which could harm the Company's revenues. As aforesaid, the primary market that the Company is focusing on is the USA.

Below are the Company's quality standards, production requirements and the licensing procedures:

### 1.26.2 US licensing procedures for the Company's products

The Company is registered as an authorized manufacturer, Registration number 9616558 (FDA QSR) and has received the Food and Drug Administration (FDA) approvals required to market and sell its first and second generation devices and sleeves within the framework of the 510 (K) Pre-market Notification procedure. This is the quickest and simplest approval process, which is required if the new product is materially similar in safety and efficacy to an existing product (a predicate device which has undergone the approval process successfully). The Company intends to work toward receiving FDA approval for the new products whose development will be completed by the Company in the future (see section 1.10 of this report). The degree to which approval is needed will be examined in the future concerning any change made in an existing product or expansion of the applications of these products.

Obtaining FDA approval requires the Company to market its products only for the purpose that the approval was received for. FDA approval is unrestricted timewise, but the FDA is permitted to conduct checks to verify that the Company is in compliance with with the legal and licensing requirements. In addition, the Company has the capacity to monitor its compliance with the FDA requirements by means of a quality assurance system. Thus it can significantly reduce the possibility of failures and even provide warnings thereof in due time in the event that any are uncovered. Non-compliance with the requirements could lead to sanctions against the Company, including the publication of a public warning concerning the product, imposition of fines and civil indemnity on Company, refusal to approve the Company's new products or revoking of the licenses for existing products.

### 1.26.3 Licensing procedures in the European Union

A permit from the Notified Body for the products' CE Mark is a mandatory condition for marketing the Company's products in the European Union. This permit is applicable in all European Area countries, including EU member states and others such as Switzerland, Norway, and Iceland. This mark is a "conformance mark" that constitutes a declaration by the manufacturer concerning the product's compliance with the relevant requirements and guidelines issued by the European Union under European guideline MDD:93/42/EEC. This guideline relates to medical devices. Since these products fall in

the low public health risk category and the Company complies with the ISO standards, as described in section 1.26.7 below, the process for obtaining the approval is conditional to the Company's declarations concerning the product's conformity with the directive. Each country has a the competent regulatory authority responsible for enforcement, *inter alia*, of the manufacturers with the authority in its jurisdiction to discontinue the marketing of products, give warnings for them, demand additional information about them, recall specific production batches which are found to be faulty, and take any other action required to safeguard public health. The enforcement authorities in all countries are interconnected, and except for cases where the supervision is only relevant to specific processes or events in a particular country, for the most part, the implications of enforcement actions by the authority in one country also affect the other countries in the European Area. In contrast to FDA approval, which is unrestricted timewise, the European approval must be renewed in an annual inspection process. The annual inspection of the Company's product was successful and the approval was renewed for another year.

1.26.4 The following table summarizes the various licensing stages of the Company's products and its evaluation concerning the requirements to complete the licensing processes for each of its current products or services.

<b>Product name</b>	<b>License</b>	<b>Authorizing entity</b>	<b>Stage</b>
<b>WizAir<sup>®</sup> system (including sleeve), ActiveCare<sup>®</sup> DVT</b>	EU and related states	Medcert <sup>18</sup>	Approval exists that must be renewed annually
	USA	FDA	
	Japan	Carried out by the distributor	Approval exists
<b>ActiveCare+SFT<sup>®</sup> system (including sleeve)</b>	USA	FDA	There is an approval that needs to be renewed each year
<b>ActiveCast ActiveCare Vascular<sup>®</sup></b>	USA, Europe and Israel	FDA, Medcert, and the Ministry of Health	The product development has not yet been completed. When it is completed, the license applications will be filed.

For information of the anticipated costs to develop the new products up to the regulatory approval stage, see section 1.17 of this report.

- 1.26.5 All of the Company's evaluations specified above in this section 1.26, including with respect to the Company's capacity to obtain licenses for its products, licensing tracks, time required to obtain the licenses and license costs, is forward looking information and relies on the Company's assessments and experience, and in certain cases noted above, on informal, non-binding negotiations with the various licensing authorities or the opinions of various consultants. All of the Company's above evaluations are based on the current legal situation concerning the various licensing tracks described above and any change in the laws applicable in the USA, the European Union or other countries could significantly alter the licensing processes for the Company's products, including the time required to obtain a license and the costs involved. It is uncertain whether the Company's above evaluations will indeed materialize. If the Company does not receive a license for one or more of its products in the USA and/or the EU, or if the time required to complete the licensing processes or to obtain the standard marks required in the USA or the EU is significantly extended and/or if the costs involved are significantly increased, this would prevent the Company from marketing its products in these markets or receiving a license and its financial results would be affected accordingly.

1.26.6 Clinical trials on human beings

<sup>18</sup> One of the approved accrediting entities authorized by the European Authority and member states in the medical companies and products field.

Under Procedure number 14 of the Ministry of Health's pharmaceutical administration - clinical trials on human beings (**the Procedure**), any clinical trial, including the planning, approval, implementation, documentation and manner in which the trial is reported, must be carried out in accordance with the Public Health Regulations (clinical trials in human subjects), 1980 (**the Regulations**), the procedure, the provisions of the latest international harmonization procedure for proper clinical procedures (research products), and the provisions of the latest standard for medical research on human beings using medical products and devices. A condition for the conducting trials by the Company is prior approval from the entities authorized to approve clinical trials on human beings. The trials must meet the Helsinki declaration principles and receive the approval of the Helsinki committee in each hospital where they are conducted<sup>19</sup>. The doctor and/or the doctors committee that the Company cooperates with submit the trial protocol to the medical institution's Helsinki committee.

A clinical trial on human beings in a hospital will not be approved unless its Helsinki committee has informed the hospital's medical director in writing that it has approved the trial and the director of the hospital is convinced that the trial does not contradict the Helsinki declaration and the regulations. In certain cases specified in the regulations, a special opinion from the supreme Helsinki committee for medical experiments on human beings, as defined in the regulations, will be required to approve the trial. The manner of the filing, approving and controlling clinical trials and medical research on humans are all regulated in the procedure.

1.26.7 Quality standards for the Company's facilities and the manufacturing processes for its products

Israeli standard ISO 13485 (1996): during 2004, the Company passed the required tests and received approval of this standard for its operations in planning, production, auditing, marketing and servicing of pneumatic medical systems.

---

<sup>19</sup> The Helsinki declaration is a declaration concerning the recommendations which guide doctors conducting bio-medical research involving human beings, Helsinki 1954, as amended in Tokyo 1975, and whose wording is given in the first addition to the Public Health Regulations (clinical trials in human subjects) -1980. The Helsinki committee is a committee set up in accordance with section 2 of Chapter A of the Helsinki declaration. The role of the Helsinki committee is to approve conducting of clinical trials on human beings, after it has been verified that the trials comply with the ethical and scientific criteria, as defined in the Helsinki declaration.

This standard focuses on medical devices and includes the planning, production, auditing, marketing and service requirements for medical devices. Complying with this standard is one of the pre-conditions for approval of sale in Europe and Canada.

The entity which awarded these ISO standards to the Company as detailed above is DQS GmbH (the German management system licensing company), a member of the international umbrella organization IQNET (the International Quality Network).

The validity of this standard in Europe was set until December 21, 2006 and in Canada until the end of March 2006. The Company successfully passed the Europe license renewal test under the ISO 13485:2003 standard, which replaces the above standard, and received official approval. Since the Company is not active in the Canadian market, it did not renew the Canadian license.

Israeli Standard DIN EN ISO 13485 (2001): during 2004, the Company passed the required tests and received approval of this standard for its operations in the area of planning, production, auditing, marketing and servicing of pneumatic medical system.

This standard focuses on medical devices and includes the planning, production, auditing, marketing and servicing requirements thereof.

The Company also passed the required tests and obtained certification under the second appendix of European Standards Council Directive MDD:93/42/EEC for compliance of the Company's product QA system with the document's requirements. This directive deals with medical devices and contains the Company's QA requirements for planning, production, auditing, marketing and servicing of medical devices.

This approval affords the Company the right to sell its products in EEC member states, subject to additional conditions, and allows it to mark the products there with the CE mark.

The entity that awarded these standards to the Company, as detailed above, is MEDCERT (a German licensing and testing company).

The certification for above the standard and directive document is valid until December 21, 2011.

1.26.8 Business license

The Company holds a license to conduct a medical equipment manufacturing plant business valid until September 30, 2010. The Company is currently in the process of extending the license with the state authorities.

The Company holds a confirmation of the registration of its ActivCAre+SFT System in the medical accessories and devices registry valid until December 31, 2010.

**1.27 Material agreements**

1.27.1 The material agreements, not in the regular course of business, which the Company is party to or under which, to the best of its knowledge, it has entitlement during the period described in the report or which have affected its activities in this period is the agreement signed with the Scripps hospital chain. See section 1.11.4 of this report.

1.27.2 On December 3, 2008, the Company signed an agreement with Clal Finances Betucha Management and Investments Ltd. (**Clal Finances**) whereby which Clal Finances will serve as a market maker for the Company's shares and bonds (Series A) under the Stock Exchange rules and directives, and the provisions of the law. In December 2009, the Company terminated its contract with Clal Financing in respect to the market making of the Company's bonds and in November 2010, it terminated its contract with Clal Financing with respect to market making of the Company's shares.

1.27.3 For information concerning the Company's credit line agreement, see section 1.23 of this report.

**1.28 Cooperation agreements**

1.28.1 For information about contracts with significant suppliers, see sections 1.20.3 and 1.20.4 above

**1.29 Legal proceedings**

As at report, the Company and its subsidiary are not party in any significant legal proceedings.

**1.30 Business goals and strategy**

1.30.1 The Company set itself a strategic goal of becoming a leader market for limbs blood flow enhancement solutions, particularly DVT prevention solutions. It recognizes great business potential in this field and is acting to solidify its position in this market, especially in the US, where the Company's key target market is located.

As part of this strategy, the Company is operating as follows:

1.30.2 Sales promotion of the first generation device in the US DVT prevention market as an alternative to the use of drugs by expanding the USA Company's clinical marketing force, as described in section 1.7.11 of this report.

1.30.3 Development of other applications for the limbs blood flow enhancement devices. For information of the new products under development, see section 1.10 of this report.

1.30.4 The Company is in various stages of development of three other products based on the Company's existing technological platform and patents. These products are designed to deal with three additional markets: (1) diagnostics – identification of DVT development; (2) treatment of fractures and (3) ulcer treatment of (diabetic or venous). Each of these three future fields is estimated by the Company as a potential market of hundreds of millions of USD.

The goals and strategies described in this section include forward looking information and are a vision and a objective. The Company is uncertain of its capacity to realize the vision and achieve its goals, which to a large extent are based on factors beyond its control, like: the development of which of the above products will be completed successfully and which of these products will gain commercial success. This information could change based on the Company's requirements and the external environment.

1.30.5 The Company growth targets

In the Company's estimation, because of the advantages of the SFT device and following the Company's success in proving in clinical trials that the device is an alternative to the existing drug therapy, the potential in the US orthopedic market (the Company's immediate market) for small, portable devices that enable replacing DVT prevention drug therapy, such as the Company's device, amounts to USD 800 million per annum. This is based on the fact that over two million patients require knee or hip replacement therapy or hip fracture therapy annually. The overall future US SFT device market, which includes all surgical operations lasting over 3 hours, is estimated at approximately USD 1.5 billion.

The Company has set itself the goal of being a dominant player in this target market and in its opinion, the resources it will invest to create this market and change the current generally accepted medical practice could allow it to realize this target.

1.30.6 The above targets and the information about the market potential of the SFT device reflect the Company's vision of the market and its position As at report date. Naturally, they may changes based on the developments in the Company and the market. In addition, meeting the above targets is not certain and is subject, *inter alia*, to circumstances and factors beyond the Company's control.

1.30.7 The information included above in this section and its impact on the Company and its business results is forward looking information based on the Company's forecasts and its evaluations. It is uncertain whether the Company will succeed in realizing the above strategies, fully or partially, and whether realization thereof will lead to the expected results. Realization of the strategies and their implications for the Company could be materially affected by external factors, including changes in market trends and/or other possible impacts on the Company.

**1.31 Development expectations in the forthcoming year**

As at report date, the Company does not have any plans beyond the regular course of business which the Company has decided to implement in the forthcoming year which could materially impact on the state of its business and the results of its operations, which have not been detailed in this report.

**1.32 Exceptional changes in the Company's business**

The Company is unaware of any exceptional changes in its business, including during its regular operations, in the period from the date of the financial statements until publication of this report.

**1.33 Events or matters beyond the Company's regular business**

To the best of the Company's knowledge, there is no event or matter that has not been discussed in sections 1.1 to 1.32 which is beyond the Company's regular course of business due to its nature, scale or possible results, which has or might have a significant impact on the corporation.

**1.34 Financial information on geographical segments**

The Company's geographical segments are the USA, Japan and the rest of the world. Below are details of the revenues and the assets of these segments:

	2010		2009	
	Revenues	Assets	Revenues	Assets
USA	5,050	3,564	2,498	5,422
Japan	436	-	628	90
The rest of the world	240	372	201	74
Unattributed	-	6,864	-	4,120
Total	5,726	10,800	3,327	9,706

### 1.35 **Risk factors**

#### **Sector-specific risks**

- 1.35.1 **Change in the regulatory situation with respect to licensing the Company's products and services:** The Company is subject to medical laws, licenses and permits. Stiffening of regulatory requirements to license the Company's products and services or changes to requirements which have already been met by the Company could make it more difficult and more expensive and/or delay the licensing process for the Company's products and services or prevent obtaining a license. This could delay or prevent the Company from marketing its products and services in the different countries. Nevertheless, the Company's products are non-invasive and/or are not drugs and therefore, the Company estimates that the probability of change in the regulatory position with respect to its products is low.
- 1.35.2 **The global and local financial crisis:** The global financial crisis could lead to a decline in demand for the Company's products and harm countries where the Company purchases its raw materials. An economic collapse in these countries could prevent the Company from marketing its devices and purchasing raw materials, either permanently or temporarily. In addition, continuation of the economic crisis could make it difficult for the Company to obtain additional financing for its operations.
- 1.35.3 **Reduction of intellectual property rights protection:** Changes in legislation or policies with respect to patent approvals and the scope of protection provided could impair the

Company's capacity to compete in the relevant markets and protect its intellectual property.

- 1.35.4 Responsibility for product quality: The Company is exposed to civil and criminal actions on the part of patients with respect to the quality of its products if faults are discovered and/or if in future they are found to cause damage. However, the Company estimates that in the view of the fact that As at report date the Company's devices are used as supplementary products to the drug therapy for DVT prevention and that it conducts clinical trials to test and to prove the superiority of its products, its exposure to claims of this type is not high.
- 1.35.5 Technological developments: The Company is exposed to other technological developments in DVT prevention or blood flow enhancement, which could counteract the current advantages of the Company's innovative product. For further information, see section 1.14 of this report.
- 1.35.6 Pharmaceutical developments: The Company is exposed to developments in the DVT preventive medication field, whether the development of cheaper medication than that existing on the market or more efficient medication without significant side effects. As at report date, this is an insignificant threat which seems unlikely in the coming years.

**Risks particular to the Company**

- 1.35.7 Dependency on external financing for the Company's operations: The Company has negative cash flows from its current operations. Therefore, it is dependent on obtaining external financing. In the Company's estimation, following the capital raising and debt collection which it carried out during 2010 and at the beginning of 2011, there will be no need to raise additional capital in 2011.
- 1.35.8 Dependency on suppliers: The Company is dependent on two suppliers, namely the sleeve manufacturer and pump manufacturer for the second generation device. For further information, see sections 1.20.3 and 1.20.4 below. Termination of supply by these suppliers could impair the Company's production capacity for the time period required to reorganize (six to twelve months) and find alternative suppliers.
- 1.35.9 Currency exposure: the Company is exposed to risks related to changes in the USD exchange rate against other currencies (primarily Euro and NIS). Most of the Company's sales are denoted in USD, whereas some of its expenses are incurred in other currencies

(primarily NIS and Euro). Since there is no full overlap between the currencies in which the Company produces its revenues and those in which it incurs its expenses, exchange rate changes could affect its profitability. In addition, a considerable portion of the Company's financial liabilities are denoted in NIS. The Company partially hedges this exposure by investing a portion of its cash balances in NIS investments as well as carrying out forward transaction hedging of the USD rate.

- 1.35.10 Variable interest rates: As aforesaid in section 1.23 of this report, the Company has taken up credit at variable interest rates. Therefore, an increase in the interest rates would affect the Company's financing expenses. A small increase in the base interest rate was recorded during 2010, which led to an immaterial increase in the Company's financing costs.
- 1.35.11 Lack of success in the clinical trials: A lack of success in the Company's future clinical trials could affect the Company's results and its forecast of increasing the market share of its products in the DVT field in the coming years.
- 1.35.12 Lack of change in current generally accepted DVT prevention practice: If the current generally accepted practice of drug therapy in combination with supplementary treatment using devices is not replaced by a new practice whereby the main and binding treatment is administered using devices, this could affect the Company's forecast of increasing the market share of its products in the DVT prevention field in the coming years.
- 1.35.13 New products under development: The Company is pursuing the development of new products. The sales and marketing of these products is conditional to reinforcing the clinical trial findings, obtaining licensing for the products, and the other success and risk factors that are described in this report. It is uncertain whether the Company will succeed in the clinical research and/or obtain all the regulatory approvals required to produce and market the products and/or succeed in introducing them into the market.
- 1.35.14 The Company's dependency on two key employees: The Company is dependent on the Company CEO and Chief Scientist, who are key Company employees. Termination of their employment in the Company could impair its functioning and business results for at least the time required to reorganize, as described in section 1.19.6 of this report.
- 1.35.15 Airport strikes: Exceptionally long strikes and/or sanctions at the airport could cause significant delays in supplying products, which could result in higher costs associated

with alternative, more expensive means of shipment, and in extreme cases, this could even lead to a loss of customers.

However, in view of the Company's capacity to make arrangements to manufacture the products overseas in a relatively short time period without incurring any significant additional cost, this factor is not a long-term risk for the Company

1.35.16 The following table shows the Company's risk factors by the nature of the risk and the management's opinion in respect of their impact on the Company's business:

	<b>Risk factor</b>	<b>Great impact</b>	<b>Moderate impact</b>	<b>Small impact</b>
Sector specific risks	Changes in the regulatory situation		+	
	The global economic situation		+	
	Reduction in the intellectual property rights protection		+	
	Responsibility for product quality		+	
	Technological developments	+		
	Pharmaceutical developments	+		
Risks peculiar to the Company	Dependency on external finance	+		
	Dependency on suppliers		+	
	Currency exposure			+
	Variable interest rates			+
	Clinical trial success		+	
	Lack of change in the current generally accepted DVT prevention practice	+		
	New products for development			+
	Dependency on two key employees		+	
	Airport strikes			+

**Medical Compression Systems (D.B.N.) Ltd.**

**Report by the Directors on the Company's Affairs for the Year Ended December 31, 2010**

The Board of Directors of Medical Compression Systems (D.B.N.) Ltd. Is Pleased To Present Its Report For The Year Ended December 31, 2010.

**1. The Company and Its Business Environment:**

In 1997, Medical Compression Systems (D.B.N.) Ltd. ("company" or "entity") was incorporated in Israel, and today operates in Israel, Japan, Korea and the United States (operations in the United States are carried out directly, or through a subsidiary, as defined below). The company is primarily involved in the development, production, and marketing of non-invasive and non-drug solutions for the improvement of blood circulation in the limbs. The company's first product was a device to prevent the Deep Vein Thrombosis ("DVT") syndrome. For additional information on the company's operations, see 1.7 for a report on the company's business affairs (Part A), which is attached to this report.

The consolidated financial results include the operating results of the company as well as the operating results of Medical Compression Systems Inc., a fully owned US subsidiary. All data in this report is expressed in United States Dollars, which is the company's functional currency, as explained in note 2D to the financial statements, attached under Chapter C to this report.

Up to this year, the first generation of Active Care ® was sold, with sales totaling \$24 million in the United States, Japan, and Israel. During 2008, clinical test trials were completed proving that the company's second generation project - Active Care + SFT ® ("SFT") was safer for use and just as efficient as "Lovenox" the market's leading blood clot drug for joint replacement operations. During 2009, product marketing began. As part of the company's strategy to maintain its technological leadership, the company has started to develop its third-generation product - Active Care +SFT + Diagnostics. During March 2010, results were published in JBJS, the profession's leading orthopedic monthly.

Users of SFT products can be divided into two primary types - medical centers (with the products marketed through agents and directly by the company itself) and patients, who are treated at home after release from hospitalization, through agents (DME providers) with which the company has contracted with. The SFT products are available at medical centers and/or at the agents, remain the property of the company, and are reported under property, plant and equipment in the statement of financial position. Company revenue is earned on payments for treatments provided using the product. For additional information, see note 1.11.7 to the financial statements attached under Part A.

As part of its strategy to maintain technological leadership, the company has started to develop its third-generation product - Active Care +SFT + Diagnostics. The objective of this development is to improve the ability to identify and diagnose DVT buildup. It should be noted that notwithstanding any preventive care with drugs or the company's device, deep vein blood clots still occurred in a group of patients (approximately 5%), and accordingly the company believes that the device, together with the DVT preventive treatment, will give it a significant advantage, and will provide a solution for diagnosing this complication when it appears.

The company's Active Care + SFT + Diagnostics product is expected to be a leading product in its field and will allow for a mix of preventing and diagnosing DVT. If the third generation's development objectives will be realized, the product will set a new standard in the field of DVT prevention and treatment.

It should be noted that the product is a natural follow up on the Active Care + SFT ® development.

The financial information included in this report, including comparative information, was extracted from the company's financial statements, which were prepared under International Financial Reporting Standards.

**2. Events during the Report Year:**

2.1. On January 5, 2009, the company signed an agreement with an Israeli financial institution ("lender") for a credit line of \$1 million, of which the company has already drawn \$750 thousand.

On February 17, 2010, the company agreed to changes in the loan terms, and receipt of an additional credit line of \$250 thousand. During August 2010, the company used its additional credit line. The additional loan will be repayable in 24 equal installments, from July 29, 2011. During September 2010, the company signed an agreement with the lender for a new credit line of \$750 thousand. During December 2010, the company used its new credit line in full. For additional information, see note 12 to the financial statements, attached under Chapter C of this report.

2.2. On March 1, 2010, the Board of Directors approved a grant to the president of its subsidiary in accordance with terms of his employment, of 350 thousand options available for conversion into 350 thousand Ordinary shares, NIS 0.01 par value each. For additional information on the options and benefits, see note 18 C to the financial statements, attached under Chapter C of this report.

2.3. On March 8, 2010, the Board of Directors approved the appointment of Mr. Eitan Nahum, as chairman of Board of Directors. On said date, the Board of Directors also approved the terms of his tenure as chairman of the Board of Directors and as consultant, including a grant of 350 thousand options available for conversion into 350 thousand Ordinary shares, NIS 0.01 par value each. Terms of his tenure including the option grants, were approved by the July 26, 2010 general meeting of shareholders. For additional information, see notes 18 C and 23I to the financial statements, attached under Chapter C of this report, and Regulation 21, attached under Chapter D of this report.

2.4. On March 8, 2010, the Board of Directors, after the January 12, 2010 approval by the Audit Committee, approved a \$ 40 thousand bonus to the company's CEO, in respect of the year ended December 31, 2009.

2.5. On April 30, 2010, the company redeemed 2,439,229 of par value bonds at a cost of \$721 thousand.

2.6. On May 11, 2010, the Board of Directors approved a grant to the VP - Commercial Operations, of 350 thousand options available for conversion into 350 thousand Ordinary shares, NIS 0.01 par value each. For additional information on the options and benefits, see note 18C to the financial statements, attached under Chapter C of this report.

2.7. On June 20, 2010, the Board of Directors approved the terms of tenure of Mr. Adi Dagan, as CEO of the company, and as consultant after the term of his tenure, and a grant of 420 thousand options available for conversion into 420 thousand Ordinary shares, NIS 0.01 par value each. For additional information, see notes 18C and 23K to the financial statements, attached under Chapter C of this report and Regulation 22 attached under Chapter D of this report.

On January 27, 2011, the Board of Directors approved an extension of Mr. Dagan's tenure as CEO, for an additional term of three months beginning April 1, 2010, with terms of employment unchanged.

2.8. On June 20, 2010, the Board of Directors approved a grant to Dr. Jacob Barak, VP-Technology, of 350 thousand options available for conversion into 350 thousand Ordinary shares, NIS 0.01 par value each. For additional information, see notes 18 C and 23L to the financial statements, attached under Chapter C of this report and Regulation 22 attached under Chapter D of this report.

2.9. During the July 27, 2010-August 9, 2010 period, the company raised \$1 million (equivalent to NIS 3,774 thousand) through a rights issue to its shareholders. For additional information, see note 17I to the financial statements, attached under Chapter C of this report.

2.10. On September 5, 2010, Mr. Menachem Inbar was appointed company director.

2.11. On October 22, 2010, the general meeting of shareholders approved a non-significant private placement to controlling shareholders of the company – Accelmed and Nissan. The grant includes 400 thousand Ordinary shares, NIS 0.01 par value each, against a consideration of \$333 thousand (equivalent to NIS 1,200 thousand), reflecting a price of NIS 3 per share. For additional information, see notes 17J and 23M to the financial statements, attached under Chapter C of this report.

2.12. During 2010, directors and senior officeholders of the company converted 241,135 options into 241,135 Ordinary shares, NIS 0.01 par value.

2.13. On December 23, 2010, the Board of Directors approved a grant to Mr. Ori Mor, Chief Financial Officer, of 70 thousand options available for conversion into 70 thousand Ordinary shares, NIS 0.01 par value each. For additional information on the options and benefits, see note 18C to the financial statements, attached under Chapter C of this report.

### **3. Subsequent Events:**

3.1. On January 27, 2011, the Board of Directors approved a non-significant grant of 144 thousand options available for conversion into 144 thousand Ordinary shares, NIS 0.01 par value each, including 109 thousand options to 13 Israeli employees of the company (including one officeholder) and 35 thousand options to an American employee of the subsidiary. The options to the one officeholder are considered "non-significant".

3.2. On January 27, 2011, the Board of Directors approved a change of terms in respect of the 350 thousand options that were granted to Dr. Jacob Barak, VP-Technology, as noted in note 18C(18). According to the change, in the event of any merger, acquisition, or reorganization of the company, or into another company, and if the company is not the surviving company, or a sale of all or part of the company's assets or shares, and if his employment will be discontinued at the request of the acquiring company, the option's vesting program terms will be accelerated vis à vis options that have not yet been exercised by the recipient, such that all options as stated will vest 10 days before the transaction date.

3.3. On March 24, 2011, the Board of Directors approved a non-significant private issue of 1,046,667 Ordinary shares, NIS 0.01 par value each, to a number of recipients who are not controlling shareholders of the company and not interested parties of the company, except for Yelin Lapidot Provident Fund Management Limited which is an interested party of the company on the basis of its holdings, against a consideration of NIS 3,925 thousand, reflecting a share price of NIS 3.75.

In addition, the controlling shareholders of the company agreed to invest \$300 thousand in the company, under the same terms as noted above, subject to approvals required by law.

3.4. During March 2011, an Israeli bank offered the company a postponement of the repayment date of a \$ 1 million debt to it, allowing for repayments to begin during June 2012, and additional credits of \$500 thousand for repayment in 24 payments from June 2012, against a conditional grant in the event of a sale of most of the company's shares to an outside investor. The offer is limited in time, and the company has not yet decided if to accept the offer, because of other offers that it has received.

### **4. Financial Situation:**

#### **4.1. Working Capital:**

The company's working capital totaled \$1,459 thousand as of December 31, 2010, compared with \$2,548 thousand as of December 31, 2009. Working capital as of December 31, 2010 includes, inter alia, cash and cash equivalents of \$2,084 thousand, trade receivables of \$1,611 thousand, and inventory of \$483 thousand, offset primarily by current maturities of convertible bonds of \$1,118 thousand, trade payables of \$997 thousand, current maturities of bank loans of \$363 thousand and other payables of \$839 thousand.

The company's working capital as of December 31, 2009, includes, inter alia, cash and cash equivalents of \$3,301 thousand, trade receivables of \$551 thousand, and inventory of \$463, offset primarily by current maturities of convertible bonds of \$716 thousand, trade payables of \$649 thousand, current maturities of bank loans of \$272 thousand and other payables of \$321 thousand.

As noted in 9 below, during 2010 the company raised \$2,048 thousand, through a private placement, a rights issue, and options conversion. Furthermore, the company also drew \$1 million from its credit line, as noted in 2.1 above.

#### **4.2. Inventory:**

Inventory as of December 31, 2010 totaled \$483 thousand compared with \$463 thousand as of December 31, 2009.

#### **4.3. Property Plant and Equipment:**

Assets as of December 31, 2010 totaled \$1,709 thousand compared with \$835 thousand as of December 31, 2009. The increase results primarily from investments in SFT products (see 1 above), offset by accumulated depreciation. As already noted, the SFT product is available at various medical centers and/or its agents (DME provider), but remains the property of the company, generating revenue against payments for treatment offered using the product.

#### **4.4. Equity:**

Equity as of December 31, 2010 totaled \$5,525 thousand compared with \$5,901 thousand as of December 31, 2009. The change in equity is the result of capital issues, exercise of options and the cost of share-based payments, offset by current losses.

### **5. Operating Results:**

#### **5.1. Revenue:**

Revenue for 2010 totaled \$5,726 thousand compared with \$3,327 thousand during 2009, reflecting an increase of 72%. The increase during the period resulted from a significant increase SFT product sales and an increase in sales of first generation products to US medical centers.

#### **Breakdown of Revenue during 2010, By Quarter** **(Expressed In \$ Thousands)**

<b>Period</b>	<b>Total for 2010</b>	<b>10-12/ 2010</b>	<b>7-9/ 2010</b>	<b>4-6/ 2010</b>	<b>1-3/ 2010</b>
<b>Revenue</b>	5,726	1,604	1,520	1,279	1,323
<b>Increase (decrease) vis à vis the previous quarter</b>		5.5%	18.8%	-3.3%	

The increase in revenue during the last two quarters reflects an increase in SFT sales.

**Breakdown of Revenue, By Primary Customers (Expressed In \$ Thousands)**

	2010	2009
<b>Scripps - First Generation</b>	1,415	1,170
<b>Harada</b>	436	628
<b>Others - First Generation</b>	1,998	1,276
<b>Others - SFT</b>	1,877	253
<b>Total</b>	5,726	3,327

Products destined for the Scripps Clinic hospital chain are purchased directly from the company by Professional Hospital Supply, a logistics company that services the Scripps chain. Harada is a local distributor in Japan, through which the company makes all its sales in Japan.

**5.2. Breakdown by Business Segments:**

Company management decided to focus on a segmental analysis of first-generation and second-generation (SFT) and products. The analysis of business segments reported in the financial statements also focuses on this breakdown.

**Breakdown of Revenue, By Business Segment (Expressed In \$ Thousands)**

	2010		2009	
	Revenue	%	Revenue	%
<b>First-generation products</b>	3,849	67%	3,074	92%
<b>Second-generation products</b>	1,877	33%	253	8%
<b>Total</b>	5,726	100%	3,327	100%

**5.3. Gross Profit:**

Gross profit for 2010 was \$3,200 thousand, or 55.9% of revenue, compared with \$1,443 thousand, or 43.4% of revenue during 2009. The increase in gross profit and the gross profit margin during 2010 compared with 2009 is primarily the result of increased sales of SFT products, which yield higher profit margins.

**Changes in Gross Profits, By Quarter During 2010**

	10-12/ 2010	7-9/ 2010	4-6/ 2010	1-3/ 2010	2009
<b>Gross Profit</b>	946	900	681	673	1,443
<b>Gross Profit Margin</b>	59.0%	59.2%	53.2%	50.9%	43.4%

**5.4. Research and Development Costs:**

During 2010, the company incurred research and development costs of \$760 thousand compared with \$646 thousand during 2009 (including costs that were capitalized to balance sheet accounts), the result of increases in the cost of share-based payments in respect of options granted to the VP-Technology during 2010, of \$132 thousand compared with \$4 thousand during 2009. During 2009 of all research and development costs, in accordance with provisions of IAS 38, \$61 thousand was capitalized and recorded as an intangible asset. Accordingly, research and development costs during 2009 totaled 585 thousand.

**5.5. Selling and Marketing Expenses:**

During 2010, selling and marketing expenses totaled \$3,545 thousand compared with \$1,422 thousand during 2009. The increase in selling and marketing expenses resulted from an allocation of more financial and managerial resources for increasing SFT sales in the United States. The allocation of resources includes, inter alia, recruitment of a senior management team and a sales team for the marketing and sales staff, and additional financial resources to market the company's products. In addition, there was an increase in agents' commissions, which are a function of SFT revenue. The significant increase in company revenue from SFT product treatments, also led to an increase in these expenses, which during 2010 totaled \$504 thousand compared with \$73 thousand during 2009. In addition, 13% of the change is explained by an increase in the cost of share-based payments in respect of options granted to employees of the subsidiary and to the company's CEO during 2010. Total expenses in respect of this component during 2010 totaled \$273 thousand, compared with \$12 thousand during 2009.

**5.6. Management and General Expenses:**

During 2010, management and general expenses totaled \$1,555 thousand compared with \$1,148 thousand during 2009. The increase in management and general expenses during the year resulted primarily from an increase in the cost of share-based payments which totaled \$251 thousand during 2010 compared with \$61 thousand during 2009, and an increase in professional services (including various consulting services), resulting inter alia from an expansion of company operations. During 2010, these expenses totaled \$494 thousand compared with \$316 thousand during 2009, including \$26 thousand in respect of a provision for doubtful debts.

**5.7. Operating Loss:**

The operating loss for 2010 totaled \$2,660 thousand compared with an operating loss of \$1,712 thousand during 2009. The increase in the operating loss resulted mainly from the increase in selling and marketing expenses, as noted in 5.5 above, offset by an increase in gross profits, as noted in 5.3 above. The 2010 operating loss includes \$662 thousand in respect of cost of share-based payments, which do not involve any cash flows, compared with \$56 thousand during 2009.

**5.8. Financing Income and Expenses:**

Net financing expenses during 2010 totaled \$542 thousand (financing expenses of \$606 thousand against financing income of \$64 thousand), compared with net financing expenses of \$1,411 thousand during 2009 (financing expenses of \$1,414 thousand against financing income of \$3). The change is mainly the result of a \$50 thousand decrease in bond revaluation expenses during 2010 compared with \$1,022 thousand during 2009, offset by a 2010 increase in option revaluation of \$316 thousand compared with \$67 thousand during 2009.

**5.9. Net Loss for the Period:**

Losses during 2010 totaled \$3,202 thousand compared with \$3,123 thousand during 2009. Most of the increase resulted from an increase in selling and marketing expenses as noted in 5.5 above, offset by an increase in gross profits as noted in 5.3 above and a decrease in financing expenses as noted in 5.8 above.

6.

**Summarized Consolidated Statements of Operations, by Quarter, for 2010**  
**(Expressed in \$ Thousands)**

	2010	4 <sup>th</sup> Quarter	3 <sup>rd</sup> Quarter	2 <sup>nd</sup> Quarter	1 <sup>st</sup> Quarter
<b>Revenue</b>	5,726	1,604	1,520	1,279	1,323
<b>Cost of revenue</b>	2,526	658	620	598	650
<b>Gross profit</b>	3,200	946	900	681	673
<b>Research and development</b>	760	215	177	221	147
<b>Selling and marketing</b>	3,545	1,077	919	788	761
<b>Management and general</b>	1,555	556	388	320	291
<b>Operating loss</b>	(2,660)	(902)	(584)	(648)	(526)
<b>Net financing income (expense)</b>	(542)	(366)	(75)	124	(225)
<b>Loss</b>	(3,202)	(1,268)	(659)	(524)	(751)

**7. Liquidity and Cash Flows:**

**7.1. Cash Flows - Current Activities:**

Cash flows used for current activities during 2010 totaled \$2,219 thousand compared with cash flows used for current activities of \$2,203 thousand during 2009. The increase in net cash used for current activities resulted primarily from an increase in the loss (see 5.9 above), an increase in trade receivables, an increase of \$1,060 thousand during 2010 compared with an increase of \$67 thousand during 2009, offset by an increase in the cost of share-based payments of \$662 thousand during 2010 compared with \$56 thousand during 2009 and an increase in expenses charged as a result of changes in the fair value of options measured at fair value of \$316 thousand during 2010 and compared with \$67 thousand during 2009.

**7.2. Cash Flows - Investing Activities:**

Cash flows used for investing activities totaled \$1,283 thousand during 2010 compared with cash flows used for investing activities of \$155 thousand during 2009. The change resulted primarily from the manufacture of SFT products, with a total turnover of \$1,463 thousand during 2010. As already noted these products are located at medical centers and/or agents and generate revenue income for the company.

**7.3. Cash Flows - Financing Activities:**

Cash flows from financing activities totaled \$2,285 thousand during 2010, resulting primarily from a capital issue, and proceeds on exercise of options, as noted in 9 below, and a long-term bank loan as noted in 2.1 above, offset by bond repayments as noted in 2.5 above, compared with cash flows from financing activities of \$4,511 thousand during 2009, which resulted primarily from private placement of \$2,328 thousand, a shelf offer of \$1,931 thousand and a long-term bank loan, offset by repayment of a long term bank loan.

**8. Cash Flows Expected To Be Available To Finance the Entity's Liabilities, Based On Its Liabilities and Expectations as of December 31, 2010:**

The company has incurred ongoing negative cash flow from current activities, however, the company's Board of Directors has decided, that the negative cash flows do not reflect any liquidity problems. The Board of Directors believes that there is no reasonable concern that during the forecasted cash flow period, that the company will not comply with its current and expected liabilities when due. The Board of Directors has based its conclusions on the fact that the company has sufficient cash balances in order to repay its debts and liabilities on their due dates, and accordingly the company does not expect any liquidity problems.

**9. Financing Sources:**

- 9.1. During 2010, the company raised \$885 thousand through a private placement,  
 9.2. During 2010, the company raised \$1 million through a rights issue,  
 9.3. During 2010, 696,501 options were converted against proceeds of \$163 thousand,  
 9.4. During 2010, the company drew \$1 million from its credit line, as noted in 2.1 above.

**10. Donations:**

The company does not have any formal donation policy. During the report year, the company donated \$50 thousand to a US medical center.

**11. Disclosure of Financial Liabilities Designated At Fair Value through Profit And Loss and Treated Accordingly In the Financial Statements:**

The company's financial liabilities designated at fair value as of December 31, 2010 include NIS 3,658,844 par value of Series A Bonds, convertible into shares. These bonds bear interest of 6.25% per year, and are linked to the Consumer Price Index of May 2006.

**Expected Payments Vis À Vis The Balance Of Convertible Bonds,  
As Of December 31, 2010, Expressed In \$ Thousands.**

	Interest	Capital	Total
<b>April 30, 2011</b>	37	1,168	1,205

In accordance with International Accounting Standard 32 - "Financial Instruments: Presentation" as the conversion component is linked to the Consumer Price Index, and is not denominated in US Dollars (the company's functional currency), the bonds are deemed a financial liability without any capital component. In accordance with International Accounting Standard 39 - "Financial Instruments: Recognition and Measurement" the company measures its bonds which are convertible into shares at fair value. Changes in fair value are charged to profit and loss during each report period.

**Details Of The Fair Value Of Bonds, And Changes Therein, Expressed In \$ Thousands**

	31.12.2010	31.12.2009
<b>Book value of convertible bonds, less accrued interest payable</b>	1,118	1,789
<b>Increase (decrease) in the fair value of convertible bonds, for the year ended</b>	50	1,022

Changes in the fair value of the convertible bonds mirror fluctuations in the prices of these securities on the Stock Exchange.

In addition, on April 30, 2010, the company redeemed 40% of its convertible bonds. See note 12A to the financial statements, attached under Chapter C of this report.

**12. Exposure To Market Risks And Their Management:**

The economic and accounting risks to which the company is exposed include - exchange rate risks, and to a lesser degree, changes in the Consumer Price Index and interest rates - the company is exposed to changes in the US Libor linked interest rates because of loans from a financial institution denominated in Libor linked interest rates. The company's policy on reducing its exposure is based on holding sufficient cash balances to cover, to its best, the foreign currency nature of its liabilities.

Company expenses and costs include a foreign currency component (mainly the Dollar), primarily for materials and services, and a Shekel component (primarily for labor, vehicle and communication expenses).

Accordingly, there is some exposure to relative changes in foreign currency exchange rates, mainly the Dollar-Shekel, Japanese Yen-Dollar, and the Euro-Shekel rates.

During the report period, the company entered into forward transactions in foreign currency, the goals of which were to protect it against fluctuations in foreign currency on part of its Shekel- denominated expenses. The foreign currency forward contracts are not designated as hedging instruments on cash flows, fair value or net investments, and are closed once a month, matching the periods when the company is exposed to the Shekel vis à vis said expenses. These derivatives are not considered hedging instruments from the accounting standpoint.

The company has appointed its Chief Executive Officer, Mr. Adi Dagan to manage its economic risks, and its Chief Financial Officer, Mr. Uri Mor, to manage its financial market risks. For information on market risks, see note 13 to the financial statement, attached under Chapter C of this report. On a regular basis, the Board of Directors considers the company's degree of exposure to market risks, and decides if there is any need for a change in its policy on managing these risks and the steps that are necessary to protect the company.

Below are the linkage terms of the balances, expressed in thousands of US Dollars.

## (B-10)

	December 31, 2010							December 31, 2009						
	¥	€	NIS	CPI	Non Linked Items	Non- Monetary Items	Total	¥	€	NIS	CPI	Non Linked Items	Non- Monetary Items	Total
<b>Assets:</b>														
<b>Cash and cash equivalents</b>	56	82	639	-	1,307	-	2,084	-	-	2,849	-	452	-	3,301
<b>Restricted deposit</b>	-	-	90	-	-	-	90	-	-	6	-	-	-	6
<b>Trade receivables</b>	-	-	94	-	1,517	-	1,611	84	-	74	-	393	-	551
<b>Other receivables</b>	-	-	186	78	16	228	508	-	-	73	3	-	109	185
<b>Inventory</b>	-	-	-	-	-	483	483	-	-	-	-	-	463	463
<b>Long-term balances</b>	-	-	15	-	-	104	119	-	-	-	24	-	111	135
<b>Property, plant and equipment, net</b>	-	-	-	-	-	1,709	1,709	-	-	-	-	-	835	835
<b>Other assets, net</b>	-	-	-	-	-	4,196	4,196	-	-	-	-	-	4,230	4,230
	56	82	1,024	78	2,840	6,720	10,800	84	-	3,002	27	845	5,748	9,706
<b>Liabilities:</b>														
<b>Bank loans</b>	-	-	-	-	1,750	-	1,750	-	-	-	-	752	-	752
<b>Trade payables</b>	-	97	602	-	298	-	997	-	14	241	-	394	-	649
<b>Other payables</b>	-	-	401	12	426	-	839	-	-	292	-	29	-	321
<b>Convertible bonds*</b>	-	-	-	-	-	1,118	1,118	-	-	-	-	-	1,789	1,789
<b>Options</b>	-	-	-	-	-	530	530	-	-	-	-	-	214	214
<b>Liabilities for employee severance</b>	-	-	-	-	-	41	41	-	-	-	-	-	80	80
	-	97	1,003	12	2,474	1,689	5,275	-	14	533	-	1,175	2,083	3,805

\* The convertible bonds are CPI linked, and total \$1,168 thousand (2009: \$1,790 thousand). The bonds are measured in accordance with IAS 39, based on the instrument's stock exchange price. Accordingly, the bonds are valued at \$ 1,118 thousand (2009: \$1,789 thousand) only and are classified as non-monetary items.

**Sensitivity Tests - Sensitive Instruments, According To Changes In Market Factors.**

	Sensitivity To The Consumer Price Index				
	Income (Loss) From Changes		Fair Value As of December 31, 2010	Income (Loss) From Changes	
	Increase Of 10% In Market Factors	Increase Of 5% In Market Factors		Decrease Of 5% In Market Factors	Decrease Of 10% In Market Factors
Expressed In \$ Thousands					
Convertible bonds, and interest there on	(121)	(60)	1,205	60	121

**13. Compensation To Interested Parties And Senior Officeholders:**

Following are the Board of Directors' explanations regarding compensation given during the report period to interested parties and senior officeholders of the company, as referred to in Regulation 21 of Securities Regulations (Periodic and Immediate Reports), 5730-1970 ("Reporting Regulations") included under the "Additional Details on the Entity" chapter .

Before convening the Board of Directors, members of the Board of Directors receive details on the employment agreements of each interested party and senior officeholder of the company including market comparative data of compensation paid to officeholders and interested parties of other companies of the same scope and fields of operations as the company, whenever this information is available to the company. On March 31, 2011, a meeting of the Board of Directors was held to discuss the terms of employment of each interested party and senior officeholder of the company. Moreover, the Board of Directors also reviewed the fields of responsibility and performance of each interested party and senior officeholder and individual operating results vis à vis operating results of the company, against comparative data of compensation to interested parties and senior officeholders in similar positions, at companies whose fields of operations and scope of operations are similar to those of the company.

In order to consider the relationship between the compensation given to officeholders and interested parties and their contribution to the company, the Board of Directors considered the information detailed in Regulation 21 of the Reporting Regulations and Schedule 6 of the Regulations, and set out criteria for considering the compensation. The main points of the criteria are as follows: (A) compliance by the officeholder with requirements of the position that he holds and the company's targets, accompanied by an evaluation of his functioning, performance and contribution by company management and the Board of Directors (B) the scope and complexity of company operations (C) market terms and (D) changes in the scope of operations of the company and market terms.

The Board of Directors discussed, inter alia, the fields of responsibility and the effectiveness, of each senior officeholder and interested party during 2010 and the relationship between the amount of compensation given to each of said during the report period, and his contribution to the company during this period.

As part of the process of approving the 2010 financial statements, the Board of Directors decided, vis à vis each interested party and senior officeholder of the company, that the compensation offered is fair and reasonable and reflects his contribution to the company during 2010.

**Following Are The Main Points Considered By The Board Of Directors In Respect Of Compensation Paid To Each Interested Party and Senior Officeholders:**

**13.1. Mr. Adi Dagan, CEO:**

For details on compensation paid to the company's CEO for 2010, see Regulation 21, under "Additional Details on the Entity", below. During a meeting of the Board of Directors, the following points were discussed:

(A). The importance of Mr. Dagan's experience and personal contribution to the company's operations and success.

(B). Mr. Dagan is the company's founder, has managed it for 11 years, and has been responsible in the most deciding way, including during 2010, for building the company's business model and leading the SFT strategic change, which has earned the company significant business potential. In addition, Mr. Dagan has made serious contacts with leading factors in the American market, leading the company's entry into the American market.

(C). In the opinion of members of the Board of Directors, the compensation paid to Mr. Dagan is in accordance with Israeli market standards. Members of the Board of Directors believe that the bonus formula established for Mr. Dagan is representative of the industry and offers an incentive to Mr. Dagan, as company CEO, to improve company results. The bonus formula reflects the main targets, which the Board of Directors has defined for the CEO of the company - significant growth in sales and profitability. The bonus is a factor of the volume of sales turnover and profitability as set out in the formula and is reasonable vis à vis compensation paid to officeholders at public companies in Israel and vis à vis the industry.

(D). In addition, members of the Board of Directors are of the opinion that the CEO makes a significant contribution to the company's strategic success.

Based on the mix of information and data presented to the Board of Directors, in the opinion of the Board of Directors, after considering that discussed during the meeting and after reviewing, inter alia, the company's operating results, compliance with goals, Mr. Dagan's performance, and the comparative data, the compensation paid to Mr. Dagan during 2010 is considered reasonable and fair.

**13.2. Dr. Jacob Barak, VP- Technology:**

For details on compensation paid to the company's VP-Technology for 2010, see Regulation 21, under "Additional Details on the Entity", below. During a meeting of the Board of Directors, the following points were discussed:

(A). Dr. Barak's significant experience and personal contribution to the company's operations and success. Dr. Barak is a significant factor in the company's operations and success, and is instrumental to the company in maintaining its operations.

(B). Dr. Barak is one of the company's founders and has developed the technology that serves as a basis for its products. Members of the Board of Directors have noted his importance and personal contribution to the company, as innovator and developer of the company's first products, and the support for developing the company's products. As the company is now making inroads in markets where large companies are established and are known, the ability of the company to access these markets is dependent on its constant creativity and innovations in order to continue to market-differentiate its products in a manner that will enable it to compete successfully with its competitors. Members of the Board of Directors believe that for meeting these goals, there is definite importance to the significant contribution of Dr. Barak to the company's growth and success.

(C). In the opinion of members of the Board of Directors, Dr. Barak receives compensation which is proper and reasonable vis à vis his contributions, performance, continued operations of the company, and vis à vis that accepted in the market and vis à vis the company's own particular circumstances.

(D). In the opinion of members of the Board of Directors, the social benefits paid to Dr. Barak are in accordance with Israeli market standards.

Based on the mix of information and data presented to the Board of Directors, in the opinion of the Board of Directors, after considering that discussed during the meeting and after reviewing, inter alia, the company's operating results, compliance with goals, Dr. Barak's performance, and the comparative data, the compensation paid to Dr. Barak during 2010 is considered reasonable and fair.

### **13.3. Mr. Ori Mor, Chief Financial Officer**

For details on compensation paid to the company's CFO for 2010, see Regulation 21, under "Additional Details on the Entity", below. During a meeting of the Board of Directors, the following points were discussed:

(A) The Board of Directors has considered Mr. Mor's performance and contribution during 2010 and inter alia, all that related to managing the financial set up and raising funds for the company, preparing the financial statements of the company, preparations and readiness of the company to embed the company's internal controls and its successful application, and the handling of tax issues, and has decided that Mr. Mor has complied with the terms of the agreement with him and requirements of this position in a most professional and responsible manner.

(B) In the opinion of members of the Board of Directors, the terms of his employment are reasonable vis à vis that acceptable in the Israeli market, and vis à vis the company's own particular considerations.

Based on the mix of information and data presented to the Board of Directors, in the opinion of the Board of Directors, after considering that discussed during the meeting and after reviewing, inter alia, the company's operating results, compliance with goals, Mr. Mor's performance, and the comparative data, the compensation paid to Mr. Mor during 2010 is considered reasonable and fair.

### **13.4. Mr. Ambaw Bellete, Subsidiary President:**

For details on compensation paid to the subsidiary's President for 2010, see Regulation 21, under "Additional Details on the Entity", below. During a meeting of the Board of Directors, the following points were discussed:

The Board of Directors is the opinion that Mr. Bellete's salary does not exceed that common in the marketplace and inter alia, after considering salaries paid in the United States for a similar position, and based on information provided by an outside consultant who was hired for recruiting Mr. Bellete.

Based on the mix of information and data presented to the Board of Directors, in the opinion of the Board of Directors, after considering that discussed during the meeting and after reviewing, inter alia, the company's operating results, compliance with goals, Mr. Bellete's performance, the compensation paid to Mr. Bellete during 2010 is considered reasonable and fair.

### **13.5. Mr. Charlie Harrison, VP-Commercial Operations:**

For details on compensation paid to the company's VP-Commercial Operations for 2010, see Regulation 21, under "Additional Details on the Entity", below. During a meeting of the Board of Directors, the following points were discussed:

The Board of Directors is of the opinion that Mr. Harrison's salary reflects his performance and contribution to company operations during the report period. The salary earned by Mr. Harrison is determined on the basis of information available to management and the Board of Directors in respect of similar positions in the United States. It should be noted that his salary is also a factor of other officeholders of the company.

Based on the mix of information and data presented to the Board of Directors, in the opinion of the Board of Directors, after considering that discussed during the meeting and after reviewing, inter alia, the company's operating results, compliance with goals, the compensation paid to Mr. Harrison during 2010 is considered reasonable and fair.

**13.6 Mr. Eitan Nahum, Chairman Of The Board Of Directors:**

For details on compensation paid to the Chairman of the Board of Directors for 2010, see Regulation 21, under "Additional Details on the Entity", below. During a meeting of the Board of Directors, the following points were discussed:

(A). Mr. Nahum serves as Chairman of the Board of Directors and provides consulting services. The Board of Directors has considered his strong efforts and contributions to the company and its subsidiary including efforts to implement the company's strategic plan, and found that after considering his efforts on behalf of the company, his contribution to the company, as well as other information that it received, Mr. Nahum's terms of compensation are appropriate, fair and reasonable.

(B). Mr. Nahum has strong and broad marketing and operational experience, including marketing setups in the company's fields of operations in general, and especially in companies operating in the US biomed field. Accordingly, members of the Board of Directors believe that Mr. Nahum's vast experience will help it in its efforts to penetrate and to establish its position in the US market.

(C). Members of the Board of Directors believe that the compensation to the Chairman of the Board of Directors is reasonable and acceptable vis à vis similar positions and services, is fair under the circumstances and reflects compensation, which is in line with his significant contribution in serving as Chairman of the Board of Directors.

Based on the mix of information and data presented to the Board of Directors, in the opinion of the Board of Directors, after considering that discussed during the meeting and after reviewing, inter alia, the company's operating results, compliance with goals, the compensation paid to Mr. Nahum during 2010 is considered reasonable and fair.

**14. Disclosure Regarding The Procedure For Financial Statement Approval:**

14.1. The Board of Directors is the forum responsible for the company's overall direction.

14.2. In accordance with Companies Regulations (Provisions and Conditions for the Process of Approving Financial Statements), 5770-2010, the Board of Directors has appointed a committee to examine its financial statements. This committee will be responsible for the company's prime controls, and will discuss, inter alia, the financial statements of the company, including internal audit controls related to the prime controls, and will submit its recommendations to the Board of Directors. This committee, which in fact will be the audit committee, has three members, all of whom hold accounting and financial expertise, as noted in 16 below. The members have submitted their declarations before appointment to the audit committee. The committee convened to discuss the financial statements after drafts of the financial statements were promptly sent to its members.

14.3. The meeting of the committee called to consider the financial statements was held on March 28, 2011, with Mr. Gad Appelbaum (independent director and chairman of the committee), Ms. Michal Even-Chen (independent director), and Dr. Amir Guttman (director) in attendance.

14.4. In addition, Mr. Ori Mor, Chief Financial Officer, Mrs. Avital Perlstein, Controller, and representatives of the company's public auditors – Kost, Forer, Gabbay & Kasierer, and the company's legal counsel – Pearl, Cohen, Zedek Latzer, also participated.

14.5. At the committee meeting, the Chief Financial Officer reviewed the principles of the financial statements and significant issues involved in the financial reporting, including:

- (A). Valuations and estimates that were included in the financial statements.
- (B). Assumptions and estimates that serve to base information reported in the financial statement.
- (C). The accounting policies and treatment adopted vis à vis the company's significant issues.
- (D). Internal audit issues related to financial reporting.
- (E). Completeness and appropriateness of the disclosures in the financial statements.

14.6. As part of the discussion, members of the committee raised various questions and submitted requests for clarification of various issues relating to the financial statements, and received replies from company management and representative of the public auditors. At the end of the discussion, the committee prepared its recommendations regarding approval of the financial statements, which were submitted to members of the Board of Directors before their discussion on the financial statements.

14.7. A draft of the periodic report was also promptly submitted to members of the Board of Directors, before their meeting to approve the financial statements.

14.8. The meeting of the Board of Directors to approve the financial statements was held on March 31, 2011, with the participation of all members of the Board of Directors as well as representatives of the public auditors. At said meeting, the chairman of the committee presented members of the Board of Directors with the committee's recommendations in respect of the financial statements. The Board of Directors discussed the committee's recommendations and found that, in its opinion, the recommendations of the committee were promptly submitted for discussion at the Board of Directors, considering the scope and complexity of its recommendations.

14.9. At said meeting, members of the Board of Directors raised several questions and requests for clarifications on various issues relating to the financial statements, the Board of Directors' report, and the report on forecasted cash flows, including a check of the reasonability of the basic assumptions and estimates used by the company in preparing its expected forecast. Company management replied to said questions.

14.10. At the end of the discussion, the Board of Directors decided to approve the financial statements as of December 31, 2010, including the Directors' Report and the report on the effectiveness of internal controls.

#### **15. Disclosure Regarding Independent Directors:**

The company has not adopted the provisions of Section 219 (E) of Companies Law, 1999, regarding the number of independent directors.

#### **16. Details Of Directors Having Accounting Expertise:**

In accordance with the provision of Section 92 (A) (12) of Companies Law, 1999, the company's Board of Directors has decided that the minimum number of directors to hold accounting and financial expertise will be one, this considering, inter alia, the company's size, its operations, and the number of its directors. In the company's opinion, this fact will enable the Board of Directors to comply with its responsibilities in accordance with law and the company's incorporation documents. As of financial statement publication date, five members of the Board of Directors hold accounting and financial expertise, as follows:

16.1. Dr. Amir Guttman, Ph.D. - Business Administration (Accountancy), University of California, Berkeley, Lecturer in the Master of Business Administration Program, Leon Recanati Graduate School of Business Administration, Tel Aviv University, managing partner of Aviv Venture Capital Fund, and a director of other companies.

16.2. Dr. Uri Geiger holds a doctoral degree in law from Columbia University. Dr. Geiger has extensive business experience and is a director of other companies.

16.3. Mrs. Michal Even-Chen - independent director, B.A. in Economics and International Relations and M.A. in International Relations. Mrs. Michal Even-Chen has extensive business experience and is a director of other companies.

16.4. Mr. Gad Appelbaum - independent director, B.A. in Economics and M.A. in Public Administration. Mr. Appelbaum has extensive business experience and is a director of other companies.

16.5. Mr. Menachem Inbar, B.A. in Economics, and M.A. in Law. Mr. Inbar has extensive business experience and is a director of other companies.

### **17. The Internal Auditor:**

On October 25, 2006, Mr. Avner Eliav, Certified Public Accountant and partner of an independent accounting firm, was appointed internal auditor.

The internal audit work is structured on professional internal audit standards, professional directives, and guidelines, as approved by the Institute of Internal Auditors, and in accordance with the requirements of Companies Law and Law of Internal Audits.

The internal auditor is independent vis-à-vis holdings of securities of the audited party, significant business relationships with the audited party or of any party related to said. The internal auditor provides services to the company and is not part of the company's staff.

The internal auditor reports to the Chairman of the Board of Directors.

#### **17.1. Audit Plan:**

The internal auditor submits his annual audit plan proposal to company management, which then reviews the plan and forwards it for approval by the Audit Committee of the Board of Directors, which is responsible for ultimate approval. The internal auditor has some flexibility in carrying out the audit plan. The internal auditor is not employed in any internal audit function or in any other manner, by the company or by its subsidiary. During 2010, the internal auditor worked 120 hours on behalf of the company. The internal auditor has full access to all information systems of the company. The internal auditor's reports are submitted in writing to the Chairman of the Board of Directors, the Chairman of the Audit Committee and to the Chief Executive Officer, after having submitted a draft for comments by management.

During 2010, the internal auditor's compensation totaled \$6 thousand. As the compensation is set in advance, the Board of Directors believes that this factor does not have any effect on the internal auditor's discretion.

In the Board of Directors' opinion, under the circumstances and considering the company's operations, its nature, continuity of operations, the internal auditor's audit plan is at this stage reasonable and adequate to realize the objectives of the company's internal audit.

### **18. Disclosures Regarding The Public Auditors' Fees:**

**Professional Fees And Hours Incurred By The Company's Public Auditors, For Audit Services,  
Services Related To The Audit, Current Tax Work And For Additional Services  
(Expressed In \$ Thousands)**

	2010		2009	
	Audit, Taxation, and Goshen Committee Report Related Work	Other Services	Audit And Taxation	Other Services
Professional fees	75	-	60	-
Hours expended	1,145	-	855	-

Audit fees are based on a per-hour rate, and were paid to Kost, Forer, Gabbay & Kasierer, the company's public auditors.

During 2009, the audit services included reviews of the quarterly financial statements dated March 31, 2009, June 30, 2009, and September 30, 2009, and audits of the annual financial statements dated December 31, 2009.

During 2010, the audit services included reviews of the quarterly financial statements dated March 31, 2010, June 30, 2010, and September 30, 2010, and audits of the annual financial statements dated December 31, 2010.

### **19. Critical Accounting Estimates:**

The company and its subsidiary have not made use of any critical accounting estimates, the use of said and/or any reasonable change thereto, or the result of the use of any other reasonable estimate, may significantly affect the financial situation and/or operating results of the company. However, increased SFT sales revenue may have an effect on the company's future financial results, and on the value of its research and development assets. In addition, for the purpose of calculating income recognized on SFT sales in the company's financial statements, the company estimates the average price per product use, and collection rates.

For information on the prime estimates and assumptions, which the company used in preparing its financial statements, see note 2B to the financial statements, attached under Chapter C to this report.

### **20. Peer Review:**

The Board of Directors has consented to a peer review. The goal of a peer review is to ensure proper accounting controls and to strengthen said, by creating appropriate systems for supervision. The Board is prepared to cooperate with its adoption and promotion.

### **21. Details Regarding Debt Instruments Of The Entity Held By The Public:**

21.1 As of publication date of this periodic report, there is 1 bond series still outstanding, as detailed below:

Series	Issue Date	Par Value Upon Issue (NIS Thousands)	Par Value Of Bonds Outstanding As Of 31.12.10 (NIS Thousands)	Par Value Of Bonds Outstanding Plus Linkage Differences As Of 31.12.10	Accrued Interest Payable As Of 31.12.10 (NIS Thousands)	Fair Value Of The Series In The Financial Statements As Of 31.12.10 (\$ Thousand)	Stock Exchange Value As Of 31.12.10 (\$ Thousand)	Type Of Interest And Rate	Capital Repayment Dates	Interest Repayment Dates	Linkage Base And Terms (Capital And Interest)
Series A	4.5.06	19,400	3,659	4,146	43	1,118	1,130	Fixed Interest Of 6.25%	40% on April 30, 2010 and 60% on April 30, 2011	October 30 and April 30 as from October 30, 2006 to April 30, 2011	Linked To The Consumer Price Index, For The Month Of March 2006

21.2. Series A Convertible Bonds, as detailed below. According to the trust deed, the company does not have the right of early repayment.

21.3. Hermetic Trust (1975) Ltd. serves as trustee for the Series A Bonds, details of which are as follows:

Contact person: Dan Avnon and/or Merav Offer-Oren; Address: 113 Hayarkon St., Tel Aviv 63573; P.O. Box 3524, Tel Aviv 61034. Telephone: 03-527-4867; Fax: 03-527-1451; e-mail: [hermetic@hermetic.co.il](mailto:hermetic@hermetic.co.il).

**21.4. Convertible Bonds:****Details Of Series A Bonds Conversion Terms**

Series	Securities That May Be Issued Upon Conversion Of The Bonds	Conversion Rate
Series A	Ordinary Shares, NIS 0.01	The conversion rate will be NIS 14.69 par value. Bonds can be converted into 1.36 Ordinary Shares, NIS 0.01 par value of the company <sup>1</sup>

**21.5. Series Bonds - Main Terms:**

The main terms of the bonds are as noted in 21.1 and 21.4 <sup>2</sup> above. If the company will not comply with certain milestones, as set out in its prospectus dated May 2006 ("milestones"), by September 30, 2007, up to 70% of the Series A bonds will be available for early repayment.

21.6. During the report year and as of publication of this report, there were no conversions of Series A Bonds.

**21.7. Adjustments Upon Distribution: <sup>3</sup>**

Distribution of bonus shares - if the company will distribute bonus shares, from the prospectus date and until the end of the conversion period, the Series A bondholders will continue to maintain their rights, such that immediately after the "determining date", the number of shares that a Series A bondholder will be entitled to upon conversion will be increased, by adding the number of shares that the Series A bondholder was entitled to as bonus shares if he had converted his Series A Bonds on the "determining date". The method of adjustment in the event of any rights issue cannot be changed. In the event of said adjustment, a Series A bondholder will not be entitled to receive any fractional shares. Excess shares that will be created as a result of said act, will be sold by the company on the stock exchange within one month of the exercise date, and the net proceeds less expenses, commissions and fees, will be paid to the entitled parties.

---

1. The conversion rate was adjusted following the December 2008 rights issue.

2. In addition, the bond terms stated that if the company will not comply with the milestones which were noted in the company's May 2006 prospectus ("milestones") by September 30, 2007, then, up to 70% of the Series A Bonds would be available for early repayment. To ensure compliance with all Series A Bond and Trust Deed terms, and to ensure payment of the bond capital, interest and linkage differences, until compliance with its milestones, the company recorded a lien in favor of the trustee on a bank account which served for the receipt of up to 70% of the par value of Series A Bonds proceeds. On October 2, 2007, the company announced that it was non-compliant vis à vis the milestones, and the right of each Series A bondholder to an early repayment of up to 70% of bonds that he held, on October 31, 2007. On October 31, 2007, the company called NIS 13,301,927 par value of bonds, for early repayment, or 68.6% of all Series A Bonds outstanding. The total amount paid by the company was NIS 13,514 thousand. After said repayment, NIS 6,098,073 par value of Series A Bonds remained outstanding. After the early repayment (by using the cash balances that were held in the lien account), said liens were lifted.

3. Said is in addition to all legal and Stock Exchange regulations.

Rights issue - if company shareholders will be offered, through a rights issue, securities of any type whatsoever, the quantity of shares that will be created upon conversion of the Series A Bonds will be adjusted for the rights' benefit component, as reflected by the relationship between the share price on the stock exchange on the "determining date", and the base price, "ex-rights". The method of adjustment in the event of any rights issue is not subject to change.

In addition, the company will not distribute any bonus shares that are not NIS 0.01 par value ordinary shares. to its NIS 0.01 par value shareholders. The company will not change the ancillary rights in respect of the NIS 0.01 par value ordinary shares, and will not issue shares of any new class that will be entitled to participate in any excess property of the company upon liquidation.

Dividend distributions - if the company will distribute a dividend in cash, the new conversion rate of the Series A Bonds will be adjusted for the ratio between the share price on the stock exchange on the determining date and the base price, "ex-rights". The method of adjustment in the event of any distribution of dividends is not subject to change.

#### **21.8. Terms for Involuntary Conversion:**

Should the company decide on a voluntary liquidation ("liquidation decision"), it will advise all outstanding Series A bondholders and the Trustee. Each bondholder who gave notice vis à vis said notice will be entitled, at his discretion, to be considered as if he exercised the conversion right vis-à-vis the Series A Bonds that he held, before passing the liquidation decision, if he advised the company in writing of his intention within three months of the liquidation decision. Accordingly, the bond holder will be entitled to participate in the distribution of any excess property of the company upon liquidation among its shareholders (after settlement of all company liabilities), in an amount that the company would have received upon liquidation of the company, if he was a shareholder of the company before the liquidation decision following conversion of his bonds - after deductions for interest and linkage differences paid him vis-à-vis said bonds on the date of the liquidation decision, or afterwards (however, except for interest and linkage differences whose payment date was before the date of the liquidation decision, even if paid on the date of the liquidation decision or afterwards).

#### **21.9. Description And Explanation Of Events And Significant Changes That Transpired Vis-À-Vis The Debt Instruments**

On October 2, 2007, the company announced its noncompliance with milestones, and the right of all Series A bondholders to an early repayment of up to 70% of all bonds that they held on October 31, 2007.

On October 31, 2007, the company early-repaid bonds of NIS 13,301,927 par value, reflecting 68.6% of all Series A Bonds outstanding. The total amount paid by the company was NIS 13,514 thousand. After said repayment, NIS 6,098,073 par value of Series A Bonds remained outstanding.

In accordance with the bond terms, on April 30, 2010 the company redeemed 40% of its outstanding convertible bonds, such that after said redemption, 3,658,444 par value of Series A Bonds remained in circulation.

As of publication date of this report, there were no conversions of Series A Bonds.

#### **21.10. Series Bond Collateral:**

To ensure compliance with all Series A Bond and Trust Deed terms, and to ensure payment of the bond capital, interest, and linkage differences, until compliance with its milestones, the company recorded a lien in favor of the trustee on a bank account which served for the receipt of 70% of the par value of Series A Bonds. After the early redemption (by using the cash balances that were held in the restricted account), said liens were lifted.

22.11. The Trust Deed that served as the basis for the bond issue did not impose any limitations on the company vis-à-vis creation of additional liens on its assets or vis-à-vis the authority of the company to issue other debt instruments.

22.12. As of December 31, 2010, the company was in compliance with all terms and liabilities under the Trust Deed vis-à-vis the Series A Bonds, there were no terms that would require calling said bonds for immediate repayment, and no notices were received from the trustee contrary to that stated above.

**This report was approved by the company's Board of Directors at its meeting held on March 31, 2011.**

---

**Eitan Nahum**  
**Chairman Of**  
**The Board Of Directors**

---

**Adi Dagan**  
**Chief Executive Officer**

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS AT DECEMBER 31, 2010**

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS AT DECEMBER 31, 2010**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
<b>Auditors' Report Regarding The Audit Of Internal Control Components</b>	<b>1</b>
<b>Auditors' Report To The Consolidated Financial Statements</b>	<b>2</b>
<b>Consolidated Statements Of Financial Position</b>	<b>3 – 4</b>
<b>Consolidated Statements Of Comprehensive Loss</b>	<b>5</b>
<b>Consolidated Statements Of Changes In Equity</b>	<b>6</b>
<b>Consolidated Statements Of Cash Flows</b>	<b>7 – 8</b>
<b>Notes To Consolidated Financial Statements</b>	<b>9 - 68</b>

**Auditors' Report To The Shareholders Of Medical Compression Systems (D.B.N.) Ltd.  
On The Audit Of Internal Control Components Over Financial Reporting In Accordance With  
Paragraph 9b(C) Of Securities Regulations (Periodic And Immediate Reports), 5730-1970**

We have audited the internal control components over financial reporting of Medical Compression Systems (D.B.N.) Ltd. ("company") as at December 31, 2010. These control components are as explained in the following paragraph. The company's board of directors and management are responsible for maintaining effective internal controls over the financial reporting process and for assessing the effectiveness of the company's internal control components over the financial report attached to the periodic report as at the above-noted date. Our responsibility is to express an opinion on the company's internal control components over its financial reporting based on our audit.

The internal control components over financial reporting audited by us are in accordance with Auditing Standard 104 of the Institute of Certified Public Accountants in Israel "Audit of Internal Control Components over Financial Reporting" ("Auditing Standard 104"). These components include: (1) entity level controls, including controls on the preparation and closing of the financial reporting process and information technology general controls; (2) controls over sales; (3) controls over payments (jointly - "audit control components").

We conducted our audit in accordance with Auditing Standard 104. This Standard requires us to plan and perform the audit to identify the audit control components and to obtain reasonable assurance about whether these control components were effective in all material respects. Our audit included obtaining an understanding of the internal controls on financial reporting, identifying the audit control components, assessing the risk that a material weakness exists in the audit control components, and testing and evaluating the design and operating effectiveness of said control components based on the assessed risk. Our audit, regarding those control components, also included such other procedures, as we considered necessary in the circumstances. Our audit referred only to the audit control components, as opposed to internal controls over all significant processes related to financial reporting, and accordingly, our opinion relates to the audit control components only. In addition, our audit also did not consider any mutual effects between the audit control components and any non-audit control components, and accordingly, our opinion does not consider these possible effects. We believe that our audit provides a reasonable basis for our opinion in the context explained above.

Because of its inherent limitations, internal controls over financial reporting as a whole, and internal control components in particular, may not prevent or detect misstatements. In addition, projections of any current evaluation of effectiveness to future periods are subject to a risk that any controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the company maintained, in all material respects, effective audit control components as at December 31, 2010.

We have also audited, in accordance with generally accepted auditing standards in Israel, the company's consolidated financial statements as at December 31, 2010 and 2009, for each of the three years in the period ended December 31, 2010. Our report dated March 31, 2011, included an unqualified opinion on said financial statements.

**Haifa, Israel  
March 31, 2011**

**KOST FORER GABBAY & KASIERER  
Certified Public Accountants (Isr.)**

## **Auditors' Report to the Shareholders of Medical Compression Systems (D.B.N.) Ltd.**

We have audited the accompanying consolidated statements of financial position of Medical Compression Systems (D.B.N.) Ltd. ("company") as at December 31, 2010 and 2009 and the consolidated statements of comprehensive loss, changes in equity and cash flows for each of the years ended December 31, 2010, 2009 and 2008. These financial statements are the responsibility of the company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards, including those prescribed under the Auditors' Regulations (Auditors' Mode of Performance), 5733 - 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the board of directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the company and its consolidated subsidiary as at December 2010 and 2009, and the results of their operations, changes in equity and cash flows for each of the years ended December 31, 2010, 2009 and 2008, in accordance with International Financial Reporting Standards and in accordance with Securities Regulations (Annual Financial Statements) 5770 – 2010.

We have also audited, in accordance with Auditing Standard 104 of the Institute of Certified Public Accountants in Israel "Audit of Internal Control Components over Financial Reporting," the components of the company's internal control over financial reporting as at December 31, 2010. Our report dated March 31, 2011 included an unqualified opinion on the effectiveness of said components.

**Haifa, Israel  
March 31, 2011**

**KOST FORER GABBAY & KASIERER  
Certified Public Accountants (Isr.)**

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

	<u>Note</u>	<u>December 31,</u>	
		<u>2010</u>	<u>2009</u>
		<u>\$ Thousands</u>	
<u>Current Assets:</u>			
Cash and cash equivalents	3	2,084	3,301
Restricted deposits		90	6
Trade receivables	4	1,611	551
Receivables	5A	508	185
Inventory	6	483	463
		<u>4,776</u>	<u>4,506</u>
<u>Non-Current Assets:</u>			
Long-term receivables (including options granted to a financial institution)	5B, 12C	119	135
Property, plant and equipment	7	1,709	835
Development costs (including patents)	8	4,196	4,230
		<u>6,024</u>	<u>5,200</u>
		<u>10,800</u>	<u>9,706</u>

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

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

	<u>Note</u>	<u>December 31,</u>	
		<u>2010</u>	<u>2009</u>
		<u>\$ Thousands</u>	
<u>Current Liabilities:</u>			
Current maturities- long-term bank loans	9	363	272
Current maturities – convertible bonds	12	1,118	716
Trade payables	10	997	649
Other payables	11	839	321
		<u>3,317</u>	<u>1,958</u>
<u>Long-Term Liabilities:</u>			
Bank loans	12	1,387	480
Convertible bonds	12	-	1,073
Options	12	530	214
Employee benefit liabilities	14	41	80
		<u>1,958</u>	<u>1,847</u>
<u>Equity:</u>			
	17		
Share capital		99	91
Share premium		21,129	18,910
Capital reserve - share-based payments		1,511	912
Accumulated loss		(17,214)	(14,012)
		<u>5,525</u>	<u>5,901</u>
		<u>10,800</u>	<u>9,706</u>

**March 31, 2011**

**Date Of Financial  
Statements Approval**

**Eitan Nahum  
Chairman of the  
Board of Directors**

**Adi Dagan, Chief  
Executive Officer**

**Ori Mor, Chief  
Financial Officer**

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

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

	Note	Year Ended December 31,		
		2010	2009	2008
		\$ Thousands		
		(Except for Loss per Share Data)		
Revenue:				
First Generation Products		3,849	3,074	4,180
Second Generation Products- SFT		1,877	253	-
Total		<u>5,726</u>	<u>3,327</u>	<u>4,180</u>
Cost of revenue	19A	<u>(2,526)</u>	<u>(1,884)</u>	<u>(2,764)</u>
Gross profit		3,200	1,443	1,416
Research and development expenses	19B	(760)	(585)	(530)
Selling and marketing expenses	19C	(3,545)	(1,422)	(763)
Management and general expenses	19D	<u>(1,555)</u>	<u>(1,148)</u>	<u>(1,150)</u>
Operating loss		(2,660)	(1,712)	(1,027)
Financing income	19E	64	3	755
Financing expenses	19E	<u>(606)</u>	<u>(1,414)</u>	<u>(171)</u>
Loss		(3,202)	(3,123)	(443)
Other comprehensive income		-	-	-
Total comprehensive loss		<u>(3,202)</u>	<u>(3,123)</u>	<u>(443)</u>
<u>Loss per share (expressed in \$):</u>	20			
Basic loss per share and diluted loss per share		<u>(0.087)</u>	<u>(0.113)</u>	<u>(0.019)</u>

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

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

	Share Capital	Share Premium	Capital Reserve - Share- Based Payments	Accumulated Loss	Total
	\$ Thousands				
<u>Balance, January 1, 2008</u>	31	13,347	115	(10,446)	3,047
Total comprehensive loss	-	-	-	(443)	(443)
Private issue of shares (1)	3	584	-	-	587
Rights issue (2)	26	1,165	-	-	1,191
Cost of share-based payments	-	-	143	-	143
<u>Balance, December 31, 2008</u>	<u>60</u>	<u>15,096</u>	<u>258</u>	<u>(10,889)</u>	<u>4,525</u>
<u>Balance, January 1, 2009</u>	60	15,096	258	(10,889)	4,525
Total comprehensive loss	-	-	-	(3,123)	(3,123)
Share issued (3) (see notes 17 G and 17 H)	31	3,812	-	-	3,843
Options granted to issue consultants and underwriters (see notes 17G and 17 H)	-	-	272	-	272
Option issued to a financial institution (see note 12 B 3)	-	-	326	-	326
Options exercised	*	2	-	-	2
Cost of share-based payments	-	-	56	-	56
<u>Balance, December 31, 2009</u>	<u>91</u>	<u>18,910</u>	<u>912</u>	<u>(14,012)</u>	<u>5,901</u>
<u>Balance, January 1, 2010</u>	91	18,910	912	(14,012)	5,901
Total comprehensive loss	-	-	-	(3,202)	(3,202)
Shares issued (4) (see notes 17 J and 17 K)	3	858	-	-	861
Rights issue (5)	3	979	-	-	982
Options issued to a financial institution (see note 12 B 3)	-	-	158	-	158
Options exercised	2	382	(221)	-	163
Cost of share-based payments	-	-	662	-	662
<u>Balance, December 31, 2010</u>	<u>99</u>	<u>21,129</u>	<u>1,511</u>	<u>(17,214)</u>	<u>5,525</u>

- (1). After deduction of issue costs of \$104 thousand.  
(2). After deduction of issue costs of \$69 thousand.  
(3). After deduction of issue costs of \$336 thousand.  
(4). After deduction of issue costs of \$24 thousand.  
(5). After deduction of issue costs of \$18 thousand.

\* Amount is less than \$ 1 thousand.

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

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$ Thousands</b>		
<u>Cash flows from operating activities:</u>			
Loss for the year	(3,202)	(3,123)	(443)
Adjustments to reconcile loss to net cash used in operating activities:			
Reconciliation of profit and loss items:			
Depreciation and amortization	359	214	177
Net changes in liabilities for cessation of the employee-employer relationship	33	(1)	14
Change in fair value of convertible bonds, measured at fair value through profit and loss	50	1,022	(441)
Change in fair value of options, measured at fair value through profit and loss	316	67	(227)
Net financing expenses	89	251	131
Cost of share-based payment	662	56	143
	1,509	1,609	(203)
Changes in asset and liability items:			
Increase in trade receivables	(1,060)	(67)	(398)
Decrease (increase) in other receivables (including long-term)	(149)	81	8
Decrease (increase) in inventory	(20)	(41)	178
Increase (decrease) in trade payables	348	(426)	637
Decrease in advances from customers	-	-	(178)
Increase (decrease) in other payables	444	15	(8)
	(437)	(438)	239
Cash paid and received in respect of:			
Interest paid	(101)	(254)	(147)
Interest received	12	3	16
	(89)	(251)	(131)
Net cash used for operating activities	(2,219)	(2,203)	(538)

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

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$ Thousands</b>		
<u>Cash flows from investing activities:</u>			
Investment in restricted deposits	(84)	-	-
Acquisition of property, plant and equipment	(1,199)	(94)	(937)
Capitalization of development costs	-	(61)	(1,232)
Net cash used for investing activities	(1,283)	(155)	(2,169)
<u>Cash flows from financing activities:</u>			
Options exercised	163	2	-
Net change in short-term credits from banking entities	-	-	(26)
Repayment of convertible bonds	(721)	-	-
Receipt of a long-term bank loan	1,000	750	-
Repayment of a long-term bank loan	-	(500)	-
Proceeds from a private issue of shares (after issue costs) (see notes 17 J and 17 K)	861	2,328	587
Proceeds from an issue of shares and traded options (after issue costs) (see note 17 H)	-	1,931	-
Proceeds from the issue of shares by way of a rights issue (after issue costs) (see note 17)	982	-	1,191
Net cash provided by financing activities	2,285	4,511	1,752
<u>Increase (decrease) in cash and cash equivalents</u>	(1,217)	2,153	(955)
<u>Cash and cash equivalents, beginning of the year</u>	3,301	1,148	2,103
<u>Cash and cash equivalents, end of the year</u>	2,084	3,301	1,148

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

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 1 – GENERAL:**

**A.** Medical Compression Systems (D.B.N.) Ltd. ("company") was incorporated in Israel in 1997. The company operates in Israel and in the United States directly and through its consolidated U.S. subsidiary - Medical Compression Systems Inc. ("Inc."). The company is primarily involved in the development, production, and marketing of non-invasive and non-drug solutions for the improvement of blood circulation in lower limbs, in order to prevent blood clots in the deep veins.

**B. Definitions:**

**In These Financial Statements:**

The Company	-	Medical Compression Systems (D.B.N.) Ltd.
Group	-	Medical Compression Systems (D.B.N.) Ltd., and its consolidated subsidiary.
Consolidated subsidiary	-	Medical Compression Systems Inc. The company holds control therein (as defined by IAS 27 (2008)) and its financial statements are consolidated with those of the company.
Related parties	-	As defined by IAS 24.
Interested parties and controlling shareholders	-	As defined by Securities (Annual Financial Statements), 5770-2010.
Foreign currency	-	Any currency, which is not the United States Dollar
Dollar	-	United States Dollar

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:**

**A. Presentation Basis Of The Financial Statements:**

**1. Measurement Basis:**

The company's financial statements are prepared on the historical cost basis, except for convertible bonds, and options measured at fair value.

The company has decided to present its statement of comprehensive income based on the nature of its operations.

**2. Reporting Format:**

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), which include:

- A.** International Financial Reporting Standards (IFRS).
- B.** International Accounting Standards (IAS).
- C.** Interpretations by the International Financial Reporting Interpretations Committee (IFRIC), and by the Standing Interpretations Committee (SIC).

These financial statements have also been prepared in accordance with Securities Regulations (Annual Financial Statements), 5770-2010.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**3. Consistently Applied Accounting Policies:**

The accounting policies applied in these financial statements have been applied consistently for all periods reported.

**4. Changes in Accounting Policies Further To Adoption of New Standards:**

**IAS 1 – Presentation of Financial Statements:**

IAS 1, amended, considers the classification of liabilities as current or non-current in respect of convertible financial instruments. As amended, liability terms which enable the counterparty, at any time, to cause a settlement of a liability of the entity by issuing equity instruments, does not automatically affect the classification of liabilities in the financial statements as current or non-current. The amended statement's provisions have been adopted from January 1, 2010. Comparative figures were restated.

**IAS 7 – "Statement of Cash Flows":**

IAS 7, amended, requires that only cash flows that have triggered an asset recognition, can be classified under cash flows from investing activities. The amendment has been adopted retrospectively, from January 1, 2010.

**IAS 39 – "Financial Instruments: Recognition And Measurement":**

**A.** IAS 39, amended, states that a company is allowed to designate part of the change in the fair value or fluctuations in cash flows in respect of a financial instrument as a hedged item. The amendment is adopted from January 1, 2010, on a retrospective basis, however hedging relations may not be redesignated

**B.** In addition, IAS 39 states that only forward contracts between a purchaser and seller in respect of the sale or purchase of a controlled entity, as part of business combinations at a future date, are not within the framework of IAS 39, when the forward contract term is not more than the term necessary for receiving approvals required for a transaction. The amendment is adopted on a going forward basis from January 1, 2010, for all contracts that have not yet expired by said date.

**B. Significant Judgments And Assumptions Used In Preparing The Financial Statements:**

**1. Considerations:**

During the process of implementing the significant accounting policies used by the group, there were no considerations involved which had a significant effect on amounts recognized in the financial statements:

**2. Estimates And Assumptions:**

Preparation of the financial statements requires management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, revenue and expenses. Estimates and underlying assumptions are reviewed on an ongoing basis. Changes in accounting estimates are recognized as incurred.

Presented below is information on the main assumptions used in the financial statements in respect of uncertainty as at financial statement date, and the critical estimates made by the group and for which any significant change in the estimates and assumptions could change the value of assets and liabilities in the financial statement in the next reporting period:

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**Amortization Of Development Costs:**

Development costs are capitalized in accordance with the accounting policy reported in note 2K. In order to calculate the costs that are to be capitalized, management prepares an estimate of the cash flows expected to be generated by the asset, the functional currency exchange, discount rates, and the expected period of benefits. See 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 include the share price, the exercise price, expected fluctuations, expected lifespan, expected dividends, and non-risk interest rates.

**C. Consolidated Financial Statements:**

The consolidated financial statements include the financial statements of Medical Compression Systems (D.B.N.) Inc., a controlled subsidiary. Control exists if a company has the ability, either directly or indirectly, to determine the financial and operational policy of the controlled company. When testing for control, the effect of potential voting rights, exercisable at financial statement date, are taken into account. The financial statements are consolidated from when control is attained, until control ceases.

Material intercompany balances, transactions, profits, and losses vis à vis transactions between group companies have been eliminated in full in the consolidated financial statements.

The financial statements of the company and its subsidiary have been prepared as at identical dates and for identical periods. The accounting policies used in preparing the financial statements of the consolidated subsidiary were uniform and consistent with those used for preparing the financial statements of the company.

**D. Functional Currency And Foreign Currency:**

**1. Functional And Presentation Currencies:**

The company's presentation currency for financial statement purposes is the United States Dollar.

The functional currency, which is the currency that best reflects the economic environment in which the company operates and transacts, is separately determined for each group company, and its financial position and its operating results are measured in this currency.

The functional currency of the company and its consolidated subsidiary is the US Dollar.

**2. Transactions, Assets, and Liabilities in Foreign Currency:**

Transactions denominated in foreign currency are initially recorded at the exchange rate prevailing on transaction date. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated to US Dollar's at the exchange rate prevailing on financial statement date. Exchange differences are charged to profit and loss. Non-monetary assets and liabilities are translated to US Dollars at exchange rates prevailing on transaction date. Non-monetary assets and liabilities denominated in foreign currency and presented at fair value are translated to US Dollars at the exchange rate prevailing on the date when the fair value is determined.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**E. Cash Equivalents:**

All highly liquid investments, including short-term bank deposits that are not pledged, with original maturities of three months or less from the date of the original investment, or exceeding three months but cannot be withdrawn immediately without penalty, and are part of the group's cash management framework, are considered cash equivalents.

**F. Provision for Doubtful Debts:**

The provision for doubtful debts is determined on a specific basis for debts, which, in the opinion of company management, collection of which is doubtful. In addition, the company recognizes a provision vis-à-vis customer groups, which are evaluated, on a collective basis, for any impairment of value based on their credit risk nature. Customer debts that have decreased in value are written off when it is determined that they are no longer collectible.

**G. Inventory:**

Inventory is measured at the lower of cost or net realizable value. The cost includes any direct expenses incurred to purchase the inventory, to deliver it and to place it in its current position. Net realizable value is an estimate of the selling price during the normal course of business, less an estimate of costs to complete and costs required to make the sale.

Inventory cost is determined as follows:

Raw materials - at average moving cost.

Work in process – at average cost, including materials, labor, direct production costs, and other indirect costs.

Finished products - at average cost, including materials, labor, direct production costs and other indirect costs.

On a regular basis, the company reviews its inventory position and aging, and as required, records provisions for slow-moving inventory.

In any period when production is not normative, the cost of inventory will not include any fixed overhead costs beyond costs incurred during normal production. Costs that were not allocated, are charged to profit and loss during the period incurred. In addition, inventory cost does not include exceptional costs vis-à-vis materials, labor and other items that relate to inefficiencies.

**H. The Business Cycle:**

The normal business cycle of the company does not exceed one year. Accordingly, current assets and current liabilities include items that are designated and are expected to be realized during the company's business operating cycle.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**I. Financial Instruments:**

**Financial Assets:**

Financial assets within the scope of IAS 39 are initially recognized at fair value with the addition of directly attributable transaction costs, other than investments stated at fair value, with changes in fair value charged to profit and 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 measured at fair value through profit and loss.
- Investments held until maturity.
- Loans and other receivables.
- Available-for-sale financial assets.

**1. Loans And Other Receivables:**

The group has loans and other receivables, which are financial assets (and which are not derivatives) with fixed repayment or repayment terms that can be fixed, that are not traded in an active market. After initial recognition, the loans and other receivables are measured at amortized cost using the effective interest rate method, with consideration given to any transaction costs and any provision for impairment.

Gains or losses are charged to comprehensive income, when the loans and/or other receivables are settled, if any provision for impairment is recognized, or following periodic amortization charges.

**2. Fair Value:**

The fair value of financial instruments traded in an active market is set by the market price as at financial statement date. In respect of financial assets that do not have an active market, fair value is determined using estimates based on economic models.

**Financial Liabilities:**

**1. Financial Liabilities At Amortized Cost:**

Loans and credits are initially recognized at fair value less transaction costs attributed directly, if any (for example, the cost of securing a loan). After initial recognition, the loans, including bonds, are reported according to their terms, on the amortized cost basis using the effective interest rate method, which also takes into account the cost of the transaction directly attributed. Short-term credits (such as suppliers' credit and other payables) are reported according to their terms, and generally at nominal value. Any gains or losses are recognized in the statement of comprehensive income upon settlement of the financial liability and after amortization.

**2. Financial Liabilities Measured At Fair Value through Profit and Loss:**

Financial liabilities measured at fair value through profit and loss include financial liabilities that are designated upon initial recognition to be measured at fair value, with fair value changes charged to comprehensive income. The company has issued Series A convertible bonds, which are linked to the Consumer Price Index.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

In accordance with IAS 39 "Financial Instruments: Recognition and Measurement", on transition date, the company chose to designate its hybrid contract entirely as a financial liability at fair value through profit and loss, with fair value being the price of the instrument on the stock exchange. Accordingly, said bonds are reported at their fair values as determined by trading on the stock exchange.

**Bundled Securities:**

Upon issue of bundled securities, the consideration received (before issue expenses) is allocated to the component securities issued in the package according to the following allocation order - fair value is first determined for financial derivatives (such as, options with an exercise premium linked to the Consumer Price Index, or linked to a currency other than the company's functional currency, and other financial instruments that are reported at fair value in each period). Once done, fair value is determined for financial liabilities and complex instruments (such as, convertible bonds), not reported at fair value in each period, but rather reported at present value, with the consideration allocated to the equity instruments being determined as the residual value, being the difference between the total consideration received and the relevant proceeds allocated as above. Issue expenses are allocated to each component relative to the amounts determined for each component as described above, net of any related taxes, if applicable with regard to equity instruments. After said allocations, each component is accounted for in accordance with its contractual substance (either as a financial liability or as an equity instrument).

**De-recognition of Financial Instruments:**

**Financial Assets:**

A financial asset is derecognized when the validity of the contractual right to receive cash flows from the financial asset expires, or if the company transfer its contractual rights to receive the cash flows from the financial assets, or accepts an obligation to pay the cash flows received in full to a third party, without any substantive delay, or substantially transferred all risks and benefits inherent in the asset, or did not transfer and even did not substantially maintain all the risks and benefits inherent in the asset, but transferred control over the asset.

**Financial Liabilities:**

A financial liability is derecognized when the liability is settled, cancelled, or expires. A financial liability is settled when the debtor (the group):

- Repays the debt in cash, in other financial assets, or by goods or services, or
- Is legally released from any liability.

**Impairment Of Financial Assets:**

At every financial statement date, the group tests for the existence of any objective proof indicating an impairment of a financial asset or groups of financial assets.

**Financial Assets Reported At Amortized Cost:**

The objective proof vis-à-vis loans and other receivables reported at amortized cost is confirmed when one event or more adversely affects estimated future cash flows from the asset after recognition. Proof of any impairment includes signs of the debtor having financial difficulties, liquidity problems and any inability to meet capital or interest repayments. The loss charged to comprehensive income is the difference between the asset's balance in the financial statements, and the present value of any estimated future cash flows (which do not include any future credit losses that have not yet been incurred), discounted using the financial asset's original effective interest rate (the effective interest rate that was used upon initial recognition).

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**J. Leases:**

The tests applied to classify a lease as a finance lease or as an operating lease are based on the substance of the agreements, as examined in accordance with the following criteria prescribed in IAS 17, at the time of the agreements being entered into.

**The Group as Lessee – Operating Leases:**

Lease agreements, which do not actually transfer all risks and rewards incident to ownership of the leased asset, are classified as operating leases. Lease payments are recognized as expenses in profit and loss on the straight-line basis, over the lease period.

A lease of land, not part of any land held investment purposes, is stated at fair value, as determined by the Israel Lands Authority, and is classified as an operating leases. The amount attributed to the leased land is recognized in the financial statements under "prepayments in respect of operating leases" and as an expense in the statement of comprehensive income, on the straight-line basis over the lease term.

**K. Property, Plant And Equipment:**

Property, plant, and equipment items are recorded at cost with the addition of direct purchase costs, less accumulated depreciation and do not include ongoing maintenance expenses. Cost includes spare parts and ancillary equipment that can only be used in connection with the machinery and equipment.

Depreciation is calculated in equal annual installments, according to the straight-line method, over the estimated useful lives of the assets, as follows:

	<u>%</u>	<u>Primarily, %</u>
Machinery and equipment	15	
Computers and ancillary equipment	33	
Office equipment and furniture	7-15	10
Leasehold improvements	17-25	25
Devices available for leasing purposes	20-33	25

Leasehold improvements are amortized using the straight-line method, over the lease period (including any option period, which the group intends to exercise) or over the estimated useful lives of the assets, whichever of the methods is shorter in time.

The estimated useful lives, depreciation method and residual value of each asset are reviewed at least at each year-end, and changes are treated prospectively as a change in an accounting estimate. With regard to any impairment of property, plant, and equipment, see below.

Depreciation is discontinued when the asset is classified as "held for sale" or when it is derecognized, whichever is earlier. An asset is derecognized at the time of its sale, or when the economic benefits are no longer expected from its use. Any gain or loss on de-recognition of the asset (calculated as the difference between the net proceeds received upon de-recognition, and the depreciated book cost of the asset) is charged to comprehensive income in the period when the asset is derecognized.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**L. Intangible Assets:**

After initial recognition, the intangible assets are reported at cost less any accumulated amortization and less any provision for impairment of value. Costs of intangible assets, which have been internally developed, except for costs, which have been capitalized, are charged to comprehensive income as incurred.

In management's opinion, intangible assets have a finite life. The assets are amortized over their useful economic lives and a review for impairment is made when events or circumstances indicate a possible impairment in value. The amortization period and amortization method of intangible assets are reviewed at least once a year. A change in the useful life or in the pattern of expected consumption of the economic benefits expected to be generated by the asset will be treated as a change in the amortization period or method, and will be reported as a change in an accounting estimate. Amortization expenses are charged to comprehensive income.

Useful lives of intangible assets are as follows:

Development costs - according to the rate of sales vis à vis the quantity of units that are the result of development efforts, expected to be sold.

**Research and Development Expenses:**

Research and development expenses are charged to comprehensive income as incurred. An intangible asset that results from a development project, or from any internal development, is recognized if it is possible to prove the technological feasibility of completing the intangible asset, so that it will be available for use or for sale; the intention of the company to complete the intangible asset and to use it or to sell it; the ability to use the intangible asset or to sell it; how the intangible asset will generate future economic benefits; the availability of the necessary resources - technical, financial and others, to complete the intangible asset and the ability to reliably measure any expenses incurred during its development.

During the development period, any impairment of value of the asset is considered once a year. After initial recognition, the asset is measured at cost and reported after accumulated amortization and after any accumulated provisions for impairment. Amortization of the asset begins when development has been completed and the asset is available for use. The asset will be amortized over the period of time when sales are expected from the asset that was developed. During the period before the asset is ready for use, and before any amortization, a provision for impairment is considered annually.

**Patents:**

Patent registration costs are recognized as assets only after compliance with terms for recognition as an asset. These costs are amortized on the straight-line basis over the patent's expected period of economic benefits (five years). During each report period, the company considers the need for any provision for impairment.

Gains or losses from any de-recognition of an intangible asset reflect the difference between the net consideration received upon the de-recognition, and the cost of the asset. The difference is charged to comprehensive income.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**M. Impairment of Non-Financial Assets:**

The company considers the need for a provision vis à vis the carrying value of non-financial assets (property, plant and equipment, patents and development costs) when there are signs resulting from events or changes in circumstances indicating that the carrying value is not recoverable. If the carrying values of the non-financial assets exceed their recoverable amounts, the assets are written down to their recoverable values. Recoverable value is the greater of the fair value less selling costs, and value in use. In estimating value in use, the expected cash flows are discounted using a pre-tax discount rate that reflects specific risks for each asset. With respect to an asset that does not generate cash flows of its own, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are charged to comprehensive income.

**N. Deferred Taxes:**

As no taxable income is expected to be earned in the future, no deferred tax assets were recorded in these financial statements.

**O. Share-Based Transactions:**

Company employees are entitled to benefits in the form of equity instruments.

**Equity Settled Transactions:**

The cost of equity-settled transactions with employees is measured at fair value on the day of granting the equity instruments. The fair value is determined using an accepted option-pricing model. For more information, see note 18. The estimate of fair value does not consider vesting terms (that include service and performance terms, which are not market terms). The only terms that are considered in estimating fair value include market terms and terms, which are not vesting terms. With regard to other service providers, the cost of a transaction is considered the fair value of the goods or services received in consideration for the equity instruments. When it is not possible to measure the fair value of the goods or services received in consideration for the equity instruments, they will be measured at the fair value of the equity instruments granted.

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

An expense in respect of grants, which eventually are not vested, is not recognized, except for grants whose vesting terms are dependent on market terms, and are treated as grants whose vesting has no relationship to any market terms, assuming that all other vesting terms (service and/or performance) were complied with.

If the company changes the terms of the equity-settled grant, an additional expense is recorded in addition to the original expense that was calculated, this in respect of every change that increases the fair value of the share-based arrangement or that benefits the employee, at the fair value on the date of the change.

**P. Employee Benefit Liabilities:**

The group has a number of employee benefit programs:

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**1.Short-Term Employee Benefits:**

Short-term employee benefits include salaries, vacation days, sickness, convalescence and national insurance employer's contributions and are recognized as expenses as the services are provided. The liability for cash bonuses or profit participation plans, is recognized if the group has a legal or implied obligation to pay said amounts in respect of the service provided by the employee in the past, and the amount thereof can be reliably estimated.

**2. Post-Employment Benefits:**

The benefit plans are financed generally by deposits with insurance companies and are classified as defined contribution plans or as defined benefit plans.

The group has a defined contribution plan, in accordance with Section 14 of the Severance Pay Law, pursuant to which the group makes regular contributions, without it having any legal or implied obligation to make additional payments, even if the principal amounts that have accumulated are insufficient to pay all the benefits to the employee, which relate to the employee's service in the current period and in past periods. Contributions to the defined contributions plan for severance or compensation are recognized as an expense at the time of their deposit with the plan, in parallel with the receipt of employment services from the employee. No additional provision is required in the financial statements.

Moreover, in respect of some employees, the group has a defined benefit plan for severance payments in accordance with Severance Pay Law. According to said law, employees are entitled to receive severance payments upon their dismissal or upon their retirement. The liability for the cessation of the employee-employer relationship is calculated using the last monthly salary earned by the employee, multiplied by the number of years of his employment.

The company makes regular deposits with pension funds and insurance companies (plan assets) in order to satisfy its liabilities for the payment of severance pay.

The liability for employee benefits reported in the financial statements, reflects the present value of the defined benefit plan liabilities less the fair value of plan assets.

Actuarial gains or losses are charged to profit or loss, as incurred.

**Q. Revenue Recognition:**

Revenue is recognized when the revenue can be reliably measured, when it is probable that the economic benefits associated with the transaction will flow to the company and when the costs incurred or to be incurred in respect to the transaction can be reliably measured. Revenue is measured using the fair value of the transaction consideration, less any commercial discounts, quantity discounts, or refunds.

The specific conditions that must exist in order to recognize revenue are as follows:

**First Generation Product Revenue:**

Product revenue is recognized when the significant risks and returns involved in the ownership of the products are transferred to the buyer, and the seller no longer has any ongoing administrative involvement, and does not maintain any effective control over the products that were sold. Generally speaking, the transfer of risks and rewards, further to ownership, happens together with the transfer of title or the transfer of possession to the buyer, and accordingly, the transfer of ownership to all customers of the company occurs when the product arrives at the customer.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**SFT Revenue – Service Revenue:**

Initially, the SFT instrument is positioned at hospitals and medical centers, and the instrument remains company property. A sale is concluded when use is made of the instrument

Income from providing a service is recognized when the result of a transaction involving the service can be reliably measured, and the service was provided.

Transaction results can be reliably measured when all terms, as noted, exist - (A) the amount of revenue can be reliably measured; (B) It is expected that the economic benefits from the transaction will accrue to the company; (C) the stage of completion of the transaction at report date can be reliably measured; (D) the costs incurred as part of the transaction and the costs required to finalize the transaction can be reliably measured.

**Interest Income:**

Interest income is recognized on a cumulative basis using the effective interest method.

**R. Discounts to Customers:**

Regular discounts to customers are included in the financial statements upon approval and are charged to revenue.

**S. Cost of Revenue and Discounts from Suppliers:**

Cost of revenue includes expenses in respect of loss, warehousing, and delivery of inventory up to the final selling point.

Discounts are deducted from purchase cost when the terms entitling the customer to a discount are met. Part of the discount vis à vis a purchase that becomes part of closing inventory is added to inventory, while the remaining part reduces the cost of revenue.

**T. Financing Income And Expenses:**

Financing income includes interest income in respect of funds that were invested, changes in the fair value of financial assets measured at fair value through profit and loss and exchange rate gains. Financing income is recognized as accrued, using the effective interest rate method.

Financing expenses include interest on loans received and changes in the fair value of financial assets measured at fair value through profit and loss.

Gains and losses on exchange rate differences, and changes in the fair value of financial instruments that are reported under comprehensive income, are reported on a net basis.

**U. Operating Segments:**

An operating segment is a component of the group, which complies with the following three terms:

1. Engages in business activities from which it may earn revenue and incur expenses, including revenue and expense relating to inter-group transactions.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

2. Whose operating results are reviewed regularly by the group's chief operating decision maker to take decisions on resources to be allocated to the segment and to assess its performance.

3. Separate financial information is available.

**V. Loss Per Share:**

The loss per share is calculated by dividing the net loss attributable to equity holders of the company by the weighted number of ordinary shares outstanding during the period. The basic loss per share includes only shares, which were actually outstanding during the period. Potential ordinary shares (convertible securities such as convertible bonds, options, and options to employees) are included only in calculating the diluted loss per share if their conversion dilutes the loss per share, such that their conversion increases the loss per share from continuing operations. In addition, potential ordinary shares that were converted during the period are included in diluted loss per share only up to the date of their conversion, and from that date onwards are included in basic loss per share.

**W. Statement Of Comprehensive Income Presentation:**

The company has elected to present a single statement of comprehensive income, combining all operating and comprehensive income items.

**X. Disclosure Of New IFR Standards In The Period Prior To Their Implementation:**

**IFRS 7 - "Financial Instruments: Disclosure":**

The amendment deals with a number of issues, including:

1. Clarification of requirements for disclosure, as explained in the standard. Accordingly, the connection between quantitative disclosures and qualitative disclosures and the manner and scope of risks related to financial instruments, is stressed. In addition, requirements for disclosure of securities that an entity holds were minimized, while the requirement for disclosure of credit risks was amended. The amendment will be adopted retrospectively, for periods beginning January 1, 2011. Early adoption is allowed.

2. New and broad disclosure requirements regarding the settlement of financial assets and disclosure requirements where there are extraordinary transfer rounds close to report date. The objective of the amendment is to aid users of the statements to evaluate the exposure to risks vis à vis transfers of financial assets and the effect of these risks on the financial position of the entity. The amendment will increase transparency of reporting on transfer transactions, especially vis à vis transactions involving any securitization of financial assets. The amendment will be adopted on a going forward basis, for periods beginning January 1, 2012. Early adoption is allowed.

The company will include all relevant disclosure requirements in its financial statements.

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

**IFRS 9 - "Financial Instruments":**

1. During November 2009, IFRS 9 was published, as part of the first phase in a project to replace IAS 39- "Financial Instruments: Recognition and Measurement". IFRS 9 focuses mainly on the classification and measurement of financial assets and is binding on all financial assets that fall under IAS 39.

The standard requires that upon initial recognition, all financial assets (including hybrid instruments, as part of a host contract, which is a financial asset) be measured at fair value. In subsequent periods, the entity must measure its debt instruments at amortized cost only if the following two terms exist jointly:

- The asset is held as part of a business model, which requires holding the asset so as to collect any contractual cash flows.
- On the basis of the financial asset's contractual terms, the entity is entitled, on certain dates, to receive cash flows, which are solely payments of principal and interest on the principal balance.

Notwithstanding that said, the entity may, upon initial recognition, designate a debt instrument which complies with said two terms at fair value through profit and loss, if so doing significantly cancels or reduces any accounting mismatching in measurement or recognition, that would occur if not for said.

Subsequent measurement of all other debt instruments and other financial assets will be at fair value.

Financial assets that are equity instruments will be measured in subsequent periods at fair value, and any differences will be charged to profit and loss or to other comprehensive profit (loss), according to the accounting policy chosen, for each instrument independently (amounts recognized in comprehensive income will not be reclassified afterwards to profit or loss). If the issue concerns equity instruments held for trade purposes, said must be measured at fair value through profit and loss. The choice is final. However, if the entity changes its business model on the management of financial assets, it must reclassify all financial instruments, which are affected by the change in the business model in order to reflect said change. In all other circumstances, a reclassification of financial assets is not allowed.

The standard will be binding from January 1, 2013. Early adoption is allowed. Initial adoption of the amendment is retrospective, with a restatement of comparative information, subject to relief afforded by the standard.

2. During October 2010, amendments were issued to IFRS 9 dealing with settlements and financial liabilities. According to provisions of the amendment, the entity must continue adopting provisions of IAS 39 in respect of any settlement, and in respect of financial liabilities, for which the fair value alternative was not chosen (designation at fair value through profit and loss). That is, the classification and measurement of IAS 39 will continue to be binding on financial liabilities held for trade purposes and on financial liabilities that are measured at amortized cost.

Changes further to said amendments affect the measurement of liabilities, for which the fair value alternative was chosen. Accordingly, a change in the fair value of liabilities - attributed to changes in credit risks - will be charged to other comprehensive income. All other changes in fair value will be charged to comprehensive income. If the charge vis à vis a change in the fair value of liabilities, as a result of changes in credit risks, to other comprehensive income, causes an accounting mismatching in the statement of comprehensive income, then said change will be charged to the statement of comprehensive income and not to other comprehensive income.

In addition, the amendment requires that liabilities vis à vis certain derivatives on non-quoted equity instruments, not be measured at cost but rather at fair value.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

The standard becomes binding on January 1, 2013. Early adoption is allowed, on condition that the entity also adopts provisions of IFRS 9 dealing with the classification and measurement of financial assets (asset phase). Initial adoption will be made retrospectively, by way of a restatement of comparative figures, subject to relief afforded by the standard.

In the company's opinion, the amendments will not have any significant effect on the financial statements.

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

The amendment to IAS 32 states that rights, options or share options to acquire a fixed number of the company's equity instruments for a fixed amount of any currency, be classified as equity instruments if the company offers the rights, options or share options pro rata to all existing owners of the same class of its non-derivative equity instruments. The amendment will be adopted retrospectively in the financial statements for annual periods beginning on January 1, 2011. Early adoption is allowed.

In the company's opinion, the amendment will not have any significant effect on the financial statements.

**NOTE 3 - CASH AND CASH EQUIVALENTS:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Cash and deposits in New Israel Shekels, available for immediate withdrawal	639	2,849
Cash and deposits in US Dollars, European Euros, and Japanese Yen, available for immediate withdrawal	1,445	452
	<u>2,084</u>	<u>3,301</u>

**NOTE 4 - TRADE RECEIVABLES:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Open accounts, local	94	74
Open accounts, foreign	1,543	477
Provision for doubtful debts	(26)	-
Net trade receivables	<u>1,611</u>	<u>551</u>

Any impairment in the value of trade receivable debts is treated through the provision for doubtful debts. Trade receivable debts do not bear interest. Average open trade credit days is 67.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 - TRADE RECEIVABLES (CONTINUED):**

Analysis of net open trade receivable balances for which no provision for impairment was recorded, by period in arrears, vis-à-vis report date:

	Debtors, Without Arrears	Debtors With Past Due Collection Dates, With Arrears In Collection Of					Total
		Up To 30 Days	30-60 Days	60-90 Days	90- 20 Days	More Than 120 Days	
\$ Thousands							
December 31, 2010	1,085	169	152	74	35	96	1,611
December 31, 2009	275	141	60	35	37	3	551

Analysis of net open trade receivable balances, by period in arrears, vis-à-vis financial statement publication date:

	Debtors, Without Arrears	Debtors With Past Due Collection Dates, With Arrears In Collection Of					Total
		Up To 30 Days	30-60 Days	60-90 Days	90- 20 Days	More Than 120 Days	
\$ Thousands							
December 31; 2010	251	26	14	47	10	20	368

**NOTE 5 – OTHER RECEIVABLES:**

**A. Short Term:**

	December 31,	
	2010	2009
\$ Thousands		
Institutions	200	22
Prepayments	274	143
Others	34	20
	508	185

**B. Long-Term:**

	December 31,	
	2010	2009
\$ Thousands		
Lease deposits	15	-
Long term prepayments (see note 12C)	104	135
	119	135

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 6 - INVENTORY:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Raw materials, etc.	365	250
Work in process	21	42
Finished products	97	171
	<u>483</u>	<u>463</u>

**NOTE 7 - PROPERTY, PLANT AND EQUIPMENT:**

Balance, December 31, 2010:

	<b>Machinery And Equipment</b>	<b>Computers And Ancillary Equipment</b>	<b>Office Furniture And Equipment</b>	<b>Leasehold Improvements</b>	<b>Products Available For Leasing Purposes</b>	<b>Total</b>
	<b>\$ Thousands</b>					
Cost:						
Balance, January 1, 2010	313	159	41	21	971	1,505
Additions						
Acquisitions and internally developed assets	6	7	8	-	1,178	1,199
Balance, December 31, 2010	<u>319</u>	<u>166</u>	<u>49</u>	<u>21</u>	<u>2,149</u>	<u>2,704</u>
Accumulated Depreciation:						
Balance, January 1, 2010	196	152	31	21	270	670
Additions						
Depreciation	30	5	4	-	286	325
Balance, December 31, 2010	<u>226</u>	<u>157</u>	<u>35</u>	<u>21</u>	<u>556</u>	<u>995</u>
Depreciated Cost, December 31, 2010	<u>93</u>	<u>9</u>	<u>14</u>	<u>-</u>	<u>1,593</u>	<u>1,709</u>

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 7 - PROPERTY, PLANT AND EQUIPMENT (CONTINUED):**

Balance, December 31, 2009:

	<b>Machinery And Equipment</b>	<b>Computers And Ancillary Equipment</b>	<b>Office Furniture And Equipment</b>	<b>Leasehold Improvements</b>	<b>Products Available For Leasing Purposes</b>	<b>Total</b>
	<b>\$ Thousands</b>					
Cost:						
Balance, January 1, 2009	313	149	40	21	888	1,411
Additions						
Acquisitions and internally developed assets	-	10	1	-	83	94
Balance, December 31, 2009	<u>313</u>	<u>159</u>	<u>41</u>	<u>21</u>	<u>971</u>	<u>1,505</u>
Accumulated Depreciation:						
Balance, January 1, 2009	160	143	30	20	110	463
Additions						
Depreciation	36	9	1	1	160	207
Balance, December 31, 2009	<u>196</u>	<u>152</u>	<u>31</u>	<u>21</u>	<u>270</u>	<u>670</u>
Depreciated Cost, December 31, 2009	<u>117</u>	<u>7</u>	<u>10</u>	<u>-</u>	<u>701</u>	<u>835</u>

**NOTE 8 - INTANGIBLE ASSETS:**

Balance, December 31, 2010:

	<b>Patents</b>	<b>Development Costs</b>	<b>Total</b>
	<b>\$ Thousands</b>		
Cost:			
Balance, January 1, 2010	120	4,233	4,353
Additions	-	-	-
Balance, December 31, 2010	<u>120</u>	<u>4,233</u>	<u>4,353</u>
Accumulated Amortization:			
Balance, January 1, 2010	120	3	123
Amortization	-	34	34
Balance, December 31, 2010	<u>120</u>	<u>37</u>	<u>157</u>
Amortized cost, December 31, 2010	<u>-</u>	<u>4,196</u>	<u>4,196</u>

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 8 - INTANGIBLE ASSETS (CONTINUED):**

Balance, December 31, 2009:

	<u>Patents</u>	<u>Development Costs</u>	<u>Total</u>
		<u>\$ Thousands</u>	
Cost:			
Balance, January 1, 2009	120	4,172	4,292
Additions	-	61	61
Balance, December 31, 2009	<u>120</u>	<u>4,233</u>	<u>4,353</u>
Accumulated Amortization:			
Balance, January 1, 2009	116	-	116
Amortization	4	3	7
Balance, December 31, 2009	<u>120</u>	<u>3</u>	<u>123</u>
Amortized cost, December 31, 2009	<u>-</u>	<u>4,230</u>	<u>4,230</u>

The amortization of intangible assets is classified in the statement of comprehensive income, as follows:

	<u>Year Ended December 31</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	<u>\$ Thousands</u>		
Under:			
Research and development expenses	-	4	10
Cost of revenue	34	3	-
	<u>34</u>	<u>7</u>	<u>10</u>

**NOTE 9 - SHORT-TERM BANK CREDITS:**

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
	<u>\$ Thousands</u>	
Current maturities of long-term loans	<u>363</u>	<u>272</u>

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 10 - TRADE PAYABLES:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Open accounts, local	566	242
Open accounts, foreign	395	347
Checks payable	36	60
	<u>997</u>	<u>649</u>

**NOTE 11 - OTHER PAYABLES:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Employees and salary-related institutions *	381	149
Provisions for vacation and recuperation payments	75	62
Other payables and expenses payable	383	110
	<u>839</u>	<u>321</u>
* Of which, interested parties (1)	<u>200</u>	<u>18</u>

(1) As noted in note 23L, from June 2010, the VP-Technology is no longer considered an "interested party".

**NOTE 12 - NONCURRENT LIABILITIES:**

**A. Breakdown:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Bank loans (1)	1,750	752
<u>Less</u> - current maturities	<u>(363)</u>	<u>(272)</u>
	<u>1,387</u>	<u>480</u>
Convertible bonds (2), (3)	1,118	1,789
<u>Less</u> - current maturities	<u>(1,118)</u>	<u>(716)</u>
	<u>-</u>	<u>1,073</u>
	<u>1,387</u>	<u>1,553</u>

(1) The bank loans are at LIBOR +5% and are reported net of current maturities (see C below).

(2) The convertible bonds bear fixed interest of 6.25% and are reported at fair value.

(3) During the report period, the company redeemed 2,439,229 of par value bonds, against a consideration of \$ 721 thousand. Accordingly, 3,658,844 of par value bonds are still outstanding as at December 31, 2010, with a redemption date of April 30, 2011.

**NOTE 12 - NONCURRENT LIABILITIES (CONTINUED):**

**B. Options:**

1. During 2007, the company agreed with institutional investors and interested parties on a private issue of shares and options, and issued 4,171,697 ordinary shares, NIS 0.01 par value each, and 4,171,697 options convertible into 5,697,483 ordinary shares, NIS 0.01 par value each. The options were convertible up to July 2010. Regarding the adjustment of the conversion ratio of the options to shares following a rights issue, see note 17 F. During July 2010, 4,171,697 options expired.

2. In addition, the company has 801,343 options, registered, that are convertible into 801,343 ordinary shares, NIS 0.01 par value each, against payment of an exercise premium of NIS 3.1, not linked (see note 17 H).

The options are convertible in currencies other than the company's functional currency and accordingly, they are measured at fair value, under liabilities.

**C.**

1. On January 5, 2009, the company signed a credit line agreement with an Israeli bank ("lender"), as follows:

A. The lender approved a \$1 million credit line for the company ("credit line"), against which the company drew \$750 thousand. In addition, the lender consented that, if by August 31, 2009 the company would so request, to provide an additional credit line of \$1 million, subject to the company complying with certain targets as set out in the agreement in respect of sales, operating profitability, cash flows and the number of patients treated with the company's medical devices (second-generation) during the first half of 2009 ("additional credit line"). The company did not draw funds from the credit line beyond that which it had actually drawn.

B. The loan that the company did draw from its credit line, bears a variable interest rate per year of 1 month LIBOR +5%. The loan will be repaid in 24 equal installments beginning after the end of the year from the date of drawing from the credit line (a grace period of one year). The company was given the right of early repayment, without penalties. Regarding changes in the loan terms, see note 12C(2).

C. On the date of approving the credit line, the company granted the lender options that could be converted during a period of up to six years from grant date into 1,165,380 shares (subject to adjustments),

In addition, the company also granted options convertible into 224,215 ordinary shares, NIS 0.01 par value each, at an exercise price of \$0.223 per share, to a consultant who aided it in obtaining the credit line from the lender.

The benefit in respect of the option grant calculated using the Black & Scholes model, is estimated at \$326 thousand. The benefit is based on a variance 63.96% as at grant date, a share price of NIS 1.336 as at grant date (\$0.35), and an annual discount rate of 2.69% per year, as at grant date.

The benefit was recorded as a pre-payment and is amortized over the loan period.

**NOTE 12 - NONCURRENT LIABILITIES (CONTINUED):**

D. To guarantee the credits, the company recorded a floating lien on all its assets, including various rights in favor of the lender. The US subsidiary also recorded a lien on various rights in favor of the lender.

E. As part of the agreement with the lender, the company and its subsidiary agreed that if Aviv Ventures 1, Limited Partnership and Nissan Holdings (T.R.) Ltd., will no longer be controlling shareholders of the company, or if another controlling shareholder will be added to the company who is not one of the current controlling shareholders (in lieu of, or in addition to) without approval of the lender in advance, the lender will be entitled to call the loan for immediate repayment. Further to the investment agreement with an outside investor, as noted in note 17 G, the company received a letter from the lender stating that it did not object to the investment agreement and the shareholders' agreement between the current controlling shareholders and the outside investor, and that the creation of a controlling core with the outside investor, is not considered a breach of the agreement terms, or any other term of the relationship between said and the company.

F. Financial Covenants:

Under the agreement with the lender, the company is committed to complying with various financial covenants, as follows:

1. To maintain cash balances sufficient for three months of operations at least, based on average monthly cash flows over the previous three months.
2. The relationship between cash balances and trade receivables as at December 31, 2009 and the amount set aside for payment to company bondholders on April 30, 2010 will be greater than two, and cash held by the company on said date will be at least \$1 million.

As at December 31, 2010, the company complies with all financial covenants.

G. During February 2010, all 224,115 options that were granted to the consultant who aided the company in obtaining the credit line, as well as 291,345 options that were granted to the lender, as noted in paragraph C above, were converted into 455,366 ordinary shares for an overall consideration of \$52 thousand (part of the conversion was "cash less").

2. On February 17, 2010, the company agreed with a lender ("agreement") on changes to the loan terms, and the provision of an additional credit line (valid until February 1, 2011) of \$250 thousand ("additional loan"). This loan was drawn in full on July 29, 2010.

The following terms will be binding for both the original loan and for the additional loan:

- A. The original loan and the additional loan will bear 1-month LIBOR plus 5%, as set out in the loan terms.
- B. The loan will be repayable in 24 equal installments, from March 1, 2011 (the original loan terms set repayment from February 1, 2010). The company was given the right to early-repay both the original loan and the additional loan, without penalty.

**NOTE 12 - NONCURRENT LIABILITIES (CONTINUED):**

C. The original financial covenants, to which the company had agreed to comply with, will be amended as follows:

1. At all times, and until repayment of the original and additional loans, the company is required to maintain cash balances sufficient for three months of operations, at least, based on the last three month cash flows.
2. The relationship between cash balances and trade receivables as at December 31, 2010, and the amount set aside for payments to company bondholders during 2011, will be greater than 2, and cash held by the company on said date will be at least \$1 million.
3. The relationship between cash balances and trade receivables (at the end of each calendar quarter) less debts payable to bondholders divided by the balance of debt payable to the lender will be at least 1.2.

As at December 31, 2010, the company complies with all financial covenants.

D. To secure the original and additional loan balances, the collateral, which the company and its US subsidiary gave to secure the loan capital, will remain in force.

E. In the event of any "exit" (as this term is defined by the agreement), the company will pay the lender \$200 thousand.

3. On September 13, 2010, the company signed an agreement with the lender for the following credit line:

A. The lender will provide a \$750 thousand credit line, for use not later than December 31, 2010. This credit line was drawn in full on December 29, 2010.

B. The loan that the company will receive on the basis of said credit line, will bear 1-month LIBOR plus 5%, as set out in the loan terms.

C. The loan that the company will receive will be repaid in four monthly, equal and consecutive payments, from February 2012.

D. Upon drawing from the new credit line, the company granted the lender options, which will be available for conversion during a period of up to six years from the date of their grant, for the purchase of 183,000 ordinary shares at an exercise price of NIS 3.1 per share.

E. Under the agreement with the lender, the company is committed to complying with various financial covenants, in addition to those noted in note 12C2(C), as follows:

The ratio between property, plant and equipment and the loan balance not yet repaid on the basis of the new agreement will be at least 1.33.

As at December 31, 2010, the company complies with all financial covenants.

F. On December 29, 2010, the company granted 183,000 options, as noted in paragraph D above. The benefit in respect of the option grant calculated using the Black & Scholes model, is estimated at \$158 thousand. The benefit is based on a variance 80% as at grant date, a share price of NIS 4.108 as at grant date (\$1.15), and an annual discount rate of 3.96% per year, as at grant date.

The benefit was recorded as a pre-payment and is amortized over the loan period.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 13 - FINANCIAL INSTRUMENTS:**

**A. Classification Of Financial Assets And Financial Liabilities:**

The classification of financial assets and financial liabilities, by financial instrument groups in accordance with IAS 39 is as follows:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
	<u>\$ Thousands</u>	
Financial Assets:		
Loans and other receivables	1,627	571
Financial assets at fair value through profit and loss	<u>11</u>	<u>-</u>
	<u>1,638</u>	<u>571</u>
Financial Liabilities:		
Financial liabilities measured at amortized cost	2,965	1,550
Financial liabilities at fair value through profit and loss	<u>1,648</u>	<u>2,003</u>
	<u>4,613</u>	<u>3,553</u>

**B. Financial Risk Factors:**

The group's operations expose it to various financial risks, such as market risk (including foreign currency risk, CPI risk, interest rate risk, and price risk), credit risk, and liquidity risk. The group's comprehensive risk management plan focuses on measures to minimize any possible adverse effects on its financial performance.

The company has appointed its VP-Finance, Mr. Ori Mor, responsible for managing the company's risks, on the basis of a Board of Directors-approved policy. Mr. Mor, in his position as responsible officer, evaluates and hedges financial risks. The Board of Directors provides written guidelines for the comprehensive management of risks, and policies for exposures to specific risks, such as foreign exchange risks, interest rate risks, credit risks, the use of both derivative and non-derivative financial instruments, and the investment of available funds.

**1. Market Risk:**

A. Exchange Rate Risk:

The group is exposed to exchange rate risk primarily further to its exposure to the New Israel Shekel. The exchange rate risk is a function of recognized liabilities that are denominated in a currency, which is not the group's functional currency.

B. Consumer Price Index Risk:

The group issued bonds that are linked to the Consumer Price Index. The net total of financial instruments which are linked to the Consumer Price Index, and because of which the group is exposed to changes in the Consumer Price Index, was \$1,205 thousand as at December 31, 2010.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 13 - FINANCIAL INSTRUMENTS (CONTINUED):**

C. Interest Rate Risk:

The group is exposed to a risk in respect of changes in market interest rates, as its long term loans payable bear variable interest rates.

D. Price Risk:

The group issued convertible bonds and marketable options, which are traded on the stock exchange, measured at fair value through profit and loss. Therefore, the group is exposed to a price risk in respect of fluctuations in the prices of bonds and options, which are based on stock exchange prices.

**2. Credit Risk:**

The group has no significant exposure to credit risks.

**3. Liquidity Risk:**

The company considers the risk of cash unavailability, through the use of monthly budgets. The following table presents the repayment dates of the group's financial liabilities, by contractual terms, in non-capitalized amounts (including interest payments).

Balance, December 31, 2010:

	<b>Up To One Year</b>	<b>One Year To Two Years</b>	<b>Two Years To Three Years</b>	<b>Total</b>
	<b>\$ Thousands</b>			
Bank loans	409	1,327	132	1,868
Trade payables	997	-	-	997
Payables	839	-	-	839
Convertible bonds *	1,205	-	-	1,205
	<u>3,450</u>	<u>1,327</u>	<u>132</u>	<u>4,909</u>

Balance, December 31, 2009:

	<b>Up To One Year</b>	<b>One Year To Two Years</b>	<b>Two Years To Three Years</b>	<b>Total</b>
	<b>\$ Thousands</b>			
Bank loans	308	419	77	804
Trade payables	648	-	-	648
Payables	321	-	-	321
Convertible bonds *	828	1,140	-	1,968
	<u>2,105</u>	<u>1,559</u>	<u>77</u>	<u>3,741</u>

\* Actual liability balances, and not fair value balances as reported in the books.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 13 - FINANCIAL INSTRUMENTS (CONTINUED):**

**D. Fair Value:**

Balances of cash and cash equivalents, trade receivables, other receivables, bank credits, trade payables, other payables, options (1) and convertible bonds (1) are equal to or closely equal to their fair values.

(1). Fair value is based on market quotes available in an active market as at financial statement date.

**E. Fair Value Hierarchy:**

Financial assets are reported at fair value and are classified according to categories having similar characteristics, by the following fair value hierarchy, which is determined according to the source of information that was used for determining the fair value.

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

Level 2: information, which is not quoted information included in level 1 that can be observed directly or indirectly.

Level 3: information, which is not based on observable market information (estimation techniques without use of observable market data).

**Financial Assets and Liabilities Measured At Fair Value:**

Balance, December 31; 2010:

	<u>Level 1</u>	<u>Level 2</u>
	<u>\$ Thousands</u>	
Financial assets, at fair value through profit and loss	-	11
Financial liabilities, at fair value through profit and loss:		
Convertible bonds	1,118	-
Traded options	<u>530</u>	<u>-</u>
	<u>1,648</u>	<u>11</u>

During 2010, there were no transfers of financial instruments measured at fair value, between Level 1 and Level 2 categories.

Balance, December 31; 2009:

	<u>Level 1</u>	<u>Level 2</u>
	<u>\$ Thousands</u>	
Financial liabilities at fair value through profit and loss		
Convertible bonds	1,789	-
Non -traded options	-	33
Traded options	<u>181</u>	<u>-</u>
	<u>1,970</u>	<u>33</u>

**NOTE 13 - FINANCIAL INSTRUMENTS (CONTINUED):**

F. During the report period, the company opened forward contracts in foreign currency, to hedge against fluctuations in exchange rates on part of its Shekel-denominated expenses. The forward contracts on foreign currency are not considered a hedging of cash flows, fair value or net investments, and they are realized once a month matching the periods when the company is exposed to Shekel-denominated expenses.

These derivatives are not considered hedging transactions from the standpoint of accounting policy. As at report date, the company holds a restricted deposit of \$90 thousand (NIS 300 thousand) against forward contracts.

**G. Sensitivity Tests For Changes In Market Factors:**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	

Sensitivity tests in respect of changes in the fair value of bonds:

Gain (loss) from the change:		
Increase of 10% in fair value	(113)	(179)
Decrease of 10% in fair value	113	179

Sensitivity tests in respect of changes in the NIS exchange rate:

Gain (loss) from change:		
Increase of 10% in the exchange rate	102	102
Decrease of 10% in the exchange rate	(124)	(102)

**Sensitivity Analyses And Main Assumptions:**

The changes selected in the relevant risk variables were based on management assessments of reasonable changes that are likely in these risk variables.

The company prepared sensitivity tests vis à vis the main market risk factors that could affect the operating results or reported financial situation. The sensitivity tests report profit or loss and/or change in equity (before tax) for each financial instrument in respect of the relevant risk variable as at the reporting date.

The risk factors are tested on the basis of significance of the exposure on the operating results or the financial situation for each risk factor in relation to the functional currency, assuming that all the other variables are constant.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 13 - FINANCIAL INSTRUMENTS (CONTINUED):**

**H.** Linkage terms of financial assets and liabilities, by financial instrument groups, in accordance with IAS 39:

	<b>In Foreign Currency Or Linked There to</b>			<b>Non- Linked</b>	<b>Total</b>
	<b>NIS</b>	<b>Euro</b>	<b>Japanese Yen</b>		
	<b>\$ Thousands</b>				
December 31, 2010:					
Loans and receivables	94	-	-	1,533	1,627
Financial liabilities, measured at amortized cost	711	97	-	2,157	2,965
December 31, 2009:					
Loans and receivables	74	-	84	413	571
Financial liabilities, measured at amortized cost	361	14	-	1,175	1,550

**NOTE 14 - EMPLOYEE BENEFITS - ASSETS AND LIABILITIES -:**

Benefits to employees include short-term benefits, post-employment benefits, and other long-term benefits.

**A. Post-Employment Benefits:**

Labor laws and the Severance Pay Law in Israel require the company to pay compensation to employees if they are dismissed or when they retire, or to make routine deposits with defined contribution plans under Section 14 of the Severance Pay Law, as described below. The company's liability for this is treated as a post-employment benefit.

Post-employment benefits are usually financed by deposits classified as a defined benefit plan or as a defined contribution plan, as described below.

**B. Defined Contribution Plan:**

Severance payments are subject to Section 14 of Severance Pay Law, 5723-1963. Accordingly, monthly deposits by the group with pension funds and/or insurance policies exempt it from any other liability vis à vis the employees. These deposits, together with provident fund deposits, constitute the defined contribution plan.

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Expenses - defined contribution plan	63	67

**NOTE 14 - EMPLOYEE BENEFITS - ASSETS AND LIABILITIES - (CONTINUED):**

**C. Defined Benefit Plan:**

The company's liability for employee benefits is based on a binding labor agreement, the employee's salary, and length of employment, which together generate a right to severance compensation. This amount, which approximately equals the actuarial provision required under IAS 19 is as follows:

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$ Thousands</b>	
Expenses - defined benefit plan	<u>113</u>	<u>80</u>

**NOTE 15 - TAXATION ISSUES:**

**A. Tax Laws Applicable To The Group:**

**1 Israel:**

**Income Tax Law (Taxation Under Inflationary Conditions), 5745 – 1985:**

According to said law, up to the end of 2007, results for tax purposes were measured after adjustment for changes in the Consumer Price Index.

During February 2008, the Israel Knesset amended Income Tax Ordinance - Income Tax Law (Taxation Under Inflationary Conditions), 5745 – 1985, limiting the applicability of said law from 2008 and onwards. From the 2008 tax year, results for income tax purposes are measured in nominal terms, except for certain adjustments for changes in the Consumer Price Index until December 31, 2007. The amendment includes, inter alia, cancellation of various additions and deductions for inflation, and the additional deduction for depreciation from 2008 onwards.

**Law for the Encouragement of Capital Investments, 5719-1959:**

According to said law, certain companies are entitled to various tax benefits, on the basis of their "approved enterprise" status, available for various parts of the overall enterprise, as this term is defined by law. The main benefits include:

**Investment Plan - Alternative Benefits Track:**

On May 30, 2001, the company received approval of its investment plan, which it submitted in accordance with said law, under the "alternative benefits" track. The company received confirmation of the plan's final completion, which covered investments up to September 30, 2003.

The main benefit available under this track is an exemption and a reduction of tax on income earned from the approved enterprise. The company is entitled to a corporate tax exemption on its income not distributed as dividends over a period of six years, and a reduced tax rate of 25% in the seventh year. The benefit period will start in the first year that taxable income is earned, and is limited to 14 years from the date of the initial approval (May 30, 2001).

**NOTE 15 - TAXATION ISSUES (CONTINUED):**

If dividends will be distributed from said tax-exempt income, the company will be liable for tax at the rate that would have been charged on its income from the approved enterprise in the year that it earned the income, if it did not choose the alternative benefits track (a tax rate of 25%). In addition, a distribution of dividends from approved enterprise income, whether exempt from tax or not, is subject to a deduction of tax at source of 15%, regardless of the nature of the recipient and his residence (subject to any relevant tax treaties).

Said benefits are subject to various terms as set out by law, to regulations, and to the letter of approval which served as the basis for the investment in the approved enterprises, including a minimum investment in share capital equal to at least 30% of the approved plan. Noncompliance with these terms may trigger a cancellation of the benefits, in whole or in part. In management's opinion, the company complies with said terms.

**Expansion of the Alternative Benefits Track ('Beneficiary Enterprise'):**

The company submitted a request for a pre-ruling in respect of its plan to expand the alternative track to have 2006 deemed the elective year. If the company will comply with certain criteria as set out by law, it will be entitled to a tax exemption for a period of six years, and during the remaining benefit period (one year) to a reduced tax rate of 25%.

The basic term to receive benefits under this track is that the enterprise be deemed a "competitive enterprise."

Another term for receipt of benefits under the alternative track available under Amendment 60 of the Law is that "minimum entitling investments" be made. This involves an investment in productive assets such as machinery and equipment that must be made within three years. Regarding expansion of the enterprise, the minimum entitling investment required was set at NIS 300 thousand or an amount equal to an "entitling percentage" of productive assets, the greater of the two. Productive assets will also include productive assets that serve the enterprise and that are not owned by the enterprise.

The company submitted its request to have 2006 deemed its elective year for the beneficiary enterprise expansion. During February 2007, the company received approval of its request on condition that it comply with the pre-ruling's terms.

Income entitled to benefits under the alternative track is defined as the taxable income of a company that complied with certain terms provided by the amendment ("beneficiary company"), earned by an industrial enterprise or by a hotel. The amendment provides details of the types of income entitled to benefits under the alternative track, and states that income from an industrial enterprise includes, inter alia, income from the production of software products and their development, as well as income from research and development efforts for a foreign resident (when approval for said was received from the Head of the Industrial Research and Development Administration).

In respect of the expansion program under Amendment 60, the beginning of the benefit period is determined from the election-year, or from the year in which the company first earned taxable income, the latter of the two, on condition that 12 years have not passed from the start of the election-year.

If dividends are distributed from tax-exempt income, the company will be taxed at the rate that would have been imposed on income from an approved enterprise in the year that the income was generated, if not for choosing the alternative track (25% tax rate). The company's policy is not to distribute dividends from said income.

**NOTE 15 - TAXATION ISSUES (CONTINUED):**

**Law For Encouragement Of Capital Investments, 5719-1959. Amendment:**

During December 2010, the Israel Knesset passed its Economic Policy Law for 2011 and 2012 (Legislative Amendments), 5771-2011, which set out, inter alia, amendments to the Law for Encouragement of Capital Investment, 5719-1959 ("Law"). The amendment became effective on January 1, 2011. The amendment changes the benefits tracks available under the Law, and imposes a uniform tax rate on all preferred income of a company. From the 2011 tax year, a company is allowed to choose (without any possibility to reverse its choice), if to fall under the amendment, and from said tax year (the year of choice), the company will be taxed under the amended tax rates. The tax rates under the amendment are as follows: 2011 and 2012 -15% (vis à vis Development Area "A"-10%), 2013 and 2014 - 12.5% (vis à vis Development Area "A"-7%), and from 2015 onwards - 12% (vis à vis Development Area "A"-6%). The company has not yet decided if to fall under the amendment.

**Accelerated Depreciation:**

The company is entitled to accelerated depreciation during the first five years of the use of machinery and equipment by the approved enterprise, from the first year of operating each asset.

**Terms for Benefits:**

Said benefits are conditioned on compliance with terms as defined by law, regulations and letters of approval that served for the investments in the approved enterprise, as noted above. Noncompliance with said terms may trigger a cancellation of the benefits, in whole or in part, and to a refund of all benefits plus interest. In management's opinion, the company complies with all required terms.

**Law For The Encouragement Of Industry (Taxation) 5729-1969:**

1. The company is an "industrial company" as this term is defined by law. Accordingly, and on the basis of various regulations, the company is entitled to claim depreciation expense at increased rates for equipment used in its industrial operations, as provided by regulations issued under the Taxation Under Inflationary Conditions Law. Moreover, it is also entitled to claim expenses in respect of public issues, over a three-year period (in equal annual claims).

2. The company sells products produced in US in the American market. As a result, the company is subject to American tax laws and under certain circumstances which are not under its control, US tax authorities may consider these operations as part of a "permanent establishment" that is liable for tax reporting in United States. The company has submitted its tax reports to the US tax authorities and has stated its position that the provisions of a "permanent establishment" are not relevant vis à vis its US operations. However, if it will be determined that the company did, in fact, have a "permanent establishment," the liability for tax on its income from these operations is not expected to be material, if at all, because of the offset of costs to said operations.

3. The consolidated company is taxable under US tax laws (see paragraph B(2) below).

**NOTE 15 - TAXATION ISSUES (CONTINUED):**

**B. Tax Rates Applicable To Group Profits:**

**1. The Company:**

Israeli corporate tax rates are as follows: 2007 - 29%, 2008 – 27%, 2009 - 26%, and 2010 - 25%. Tax at the reduced rate of 25% will be binding on capital gains generated after January 1, 2003, in lieu of ordinary tax rates.

During July 2009, the Israel Knesset approved the Economic Efficiency Law (Legislative Amendments to Implement the 2009-2010 Economic Plan), 5769-2009, which set out, inter alia, a gradual reduction of corporate tax and "real" capital gains tax, starting from 2011, to the following tax rates: 2011 – 24%, 2012 – 23%, 2013 – 22%, 2014 – 21%, 2015 – 20%, 2016 and thereafter – 18%.

The amendment did not have any material effect on the company's financial position or operating results.

**2. Consolidated Subsidiary:**

The US-incorporated consolidated company is subject to company tax (taxed progressively) from 15% and up to 39%, plus state and local taxes from 5.5% and up to 9.99%, respectively (these tax rates vary from state to state, according to where the company operates). Effectively, the overall weighted tax rate ranges from 20.5% to 48.99%.

A tax treaty to prevent double taxation is in effect between Israel and the United States, and on the basis of this tax treaty, the tax to be deducted at source against dividends and interest is set at 12.5% and 17.5%, respectively.

**C. Tax Assessments:**

The company has received tax assessments considered final up to and including the 2006 tax year, while the consolidated company has received tax assessments considered final because of prescription, up to and including the 2006 tax year.

**D. Losses Carried Forward For Tax Purposes:**

Losses for tax purposes that are available for carried forward in Israel, total \$ 23 million. These losses are available for an unlimited period of time,

No deferred tax receivable asset was recorded in respect of these carry forward tax losses, as they are not expected to be used in near term.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 16 - CONTINGENT LIABILITIES, COMMITMENTS, AND GUARANTEES:**

**A. Commitments:**

**1. Building Leases:**

The company signed an agreement for a 36-month building lease, from May 2008 and up to May 14, 2011. Monthly payments total \$4 thousand.

To guarantee commitments under said, the company has issued a bank guarantee of \$12 thousand (equivalent to NIS 45 thousand) in favor of the lessor.

Future contractual lease payments as at December 31, 2010 are as follows:

	<u>\$ Thousands</u>
First Year	18

**2. Vehicle Leasing:**

The company has 36-month vehicle-operating leases, up to 2013. Future contractual lease payments as at December 31, 2010 are as follows:

	<u>\$ Thousands</u>
First Year	50
Second Year	43
Third Year	36
	<u>129</u>

**B. Liens:**

To secure certain credits, the company recorded a floating lien on all assets, including various rights, in favor of the lender. Moreover, the company's US subsidiary has also recorded a lien on various assets in favor of the lender.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 17 – EQUITY:**

**A. Breakdown:**

	<b>December 31,</b>			
	<b>2010</b>		<b>2009</b>	
	<b>Authorized</b>	<b>Issued and Paid</b>	<b>Authorized</b>	<b>Issued and Paid</b>
	<b>Shares</b>			
Ordinary shares, NIS 0.01 par value each	50,000,000	38,687,840	50,000,000	35,727,174

**B. Changes In Share Capital:**

Share Capital Issued and Paid:

	<b>Quantity</b>	<b>NIS Par Value</b>
Balance, January 1, 2009	23,365,714	233,657
Share capital issue	12,329,460	123,295
Options exercised	32,000	320
Balance, December 31, 2009	35,727,174	357,272
Share capital issue	2,264,165	22,642
Options exercised	696,501	6,965
Balance, December 31, 2010	38,687,840	386,879

**C. Share Rights:**

1. Voting rights at the general meeting, rights to dividends, rights upon liquidation of the company and the right to appoint directors.

2. The shares are traded on the Tel Aviv Stock Exchange.

**D.** On May 20, 2008, the company signed an investment agreement with an interested party. On the basis of the agreement and after compliance with all terms as required, on June 12, 2008 the company issued 600,000 ordinary shares, NIS 0.01 par value each to the investor against an investment of \$400 thousand (equivalent to NIS 1,350 thousand).

**E.** On August 13, 2008, the company issued 314,489 ordinary shares of the subsidiary, NIS 0.01 par value each at NIS 2.25 per share, against an investment of \$200 thousand (equivalent to NIS 708 thousand) to an interested party, after receiving approval from the shareholders' general meeting.

**NOTE 17 – EQUITY (CONTINUED):**

**F.** On November 27, 2008, the company submitted a prospectus for a share rights issue and on December 4, 2008 submitted a shelf offering, as follows:

1. Under the shelf offering, the company offered between 13,698,970 and 18,795,993 ordinary shares, NIS 0.01 par value each ("offered shares") to its shareholders.
2. The shares were offered by way of a rights offer to company shareholders, such that each shareholder of 1 NIS 0.01 par value each, registered, ordinary share at the end of trading on December 10, 2008, was entitled to purchase 1 unit of rights, made up of 1 ordinary share, NIS 0.01 par value each of the company at a price of NIS 0.5.
3. Up to the last date for exercising the rights - December 23, 2008 - the company received 9,666,744 applications for the purchase of 9,666,744 ordinary shares of NIS 0.01 par value each.
4. As consideration for the rights exercise, as noted in 3 above, the company received \$1,260 thousand (equivalent to NIS 4,833 thousand).

Following the rights issue, the quantity of shares that would result from the conversion of bonds was adjusted for the bonus component of the rights, and accordingly each holder of NIS 14.69 par value of Series A Bonds will be entitled to convert said to 1.36574 ordinary shares. In addition, the conversion ratio of options was also adjusted, such that each option would be convertible into 1.36574 ordinary shares.

**G.** On June 10, 2009, the company signed an investment agreement with a third party investor, and issued 9,124,088 shares, against an investment of NIS 10 million (equivalent to \$2,672 thousand) (reflecting a share price of NIS 1.096, equivalent to \$0.293).

On July 29, 2009, the shareholder's general meeting approved said investment, and on August 3, 2009, an investment of NIS 10 million (equivalent to \$2,672 thousand) was made.

Following closure of said capital issue, the company paid its issue consultants NIS 500 thousand (equivalent to \$134 thousand) (5% of the investment proceeds) as a special bonus for the successful capital issue. Moreover, the company also granted them options, convertible into 456,204 ordinary shares of NIS 0.01 par value, as follows:

Option Terms:

1. The options will be available for conversion into shares against payment of an exercise premium of NIS 1.096 per share ("exercise premium").
2. The options will be available for conversion at any time, at once or in tranches, over a period from grant date, and ending on the earlier of (A) five years from the date of option grant, or (B) a merger of the company, or (C) the sale of all or most of the company's assets to a third-party ("exercise period"). The consultants may convert their options (vis-à-vis all options granted to each consultant or part of said), in one of two ways, as detailed below: (A) conversion against the payment of the exercise price in cash, or (B) a "cashless" exercise, without any payment in cash of the exercise price such that upon conversion of the options, a consultant will receive shares in an amount that reflects the financial benefit implicit in the options.

**NOTE 17 - EQUITY(CONTINUED):**

The overall benefit estimated in respect of said grants, calculated in accordance with the Black & Scholes model, and the following assumptions, was \$255 thousand (equivalent to NIS 959 thousand). The implicit benefit was deducted from the issue proceeds.

The benefit was calculated on the Black & Scholes calculation model basis, using an annual variance of 68.75%, as at grant date, a share price of NIS 2.735 per share as at grant date, and a discount rate of 3.31% as at grant date.

**H.** On October 28, 2009, the company published a shelf offering for the issue and registration of the following securities ("shelf prospectus") on the Tel Aviv Stock Exchange.

**1. Offer Details:**

**A.** Up to 3,400,000 ordinary shares, registered, of NIS 0.01 par value each, at a par value of NIS 34 thousand, offered by uniform tender to the public, together with,

**B.** Up to 850 ,000 Series 1 Options, registered ("Series 1 Options"), convertible on any trading day, from the date of registration for trading on the stock exchange and up to October 28, 2013 ("last date for exercising Series 1 Options"), such that each Series 1 Option can be converted into 1 ordinary share of NIS 0.01 par value each ("share exercise "), against payment in cash of the exercise price of NIS 3.10, (not linked) ("exercise price of Series 1 Options").

In accordance with said offer, the company issued 801,343 units (each unit includes four shares at NIS 2.35 per share, and 1 option at no cost) at NIS 9.4 per unit, against consideration of NIS 7,533 thousand. Said options were recorded under liabilities at fair value through profit and loss.

The company paid Poalim I.B.I. Underwriting and Issues Ltd., ("distributor") a commission of 2.5% on the total raised on the basis of the shelf offering, and NIS 30 thousand as a consortium commission.

In addition, the distributor received 94,276 Series 1 Options that the company was committed to issue it in a private placement, subject to receipt of all approvals required by law. The value of said options as at grant date was \$17 thousand. Said was recorded against issue proceeds.

**NOTE 17 – EQUITY (CONTINUED):**

**I.** On July 14, 2010, the company published a shelf offering for the issue and registration for trading of its securities on the Tel Aviv Stock Exchange, on the basis of a shelf prospectus originally published on November 27, 2008 ("shelf prospectus"), and amended on December 2 and December 3, 2008 and in accordance with Securities Regulations. The company offered the following securities:

**1.** Between 1,507,606 and 1,657,216 (assuming conversion of all Series A Bonds, the exercise of all traded options, and the exercise of all non-traded options that will vest up to the determining date) units of rights that were offered to ordinary shareholders of the company, who were registered in the shareholders' registry of the company at the end of trading on July 25, 2010, such that each holder of 24 ordinary shares, NIS 0.01 par value each, will receive a right to purchase 1 ordinary share of the company at NIS 3 per share.

**2.** Up to the last rights exercise date (August 9, 2010), the company received 1,258,104 applications for the purchase of 1,258,104 ordinary shares, NIS 0.01 par value each.

**3.** As consideration for said rights issue (B above) the company received \$1 million (equivalent to NIS 3,774 million) gross

**J.** On October 20, 2010, the general meeting approved a non-significant private offer to the company's controlling shareholders - A.M. Acclemed - Limited Partnership ("Acclemed") and Nissan Medical Industries Ltd. ("Nissan") (together: "recipients"), of 400,000 ordinary shares, NIS 0.01 par value each of the company ("shares offered") which will be registered for trading on the Tel Aviv Stock Exchange, against a consideration of NIS 1.2 million (equivalent to \$323 thousand), reflecting a price of NIS 3 per share. The following is a summary of the offer agreement and its principal terms:

**1.** The date of share issue and the date of payment by the recipients will be the later of, up to three days from approval of the offer by company shareholders, or upon approval by the Stock Exchange for registration of the shares for trading.

**2.** The company will issue 200,000 ordinary shares, NIS 0.01 par values each, to Acclemed, through a private offering, against payment of NIS 600 thousand (equivalent to \$ 161 thousand), according to terms set out in the agreement.

**3.** The company will issue 200,000 ordinary shares, NIS 0.01 par values each, to Nissan through a private offering, against payment of NIS 600 thousand (equivalent to \$ 161 thousand), according to terms set out in the agreement.

**4.** The shares that are offered will be equal in rights from all standpoints, to the company's outstanding share capital.

On October 26, 2010, the company issued said shares against payment of NIS 1.2 million (equivalent to \$ 323 thousand).

**K.** On October 11, 2010, the Board of Directors approved a private offer of 606,061 ordinary shares to a recipient who is not a controlling shareholder of the company or an interested party therein ("recipient"). Consideration for the share issue to be paid by the recipient in cash totals NIS 2 million (equivalent to \$538 thousand), reflecting a share price of NIS 3.3. The following is a summary of the offer agreement and principal terms.

**1.** The company will issue 606,061 ordinary shares NIS 0.01 par value each to the investor.

**NOTE 17 – EQUITY (CONTINUED):**

2. The shares that are offered as noted above, will be, from issue date, equal in rights in all respects to the company's currently outstanding share capital.

3. The recipient, or his representative, does not serve as a director or as company CEO. Furthermore, the recipient will not become an interested party of the company after the issue.

On October 26, 2010, the company issued said shares to the recipient, against payment of NIS 2 million (equivalent to \$ 538 thousand).

**L. Capital Management:**

The company's objectives in managing its share capital are as follows:

1. To maintain the group's ability to ensure the continuity of the business, and to earn a return for its shareholders, investors, and other interested parties.

2. To comply with financial covenants.

**NOTE 18 – SHARE-BASED PAYMENTS:**

**A. Expenses Recognized In The Books:**

The expense recognized in the financial statements for services provided by employees is as follows:

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$ Thousands</b>		
Share-based payment plans, settled by equity instruments	<u>662</u>	<u>56</u>	<u>143</u>

Share-based payment transactions that were granted by the Company to its employees are as follows:

**B. Israel Option Program For Employees And Officeholders:**

On December 23, 2010, the Board of Directors adopted an option plan for company employees and officeholders ("2010 Israel Options Program"). No options issued under said option program will be registered for trading on the stock exchange; however, the shares that will be issued on the basis of the conversion of options will be registered for trading on the stock exchange. The options will be issued under the "capital gains" track, under a trustee's supervision, and in accordance with Section 102 of the Income Tax Ordinance.

**NOTE 18 – SHARE-BASED PAYMENTS (CONTINUED):**

**C. Following Is A Discussion Of Option Grants That The Group Made During 2008-2010:**

1. On February 11, 2008, the Board of Directors approved the following:

A. A grant of 790,002 options as follows:

1. 541,002 options to Mr. Adi Dagan, who on grant date was a controlling shareholder, director and CEO, available for conversion into 541,002 ordinary shares.
2. 150,000 options to Mr. Eitan Nahum, Chairman of the Board of Directors, available for conversion into 150,000 ordinary shares.
3. 99,000 options to employees, available for conversion into 99,000 ordinary shares.
4. On April 2, 2008, the shareholders' general meeting approved grants in 1 and 2 above.

**Option Terms:**

1. The 541,002 options granted to Mr. Dagan will vest and be available for conversion in three equal tranches (180,334 options each tranche), upon receiving all mandatory approvals for granting the options, and on December 31, 2008 and 2009. The options will be available for conversion for up to three months after Mr. Dagan is no longer employed by the company (in accordance with an employment agreement dated December 31, 2009).

2. The 150,000 options granted to Mr. Nahum will vest and be available for conversion in three equal tranches (50,000 options each tranche), upon receiving all mandatory approvals for granting the options, and on January 1, 2009 and 2010. The options will be available for conversion up to December 31, 2011.

3. The 99,000 options granted to employees will vest and will be available for conversion in eight equal tranches (12,375 options each six month period), starting August 11, 2008. The options will be available for conversion up to December 31, 2012.

4. Each option will be available for conversion into 1 ordinary share, NIS 0.01 par value each, against payment in cash of the exercise price of NIS 3.2 vis-à-vis 1 above, and NIS 2.438 vis à vis 2 and 3 above. These exercise prices reflect the average price of the company's shares in the 30-day trading period up to February 11, 2008, the date when the option grants to the recipients were approved by the company's Board of Directors ("determining date").

**B. Economic Value of the Options:**

The benefit in respect of said grants, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$166 thousand.

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 39%-53% calculated on grant date, a share price of NIS 1.95 per share on grant date, discount rates of 1.93%-5.68% per year on grant date, and a forfeiture rate of 0%-10%.

2. On May 18, 2009 and on June 16, 2009, the Board of Directors approved, further to approval by the Audit Committee of said dates, a re-pricing of 188,635 options available for conversion into 188,635 ordinary shares that were previously granted to directors who are not controlling shareholders of the company and who are not outside directors of the company - Nahum, Eitan; Avidor, Roni, and Harrison, Charley ("recipients"). Moreover, the exercise price of options previously granted to 12 company employees, was amended.

The exercise price of options issued under the re-pricing decision will be NIS 1.76 per share (before the re-

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

pricing decision, the exercise price ranged from NIS 2.44 to NIS 9.025 per share).

**NOTE 18 – SHARE-BASED PAYMENTS (CONTINUED):**

It was also decided, that the exercise period of the options granted to the recipients, will be amended, such that the recipients will be entitled to exercise all options that they held by December 31, 2010, even if their tenure with the company ended earlier.

The benefit (including the additional benefit vis à vis changes to the option terms as noted above, calculated in accordance with the Binomial Model and various assumptions, as noted below, is \$21 thousand (equivalent to NIS 74 thousand). This benefit will be recorded as an expense over the vesting period.

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 79.71%-101.59% calculated on term change date, a share price of NIS 1.994-NIS 2.271 per share on term change date, discount rates of 0.47%-3.02% per year on term change date, and a forfeiture rate of 3%-5%.

On the basis of a decision by the Board of Directors and in accordance with a tax decision by the Income Tax Authority, said re-pricing will not be considered a tax event. Furthermore, there will be tax continuity regarding the options, so that the rights of the option recipients will not be injured.

3. On July 27, 2009, the shareholders' general meeting approved a re-pricing of 40,000 options for conversion into up to 40,000 ordinary shares that were previously granted to outside directors of the company. The exercise price of these options, under the re-pricing decision, was set at NIS 1.76 per share (before the re-pricing decision, the exercise price was NIS 7.91 per share. Furthermore, it was decided that the exercise period of options granted to outside directors would be amended, such that the outside directors will be entitled to exercise all options that they held by December 31, 2010, even if their tenure with the company ended earlier.

The benefit estimated for changes in the option terms as noted above, calculated in accordance with the Binomial model and various assumptions as noted below, is \$10 thousand (equivalent to NIS 37 thousand).

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 64.04%-102.38% calculated on the term change date, a share price of NIS 2.383 per share on the term change date, discount rates of 0.49%-2.59% per year on the term change date, and a forfeiture rate of 3%.

4. On September 4, 2009, the company granted 120,000 options for conversion into up to 120,000 ordinary shares at an exercise price of NIS 3.094 per option to two outside directors and to two other directors. The options may be exercised immediately and up to December 31, 2012.

The benefit estimated for said grants, calculated in accordance with the Binomial model and various assumptions as noted below, is \$40 thousand (equivalent to NIS 155 thousand).

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 73.75% calculated on grant date, a share price of NIS 2.735 per share on grant date, a discount rate of 3.35% per year on grant date, and a forfeiture rate of 3%.

5. On October 12, 2009, the Board of Directors approved a grant to the subsidiary's VP-Marketing, in accordance with terms of his employment, of options available for conversion into 150,000 ordinary shares of NIS 0.01 par value each.

**NOTE 18 – SHARE-BASED PAYMENTS (CONTINUED):**

Option Terms:

1. The option exercise price is NIS 2.743.
  2. The option vesting period will continue over a period of three years from the date of option grant, in three equal tranches each year (one third of all options granted at the end of each undertaking year, over a period of three years).
  3. The option exercise period will be from the date of vesting, as stated above, and for five years from grant date.
6. On October 12, 2009, the Board of Directors approved a grant to the subsidiary's VP- Sales, in accordance with the terms of his employment, of options available for conversion into 100,000 ordinary shares of NIS 0.01 par value.

Option Terms:

1. The option exercise price is NIS 2.712. This price reflects the average closing price of the company's shares in the 30-day trading period up to September 15, 2009, when the agreement was signed with the employee.
  2. The option vesting period will continue over a period of four years from the date of option grant, in four equal tranches each year (one quarter of all options granted at the end of each undertaking year, over a period of four years).
  3. The option exercise period will be from the date of vesting as stated above, and for five years from grant date.
7. On October 12, 2009, the Board of Directors approved a grant to a company employee, in accordance with terms of her employment, of options available for conversion into 10,000 ordinary shares of NIS 0.01 par value.

Option Terms:

1. The option exercise price is NIS 2.735.
2. The option vesting period will continue over a period of four years from the date of option grant, in eight equal tranches once every six months (one eighth of all options granted at the end of each six month period, over a period of four years).
3. The option exercise period will be from the date of vesting, and the earlier of (A) December 31, 2013; or (B) 90 days from the end of her employment at the company.

The benefit estimated for grants 5-7 above, calculated in accordance with the Binomial model and various assumptions as noted below, is \$97 thousand (equivalent to NIS 370 thousand).

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 42.6%-67.9% calculated on grant date, a share price of NIS 2.693 per share on grant date, a discount rate of 4.13% per year on grant date, and a forfeiture rate of 3%.

8. On November 12, 2009, the Board of Directors approved a grant to the company's CFO, in accordance with terms of his employment, of 130,000 options available for conversion into 130,000 ordinary shares of NIS 0.01 par value each.

**NOTE 18 – SHARE-BASED PAYMENTS (CONTINUED):**

Option Terms:

1. The option exercise price is NIS 0.97.
2. The option vesting period will continue over a period of four years from the date of option grant - one quarter of the grant (32,500 options) will vest on February 1, 2010, and the balance will vest in six equal tranches (16,250 options, each tranche) once every six months (from August 1, 2010 until February 1, 2013).
3. The option exercise period will be from the date of vesting and the earlier of (A) October 10, 2014 or (B) 90 days from the end of his employment at the company.
4. On July 5, 2010, the Board of Directors amended the option terms such that in the event of any merger, acquisition, etc., and on condition that the employment of the CFO will be discontinued by the acquiring company, not "for cause", the option's vesting program terms will be accelerated, and all options as stated will vest 10 days before the transaction date.

The benefit estimated for said grant, calculated in accordance with the Binomial model and various assumptions as noted below, is \$ 55 thousand (equivalent to NIS 210 thousand).

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 70%-95% calculated on grant date, a share price of NIS 2.169 per share on grant date, discount rates of 2%-3.5% per year on grant date, and a forfeiture rate of 5%.

9. On December 27, 2009, the Board of Directors approved a grant to the subsidiary's consultant, in accordance with terms of his undertaking, of 100,000 options available for conversion into 100,000 ordinary shares of NIS 0.01 par value each.

Option Terms:

1. The options will be granted as part of a compensation program, which complies with American law (USSOP).
2. The option exercise price is NIS 2.65.
3. The option vesting period will be as follows - one quarter of the grant will vest at the end of the first year from the date of option grant; and the balance, in equal tranches on the last day of each quarter over a period of three years from the first year after the grant.
4. The option exercise period will be from the initial vesting, as noted in 3 above, and for five years from grant date.
5. On February 15, 2010, the Board of Directors amended the option terms, such that in the event of any merger, acquisition, reorganization of the company, with/into another company, and if the company is not the surviving company, or in the event of a sale of all or part of the company's assets or shares, the option's vesting program terms will be accelerated vis à vis all options that were granted to the subsidiary's consultant, and all options will vest 10 days before the transaction date.

**NOTE 18 - SHARE-BASED PAYMENTS (CONTINUED):**

**10.** On December 27, 2009, the Board of Directors approved a grant to the subsidiary's consultant, in accordance with terms of his undertaking, available in two separate tranches, of 130,000 options convertible into 130,000 ordinary shares. 30,000 options that are granted in the first tranche are offered to the consultant for consulting services that he provides to the company, while 100,000 options are granted in the second tranche for consultation further to his tenure as a company director and science consultant.

Terms Of Options Granted For Consultation Services:

1. 30,000 non-traded options, available for conversion into 30,000 ordinary shares. .
2. The option exercise price is NIS 2.65.
3. The option vesting period will be in three equal tranches of 10,000 options each, at the end of each year starting from grant date and over a period of three years.
4. On February 15, 2010, the Board of Directors amended the option terms, such that in the event of any merger, acquisition, reorganization of the company, with/into another company, and if the company is not the surviving company, or in the event of a sale of all or part of the company's assets or shares, the option's vesting program terms will be accelerated vis à vis all options that were granted to the subsidiary's consultant, and all options will vest 10 days before the transaction date.

Terms Of Options Granted For Tenure as a Director and Science Consultant:

1. 100,000 non-traded options, available for conversion into 100,000 ordinary shares. .
2. The exercise price of each option is NIS 2.65.
3. The option vesting period will be as follows - one quarter of the options offered at the end of the first year from grant date, with the balance available in equal quarter tranches on the last day of each quarter over a period of three years.

On February 15, 2010, the Board of Directors amended the option terms, such that in the event of any merger, acquisition, reorganization of the company, with/into another company, and if the company is not the surviving company, or in the event of a sale of all or part of the company's assets or shares, the option's vesting program terms will be accelerated vis à vis all options that were granted to the subsidiary's consultant, and all options will vest 10 days before the transaction date.

**11.** On December 27, 2009, the Board of Directors approved a grant to the subsidiary's consultant in accordance with terms of his undertaking, of 25,000 options convertible into 25,000 ordinary shares.

Option Terms:

1. The options will vest on April 1, 2010, subject to compliance with certain company milestones. The Board of Directors has the authority to extend the period of compliance.
2. The option exercise price is NIS 2.65.
3. The option exercise period will be from the date of vesting, as noted in 1 above, and for a period of five years from grant date.

The benefit estimated for grants 9-11 above, calculated in accordance with the Binomial model and various assumptions as noted below, is \$51 thousand (equivalent to NIS 195 thousand).

**NOTE 18 - SHARE-BASED PAYMENTS (CONTINUED):**

The benefit is calculated using the Binomial Option Pricing Model, based on a variance of 76.73%-85.85% calculated on grant date, a share price of NIS 2.3 per share on grant date, and discount rates of 2%-4.3% per year on grant date.

**12.** On March 1, 2010, the company's Board of Directors approved a grant to the subsidiary's President, in accordance with terms of his employment, of 350,000 options available for conversion into 350,000 ordinary shares of NIS 0.01 par value each

**Option Terms:**

1. The options will be granted as part of a compensation program, which complies with American law (USSOP).
2. The option exercise price is NIS 3.551 per share.
3. The options will vest over a period of 36 months from grant date, and an equal amount of options will vest each three-month period. The first vesting point will be at the end of three months from grant date.
4. The option exercise period is from the date of vesting, as stated in 3 above, up to the end of four years from grant date.

The fair value of the options, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$184 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on an expected share price fluctuations of 73.5%-84.11% calculated on grant date, a share price of NIS 3.551 (\$0.94) per share on grant date, non-risk interest rates of 2.1%-3.58% per year on grant date, and a forfeiture rate of 5%.

**13.** On March 8, 2010, the Board of Directors approved a grant to Mr. Eitan Nahum, Chairman of the Board of Directors, of 350,000 options available for conversion into 350,000 ordinary shares, NIS 0.01 par value each. The options were granted after receipt of all approvals required under law, including approval by the shareholders' general meeting of July 26, 2010.

**Option Terms:**

1. The options will be granted as part of a compensation program, which complies with American law (USSOP).
- 2 The option exercise price is NIS 3.681.
3. The options will vest over a period of 36 months from grant date, and an equal amount of options will vest each six month period. The first vesting point will be at the end of six months from Board of Directors' approval – that is – March 8, 2010.
4. The option exercise period is from the date of vesting, as stated in C above, up to five years from Board of Directors' approval – that is – March 8, 2010. .

The fair value of said options, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$128 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on an expected share

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

price fluctuations of 58.45%-71.87% calculated on grant date, a share price of NIS 3.069 per share on grant date, non-risk interest rates of 2%-3.18% per year on grant date, and a forfeiture rate of 5%.

**NOTE 18 - SHARE-BASED PAYMENTS (CONTINUED):**

**14.** On March 8, 2010, the Board of Directors approved a grant to the subsidiary's consultant of 70,000 options that are available for conversion into 70,000 ordinary shares, of NIS 0.01 par value, each.

**Option Terms:**

1. The options will be granted as part of a compensation program, which complies with American law (USSOP).
2. The option exercise price is NIS 3.681 per share.
3. Vesting of the options will be over a period of 48 months from grant date, with 17,500 options vesting at the end of the first year, and the balance in 12 equal and quarterly tranches.
4. The option exercise period is from the date of vesting, as stated in 3 above, up to five years from grant date.

The fair value of said options, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$39 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on share price fluctuations of 73.77%-84.7% calculated on grant date, a share price of NIS 3.681 (\$0.98) per share on grant date, non-risk interest rates of 2%-3.7% per year on grant date, and a forfeiture rate of 5%.

**15.** On April 18, 2010, the Board of Directors extended the exercise period of 32,000 options that can be converted into 32,000 ordinary shares, NIS 0.01 par value each, which were granted to company employees (who are not officeholders and/or interested parties and/or controlling shareholders of the company), whose original date of expiry was December 31, 2010, such that said options, will expire on December 31, 2012 (as long as they will not expire earlier, in accordance with their terms, and the terms of the option plan under which they were granted).

**16.** On May 11, 2010, the Board of Directors approved a grant to the subsidiary's VP-Commercial Operations, in accordance with terms of his employment, of 350,000 options available for conversion into 350,000 ordinary shares, NIS 0.01 par value each.

**Option Terms:**

1. The options were granted as part of a compensation program, which complies with American law (USSOP).
2. The option exercise price is NIS 3.482 per share.
3. The options will vest over a period of 36 months from grant date, and an equal amount of options will vest every six months. The first vesting point will be at the end of six months from grant date.
4. The option exercise period is from the date of vesting, as stated in 3 above, up to the end of four years from grant date. The fair value in respect of said grant, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$186 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on share price fluctuations of 62%-72% calculated on grant date, a share price of NIS 3.48 (\$0.93) per share on grant date, non-risk interest rates of 2.1%-3.8% per year on grant date, and a forfeiture rate of 5%.

**17.** On June 20, 2010 the Board of Directors approved the terms of employment of Mr. Adi Dagan as CEO, and the provision of consultancy services after his term of employment. Accordingly, Mr. Dagan will be

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

granted 420,000 options available for conversion into 420,000 ordinary shares, subject to the company's option plan.

**NOTE 18 - SHARE-BASED PAYMENTS (CONTINUED):**

**Option Terms:**

1. The option exercise price is NIS 2.11 per share.
2. The options will vest in six equal tranches, at the end of each six-month period of employment, or provision of consultancy services as stated above (70,000 options per tranche), starting July 1, 2010.
3. The options will be available for conversion when vested, and will expire five years from the date of their approval for grant by the Board of Directors (June 20, 2010).

Should a transaction, as defined by the transaction agreement, transpire - the vesting dates of options which have not yet vested will be accelerated, such that their vesting dates will be 10 days before the transaction closing date. However, and vis à vis said options, if the transaction terms will require Mr. Adi Dagan to remain in his position as CEO, so long as he serves in his position before transaction date, and without any worsening of his employment terms, if Mr. Adi Dagan will refuse such request, said vesting dates as noted above will not be accelerated.

In addition, the vesting dates of options will be accelerated if the employment of Mr. Dagan with the company will be terminated at the request of the company (except for termination requiring a cancellation of any entitlement to severance pay, on the basis of law), such that the date of vesting will be the date of transaction closing.

4. The fair value in respect of said grants, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$229 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on share price fluctuations of 61%-72% calculated on grant date, a share price of NIS 3.56 (\$0.93) per share on grant date, non-risk interest rates of 2.1%-3.8% per year on grant date, and a forfeiture rate of 5%.

**18.** On June 20, 2010, the Board of Directors approved a grant of 350,000 options available for conversion into 350,000 ordinary shares of NIS 0.01 par value each, to Dr. Jacob Barak, Chief Technology Officer.

**Option Terms:**

1. The option exercise price is NIS 2.11 per share.
2. The options will vest over a period of 36 months from grant date, with an equal tranche vesting after each six month period (58,333 options each tranche), starting January 1, 2010.
3. The option exercise period is from the date of vesting, as stated in 2 above, and up to five years from grant date.
4. The fair value in respect of said grants, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$210 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on share price fluctuations of 61%-72% calculated on grant date, a share price of NIS 3.56 (\$0.93) per share on grant date, non-risk interest rates of 2.1%-3.8% per year on grant date, and a forfeiture rate of 5%.

**NOTE 18 - SHARE-BASED PAYMENTS (CONTINUED):**

5. On February 27, 2011, and after balance sheet date, the Board of Directors amended the option terms, such that in the event that any merger, acquisition, reorganization with/into another company, and if the company is not the surviving company, or in the event of any sale of all or a significant part of the company's assets or shares, the vesting terms of options granted to the subsidiary's consultant will be accelerated such that all options will vest 10 days before transaction date.

19. During the fourth quarter of 2010, outside directors of the company converted 40,000 options into 40,000 ordinary shares, for an overall consideration of \$19 thousand.

20. On October 10, 2010, a former director of the company converted 20,000 options into 20,000 ordinary shares, for an overall consideration of \$4 thousand.

21. October 31, 2011, the Chairman of the Board of Directors, Mr. Eitan Nahum, converted 150,000 options into 150,000 ordinary shares, for an overall consideration of \$73 thousand.

22. On December 20, 2010, the VP-Commercial Operations converted 31,135 options into 31,135 ordinary shares, for an overall consideration of \$15 thousand.

23. On December 23, 2010, the Board of Directors approved a grant to the company's CFO, Mr. Ori Mor, of 70,000 options available for conversion into 70,000 ordinary shares, NIS 0.01 par value each.

**Option Terms:**

1. The option exercise price is NIS 3.842 per share.
2. The option vesting period will continue over a period of 36 months from the date of option grant; with one third of the grant (23,333 options) vesting on December 23, 2011, one third of the grant (23,333) vesting on December 23, 2012, and one third of the grant (23,334) vesting on December 23, 2013.
3. The option exercise period is from each vesting date, and for up to 18 months from said vesting dates. However, in the event of any merger, acquisition, reorganization with/into another company, and if the company is not the surviving company, or in the event of any sale of all or a significant part of the company's assets or shares, on condition that the employment of the CFO will be discontinued at the request of the acquiring company (surviving company) not for cause, the vesting mechanism will be accelerated for all options, granted and not yet exercised, such that all options as stated will vest 10 days before the transaction date.
4. The fair value in respect of said grants, on grant date, calculated using the Binomial Model and various assumptions, as noted below, is estimated at \$38 thousand.

The fair value is calculated using the Binomial Option Pricing Model, based on share price fluctuations of 57.36%-72.47% calculated on grant date, a share price of NIS 4.049 (\$1.13) per share on grant, non-risk interest rates of 2.6%-4.4% per year on grant date, and a forfeiture rate of 5%.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 18 - SHARE-BASED PAYMENTS (CONTINUED):**

**D. Changes During The Year:**

Options, which are convertible into shares, granted to employees, directors and consultants, weighted average exercise prices, and changes made to the employee option plans during the current year, are as follows:

	<b>Year Ended December 31,</b>			
	<b>2010</b>		<b>2009</b>	
	<b>Number Of Options</b>	<b>Weighted Average Exercise Prices (\$)</b>	<b>Number Of Options</b>	<b>Weighted Average Exercise Prices (\$)</b>
Options outstanding, beginning of the year	1,728,187	0.67	1,092,187	0.86
Options, granted during the year	1,960,000	0.81	765,000	0.65
Options, exercised during the year	(241,135)	0.46	(32,000)	0.05
Options, expired/forfeited during the year	-	-	(97,000)	0.76
	<u>3,447,052</u>	<u>0.81</u>	<u>1,728,187</u>	<u>0.67</u>
Options outstanding, end of the year				
Options, available for conversion, end of the year	<u>1,293,427</u>	<u>0.81</u>	<u>1,194,741</u>	<u>0.68</u>

E. The weighted average contractual lifespan of the remaining options as at December 31, 2010 is 3.54 years (2009-2.76 years).

F. Option exercise prices on December 31, 2010, ranged from NIS 0.01 to NIS 5.65

**G. Measuring The Fair Value Of Options Settled By Equity Instruments:**

The company uses the Binomial Model to measure the fair value of options settled by equity instruments. Measurement is made when granting options that are settled by equity instruments, as these are options granted to company employees.

Information used for measuring the fair value of options settled by equity instruments for the year ended December 31, 2010:

	<b>2010</b>
Expected fluctuations in share prices (%)	57%-84%
Non-risk interest rates (%)	2%-4.4%
Weighted average share prices (NIS)	3.562
Lifespan up to	5

The expected lifespan of the options is based on the company's historical data, and does not necessarily reflect future exercise patterns.

"Expected fluctuations in share prices," confirms the assumption that historical share price fluctuations are good indicators of expected future trends.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 19 - STATEMENT OF COMPREHENSIVE INCOME - ADDITIONAL DETAILS:**

	Year Ended December 31,		
	2010	2009	2008
	\$ Thousands		
<b>A. Cost Of Revenue:</b>			
Use of materials	1,896	1,578	2,386
Salaries and benefits	185	156	149
Depreciation	324	196	142
Other production expenses	26	26	15
	<u>2,431</u>	<u>1,956</u>	<u>2,692</u>
Changes In Inventory:			
Decrease (increase), inventory of work in progress	21	(38)	(3)
Decrease (increase), inventory of finished products	74	(34)	75
	<u>2,526</u>	<u>1,884</u>	<u>2,764</u>
<b>B. Research And Development Expenses:</b>			
Salaries and benefits	587	432	329
Consultants	19	47	68
Vehicle maintenance	31	34	30
Patents - registration and amortization	38	43	42
Clinical research	34	-	-
Other items	51	29	61
	<u>760</u>	<u>585</u>	<u>530</u>
<b>C. Selling And Marketing Expenses:</b>			
Salaries and benefits	1,588	678	378
Foreign travel	651	278	132
Insurance	39	48	62
Professional fees	493	148	84
Advertising, marketing and exhibitions	192	94	41
Agents' commissions	504	73	-
Telephone, postage and deliveries	25	14	17
Other items	53	89	49
	<u>3,545</u>	<u>1,422</u>	<u>763</u>

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 19 - STATEMENT OF COMPREHENSIVE INCOME - ADDITIONAL DETAILS**  
**(CONTINUED):**

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$ Thousands</b>		
<b>D. Management And General Expenses:</b>			
Salaries and benefits	693	515	422
Professional fees	558	349	433
Office rentals and maintenance	69	66	81
Office expenses, postage and telephone	52	61	66
Depreciation	15	15	24
Insurance	18	17	25
Vehicle maintenance	49	44	36
Doubtful debts	26	-	-
Other items	75	81	63
	<u>1,555</u>	<u>1,148</u>	<u>1,150</u>
<b>E. Financing Income (Expenses):</b>			
Financing Income:			
Interest income	25	3	16
Change in fair value of derivatives	11	-	-
Changes in fair value of convertible bonds designated at fair value through profit and loss	-	-	441
Changes in fair value of options	-	-	227
Net foreign exchange differences	28	-	71
	<u>64</u>	<u>3</u>	<u>755</u>
Financing Expenses:			
Financing expenses - credits	154	184	59
Changes in fair value of convertible bonds designated at fair value through profit and loss	50	1,022	-
Changes in fair value of options	316	67	-
Interest expense - bonds	86	106	112
Net foreign exchange rate differences	-	35	-
	<u>606</u>	<u>1,414</u>	<u>171</u>

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 20 - LOSS PER SHARE:**

A. Details of share quantities and losses that serve for calculating the loss per share:

	Year Ended December 31,					
	2010		2009		2008	
Weighted Quantity Of Shares, In Thousands Of Shares, NIS 0.01 Par Value Each	Loss, \$ Thousands	Weighted Quantity Of Shares In Thousands Of Shares, NIS 0.01 Par Value Each	Loss \$ Thousands	Weighted Quantity Of Shares, In Thousands Of Shares, NIS 0.01 Par Value Each	Loss, \$ Thousands	
Quantity of shares and loss	36,929	(3,202)	27,711	(3,123)	22,952	(443)

B. In calculating the diluted loss per share, convertible securities as noted below were not included, as their inclusion would have decreased the diluted loss per share compared with the basic loss per share (anti-dilutive effect):

1. 3,658,844 par value of convertible bonds. .
2. 3,447,052 options to employees.
3. 2,408,858 options.

**NOTE 21 – INVESTMENT IN INVESTEE COMPANY:**

**A. Consolidated Subsidiary**

1. Additional information – consolidated subsidiary held directly by the company

	Country of Incorporation	Funds Provided By The Company To The Consolidated Company Current Account \$ Thousands	Total Investment In The Consolidated Company
2010:			
Medical Compression Systems Inc.	United States	2,244	173
2009:			
Medical Compression Systems Inc.	United States	979	52

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 22 - SEGMENTS:**

**A. General:**

The segments, as reported, are based on information used by the chief operating decision maker for decision-making vis-à-vis an allocation of resources and performance review. Accordingly, for managerial purposes - the group is structured along business units based on the products and services of the business units, with two segments as follows:

First-generation product segment - primary operations include the production, marketing, and sale of first generation products.

Second-generation products segment - primary operations include the production, marketing, and sale of second-generation products.

The accounting policy used for the operating segments is identical to that stated in note 2 T above.

Segment results reported to the chief operating decision maker include items relating directly to the segment, and items that can be allocated on a reasonable basis. Items not allocated, mainly include research, development, selling, marketing, management and general expenses, as well as net financing items (including financing expenses and income, including that vis-à-vis the adjustment of the fair values of financial instruments).

**B. Primary Report On Operating Segments:**

**1. Segment Revenue And Expenses, And Adjustments To Loss:**

For The Year Ended December 31, 2010:

	<b>First Generation Products</b>	<b>Second Generation Products</b>	<b>Total</b>
	<b>\$ Thousands</b>		
Segment revenue	<u>3,849</u>	<u>1,877</u>	<u>5,726</u>
Gross profit	<u>1,686</u>	<u>1,514</u>	3,200
Joint expenses not allocated to the segment			(5,860)
Net financing expenses			<u>(542)</u>
Loss			<u>(3,202)</u>

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 22 – SEGMENTS (CONTINUED):**

For The Year Ended December 31, 2009:

	<b>First Generation Products</b>	<b>Second Generation Products</b>	<b>Total</b>
	<b>\$ Thousands</b>		
Segment revenue	3,074	253	3,327
Gross profit	1,244	199	1,443
Joint expenses not allocated to the segment			(3,155)
Net financing expenses			(1,411)
Loss			(3,123)

For The Year Ended December 31, 2008:

	<b>First Generation Products</b>	<b>Second Generation Products</b>	<b>Total</b>
	<b>\$ Thousands</b>		
Segment revenue	4,180	-	4,180
Gross profit	1,416	-	1,416
Joint expenses not allocated to the segment			(2,443)
Net financing income			584
Loss			(443)

**C. Revenue - Additional Information:**

Revenue from any primary customer, responsible for 10% or more of total revenue reported in the financial statements:

	<b>Year ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$ Thousands</b>		
Customer A – Scripps – first generation	1,415	1,170	1,035
Customer B - Harada	436	628	394
	1,851	1,798	1,429

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

---

**NOTE 22 – SEGMENTS (CONTINUED):**

**D. Geographical Information:**

Revenue reported in the financial statements was earned in various countries (based on the customer's location), as follows:

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$ Thousands</b>		
United States	5,050	2,498	3,603
Japan	436	628	394
Other countries	240	201	183
	<u>5,726</u>	<u>3,327</u>	<u>4,180</u>

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES:**

**A. Balances With Interested Parties And Related Parties**

Breakdown

December 31, 2010:

	<b>Key Managerial Personnel \$ Thousands</b>
Other payables - due to the CEO	<u>200</u>

**December 31, 2009:**

	<b>Key Managerial Personnel \$ Thousands</b>
Other payables - due to the CEO and to the VP-Technology (*)	<u>18</u>

(\*) As noted in note 23 L, from June 2010, the VP – Technology is no longer an interested party of the company.

**MEDICAL COMPRESSION SYSTEMS (D.B.N.) LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES (CONTINUED):**

**B. Benefits To Interested Parties And Related Parties:**

Benefits in respect of key managerial personnel (including directors), employed by the company:

	Year Ended December 31,					
	2010		2009		2008	
	Amount		Amount		Amount	
	\$		\$		\$	
<u>Individuals</u>	<u>Thousands</u>	<u>Individuals</u>	<u>Thousands</u>	<u>Individuals</u>	<u>Thousands</u>	
Short-term benefits to employees	1	200	2	419	2	387
Other long-term benefits	-	-	2	28	-	21
Share-based payments	1	153	2	12	2	94
	1	353	2	459	2	502

Benefits in respect of key managerial personnel (including directors), not employed by the company:

	Year Ended December 31,					
	2010		2009		2008	
	Amount		Amount		Amount	
	\$		\$		\$	
<u>Individuals</u>	<u>Thousands</u>	<u>Individuals</u>	<u>Thousands</u>	<u>Individuals</u>	<u>Thousands</u>	
Benefits in respect of a director, not employed by the company	3	152	5	73	5	62

**C. Transactions With Interested Parties And Related Parties:**

Includes salaries, provisions for bonuses and cost of share based payments:

	Key Managerial Personnel		
	2010	2009	2008
	\$ Thousands		
Research and development expenses (*)	77	167	160
Selling and marketing expenses	234	104	58
Management and general expenses	432	188	284
	743	459	502

(\*) As noted in note 23 L, from June 2010, the VP-Technology is no longer an interested party of the company.

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES (CONTINUED):**

**D.** On April 2, 2008, the general meeting approved a February 2008 decision by the Board of Directors vis à vis an extension of the CEO's term of employment, for an additional 3 year term, starting January 1, 2007, on the basis of the original employment agreement.

Further to that stated in the original employment agreement, it was agreed that subject to a successful conclusion of the clinical testing phase, the CEO's monthly salary would be increased to NIS 45 thousand gross. The increase in salary will come into effect in the first month that the company will hold cash funds (or assets of the same degree of liquidity) of \$1 million ("sufficient cash funds"). If the date when the company will have the sufficient cash funds will fall after the date of entitlement to the salary increase, as stated above, the increased salary will be paid when the company will have sufficient cash funds, retroactively to when the clinical testing was successfully completed.

During June 2008, the company reported that the clinical testing phase was successful, and accordingly during December 2008, and after accumulating sufficient cash funds of more than \$1 million, the additional salary was paid immediately, as stated, to the company's CEO and from that date onwards the additional salary is paid on a monthly basis.

In addition, the CEO is entitled to bonuses, as follows:

**1.** At the end of each calendar year, the Audit Committee and the Board of Directors will consider a bonus to the CEO for his investment, efforts, and contribution to the company abroad. If the Audit Committee and the Board of Directors will approve a bonus, the bonus will not be less than NIS 50 thousand and will not exceed NIS 150 thousand, each time. In accordance with said, on May 5, 2008 the Board of Directors approved a bonus to the company's CEO of NIS 150 thousand for the year ended December 31, 2007. During December 2008 this bonus was paid.

In addition, on January 4, 2009, the Board of Directors approved a bonus to the CEO of NIS 150 thousand for the year ended December 31, 2008. This bonus was paid to the CEO during January 2009.

**2.** In the event of any capital issue in respect of shares and/or convertible bonds ("capital issue"), after the determining date, the CEO will be paid a bonus equal to one monthly salary for each \$ 1.4 million that the company will raise from the capital issue (after issue costs). Accordingly, during the year, the CEO was paid \$26 thousand.

**3.** For increases of at least 50% in annual sales revenue (without the right of return by the purchasers) vis-à-vis sales revenue during the previous year, a bonus of \$50 thousand will be paid.

Appropriate provisions for amounts relating to the report periods were included in the financial statements as at December 31, 2009.

**E.** On April 2, 2008, the shareholders' general meeting approved the February 2008 decision of the Board of Directors to extend the term of employment of the company's Chief Technology Officer by an additional 3 years starting January 1, 2007. There were no significant changes in the new terms of agreement, vis à vis the original employment agreement.

**F.** On September 16, 2008 the Board of Directors approved, after approval by the Audit Committee on September 11, 2008, a decision to accept a loan from a controlling shareholder of the company ("Nissan") of \$200 thousand as part of his commitment to provide the company with financing of up to \$400 thousand. The loan does not bear interest. According to the letter of commitment, the loan will be repaid, on the earlier of the following:

**1.** One year from the date of providing the loan.

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES (CONTINUED):**

2. Shortly after the point in time that funds raised by the company plus the loan will exceed \$400 thousand then the amount of repayment will be equal to said difference.

On October 27, 2008, and in accordance with a commitment, an agreement was signed between the company and Nissan, under which Nissan provided the remaining \$200 thousand as a loan to the company. The loan does not bear interest

G. On November 27, 2008, the company and Nissan signed an addendum to the September 16, 2008 loan agreement (see note F above). Terms of the loan as detailed below were amended as follows:

1. If until January 1, 2010 the company will raise an additional amount ("additional amount"), which together with the loan will exceed \$600 thousand, the company will pay within seven business days from the date of receiving the additional amount, two thirds of the excess that will be created between the additional amount and \$600 thousand to Nissan, while one third of the excess that will be created between the additional amount and the \$600 thousand, will be paid by the company to a controlling shareholder of the company (Aviv Fund).

2. On January 1, 2010, the company will repay the balance of its loan less amounts already paid, in accordance with that stated in 1 above.

3. The parties confirmed that funds provided by the Aviv Fund will not serve the company for the purposes of repaying the loan.

4. All other terms of the loan agreement remain in force.

On December 24, 2008, after a share rights issue, as stated in note 17 F, the company repaid Nissan the outstanding loan balance of \$ 400 thousand.

H. On November 26, 2008, the Board of Directors approved a decision to accept a \$200 thousand loan from the Aviv Fund. On November 27, 2008, the Aviv Fund approved the loan to the company.

Terms of the loan were as follows:

1. The loan is in US Dollars, and does not bear interest.

2. If until January 1, 2010 the company will raise an additional amount ("additional amount"), which together with the loan will exceed \$600 thousand, the company will pay within seven business days from the date of receiving the additional amount, one third of the excess that will be created between the additional amount and \$600 thousand to the Aviv Fund, while two thirds of the excess that will be created between the additional amount and the \$600 thousand, will be paid by the company to Nissan.

3. On January 1, 2010, the company will repay the balance of its loan less amounts already paid, in accordance with that stated in G above.

On December 23, 2008, further to the rights issue, the agreement expired before the company received the loan.

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES (CONTINUED):**

**I.** On March 8, 2010, the Board of Directors approved the appointment and terms of tenure of Mr. Nahum as Chairman of the Board of Directors and consultant, as follows:

**1.** A monthly payment of \$ 5,500 (gross), plus value added tax, (if relevant), which will be paid against a tax invoice to be submitted as required, by Mr. Nahum, or by a company under his control.

**2.** Mr. Nahum will be entitled to a refund of hospitality expenses, in reasonable amounts, which he will incur as part of and in the course of his duties.

**3.** See note 18C(13), vis à vis options granted to Mr. Nahum.

The terms of Mr. Nahum's tenure, and options, were approved by the July 26, 2010 shareholders' general meeting.

**J.** On March 8, 2010 the company's board of directors approved a \$ 40 thousand bonus to the CEO.

**K.** On June 20, 2010 the Board of Directors approved the terms of employment of Mr. Adi Dagan as CEO, and the provision of consultancy services after his term of employment, as follows:

**1.** The original term of Mr. Dagan's employment as CEO of the company ended on December 31, 2009. According to the new terms of employment, approved by the Board of Directors on June 20, 2010 as noted above, the term of employment of Mr. Dagan as CEO of the company was extended by an additional 15 months, from January 1, 2010 and up to March 31, 2011. At the end of his term of employment, Mr. Dagan will cease to serve as CEO of the company and the employee-employer relationship will be terminated. See note 24 B vis à vis an extension of Mr. Dagan's appointment after report date for an additional three months.

**2.** After termination, as noted above, Mr. Dagan will be entitled to a re-adjustment period of six months, from April 1, 2011 and up to September 30, 2011. During this period, Mr. Dagan will serve as consultant. He will serve up to 4 days a month, without any additional consideration beyond said re-adjustment fees.

**3.** Mr. Dagan's terms of employment, during his term of employment and during his term of re-adjustment, on the basis of the new employment agreement, will be as follows:

**A.** The monthly salary during his term of employment will remain without change, and will total NIS 50.5 thousand (gross) plus social benefits. During his re-adjustment term, Mr. Dagan will continue to receive his salary, as noted above, however without any social benefits.

**B.** See note 18C(17), vis à vis options granted to Mr. Dagan.

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES (CONTINUED):**

C. Annual bonus - Mr. Dagan will be entitled to an annual bonus, as below:

1. For each year of employment, a bonus of 1 monthly salary that will be paid within 30 days after approval of the annual financial statements of the company, unless the audit committee within said period, will decide otherwise.

2. For realizing the company's 2010 sales targets, as laid out in the annual work plan, which was approved by the Board of Directors for said year, Mr. Dagan will be entitled to a bonus according to an entitlement formula included in the employment agreement. However, the maximum bonus will be limited to 3 monthly salaries.

3. For realizing the company's 2010 profitability targets, as laid out in the annual work plan, which was approved by the Board of Directors for said year, Mr. Dagan will be entitled to a bonus according to an entitlement formula included in the employment agreement. However, the maximum bonus will be limited to 3 monthly salaries.

The company recorded a provision of NIS 92 thousand for bonuses payable in its 2010 financial statements.

D. After his readjustment period, and from October 1, 2011, Mr. Dagan will provide consulting services for an additional period, which will end on March 31, 2013, against a consultation fee payment of NIS 3,000 per day plus Value-Added Tax, linked to the Consumer Price Index. These terms are at the request of the company's CEO. Said services, if rendered, are limited to four days per month.

E. See note 24B regarding an extension of the employment of the company CEO, Mr. Dagan.

L. On June 20, 2010, the Board of Directors approved the terms of employment of Dr. Jacob Barak, the company's Chief Scientist, as follows:

1. The original employment agreement with Dr. Barak expired on December 31, 2009.

2. According to the new employment agreement that was approved on June 20, 2010, as stated, the employment agreement is for a period of three years, from January 1, 2010, and each side is entitled to terminate the employment agreement by issuing a written notice of 90 days in advance.

3. From January 1, 2010, in consideration of his employment, the company will pay Dr. Barak a salary of NIS 40 thousand (gross) each month, and from January 1, 2011, the salary will be increased to NIS 42 thousand (gross) each month. The salary will be updated and will reflect any increases in the Consumer Price Index.

4. Dr. Barak will receive 350,000 options available for conversion into 350,000 ordinary shares, NIS 0.01 par value each. The options will vest over a period of three years, in six semi-annual tranches, such that at the end of each six-month period of employment, 58,333 options will be available for conversion into 58,333 ordinary shares, except for the last tranche, the sixth, that will include 58,335 options, which will be available for conversion into 58,335 ordinary shares. The exercise period is 18 months from the date of each tranche's vesting. The option exercise price will be equal to the closing price of company shares on the Tel Aviv Stock Exchange on January 1, 2010, that is, 211.1 agorot per share.

From June 2010, Dr. Barak is no longer an interested party of the company.

**NOTE 23 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES AND RELATED PARTIES (CONTINUED):**

**M.** On October 20, 2010, the shareholders' general meeting approved a non-significant private grant to controlling shareholders of the company - Acclemed and Nissan, which was previously approved by the Audit Committee on August 12, 2010, and by the Board of Directors on September 6, 2010. According to the investment agreement, 400,000 ordinary shares, NIS 0.01 par value each, will be issued against a consideration of NIS 1.2 million (equivalent to \$323 thousand), reflecting a price of NIS 3 per-share.

**NOTE 24 - SUBSEQUENT EVENTS:**

**A.** On January 27, 2011, the Board of Directors approved a grant of 144,000 options to employees, available for conversion into 144,000 ordinary shares, NIS 0.01 par value each, including 109,000 options to 13 Israeli employees of the company (including one officeholder) and 35,000 options to an American employee of the subsidiary - Medical Compression Systems Inc.

**Option Terms:**

**1.** The grant of options to Israeli employees is part of a compensation program for Israeli employees, while the grant of options to the American employee is part of a compensation program, which is adapted to American law (USSOP).

**2.** The exercise price of each option granted to Israeli employees is NIS 3.842, while the exercise price of each option granted to the American employee is NIS 4.063.

**3.** The vesting period of the options will be spread over 36 months, as follows:

In respect of the Israeli employees, from December 23, 2010, in respect of the officeholder, from October 20, 2010 and in respect of the American employee, from May 3, 2010, with one third of the options vesting at the end of one year from said dates, one third of the options vesting at the end of the second year from said dates, and one third of the options vesting at the end of the third year from said dates.

**4.** The option exercise period will be from the date of vesting, and up to 18 months from the date of vesting.

**5.** The fair value of the options on grant date, calculated in accordance with the Binomial model, and various assumptions as noted below was estimated at \$72 thousand.

Fair value is calculated using the Binomial Option Pricing Model, based on expected share price fluctuations of 49.22%-72% calculated on grant date, a share price of NIS 4.063 per share on grant date (\$1.11), non-risk interest rates of 2.9%-4.43% on grant date, and a 5% forfeiture rate.

**B.** On January 27, 2011, the Board of Directors extended the terms of employment of Mr. Adi Dagan, as CEO, without change from the current employment agreement, for a period of three months from April 1, 2011 and up to June 30, 2011.

**C.** Mr. Dagan's monthly salary will remain without change during the extension period, and his re-adjustment period will begin on July 1, 2011 for a period of six months, based on terms noted in note 23K (2).

**NOTE 24 - SUBSEQUENT EVENTS (CONTINUED):**

**D.** On January 27, 2011, the Board of Directors approved a change of terms in respect of 350,000 options that were granted to Dr. Jacob Barak, VP-Technology, as noted in note 18C(18). According to the change, in the event of any merger, acquisition, reorganization of the company, or into another company, and if the company is not the surviving company, or a sale of all or part of the company's assets or shares, and if his employment will be discontinued at the request of the acquiring company, the option's vesting program terms will be accelerated vis à vis options that have not yet been exercised by the recipient, such that all options as stated will vest 10 days before the transaction date.

**E.** On January 27, 2011, the Board of Directors decided to adopt an option program for American employees, and office holders ("2011 American option program"). Concurrently, the Board of Directors declared that the quantity of options to be available for grant under the program will be 100,000, available for conversion into up to 100,000 ordinary shares, NIS 0.01 par value each. The Board of Directors may add to said quantity of options, as it seems fit.

The options to be available under the 2011 American option program will not be registered for trading on the stock exchange, however, the shares that will issued as a result of any option conversion, will be registered for trading on the stock exchange.

**F.** On March 24, 2011, the Board of Directors approved a non-significant private issue of 1,046,667 ordinary shares, NIS 0.01 par value each, to a number of recipients who are not controlling shareholders of the company and not interested parties of the company, except for Yelin Lapidot Provident Fund Management Limited which is an interested party of the company on the basis of its holdings, against a consideration of NIS 3,925 thousand (equivalent to \$1,107 thousand ), reflecting a share price of NIS 3.75.

In addition, the controlling shareholders of the company undertook to invest an additional \$300 thousand in the company, under the same terms as noted above, subject to approvals required by law.

**G.** During March 2011, an Israeli bank offered the company a postponement of the repayment date of a \$ 1 million debt to it, allowing for repayments to begin during June 2012, and additional credits of \$500 thousand for repayment in 24 payments from June 2012, against a conditional grant in the event of a sale of most of the company's shares to an outside investor. The offer is limited in time, and the company has not yet decided to accept the offer, because of other offers that it has received from other parties.

## **Chapter D – Additional Information About the Company**

### **Regulation 10A:**

#### **Summary of the quarterly profit and loss reports**

See the Board of Directors' report attached as Chapter B to this report, Section 6.

### **Regulation 10C:**

#### **Use of the securities proceeds, while referring to the appropriation of the proceeds based on the prospectus.**

In consideration for issuing series 1 options and Company shares on the TASE on October 29, 2009 as part of the shelf offering, the Company raised NIS 7,533 (gross, before issue expenses). The Company appropriated the proceeds of the above issue to develop its business.

In return for issuing rights to the Company's shareholders on July 14, 2010, as part of a shelf offering, the Company raised NIS 3,774 thousand (gross). The Company also appropriated the proceeds of this issue to develop its business.

### **Regulation 11:**

#### **List of investments in subsidiaries and related companies as at the balance sheet date**

<b><u>Company</u></b>	<b><u>Share type</u></b>	<b><u>No. of shares</u></b>	<b><u>Total par value</u></b>	<b><u>Adjusted cost (\$ thousands)</u></b>	<b><u>Adjusted book value (\$ thousands)</u></b>	<b><u>Rate of holding*</u></b>
Medical Compression Systems Inc.	Ordinary \$0.01	10,000	\$100	\$7	\$2,417	100%

\* Holding of issued share capital, voting rights and the authority to appoint the Board of Directors.

### **Regulation 12:**

#### **Changes in investments in subsidiaries and related companies during the report period**

None.

**Regulation 13:**

**Income of subsidiaries and related companies and the entity's income from them as at the balance sheet date**

<b><u>Company</u></b>	<b><u>Profit (loss) before tax</u></b> <b><u>(\$ Thousands)</u></b>	<b><u>Profit (loss) after tax</u></b> <b><u>(\$ Thousands)</u></b>
Medical Compression Systems Inc.	\$(0.91)	\$(0.91)

As at the end of the balance sheet year and report submission date, the Company did not receive a dividend, management fees or interest from the subsidiary.

**Regulation 14:**

**List of groups of loan balances granted as at the balance sheet date, if granting loans was one of the entity's principal activities.**

Granting loans is not one of the Company's principal activities.

**Regulation 20:**

**Stock exchange trading – securities listed for trade**

In 2010, none of the Company's securities were registered for trading, apart from the following:

	<b>Securities registration date</b>	<b>Securities type and par value</b>
1	December 2010	253,000 ordinary shares of NIS 0.01 par value arising when exercising options
2	December 2010	51,135 ordinary shares of NIS 0.01 par value arising from exercising options
3	November 2010	20,000 ordinary shares of NIS 0.01 par value arising from exercising options
4	October 2010	1,006,061 ordinary shares of NIS 0.01 par value
5	October 2010	170,000 ordinary shares of NIS 0.01 par value arising from exercising options
6	August 2010	1,120,000 ordinary shares of NIS 0.01 par value arising when exercising options
7	August 2010	919,732 ordinary shares of NIS 0.01 par value each
8	July 2010	338,372 ordinary shares of NIS 0.01 par value
9	July 2010	770,000 ordinary shares of NIS 0.01 par value arising when exercising options
10	February 2010	455,366 ordinary shares of NIS 0.01 par value arising from exercising options

In 2010, trade of the Company's securities on the stock exchange was not suspended.

**Regulation 21:****Payments to senior officeholders**

For the year ended December 31, 2010:

Particulars of compensation recipient				Compensation for services (in \$ Thousands)							Other compensation (in \$ Thousands)			Total
Name	Position	Scope of position	Rate of holdings in the entity's share capital	Salary	Bonus	Share-based payment	Management fee	Advisory fee	Commission	Directors' compensation	Interest	Rent	Other	
Adi Dagan <sup>(1)</sup>	CEO	100%	3.36%	269	92	153								514
Dr. Jacob Barak <sup>(2)</sup>	CTO	100%	3.10%	195		128								323
Ori Mor <sup>(3)</sup>	CFO	90%	-	128	7	28								163
Ambaw Bellete <sup>(4)</sup>	Subsidiary President	100%	-	235		90								325
Charlie Harrison <sup>(5)</sup>	VP Commercial Operations	100%	0.08%	200		70								270
Eitan Nahum <sup>(6)</sup>	Chairman of the Board	--	0.39%			64		57						121
Outside directors <sup>(7)</sup>	--	--	0.10%							31				31

\* The annual cost reflected in the Company's financial statements for share-based compensation.

- (1) For additional information of Mr. Dagan's employment terms, including compensation paid to him during the period after the report year, see Regulation 22 below. In addition, besides the above bonus, in 2010 a bonus of NIS 150 thousand was paid for the year ended December 31, 2009, based on the approval of the Board of Directors of March 8, 2010, following the Audit Committee's approval of January 12, 2010.
- (2) For additional information of Dr. Barak's employment terms, see Regulation 22 below.
- (3) Mr. Ori Mor serves as the Company's CFO since February 2009. In November 2009, he was granted 130,000 options exercisable for 130 thousand ordinary Company shares, 32,500 of which vested on February 1, 2010 and the rest in 7 equal tranches every six months. The exercise price of the options is NIS 0.97 per share. In December 2010, Mr. Mor was granted 70,000 options exercisable for 70,000 ordinary Company shares, of which 23,333 will vest on December 23, 2011 and the balance in 2 equal tranches per year. The option exercise price is NIS 3.8423 per share.
- (4) Mr. Ambaw Bellete serves as President of the subsidiary. By virtue of his position as President, the Company granted him 350,000 options exercisable for 350,000 ordinary Company shares. The exercise price was set at NIS 3.551 per share. The options will vest within 36 months from grant date whereby an equal quantity of options will vest every three months after the grant date.
- (5) From October 20, 2009 until March 1, 2010, Mr. Harrison served as President of the subsidiary. By virtue of his position as President, the Company granted him 25,000 options exercisable for 25,000 ordinary Company shares. The exercise premium was fixed at NIS 2.6495 per share. Since May 2010, Mr. Harrison serves as VP Commercial Operations, by virtue of which the Company granted him 350,000 options exercisable for 350,000 ordinary Company shares at an exercise price of NIS 3.482 per share. The options will vest within 36 months, when an equal quantity of options will vest every six months and the first vest date is six months from the grant date.
- (6) The terms of Mr. Eitan Nahum's tenure as Chairman of the Board of Directors and advisor, including a grant of 350,000 options exercisable for 350,000 ordinary Company shares of NIS 0.01 par value each, were approved by the Company Audit Committee March 7, 2010 and by the Company Board of Directors on March 8, 2010 and June 13, 2010. The exercise price was fixed at NIS 3.681 per share. The options will vest in six equal measures with the first exercise date being six months from the Board of Directors' approval, i.e. March 8, 2010. The tenure terms, including the option grant, were approved by the general shareholders' meeting held on July 26, 2010.
- (7) The outside directors are entitled to annual compensation at a minimal rate and compensation for every meeting at a rate ranging from minimal to the rate fixed under the Companies Regulations (Rules concerning Compensation and Expenses of an Outside Director), 5760-2000, based on the Company's rank.

## Regulation 22:

### Transactions with controlling shareholders

1. The Company CEO's tenure and employment terms and approval thereof, including granting options:

On June 20, 2010, following the Company Audit Committee's approval of June 13, 2010 of the decision described below, the Company Board of Directors approved the Company's contract with the CEO as follows:

- 1.1 Until June 10, 2010, Mr. Adi Dagan (**Mr. Dagan**) was a controlling shareholder in the Company by virtue of his holdings together with Accelmed L.P., Nissan Medical Industries Ltd., Aviv Parallel Fund I L.P., Aviv Ventures I, L.P., Dr. Jacob Barak, Jacob and Roni Barak Ltd., and Adi and Rinat Dagan in the controlling block of the Company, under a shareholders' agreement. On June 10, 2010, Mr. Dagan ceased being a controlling shareholder in the Company.
- 1.2 Mr. Dagan serves as the Company CEO under an agreement dated December 31, 2003 which was extended in an agreement dated April 3, 2008 (**the Dagan employment agreement**) until December 31, 2009.
- 1.3 In view of the expiration of the Dagan employment agreement, the Company approved contracting with Mr. Dagan in a new employment agreement (**the new Dagan employment agreement**) and a consultancy agreement (**the consultancy agreement**), as described below.
- 1.4 Under the new employment agreement, Dagan's tenure as Company CEO will be extended for another fifteen month as from January 1, 2010 to March 31, 2011 (**the employment period**). During the employment period, Mr. Dagan will serve as Company CEO and will also cooperate in handing over his position and authority to the CEO who will serve under him until the end of the employment period, when Mr. Dagan will cease serving as the Company CEO and the employer-employee relations between him and the Company will end.
- 1.5 After completion of the employment period, Mr. Dagan will be entitled to a six-month adjustment period (**the adjustment period**) from April 1, 2011 until September 30, 2011, during which he will be available to advise the Company in

the field of compression therapy and/or mechanical DVT solutions and related consultancy. Mr. Dagan's services during this period will be provided on a monthly basis in a scope not exceeding four days per month, without any additional payment beyond the adjustment fees specified below.

- 1.6 As from October 1, 2011, following the end of the adjustment period, Mr. Dagan will begin providing consulting services on compression therapy and/or mechanical DVT solutions and other services for another period ending March 31, 2013 (**the consultancy period**) in consideration of consultancy fees as specified below, all based on the Company CEO's request, if requested.
- 1.7 Under the new employment agreement, Mr. Dagan's terms of employment in the Company during the employment and adjustment period will be as follows:
  - A. Monthly salary – during the employment period: will remain unchanged at NIS 50.5 thousand (gross). The monthly salary will be updated every quarter by the CPI increase rate for the quarter ending on the update date (the base CPI for calculating the index differentials will be that of December 2009, i.e. 105.2 points). The usual social benefit provisions of this salary will be set aside (i.e. 8.33% for severance pay, 5.0% for directors' insurance/pension [against which Mr. Dagan will allocate 5.0%], 7.5% to a study fund, subject to the recognized ceiling for tax purposes [against which Mr. Dagan will contribute 2.5%] and 2.5% for loss of work capacity). During the adjustment period, Mr. Dagan will continue receiving the above salary without the related and social terms.
  - B. Equity-based compensation – Mr. Dagan will be granted 420,000 options exercisable for 420,000 ordinary Company shares, subject to the terms of the Company's option plan. The options will vest in six equal tranches at the end of every six months of employment or provision of consultancy service (70,000 options each time), while the grant date will be the date on which confirmation is received from the TASE of listing of the exercise shares for trade on the TASE. The option exercise price was calculated according to the closing price of a Company share on the TASE on the start date of the new employment agreement, i.e. NIS 2.111. The options will be exercisable from their vesting date and expire upon termination of Mr. Dagan's employment in the Company

(including the adjustment and consultancy period) or five years from the grant approval date by the Company Board of Directors (June 20, 2010), whichever is later. Options granted to Mr. Dagan in the past will expire when his employment in the Company ends (including the adjustment and consultancy period). These vesting dates will be accelerated in the event of a merger, acquisition, reorganization of the Company with or into another Company, when the Company is not the surviving Company, or the sale of all or a substantial portion of the Company's assets or shares (**the transaction**) in a manner that the vesting date of the options granted as described above will be ten days prior to finalizing the transaction. Despite the above, if in the event of a transaction Mr. Dagan is requested to remain in office as CEO without adversely affecting his employment terms and he refuses, the vesting date will not be accelerated as described above. In addition, the vesting dates of the options granted as described above will be accelerated if Mr. Dagan's employment is terminated at the Company's initiation (except under circumstances where the employment is terminated for cause) so that their vesting date will be the employment termination date (including the adjustment and consultancy period).

C. Annual bonus – Mr. Dagan will be entitled to bonus payments as described below:

1C. For the employment year, Mr. Dagan will be entitled to a bonus payment at the rate of his monthly salary on the aforesaid date (**13<sup>th</sup> salary**). The 13<sup>th</sup> salary will be paid 30 days after approval of the Company's annual financial statements, unless the Audit Committee decides within the aforesaid time not to pay a 13<sup>th</sup> salary that year for reasons specified in writing. The 13<sup>th</sup> salary will not include sums paid to and/or for Mr. Dagan as his monthly salary social benefit provisions.

2C. Mr. Dagan will be eligible to a bonus for meeting the Company's 2010 sales target as defined in the annual work plan approved by the Board of Directors (or changes to the original plan approved by the Board), based on

the eligibility formula below, when 100% of the bonus is three monthly salaries.

3C. For meeting the Company's 2010 profitability goal as defined in the annual work plan approved by the Board of Directors (or changes to the original plan approved by the Board), Mr. Dagan will be eligible to a bonus based on the eligibility formula below, when 100% of the bonus is three monthly salaries.

4C. The bonus formula will be as follows:

Achievement	Bonus rate
Less than 70% of the target	No eligibility
70%-120% of the target	70%-120% of the bonus, respectively
121% or more of the target	120% of the bonus

5C. In the event of (1) a merger, acquisition or reorganization of the Company with another entity or Company whereby the Company is not the surviving Company, or (2) the sale of all or most of the Company's assets and/or shares; when the proceeds paid to the Company and/or its shareholders for this event exceeds USD 100 million, Mr. Dagan will be eligible for a bonus of USD 500 thousand. This eligibility will survive termination of the new employment agreement (except under circumstances where this employment termination is for cause) as long as Mr. Dagan serves as a Company advisor.

D. Notice and adjustment period – following completion of the employment period, Mr. Dagan will be entitled to a 6-month adjustment period during which he will provide the Company with consultancy services as described above against a salary payment as described above (without related terms and social benefits). Mr. Dagan will be entitled to terminate the employment period early by 90 days prior written notice. If he chooses to terminate the employment period, he will not be eligible for the above adjustment period and the

consultancy agreement will not enter into force. The Company will be permitted to cancel the new employment agreement and dismiss Mr. Dagan immediately without prior notice and an adjustment period in any of the following cases:

- 1D. If Mr. Dagan fundamentally breaches any of the provisions of his employment agreement.
- 2D. If Mr. Dagan is convicted of a dishonorable offence.
- 3D. If Mr. Dagan becomes disabled or contracts a disease which prevents him from being able fulfill his position properly. Mr. Dagan's dismissal in this sub-section (3D) will not affect his rights with respect to the share options and adjustment period and they will remain in force until the end of his employment and/or the adjustment period and/or the consultancy period – whichever is latest.

E. Miscellaneous

- 1E. The Company will provide Mr. Dagan with a car during the employment period, based on the Company Board of Directors' discretion. The car usage costs, including the mandatory payments, licensing and insurance expenses involved therein, repairs, etc. will apply to and be paid by the Company. The Company will bear grossing up of the full tax arising from this benefit.
- 2E. The Company will place a mobile phone, which it owns, at Mr. Dagan's disposal and will bear all the cost during the employment period, including grossing up of the full value arising therefrom. The Company will also bear all the usage costs of one telephone line installed at Mr. Dagan's home.
- 3E. Mr. Dagan will be eligible for reasonable subsistence expenses spent as part of and for fulfillment of his role against presentation of the appropriate receipts/invoices to Company.
- 4E. Mr. Dagan will be eligible to a refund of expenses up to USD 3,000 against invoices for clothing and luggage expenses.
- 5E. Mr. Dagan will be entitled to annual paid leave of 22 working days per work year, based on the Company's policy. The leave days may be

accumulated, without the right of redemption, up to an inclusive quantity of 60 days.

- 1.8 Mr. Dagan's terms of engagement with the Company during the consultancy period under the consultancy agreement will be as follows:
  - A. The consultancy services will be provided based on the Company CEO's requirements, if any, in a scope not exceeding four days monthly.
  - B. The Company will pay Mr. Dagan NIS 3,000 per consultancy day (CPI-linked, when the base CPI is that of December 2009, i.e. 105.2 points). VAT as required by law will be added to the payment.
  - C. The Company will pay Mr. Dagan for the travelling expenses incurred while providing the consultancy services and reasonable subsistence expenses spend as part of and for fulfillment of his role, subject to submitting the appropriate documents, based on the Company's regulations.
- 1.9 During January 2011, based on the approval of the Compensation Committee of January 11, 2011, the Audit Committee of January 25, 2011 and the Board of Directors of January 27, 2011, the Company advised extending Mr. Dagan's employment under the terms of his current employment agreement for a three-month period from April 1, 2011 until June 30, 2011.

On March 8, 2010, following approval of the Audit Committee of January 12, 2010, the Board of Directors granted the CEO a bonus of NIS 150 thousand for the year ended December 31, 2009. This bonus was paid to the CEO during April 2010. He also received a bonus of NIS 97 thousand for the exceptional private placement to Accelmed (see Section 3 below) as well as a bonus of NIS 50 thousand for raising capital as part of the shelf offering memorandum published by the Company in November 2010, which was paid to the CEO during April 2010.

For further information concerning the CEO's employment agreement, see Note 23 of the financial statements attached as Section C to this report.

2. On June 2010, the Company Board of Directors approved the employment terms of Dr. Barak, the Company's Chief Scientist (**Dr. Barak**) as described below:
  - A. Dr. Barak's original employment agreement ended on December 31, 2009.
  - B. Based on the new employment agreement approved on January 20, 2010, it is for a period of three years as from January 1, 2010, while each party is entitled to terminate it by ninety (90) days prior written notice to the other party.
  - C. As from January 1, 2010, in consideration for his work in the Company, Dr. Barak will be paid a salary of NIS 40,000 gross per month. As from January 1, 2011, his salary will increase to NIS 42,000 per month. The salary will be updated on the basis of the increase rate of the CPI.
  - D. Dr. Barak will receive 350,000 options exercisable for 350,000 ordinary Company shares of NIS 0.01 par value, which will vest over three years in six half-yearly tranches, so that at the end of every six months employment, 58,333 options will be exercisable for 58,335 ordinary Company shares. The exercise period is 18 months from the vesting date of each tranche. The option exercise price is the closing price of a Company share on the TASE on January 1, 2010, i.e. 211.1 agorot per share.
  - E. In June 2010, Dr. Barak ceased being a controlling shareholder in the Company.

3. Exceptional private placement – Accelmed

In June 2009, the Company signed an investment agreement with Accelmed (which at the time of signing the agreement was not connected to the Company or its controlling shareholders) under which the Company will allocate 9,124,088 ordinary Company shares of NIS 0.01 par value each to Accelmed (which after the allocation constituted 28.08% of the voting rights and the issued and paid-up share capital of the Company, and 21.82% fully diluted) in consideration for an investment in the Company of NIS 10 million (an allocation reflecting a price per share of NIS 1.096). Simultaneous to signing the investment agreement, a shareholders' agreement was signed between Accelmed and Nissan, Aviv, Mr. Dagan and Dr. Barak under which the parties thereto will, *inter alia*, coordinate their vote with respect to appointing Company directors. First refusal rights were also prescribed in the shareholders' agreement. The shareholders' agreement cancelled previous shareholders' agreements in the Company. The investment agreement

was approved by the Audit Committee and the Board of Directors in June 2009 and the Company's shareholders meeting in July 2009. It was finalized in August 2009 and simultaneous to its implementation, the shareholders' agreement also entered into force. For further information of the investment agreement, see Section 1.3.3 of Chapter A of this report.

4. Non-significant private placement – Accelmed and Nissan

On October 20, 2010, the general shareholders' meeting approved a non-significant private placement to the Company's controlling shareholders Accelmed and Nissan, which was approved by the Audit Committee on August 12, 2010 and the Board of Directors on September 6, 2010. Under the investment agreement, 400,000 ordinary Company shares of NIS 0.01 par value each were allocated (which at the allocation date was 1.06% of the Company's voting rights and issued and paid-up capital, and 0.91% fully diluted) in consideration of an inclusive amount of NIS 1.2 million, which reflects a price of NIS 3 per share.

**Regulation 24:****Shares and convertible securities held by interested parties in the entity, subsidiary or related Company as close as possible to the report date:**

<b><u>Interested party</u></b>	<b><u>I.D. No / Company Reg. No.</u></b>	<b><u>Ordinary shares 1096890</u></b>	<b><u>Series A bonds 1096908</u></b>	<b><u>Non-marketable options 1096916</u></b>	<b><u>Marketable options 1115781</u></b>	<b><u>Rate of holding**</u></b>	<b><u>Fully diluted rate of holding*</u></b>
U.M. Accelmed Limited Partnership	550233696	9,779,258	-	-	-	25.27%	21.72%
Nissan Medical Industries Ltd. <sup>(1)</sup>	520040940	8,532,982	14,331	-	-	22.05%	18.96%
A.M.V.C. Ltd. <sup>(2)</sup>	513607473	3,793,925	104,367	-	-	9.81%	8.45%
Adi Dagan <sup>(3)</sup>	22215164	1,300,001	-	1,041,992	-	3.36%	5.20%
Yelin Lapidot <sup>(4)</sup>	513611509	2,010,063	717,126	-	-	5.19%	4.61%
Migdal <sup>(5)</sup>	520029984	3,417,355	5,580	-	431,000	8.83%	8.54%
Eitan Nahum <sup>(6)</sup>	5554373	-	-	380,000	-	-	0.84%
Michal Even-Chen <sup>(7)</sup>	56595739	20,000	-	30,000	-	0.05%	0.11%
Gad Appelbaum <sup>(8)</sup>	50220896	20,000	-	30,000	-	0.05%	0.11%

\*Options exercisable into 1.36582 ordinary Company shares.

\*\*Holdings in share capital, voting rights and authority to appoint directors.

- (1) To the best of the Company's knowledge, Nissan Group holdings in the Company's securities are 7,988,979 shares held by Nissan Holdings (T.R). Ltd, a private Company fully owned and controlled by Nissan Medical Industries Ltd, and 544,003 shares and 14,331 Series A bonds held by Nissan Medical Industries Ltd. To the best of the Company's knowledge, Nissan Medical Industries Ltd. is a public Company traded on the Tel Aviv Stock Exchange and its controlling shareholders are Yeheskel Nissan and his family.
- (2) To the best of the Company's knowledge, Aviv Venture Capital's holdings of the Company's securities are: 3,590,281 shares and 104,367 Series A par value bonds are held by Aviv Ventures I, L.P., an Israeli Limited Partnership, and

- 203,644 shares by Aviv Parallel Fund I, L.P., a foreign limited partnership. To the best of the Company's knowledge, the general partner in both partnerships is Aviv A.M.V.C. Ltd., a Company incorporated in Israel.
- (3) To the best of the Company's knowledge, 1,000,000 shares are held by Adi and Rinat Dagan Ltd., a private Company controlled by the Company CEO, Adi Dagan, and 300,001 shares by Adi Dagan.
  - (4) To the best of the Company's knowledge, Yelin Lapidot Holdings Ltd. holds 6,900 par value bonds. It also holds 159,478 ordinary Company shares and 363,489 Series A par value bonds through Yelin Lapidot Provident Funds Management Ltd. and 1,850,585 ordinary Company shares and 346,737 Series A bonds through Yelin Lapidot Mutual Funds Management Ltd. To the best of the Company's knowledge, Yelin Lapidot Holdings Ltd is a private Company controlled by Leader Financial Assets Management (2005) Ltd., Dov Yelin and Yair Lapidot.
  - (5) To the best of the Company's knowledge, Migdal Insurance and Financial Holdings Ltd. holds 2,420,526 ordinary Company shares and 300,000 Series 1 options via Migdal Holdings for Participant Funds, 986,829 ordinary shares and 131,000 Series 1 options via Migdal Holdings for Pension and Provident Funds, and 10,000 shares and 5,580 Series A 5,580 Series A par value bonds via Migdal Holdings for Stock Market Mutual Funds. To the best of the Company's knowledge, Migdal Insurance and Financial Holdings Ltd. is a private Company controlled by Assicurazioni Generali SpA.
  - (6) An interested party in the Company by virtue of his position as Chairman of the Board of Directors.
  - (7) An interested party by virtue of her position as outside director of the Company.
  - (8) Interested party by virtue of position as outside director of the Company.

## **Regulation 24 A:**

### **Authorized and issued capital and convertible securities**

<b>Type of security</b>	<b>Authorized capital</b>	<b>Issued capital</b>
Ordinary shares, NIS 0.01 par value each	50,000,000	38,699,340
Convertible securities (Series A) <sup>(1)</sup>	6,098,073	3,658,844
Options (non-marketable) <sup>(2)</sup>		5,082,791
Options (Series 1)		895,619

(1) For information concerning the Company's bonds, see the Board of Directors' report attached as Chapter B to this report.

(2) For information concerning the non-marketable options, see Note 18 of the Company's financial statements attached as Chapter C to this report.

## **Regulation 25 A:**

### **Registered address:**

Company: Medical Compression systems (D.B.N.) Ltd.  
 Company Reg. No.: 51-256573-0  
 Address: 2 Hailan Street, P.O. Box 75, Or Akiva 30600.

Tel: 04-6266630  
Fax: 04-6266640  
Email: [ori@mcsmed.com](mailto:ori@mcsmed.com)  
Balance sheet date: December 31, 2010.  
Financial statements date: March 30, 2011.

**Regulation 26:**

**Directors of the Entity**

**A. Nahum Eitan – Chairman of the Board of Directors**

I.D. Number: 5554373.

Citizenship: Israeli, USA.

Year of Birth: 1949.

Address: 181 East 65 St. 15D, NY 121, 10021, USA.

Member of the Board of Directors' committees: No.

Outside director: No.

Expert outside director: No.

Employee of the entity/subsidiary/related Company/interested party: Yes.

Tenure start date: March 8, 2010.

Education: Master of Industrial Engineering and Management, Technion Institute, Haifa.

Main occupation during the last five years: Director of various companies.

Family member of another interested party in the entity: No.

Does the Company consider him as expert in accounting and finance: No.

List of companies in which he serves as director: Niti Surgical Solutions Inc., EGM Technologies Inc., Metamorfix Ltd., Metrosleep Inc. and Skila Inc.

**B. Even-Chen Michal**

I.D. Number: 56595739.

Citizenship: Israeli.

Year of Birth: 1960.

Address: 143 Moshav Shoeva, D.N. Harei Yehuda 90855.

Member of the Board of Directors' committees: Audit Committee, Financial Statements Committee, outside director: Yes.

Expert outside director: Yes.

Employee of the Entity/subsidiary/related Company/interested party: No.

Tenure start date: September 4, 2006.

Education: Bachelor of Economics and International Relations, Master of International Relations, the Hebrew University of Jerusalem.

Main occupation during the last five years: VP Business Development at Bezeq, Self-Employed Consultant and Entrepreneur.

Family member of another interested party in the entity: No.

Does the Company consider her as an expert in accounting and finance: Yes.

List of companies in which she serves as director: The Fund for the Treatment of the Disabled (non-profit organization).

**C. Appelbaum Gad**

I.D. Number: 50220896.

Citizenship: Israeli.

Year of Birth: 1950.

Address: P.O. Box 39995, Tel Aviv.

Member of the Board of Directors' committees: Audit Committee, Financial Statements Committee, Compensation Committee.

Outside director: Yes.

Expert outside director: Yes.

Employee of the Entity/subsidiary/related Company/interested party: No.

Tenure start date: September 4, 2006.

Education: Bachelor of Economics, Master of Public Administration, the Hebrew University of Jerusalem.

Main occupation during the last five years: Management of various companies.

Family member of another interested party in the entity: No.

Does the Company consider him as an expert in accounting and finance: Yes.

List of companies in which he serves as director: A.A. Aluma Jewellery Industries Ltd., Intrade Holdings Ltd., Intrade G.G. Ltd., Alon-Intrade Ltd., Appletree Holdings 2006 Ltd., Appletree Investments 1993 Ltd., Ismargad Ltd., Gad Apple Ltd., Discount Capital Markets Ltd., Discount Underwriting Ltd., Hadassa Hay Investments (1995) Ltd., Larom Technologies Ltd., M.N.S. Aluma Jewelry Industries Ltd., Super-Fine Ltd., Comlease Ltd., Mishmar HaSharon Café Ltd., Israel Commercial Credit Services Ltd., S.A.F.O. Corporate & Investments Ltd., and Cintec Ltd.

**D. Dr. Gutman Amir**

I.D. Number: 57996241.

Citizenship: Israeli.

Year of Birth: 1963.

Address: 3 Wallach Street, Kiryat Ono.

Member of the Board of Directors' committees: Audit Committee, Compensation Committee, Financial Statements Committee.

Outside director: No.

Expert outside director: No.

Employee of the Entity/subsidiary/related Company/interested party: Yes, managing partner of the venture capital fund Aviv Venture Capital.

Tenure start date: December 1, 2003.

Education: Ph.D. of Business Administration (Accounting), University of California, Berkeley.

Main occupation during the last five years: Managing partner in Aviv Venture Capital and lecturer at the Leon Recanati Graduate School of Business Administration at Tel Aviv University.

Family member of another interested party in the entity: No.

Does the Company consider him as an expert in accounting and finance: Yes.

List of companies in which he serves as director: Friction Control Solutions Ltd.-FriCSo, and Bitband Inc.

**E. Dr. Uri Geiger**

I.D. Number: 023561293.

Citizenship: Israeli.

Year of Birth: 1968.

Address: 7 Hamayan Street, Modiin.

Member of the Board of Directors' committees: No.

Outside director: No.

Expert outside director: No.

Employee of the Entity/subsidiary/related Company/interested party: Yes, he serves as a director of U.M. Accelmed Ltd. (general partner in U.M. Accelmed Limited Partnership).

Tenure start date: August 3, 2009.

Education: Ph.D. and Master of Law (Columbia University), Bachelor of Law (the College of Management).

Main occupation during the last five years: Director of various companies, general partner in the Dragon Variation Fund, lecturer of finance at Tel Aviv University, CEO of Oridion Technologies Ltd and Light-Waves Inc.

Family member of another interested party in the entity: No.

Does the Company consider him as an expert in accounting and finance: Yes.

List of companies in which he serves as director: Chairman of the Board of Directors at Exalenz Bioscience, director at U. Geiger Investment Management Ltd., Tau Hedge Funds Management, Dragon Securities Underwriting Ltd. and U.M. Accelmed Ltd.

**F. Nissan Yehezkel**

I.D. Number: 54270764.

Citizenship: Israeli.

Year of Birth: 1957.

Address: 9 Harugei Malkut Street, Tel Aviv.

Member of the Board of Directors' committees: Compensation Committee.

Outside director: No.

Expert outside director: No.

Employee of the Entity/subsidiary/related Company/interested party: Yes, CEO of Nissan Medical Industries Ltd.

Tenure start date: December 28, 1997.

Education: High school.

Main occupation during the last five years: Chairman of the Board of Directors and CEO of Nissan Medical Industries Ltd.

Family member of another interested party in the entity: No.

Does the Company consider him as an expert in accounting and finance: No.

List of companies which he serves in as director: Chairman of the Board of Directors of Nissan Medical Technologies and N.R. Spuntech Industries Ltd, Spuntech Inc., Nirco Holdings Ltd. and Nissan Holdings (T.R.) Ltd., Nissan Medical International Ltd., Hezi Nissan Ltd., Nissan Dressing Products Ltd. and Pansement Raffin S.A.

**G. Inbar Menachem**

I.D. Number: 000483982.

Citizenship: Israeli.

Year of Birth: 1948.

Address: 6 Haholshim Street, Herzliya.

Member of the Board of Directors' committees: No.

Outside director: No.

Expert outside director: No.

Employee of the Entity/subsidiary/related Company/interested party: Yes. He serves as a director of U.M. Accelmed Ltd. (general partner in U.M. Accelmed Limited Partnership).

Tenure start date: September 5, 2010.

Education: Master of Law.

Main occupation during the last five years: Managing partner at Shifman Inbar Ltd. until January 1, 2009 and since then, head of the Arkin Holdings office.

Family member of another interested party in the entity: No.

Does the Company consider him as an expert in accounting and finance: Yes.

List of companies in which he serves as director: Carmel Group, OIS, Shifman Inbar and Sphera.

**Regulation 26 A:**

**The entity's senior officeholders**

**A. Adi Dagan – Company CEO**

I.D. Number: 22215164.

Year of Birth: 1965.

Tenure start date: December 28, 1997.

Employee of a subsidiary/related Company/interested party: No.

Education: Bachelor of Industrial Engineering and Management, Tel Aviv University.

Main occupation during the last five years: Board Member and CEO of the entity.

Family member of another interested party in the entity: No.

**B. Dr. Jacob Barak – CTO**

I.D. Number: 7631179.

Year of Birth: 1950.

Employee of a subsidiary/related Company/interested party: No.

Tenure start date: January 1, 2003.

Education: MD, cardiac surgery specialist.

Main occupation during the last five years: Cardiac surgeon, technology manager in the Company.

Family member of another interested party in the entity: No.

**B. Ori Mor – CFO and responsible for Financial Market Risks**

I.D. Number: 28029767.

Year of Birth: 1970.

Employee of a subsidiary/related Company/interested party: Yes (CFO of Inc).

Tenure start date: February 8, 2009.

Education: Master of Economics, Ben Gurion University.

Main occupation during the last five years: CIO of the Halman-Alduby Group, Corporate CFO.

Family member of another interested party in the entity: No.

**C. Charlie Harrison – VP Commercial Operations**

I.D. Number: 11206293 (passport number).

Year of Birth: 1948.

Employee of a subsidiary/related Company/interested party: No.

Tenure start date: March 8, 2010.

Education: Master of Mathematics and MBA from the University of Massachusetts.

Main occupation during the last five years: President of the subsidiary, a Company Director and President of Critical Strategies.

Family member of another interested party in the entity: No.

**D. Ambaw Bellete ( President of Subsidiary)**

I.D. Number: 135149073 (passport number).

Year of Birth: 1970.

Employee of a subsidiary/related Company/interested party: Yes.

Tenure start date: March 1, 2010.

Education: M.Sc., Murray State University.

Main occupation during the last five years: VP of Orthopedics and Urology, Sanofi Aventis.

Family member of another interested party in the entity: No.

**E. Avner Eliav – Internal Auditor (not a Company employee)**

I.D. Number: 8852840.

Year of Birth: 1938.

Employee of a subsidiary/related Company/interested party: No.

Tenure start date: October 25, 2006.

Education: Bachelor of Accounting.

Main occupation during the last five years: Partner CPA in an independent office.

Family member of another interested party in the entity: No.

**F. Avital Perlstein – Accountant**

I.D. Number: 03499637.

Year of Birth: 1979.

Employee of a subsidiary/related Company/interested party: No.

Tenure start date: October 15, 2010.

Education: Bachelor of Accounting and Economics (Bar-Ilan University).

Main occupation during the last five years: Kesselman & Kesselman, Auditing Manager and Company Accountant.

Family member of another interested party in the entity: No.

**Regulation 26 B:**

**The corporation's independent authorized signatory**

None

**Regulation 27:**

**The corporation's auditors**

Kost, Forer, Gabay & Kasierer, 2 Hapal Yam Street, Haifa.

**Regulation 28:**

**Memorandum or regulation changes**

None.

**Regulation 29:**

**Board of Directors' recommendations and decisions**

1. On May 2, 2010, the Company's general shareholders' meeting approved the following decisions:
  - A. To reappoint Dr. Amir Gutman, Dr. Uri Geiger, Nissan Yehezkel and Eitan Nahum for another term of office as Company directors.

- B. To reappoint Kost, Forer, Gabay & Kasierer as the Company's auditors and empower the Board of Directors to set their fees.
  - C. To approve the Company contracting in directors' and officeholders' liability insurance policies.
  - D. To approve granting a letter of undertaking to indemnify the Company's directors and officeholders as well as the Company contracting in an irrevocable letter of exemption to directors and officeholders (including controlling shareholders) for duty of care violations towards the Company, excluding duty of care in distribution.
2. On July 26, 2010, the Company's general shareholders' meeting approved the terms of Mr. Eitan Nahum's tenure as Chairman of the Board and remuneration for providing consultancy services by him.
  3. On July 14, 2010, the Company's general meeting published a shelf memorandum under which the Company offered its shareholders between 1,507,606 and 1,657,216 ordinary Company shares of NIS 0.01 par value each by means of rights to its shareholders whereby each holder of 24 ordinary Company shares was entitled to acquire one unit of rights composed of one ordinary Company share of NIS 0.01 par value at an exercise price of NIS 3. Based on the results of the rights offering, exercise notices of 1,258,104 rights to acquire 1,258,104 ordinary Company shares of NIS 0.01 par value each were received for total proceeds of NIS 3,774 thousand (gross).
  4. On September 5, 2010, the Company's general meeting approved the appointment of Mr. Menachem Inbar as a Company director as from the approval date of the special shareholders' meeting.
  5. On October 20, 2010, the general shareholders' meeting approved a non-significant private placement to the Company's controlling shareholders Accelmed and Nissan, which was approved by the Audit Committee on August 12, 2010 and the Board of Directors on September 6, 2010. Under the investment agreement, 400,000 ordinary Company shares of NIS 0.01 par value each were allocated (which at the allocation date was 1.07% of the Company's voting rights and issued and paid-up capital, and 1.06% fully diluted) in consideration for an inclusive amount of NIS 1.2 million, which reflects a price of NIS 3 per share.

6. On October 11, 2010, the Company Board of Directors approved a non-significant private placement of 606,061 ordinary Company shares of NIS 0.01 par value each (which at the allocation date was 1.59% of the Company's voting rights and issued and paid-up capital, and 1.37% fully diluted) to an offeree which is not a controlling shareholder or interested party in the Company in consideration for an inclusive amount of NIS 2 million, which reflects a price of NIS 3.3 per share.
7. On March 24, 2011, the Company Board of Directors approved a non-significant private placement of 1,046,667 ordinary Company shares of NIS 0.01 par value each to several offerees that are not shareholders or interested parties in the Company, excluding Yelin Lapidot Provident Funds Management Ltd., which is an interested party in the Company in view of its holdings, in consideration for a total of NIS 3,925 thousand, which reflects a price per share of NIS 3.75.

#### **Regulation 29 A:**

##### **The Company's decisions**

1. In May 2006, the Board of Directors and shareholders' meeting of the Company approved granting a letter of undertaking to indemnify the Company's directors and officeholders under which, subject to the terms specified in the letter of undertaking and the Companies Law, the Company has undertaken to indemnify each officeholder for every liability or expense as defined below imposed on them or spent as a result of activities carried out by virtue of being an officeholder in the Company or an officeholder in another Company (including activities prior to the date of the letter of undertaking), connected directly or indirectly to one or more of the events described in the addendum to the letter of undertaking, which the Company's Board of Directors decided are anticipated in light of the Company's activities at the time of providing the indemnity letter or any part of them or anything connected to them, directly or indirectly, provided that the maximal sum of the indemnity does not exceed \$ 5 million.
2. In March 2010, the Audit Committee and Board of Directors approved the Company's contracts with respect to directors and officeholders' insurance (including controlling shareholders in the Company) as well as granting indemnity and exemption letters to the Company's directors and officeholders (including controlling shareholders), which are

subject to approval of the Company's shareholders meeting. For information, see the immediate report published by the Company on March 10, 2010 (reference no. 2010-01-409500).

3. Following the decision of the Company's shareholders of May 2, 2010 (see immediate report dated May 2, 2010, reference no. 2010-01-465732) concerning approval for the Company to contract in a letter of undertaking to indemnify the Company's directors and officeholders (including directors and officeholders who are controlling shareholders in the Company)(**the indemnification letters of undertaking**) and approval for the Company to contract in an irrevocable letter exempting directors and officeholders (including those which are controlling shareholders) for duty of care violation towards the Company (**the exemption letters**), and following the Audit Committee's approval of June 13, 2010, on the same day the Company approved and ratified granting the indemnification letters of undertaking and exemption letters to the recipients listed below:

- A. All the directors serving in the Company as at the report date as follows: Ms. Michal Even-Chen, Mr. Eitan Nahum, Gad Appelbaum, Dr. Amir Gutman, Dr. Uri Geiger and Mr. Yehezkel Nissan.

The officeholders serving in the Company as at the report date as follows: Mr. Adi Dagan (CEO), Dr. Jacob Barak (CTO), Mr. Ambaw Bellete (President of the American subsidiary), Mr. Charlie Harrison (VP Commercial Operations), Mr. Ori Mor (CFO) and Ms. Avital Perlstein (Accountant).

**Date: March 10, 2011**

<b><u>Signatories</u></b>	<b><u>Position of signatories</u></b>	<b><u>Signature</u></b>
Adi Dagan	CEO	
Eitan Nahum	Chairman of the Board of Directors	