PAYTON GROUP
INTERNATIONAL

# Payton Planar Magnetics Ltd.

# Annual Report 2008

## Contents

# The Board of Directors' Report[1] on Corporate Affairs

**We are pleased to present the Board of Directors' report on the affairs of Payton Planar Magnetics Ltd. and its consolidated subsidiaries for the year ended on December 31, 2008**

**Notice**: This report contains certain forward-looking statements and information relating to the Company that are based on the beliefs of the Management of the Company as well as assumptions made by and information currently available to the Management of the Company. Such statements reflect the current views of the Company with respect to future events. Management emphasizes that the assumptions does not in any way imply commitment towards realization. The outcome of which is subject to certain risks and other factors, which may be outside of the Company's control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes may vary materially from those described herein as projected, anticipated, believed, estimated, expected or intended.

Reference in this report to forward looking statement shall be by stating that such information is given by way of estimation, evaluation, assessment, intentions, expectations, beliefs and similar terms, but it is possible that such information shall be given under other phrases.

## 1. A concise description of the corporation and its business environment

### A. The Group

Payton Planar Magnetics Ltd. ("the Company") and its consolidated subsidiaries: Payton America Inc. ("Payton America"), Payton Planar Holdings (1996) Ltd. ("Payton Holdings").

### B. The Group's main fields of activity and changes that occurred in the period from January to December 2008

The Company, an Israeli high-tech enterprise, develops, manufactures and markets Planar transformers worldwide. The Company was founded in order to revolutionize the traditional approach to the design and manufacture of transformers through the concept of planar transformers. The invention is patented in North America, Europe and Japan. The Company completed its initial public offering in 1998 on the Euronext Stock Exchange.

1. **Property in Deerfield Beach, South Florida, U.S.A**
   Payton America, the Company's U.S. subsidiary completed the transfer to its new owned premises on July 2008.
2. **Printed Circuits Board ("PCB") facility in Ashkelon –**Last year the Company took a decision to expand and modernize its Printed Circuits Board ("PCB") facility in Ashkelon, Israel, which specializes in manufacturing of Heavy Copper PCB's and Multi-Layer Boards unique for Planar Transformers and Power Electronic applications. The investment was estimated by USD 1.5 millions. As of the date of signing these reports, the new plating line started running-in stage after it's installation was completed at the end of 2008. Further investments in the PCB facility will be made during 2009.

[1] The financial statements as at December 31, 2008 form an integral part thereof.

3. On March 18, 2008, **Payton Industries, the parent company** of the Company signed a Memorandum of Understanding (“M.O.U”) with A.C.P. Advanced Cores Production (“ACP”) regarding an acquisition of 100% of ACP’s shares.

   On May 2008, after performing a technical, financial and legal due-diligence, the parent company decided not to acquire ACP.

**C. Sales**

The Group major customer base is related to the Telecom and power electronic market. Additional markets the Group aims to, are the Industrial, Automotive Instrumentation and Military markets.

Sales for the year ended December 31, 2008 amounted to USD 15,255 thousand compared with USD 18,957 thousand for the year ended December 31, 2007. The sales were mostly affected by the global slow-down. Another factor, which explains the sales decrease, is an end of a high volume project, of formerly a substantial customer (Customer B), who reached the end of its life cycle at the end of 2007.
Revenues for the year ended 2008 consisted of recurring sales to existing customers and sales to new ones.
The Sales were generated primarily from large telecom companies and from industrial applications manufacturers.
The Company believes it has effectively penetrated the larger telecom companies in Europe and nowadays is targeting telecom, automotive, industrial and military companies in: North America, Japan, Taiwan and South Korea.

**D. Principal customers**

The consolidated sales revenues include sales to major customers (which make up in excess of 10% of the sales of the Company).

| | **For the year ended December 31** | **For the year ended December 31** |
|---|---|---|
| | **2008** | **2007** |
| Customer A | 19.0% | 20.1% |
| Customer B | * | 20.1% |
| Customer C | 15.0% | ** |

* Less than 10% of the Group’s consolidated sales. It is noted that a major project of this customer reached the end of its life cycle.

** Less than 10% of the Group’s consolidated sales.

## E. Global Environment and External factors effect on the Group's activity

During 2008, there was a significant downturn in the global financial markets. Large financial entities in the United States as well as other countries collapsed and dragged after them other sectors. This led a severe credit crisis. As a result, a number of countries have decided to take various steps aimed at restoring stability and preventing a downward spiral in the financial markets, however, there is no guarantee that such steps will ultimately restrain the crisis or assuage its intensity. It appears that the direct consequences of the crisis have not yet run their full course and there is a fear that the global economy, in general, and the U.S. economy, in particular, are heading for a recession.

Along with the above-mentioned crisis, there have been additional developments in Israel, among others, large fluctuations in the exchange rates of the main currencies vis-à-vis the shekel.

The global economic crisis affects the business positions of the Group's customers resulting in orders and sales slowdown. Due to the fact that the exact course the crisis is expected to follow cannot be foreseen, it is not possible to assess its consequences to the Group. Company Management is closely monitoring the situation and will continue to track its developments and effects. In addition, Company Management is taking the necessary actions in order to cope with the situation, to the greatest extent possible.

Thanks to management's conservative cash planning policy, the Group holds a high balance of the cash, cash equivalents and deposits. Therefore, management estimates that the Group is financially strong and no liquidity problems are expected in the foreseeable future.

## F. Marketing

During year 2008 the Group participated in the following exhibitions:

- "APEC 2008" exhibition in Austin, Texas, U.S.A.
- "Electronica & Productronica China 2008 with PCIM" exhibition in Shanghai, China.
- "Technology Hitech 2008" exhibition in Tel-Aviv, Israel.
- "PCIM" exhibition in Nuremberg, Germany.
- "Power Electronics Specialists Conference" in Rhodes, Greece.
- "Electronica" exhibition in Munich, Germany.

During 2008 the Company continued its intense focus to the North American and the Far East markets.

The Company strategy, which enables fulfilling the mission of gaining worldwide recognition and market share growth, is:

- Targeting world leaders in their fields. Having these leaders as our customers is convincing other second tier companies to adopt the Planar Technology.
- In addition to the Telecom segments, focusing on additional commercial segments such as Automotive, Military and Data Processing.
- Use representatives network as sales channels.
- Expanding our activity in the North American market.
- Deepening activity with existing customers.

## G. Manufacturing

The group intends to maintain and also diversify its manufacturing capacity and capabilities, through manufacturing partners in the Far East. This activity objective is to increase flexible production capacity, lower the products cost and increase competitiveness.

It is noted that the above statement is a forward-looking statement as defined above.

## H. Competition

In the recent years there has been an increasing interest of conventional transformer manufacturer to get into the Planar field. We can note that there are more and more companies that are trying to design and manufacture the planar components. However, the Company believes in its technology advantage and capabilities and estimates it could generally benefit from an increasing competition in the market due to greater exposure of the technology.

The Company cannot estimate its future market share. The following companies are considered as its potential competitors: Pulse and Coilcraft - from the U.S.A., Premo - from Spain, Tokin - from Japan and Himag - from U.K.

## I. Order and Purchase Backlog

Order and purchase backlog of the Group as of December 31, 2008 were USD 4,045 thousand; and as of March 17, 2009 this backlog amounted to USD 4,349 (December 31, 2007 - 3,903 thousand). The backlog is composed only of firm orders.

Management estimates that most of the backlog as of 31.12.08 will be supplied until the end of September 2009.

It is noted that the above statement is a forward-looking statement as defined above.

## J. Human Resources

A factor of importance to the Company’s success is its ability to attract, train and retain highly-skilled technical, and more specifically, qualified electronics engineers with experience in high frequency magnetics and with a comprehensive understanding of high frequency magnetics, managerial and sales and marketing personnel. Competition for such personnel is intense. The Company constantly betterments its personnel and has so far succeeded in recruiting the appropriate personnel as required. This personnel is important in maintaining the pace in research, design and technical customer support. The Company is confident however, that the challenges inherent in its operations will satisfy its Company’s future recruitment needs. By the end of 2008, the Group employed 150 people (including executive officers). The Company has signed employment contracts with most of its key employees and is of the opinion that relations with its employees are satisfactory.

## K. Quality Control

Payton Group has the ISO9001:2000 certification for its quality system. It has UL recognition for the use of several Electrical Insulation Systems classes B, F and H in its products, also has recognition of the construction of a family of magnetic components as complying with the requirements of UL and IEC 60950 standards of safety. Payton is authorized by an accredited testing agency to apply the CE mark to many of its commercial transformers.

Payton also meets recognized international safety standards and conforms to MIL.T, CSA VDE and other standards.

The Company is also certified with ISO14001:2004 (Environmental standard). Payton is a Lead Free company as required by the 2002/95/EC RoHS directive.

During year 2008 the Company initiated a qualification process for Automotive International Standard TS16949:2002 and for Space & Avionic International Standard AS9100.

As of the date of signing these financial statements, the Company completed all necessary qualification audits and is about to be certified with those two important International Quality Management Standards.

Those Quality International certifications will open for Payton the doors of the Automotive and Space/Avionic markets and give Payton a competitive advantage over non certified companies

## L. Objective and Business Strategy

Since its incorporation, Payton has provided innovative and affordable Planar Magnetic solutions to the Power Electronic Industry.

By doing so, it has become the undisputable worldwide market leader in the Planar Magnetics Technology, with a blue-chip customer base of leading technology-driven OEM's.

Over the next years, Payton plans to maintain its lead and continue to facilitate the transition of the Magnetics market to the Planar Technology by:

1. Maintaining and strengthening its current blue-chip customer base. This will enable Payton to build a track record as a reliable high-volume Planar component supplier to leading OEM's.
2. Selectively developing additional key strategic customers, especially In North America, Taiwan, Japan and South Korea in order to further propagate Payton Planar unique technology.
3. In addition to the present Telecom market, Instrumentation segment, Industrial and power portable application market, to aim and focus on new high growth segments such as Automotive, Military, Avionics and Space applications.
4. Continuing to educate the Power Electronics industry about Planar technology.
5. Continuing to develop its mass production expertise to a level that will enable Payton to address the large price-sensitive segments of the global Magnetics market.
6. Payton is constantly looking for business opportunities to extend its core business with synergetic product lines.

It is noted that the above statements are a forward-looking statements as defined above.

## M. Coming year outlook

Due to the global slow-down, aforementioned (paragraph E) the group does not foresee a growth in its business activity during 2009. Notwithstanding the above said during year 2009 the group plans to continue its regular course of business. It will go on with its marketing efforts aiming to expand products exposure and enlarging market share. In addition, the group will continue its continues search for business and M&A opportunities, synergetic to its core business, in order to broaden its activity.

## N. Risk Factors

| | Major Impact | Medium Impact | Small Impact |
|---|---|---|---|
| **Macro Risks** | ▪ The global economic crisis affects the Group's customers and causes orders and sales slowdown.<br>▪ Evaluation of the local Israeli currency reflects an increase in labor costs and other operating costs. | | ▪ Chinese currency Evaluation against the USD increases cost of goods sold. |
| **Market Risks** | | ▪ Telecom and power electronic market fluctuations. | ▪ Metals prices increase especially: Copper, Steel, Tin and Silver, which are part of the transformers bill of materials. |
| **Specific Risks** | | ▪ Manufacturing partners dependency. | |

It is noted that the above table is a forward-looking statement as defined above.

## O. Current Shareholders position

| Shareholder name | Number of shares | Percentage of the outstanding shares | Comments |
|---|---:|:---:|---|
| Payton Industries Ltd. | 11,691,131 | 66.2% | Israeli company traded in the Tel Aviv stock exchange. |
| Public | 5,979,644 | 33.8% | Listed on the EuroNext since June 1998. |
| Total | 17,670,775 | 100.0% | Total outstanding shares. |

## 2. Financial position

### A. Balance Sheet as at December 31, 2008

***Cash and cash equivalents, Marketable securities and Short-term Deposits*** **-** these items amounted to a total of USD 13,984 thousand as at December 31, 2008 compared to USD 15,876 thousand as at December 31, 2007. The decrease, compared with December 31, 2007, resulted mainly of classifying its U.S Marketable Securities available for sale at the amount of USD 2,660 thousand as a long term investment. The said amount represents Company's holding of securities with an Auction Reset feature ("ARS"), which their fair value was assessed by a professional external appraisers company. See detailed information regarding Fair value analysis at paragraph B below.

***Trade accounts receivable*** **-** these amounted to USD 3,716 thousand as at December 31, 2008 compared to USD 4,277 thousand as at December 31, 2007. The decrease in this item is explained by a decrease in sales volume.

***Marketable securities available for sale (non- current assets)*** - see aforementioned explanation to item *"Cash and cash equivalents, Marketable securities and Short-term Deposits"* and information regarding Fair value analysis at paragraph B below.

***Property, plant and equipment, net*** **-** these amounted to USD 1,639 thousand as at December 31, 2008 compared to USD 1,337 thousand as at December 31, 2007. The increase in this item resulted mainly from investing in the property (Florida, U.S.A) and from purchase of new equipments for the PCB facility (Ashkelon, Israel) and for the production facility (Rishon Lezion, Israel).

***Other payables*** **-** these amounted to USD 1,053 thousand as at December 31, 2008 compared to USD 2,008 thousand as at December 31, 2007. The decrease resulted mainly due to a decrease in current liabilities to related parties.

***Current tax liability*** - this amounted to USD 1,625 thousand as at December 31, 2008 compared to USD 1,283 thousand as at December 31, 2007. The increase in company's liability for income tax payment resulted of the net profit for the period.

### B. Fair value analysis of Marketable Securities available for sale

The Company invested in U.S. Auction Rate Securities ("ARS"), a debt instrument issued by local authorities, high education institutions and others, with a long-term nominal maturity (much more than 10 years), for which the interest rate is regularly reset through an auction. In the said auction, broker-dealers submit bids on behalf of potential buyers and sellers of the bond. Based on the submitted bids, the auction agent will set the next interest rate as the lowest rate to match supply and demand. Auctions are typically held every 7or 28 days; interest on these securities is paid at the end of each auction period.

In the past, these ARS securities were classified by the Company as short-term held for trading securities. During the second quarter of 2008 the Company reexamined their classification and reached the conclusion that the aforementioned securities should have been classified on the date of purchase as short-term available for sale securities. Accordingly, USD 3,019 thousand was reclassified as at December 31, 2007. The said classification did not have an effect on the Company's statement of income and/or shareholders' equity.

By the end of the first quarter of 2008 these ARS were presented at their par value. Starting the second quarter of 2008 and in light of the liquidity crisis in the American market, the Company appealed for a valuation regarding the fair value of the ARS it holds. As at December 31, 2008 the fair value of ARS was assessed at the amount of USD 2,660 thousand (Par value - USD 2,975 thousand). The valuation was prepared by an external, independent appraiser (Houlihan Smith & Company Inc.) having suitable professional skills.
The Company included this fair value decline, amounting USD 315 thousand in a capital reserve. It is noted that, according to that valuation, the change in fair value of the aforementioned securities is due to changes in current market conditions and in the liquidity of the markets, and is not due to financial difficulties or liquidity problems of the instrument's issuer.

Furthermore, management of the Company believes that it will not be possible to materialize the said securities at their stated value in the short-term, and intends to hold them for a long-term or until their value rises back to their par value. Therefore and in accordance with IAS 39, the Company did not recognize impairment of the securities. The balance of the securities as at December 31, 2008 was presented as long-term available for sale securities.
The Company further reports that until signing these Financial Statements all weekly and/or monthly interest payments on its ARS securities are being paid on time and in full.
See also note 5 to the financial statements.

## C. Interest rate, Currency and Market exposure - Data and Policy

***Interest rate exposure***

The Group's interest rate exposure relates mainly to its balance of cash equivalents and Short-term bank Deposits. These balances are held in USD bearing USD interest rates given by banks (about 3.7%), which changes from time to time. As of the date of signing these financial statements, and due to the economy crisis in the American market, the interest rate of Short-term bank Deposits held in USD significantly went down (Three month Libor rate decrease from 4% an average rate in 2008, to 1.22%).

***Data on linkage terms***

The financial statements of the Company reflect the functional currency of the Company, which is the USD.
Most of the Group's sales in the reported period were in USD or were linked to the USD. Approximately 13% of the Group's sales were in Euro.

Approximately 94% of the costs of raw material purchased by the Group during the reported period were in USD or were linked to the USD.

Approximately 88% of the Group salaries during the reported year ended December 31, 2008 were in New Israeli Shekel ("NIS"), 12% were in USD or linked to the USD.

***Currency exposure risks***

Since most of the Group's sales and purchases were in USD or linked to the USD, the Group's gross profit was exposed to the changes in exchange rates of the USD in relation to the Euro and to the local New Israeli Shekel ("NIS") with regards to labor costs and cost of raw materials (see also Data on linkage terms, above).

The Group is exposed to erosion of the USD in relation to the NIS. Devaluation of the U.S. Dollar with relation to the local Israeli currency leads to an increase in the Group’s labor costs. Most of the Group’s salaries and other operating costs are fixed in the local NIS.  Recent fluctuation of the U.S. Dollar with relation to the NIS has an influence on the operating results of the Company.

The Company is subcontracting Chinese ventures. Devaluation of the U.S. Dollar with relation to the Chinese currency has an influence on the Group’s cost of goods sold.

***Market risks***

During 2008 the Company used derivatives, from time to time, as a tool for hedging, especially in order to hedge labor costs paid in NIS. With regards to all other operating costs, there is no need to use derivatives, since hedging is being kept inherently as part of the operational activity.

## D. Operating results

**Summary of Consolidated quarterly Statements of Income**
**US Dollars in thousands**

**Payton Planar Magnetics Ltd.**
**Consolidated Income Statements**

| | Total 2008 | Total 2007 | Quarter 10-12/08 | Quarter 7-9/08 | Quarter 4-6/08 | Quarter 1-3/08 |
|---|---|---|---|---|---|---|
| Sales revenues | 15,255 | 18,957 | 3,554 | 4,246 | 4,026 | 3,429 |
| Cost of sales | 9,364 | 9,493 | 2,083 | 2,655 | 2,562 | 2,064 |
| *Gross profit* | *5,891* | *9,464* | *1,471* | *1,591* | *1,464* | *1,365* |
| Development costs | (708) | (581) | (151) | (193) | (174) | (190) |
| Selling & marketing expenses | (1,280) | (1,439) | (316) | (362) | (289) | (313) |
| General & administrative expenses | (2,039) | (1,963) | (496) | (545) | (551) | (447) |
| Other income | 7 | - | *2* | 3 | - | 2 |
| ***Operating income*** | *1,871* | *5,481* | *510* | *494* | *450* | *417* |
| Finance income (expense), net | *179* | *405* | 205 | (104) | 5 | 73 |
| ***Profit before income taxes*** | *2,050* | *5,886* | *715* | *390* | *455* | *490* |
| Income taxes | (552) | (974) | (484) | (218) | 47 | 103 |
| ***Net profit for the period*** | *1,498* | *4,912* | *231* | *172* | *502* | *593* |

***General Note***: The Group is exposed to erosion of the USD in relation to the NIS and to the Euro. Most of the Group's salaries (88%) and other operating costs are fixed in NIS. Revaluation of the local Israeli currency drives to an increase in labor costs and other operating costs, thus, negatively affects the operating results of the Company. The average rate of the USD with relation to the NIS, during 2008, went down by 13% compared with 2007, reflecting an increase in the above-mentioned costs when they are presented in USD.
About 13% of the Group's sales in 2008 were in Euro. Revaluation of the U.S. Dollar with relation to the Euro has an influence on the Group's gross margin.

***Sales revenues*** - The Group's sales revenues for year 2008 were USD 15,255 thousand compared with USD 18,957 thousand in year 2007.
The sales were mostly affected by the global slow-down. Another factor, which explains the sales decrease, is an end of a high volume project, of formerly a substantial customer (Customer B), who reached the end of its life cycle at the end of 2007.

***Gross profit*** **–** The Group's gross results for the year ended December 31, 2008 were USD 5,891 thousand (39%), compared with gross results of USD 9,464 thousand (50%) in the year ended December 31, 2007.
The decrease in the Group's gross profit was affected by the following factors:

- Decrease in sales, due to the global slow-down.
- Devaluation of the U.S. Dollar with relation to the local currency, which caused an increase in the Group's labor costs.

- Part of the Company’s expenses included in the cost of sales couldn’t be reduced in parallel to the sales decrease; thus, the gross profit has grown smaller.
- Changes in the product-mix sold during the period.

***Development costs -*** Payton’s R&D strategy is aimed on maintaining the leadership of the Planar Technology. The R&D department works in conjunction with R&D departments of the forerunners of today’s global technology, and together they define tomorrow’s technological needs. Costs were based upon time expended by the department’s employees. The group’s development costs for the year ended December 31, 2008 were USD 708 thousand. The increase in these costs compared with last year was attributed mainly to the revaluation of the local Israeli currency (see “General Note” above).

***Selling & marketing expenses -*** The Group’s selling & marketing expenses are based on the management policy and are not related to sales, except sales commissions to the Group's reps’ and Marketing Personnel, which are calculated as a portion of sales. The Group’s marketing efforts are concentrated through participation in major power electronic shows around the world and by collaborating with its worldwide rep's Network.

***General & Administrative expenses*** - These amounted to USD 2,039 thousand in the year ended December 31, 2008 compared with USD 1,963 thousand in the year ended December 31, 2007. The slight increase in these expenses is explained by the decrease in exchange rates of the USD in relation to the NIS causing an increase in these expenses when they are presented in USD (In NIS, the General & Administrative expenses in 2008 went down by 8%, compared with 2007)

***Taxes on income -*** The Company prepares its tax reports, to the Israeli tax authorities, in NIS. During the year ended December 31, 2008 a net tax expense of USD 552 thousand was accrued, compared with USD 974 thousand in the year ended December 31, 2007. The decrease in these expenses resulted mainly of the decrease in the net profit for the period.
It is noted that during 2007 the Company could use lower tax rate due to government encouragement program providing tax benefits. In 2008 these tax benefits were negligible. (See also note 22 to the financial statements as at 31.12.08).

## 3. Liquidity

### A. Liquidity Ratios

The following table presents the financial ratios in the balance sheet:

| Payton Planar Magnetics Ltd.<br>Consolidated financial ratios | | |
|---|---|---|
| | **31 December, 2008** | **31 December, 2007** |
| Current ratio[2] | 4.77 | 4.57 |
| Quick ratio[3] | 4.27 | 4.16 |

### B. Operating activities

Cash flow generated from operating activities for the year ended December 31, 2008 amounted USD 1,733 thousand, compared with the cash flow generated from operating activities of USD 6,880 thousand for the year ended December 31, 2007. The decrease in cash flow generated from operating activities resulted mainly from the sales decrease, affected by the global slow-down, resulting with a decrease in the net profit. And in addition, from other adjustments: as a decrease in trade receivables and in other payables & tax liabilities, reflected in the consolidated cash flow report.

### C. Investing activities

Cash flow used for investing activities in the year ended December 31, 2008, amounted USD 2,523 thousand compared with USD 5,143 thousand in the year ended December 31, 2007.

Cash flow used for investing activities in the year 2008 resulted mainly from investing in deposits, in marketable securities, in property and equipments.

## 4. Financing sources

The Group financed its activities during the reported periods from its own resources.

[2] Current ratio calculation – Current assets / Current liabilities

[3] Quick ratio calculation – (Current assets – Inventory) / Current liabilities

## 5. External factors effects

5.1 The global financial markets crisis – see paragraph 1.E. "Global Environment and External factors effect on the Group's activity" above.

5.2 Revaluation of the local Israeli currency in relation to the U.S. Dollar leads to an increase in labor costs and other operating costs. Most of the Group's salaries and other operating costs are fixed in NIS, therefore, the operating results of the Company are being negatively affected.

5.3 The Company is subcontracting Chinese ventures. Devaluation of the U.S. Dollar with relation to the Chinese currency has an influence on the Group's cost of goods sold.

5.4 Revaluation of the U.S. Dollar with relation to the Euro. Part of the Group's sales are linked to the Euro (13%). Revaluation of the U.S. Dollar against the Euro has an influence on the Group's gross margin.

To the best of the Board of Directors' and management's knowledge, except the above mentioned, there have been no significant changes in external factors that may materially affect the Company's financial position or results of operations.

The Company's Board of Directors wishes to thank our shareholders for their continuance trust and belief.

The Company's Board of Directors wishes to extent its sincere thanks to the entire personnel for their efforts and contribution to the Group's affairs.

**David Yativ**
**Chairman of the Board of Directors & C.E.O.**

**Rishon Lezion, March 26, 2009.**

**Somekh Chaikin**
KPMG Millennium Tower
17 Ha'arba'a Street, PO Box 609
Tel Aviv 61006 Israel

Telephone 972 3 684 8000
Fax 972 3 684 8444
Internet www.kpmg.co.il

# Independent Auditors' Report to the Shareholders of Payton Planar Magnetics Ltd.

## Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Payton Planar Magnetics Ltd. ("the Company"), which comprise the consolidated balance sheet as at December 31, 2008, and the consolidated income statement, the consolidated statement of changes in shareholders' equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

## Auditors' responsibility

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

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

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

We did not audit the financial statements of a subsidiary whose assets constitute 9% of the total consolidated assets as at December 31, 2008 and whose revenues constitute 16% of the total consolidated revenues for the year ended December 31, 2008. The financial statements of the subsidiary were audited by other auditors whose reports thereon were furnished to us. Our opinion, insofar as it relates to amounts emanating from the financial statements of such subsidiary, is based solely on the said reports of the other auditors.

**Opinion**

In our opinion based on our audit and on the reports of the abovementioned other auditors, the consolidated financial statements give a true and fair view of the consolidated financial position of the Company as at December 31, 2008, and of its consolidated income statement, the consolidated statement of changes in shareholders' equity and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Somekh Chaikin
Certified Public Accountants (Isr.)
(A member of KPMG International)

March 26, 2009

## Consolidated Balance Sheets as at December 31

| | Note | 2008 $ thousands | 2007 $ thousands |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalents | 3 | **8,230** | 9,063 |
| Marketable securities held for trading | 4 | **1,255** | 609 |
| Marketable securities available for sale | 5 | **-** | 3,019 |
| Short-term deposits | 6 | **4,499** | 3,185 |
| Trade accounts receivable | 7 | **3,716** | 4,277 |
| Other accounts receivable | 8 | **79** | 145 |
| Inventory | 9 | **2,072** | 1,982 |
| **Total current assets** | | **19,851** | 22,280 |
| **Non-current assets** | | | |
| Deposits | | **-** | 5 |
| Marketable securities available for sale | 5 | **2,660** | - |
| Other investment | 10 | **348** | 348 |
| Property, plant and equipment | 11 | **1,639** | 1,337 |
| Deferred taxes | 12 | **90** | 122 |
| **Total non-current assets** | | **4,737** | 1,812 |
| **Total assets** | | **24,588** | 24,092 |

David Yativ
Chief Executive Officer and
Chairman of the Board of Directors

Michal Lichtenstein
V.P. Finance & CFO

March 26, 2009

## Consolidated Balance Sheets as at December 31 (cont'd)

| | Note | 2008<br>$ thousands | 2007<br>$ thousands |
|---|---|---|---|
| **Liabilities and shareholders' equity** | | | |
| **Current liabilities** | | | |
| Trade payables | 13 | **1,482** | 1,584 |
| Other payables | 14 | **1,053** | 2,008 |
| Current tax liability | | **1,625** | 1,283 |
| **Total current liabilities** | | **4,160** | 4,875 |
| **Non-current liabilities** | | | |
| Employee benefits | 15 | **152** | 124 |
| **Total non-current liabilities** | | **152** | 124 |
| **Shareholders' equity** | | | |
| Share capital | 20 | **4,836** | 4,836 |
| Share premium | | **8,993** | 8,993 |
| Capital fund for available-for-sale assets | | **(315)** | - |
| Accumulated earnings | | **6,762** | 5,264 |
| **Total shareholders' equity** | | **20,276** | 19,093 |
| **Total liabilities and shareholders' equity** | | **24,588** | 24,092 |

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

**Consolidated Income Statements for the year ended December 31**

| | Note | 2008<br>$ thousands | 2007<br>$ thousands |
|---|---|---|---|
| Revenues | 21A | **15,255** | 18,957 |
| Cost of sales | 21B | **9,364** | 9,493 |
| **Gross profit** | | **5,891** | 9,464 |
| Development costs | | **(708)** | (581) |
| Selling and marketing expenses | 21C | **(1,280)** | (1,439) |
| General and administrative expenses | 21D | **(2,039)** | (1,963) |
| Other income | | **7** | - |
| **Operating income** | | **1,871** | 5,481 |
| Finance income | 21E | **449** | 586 |
| Finance expense | 21E | **(270)** | (181) |
| Finance income, net | | **179** | 405 |
| **Profit before income taxes** | | **2,050** | 5,886 |
| Income taxes | 22 | **(552)** | (974) |
| **Profit for the year** | | **1,498** | 4,912 |
| **Basic and diluted earnings per ordinary share (in $)** | 23 | **0.08** | 0.28 |

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

## Consolidated Statement of Shareholders' Equity

| | Share capital | | Share | Capital fund for available- | Accumulated | |
|---|---|---|---|---|---|---|
| | Number of shares | $ thousands | premium $ thousands | for-sale assets $ thousands | earnings $ thousands | Total $ thousands |
| **Balance at January 1, 2007** | 17,670,775 | 4,836 | 8,993 | - | 352 | 14,181 |
| Net profit for the year | - | - | - | - | 4,912 | 4,912 |
| **Balance at December 31, 2007** | 17,670,775 | 4,836 | 8,993 | - | 5,264 | 19,093 |
| Capital fund for available-for-sale assets | **-** | **-** | **-** | **(315)** | **-** | **(315)** |
| Net profit for the year | **-** | **-** | **-** | **-** | **1,498** | **1,498** |
| **Balance at December 31, 2008** | **17,670,775** | **4,836** | **8,993** | **(315)** | **6,762** | **20,276** |

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

**Consolidated Statements of Cash Flows for the year ended December 31**

| | 2008 $ thousands | 2007 $ thousands |
|---|---|---|
| **Net Operating activities** | | |
| Net profit for the year | **1,498** | 4,912 |
| Adjustments to reconcile net income to net cash generated from operating activities: | | |
| Depreciation | **227** | 207 |
| Capital gain on sale of equipment | **(7)** | - |
| Increase (decrease) in employee benefits | **28** | (70) |
| Decrease in trade receivables | **561** | 1,016 |
| Decrease (increase) in other accounts receivable | **66** | (77) |
| Increase in inventory | **(90)** | (38) |
| (Decrease) increase in trade payables | **(118)** | 8 |
| (Decrease) increase in other payables and tax liability | **(613)** | 825 |
| Decrease in deferred taxes | **32** | 45 |
| Finance expenses, net | **149** | 52 |
| **Cash flows generated from operating activities** | **1,733** | 6,880 |
| **Investing activities** | | |
| Investments in marketable securities held for trading | **(747)** | (1,591) |
| Investments in marketable securities available for sale | **(1,000)** | (3,014) |
| Proceeds from sale of marketable securities held for trading | **-** | 1,316 |
| Proceeds from sale of marketable securities available for sale | **1,039** | - |
| Investments in deposits, net | **(1,309)** | (849) |
| Investment in property, plant and equipment | **(547)** | (1,014) |
| Proceeds from sale of equipment | **41** | 9 |
| **Cash flows used for investing activities** | **(2,523)** | (5,143) |
| **(Decrease) increase in cash and cash equivalents** | **(790)** | 1,737 |
| **Cash and cash equivalents at beginning of the year** | **9,063** | 7,269 |
| **Effect of exchange rate fluctuations on cash held** | **(43)** | 57 |
| **Cash and cash equivalents at end of the year** | **8,230** | 9,063 |
| **Supplementary disclosure** | | |
| Interest received included in cash flows generated from operating activities | **436** | 436 |
| Tax paid included in cash flows generated from operating activities | **199** | 91 |

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

## Note 1 - General

Payton Planar Magnetics Ltd. (“the Company”), an Israeli high-tech company, was incorporated in December 1992. The Company develops, manufactures and markets planar transformers for high density, high frequency off line power supplies and operates abroad through its subsidiaries and distributors. Its manufacturing includes the manufacture of printed circuits. In June 1998, the Company completed its initial public offering in the Euro NM.

## Note 2 - Significant Accounting Policies

The financial statements were authorized for issue by the directors on March 26, 2009.

**A. Definitions**

1. **Subsidiaries** – those enterprises controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date the control effectively ceases.

2. **The Group** – the Company and its subsidiaries.

3. **Payton Industries Ltd. -** parent company, traded in the Tel Aviv Stock Exchange.

4. **Related parties** – a party that has the ability to control or exercise significant influence over the other party in making financial and reporting decisions. Such relationships include:

    1. Parent-subsidiary relationships.
    2. Entities under common control.
    3. Individuals who, through ownership, have significant influence over the enterprise and close members of their families.
    4. Key management personnel.

5. **Israeli CPI** – The Consumer Price Index as published by the Central Bureau of Statistics in Israel.

6. **NIS** – The Israeli currency - New Israeli Shekel.

7. **$** – U.S. Dollar

**B. Statement of compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and its interpretations adopted by the International Accounting Standards Board ("IASB").

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

### C. Basis of preparation

The consolidated financial statements are presented in dollars, the Company's functional currency, rounded to the nearest thousand. They have been prepared on the historical cost basis, except for marketable securities, which are measured at fair value.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements. The accounting policies have been applied consistently by Group entities.

The statement of cash flows for the year ended December 31, 2007 includes the reclassification of some items in immaterial amounts.

### D. Basis of consolidation

1. Subsidiaries - see Note 2A.

2. Intra-group balances and transactions, and any unrealized gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

### E Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognized in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction

### F. Cash and cash equivalents

Cash comprises cash balances available for immediate use and call deposits.

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

**G. Allowance for doubtful accounts**

The allowance for doubtful accounts is computed on the specific identification basis for accounts, which, in management's estimation, are doubtful of collection. In determining the appropriateness of the provisions, management based itself, among other things, on an evaluation of the risk based on the information in its possession regarding the financial condition of the debtors, the scope of their activities and an assessment of the collaterals received from them. Doubtful debts, regarding which management believes there is no chance of collecting, are written off the books based on a management decision.

**H. Inventory**

1. Inventory is stated at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

2. The cost of inventories is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

**I. Property, plant and equipment**

1. Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses.
   Depreciation is recognized in profit or loss on a straight-line method over the useful lives of the assets as estimated by management.

2. Annual rates of depreciation are as follows:

| | % | |
|---|---|---|
| Buildings | 3 | |
| Machinery and equipment | 15 | |
| Motor vehicles | 15 | |
| Computers and office equipment | 6 – 33 | (mainly 33%) |

   Leasehold improvements are depreciated over the shorter of the lease period or the useful life of the leasehold improvement (mainly 10%).

   Depreciation methods, useful lives and residual values are reassessed at the reporting date.

3. Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditure, is capitalized. Other subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognized in the income statement as an expense as incurred.

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

### J. Other investment

Other investment that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is measured at cost less impairment losses.

### K. Revenue recognition

Revenue from the sale of goods is recognized in the income statement when the significant risks and rewards of ownership have been transferred to the buyer.
No revenue is recognized if there are significant uncertainties regarding recovery of the consideration due, associated costs or possible return of goods.

Customers have no option of returning the product or canceling orders. Customers approve the product in the prototype manufacture stage. As products are modified and developed for new customers (or new products adapted to existing customers), customers can have no claim against the product other than a claim of defectiveness after approval of the prototype.

### L. Joint expenses of the Company and related companies

Beginning January 1, 2008 the joint general and administrative expenses of the Company and of Payton Technologies Ltd. (a subsidiary of the parent company) are allocated 87% to the Company and 13% to Payton Technologies Ltd.

### M. Employee benefits

1. Defined contribution plans

   Obligation for contribution to defined contribution plans is recognized as an expense in the income statement as incurred.

2. Defined benefit obligations

   The liabilities of the Group arising from defined benefit obligations, and the related current service cost, are determined using the projected unit credit method. Valuations are carried out annually for the plan. Actuarial advice is provided by an external consultant.

   Such a plan is externally funded, with the assets of the schemes held separately from those of the Group in independently insurance policies.

   Actuarial gains and losses arise mainly from changes in actuarial assumptions and differences between actuarial assumptions and what has actually occurred. They are recognized in the income statement in its full amount in the periods it incurs.

   For defined benefit plans the actuarial cost charged to the income statement consists of current service cost, interest cost, expected return on plan assets as well as actuarial gains or losses that are recognized.

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

### N. Development costs

Development costs are mainly incurred to customize products for individual contracts. These development costs are expensed as incurred.

### O. Operating lease payments

Payments made under operating leases are recognized in the income statement on a straight-line basis, over the term of the lease.

### P. Financial instruments

1. Non-derivative financial instruments

   Financial instruments include: cash and cash equivalents, trade receivables, other receivables, credit from others, and short and long term payables.

   The fair value of the financial instruments was determined at the present value of the future cash flows resulting from using appropriate discount rates. In management's opinion the fair value of financial instruments is not materially different from their stated value.

2. Investments in marketable securities, at fair value through profit or loss.

   An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss. The fair value of these financial instruments is determined by reference to their quoted bid price at the reporting date.

3. Available-for-sale financial assets

   The Group's investments in certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses are recognized directly in equity. When an investment is derecognized, the cumulative gain or loss in equity is transferred to profit or loss. The fair value of these assets is determined by reference to their quoted bid price at the reporting date and in the absence of a quoted bid price it is determined by a valuation prepared by external independent appraisers having suitable professional skills.

### Q. Provisions

A provision is recognized in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is more likely than not that an outflow of economic benefits will be required to settle the obligation.

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

## R. Finance Income and expenses

Finance income comprises interest income on funds invested, dividend income, changes in the fair value of financial assets at fair value through profit or loss and foreign currency gains that are recognized in profit or loss. Interest income is recognized as it accrues, using the effective interest method. Dividend income is recognized on the date that the Company’s right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Finance expenses comprise interest expense on borrowings, unwinding of the discount on provisions, foreign currency losses, changes in the fair value of financial assets at fair value through profit or loss, impairment losses recognized on financial assets, and losses on hedging instruments that are recognized in profit or loss. All borrowing costs are recognized in profit or loss using the effective interest method.

## S. Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, nor differences relating to the extent they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that is no longer probable that the related tax benefit will be realized.

## T. Earnings per share

The Company presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted.

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

## U. Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

## V. Impairment

1. The carrying amounts of the Group's assets other than inventories and deferred tax assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognized in the income statement.

2. Calculation of recoverable amount

   The recoverable amount is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

3. Reversals of impairment

   An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

   An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

## W. New standards and interpretations not yet adopted

1. IFRS 8 *Operating Segments* (hereinafter – the Standard) determines that the “management approach” should be used in segment reporting, meaning in accordance with the format of the internal reports provided to the decision makers of the entity. Currently the Company presents segment information in respect of its geographical segments. As it is the management’s approach, the Group will continue presenting segment information in respect of geographical segments. The Standard is effective for annual periods beginning on or after January 1, 2009.

2. Revised IAS 23 *Borrowing Costs* (hereinafter – the Standard) removes the option to expense borrowing costs and requires that an entity capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The Standard is effective for annual periods beginning on or after January 1, 2009 and is not expected to have a material effect on the financial statements.

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

**W. New standards and interpretations not yet adopted (cont'd)**

3. Revised IAS 1 *Presentation of Financial Statements* (hereinafter – the Standard) requires the aggregation in the financial statements of information having common characteristics and the presentation of a statement of comprehensive income. The Standard allows the presentation of income and expense items and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The titles of some of the financial statements were changed in order to reflect their function more clearly (for example, the balance sheet is renamed a statement of financial position). The Standard will come into effect for annual periods beginning on or after January 1, 2009. Early adoption is permitted.

   The financial statements of the Company will be presented according to the requirements of the Standard.

4. IFRS 3 (2008), "Business Combinations", refers also to business combinations executed only by contract. The definition of a business combination focusses on obtaining control, including a contingent consideration. The buyer can choose to measure the rights that do not confer control at their fair value on the date of acquisition, or according to the relative part of the fair value of the identified assets and liabilities of the acquired party. When the acquisition is effected by consecutive purchases of shares (purchase in stages), the identified assets and liabilities of the acquired party are recognized at their fair value when control is obtained. IFRS 3 (2008) shall apply to the financial statements of the Company for 2010 and is not anticipated to have an effect on the financial statements of the Company.

5. Revised IFRS 2 *Share-Based Payment* (hereinafter – the Standard) provides that vesting conditions are conditions that determine whether the group is receiving the services that entitle the other party to a share-based payment, and they are restricted to service and performance conditions. Non-vesting conditions will be reflected in the fair value of the share-based payment on the grant date, and after the grant date the group shall not adjust the fair value in respect of these conditions. Furthermore, the Standard specifies the accounting treatment of non-compliance with non-vesting conditions. The Standard shall apply retroactively to annual periods beginning after January 1, 2009 and permits early adoption along with disclosure.

   The standard is not anticipated to have an effect on the financial statements of the Company.

6. Revised IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements* (hereinafter – the Standards). The Standards require classifying as equity certain puttable financial instruments, obligations arising on liquidation and instruments requiring the entity to deliver to a third party, only upon liquidation, a pro rata share of the net assets of the entity, in certain circumstances. It also provides disclosure requirements regarding puttable financial instruments that were classified as equity. These Standards shall apply to annual reporting periods beginning on or after January 1, 2009 and early adoption is permitted and is not anticipated to have an effect on the financial statements of the Company.

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

**W. New standards and interpretations not yet adopted (cont'd)**

7. Revised IAS 27 *Consolidated and Separate Financial Statements*, and IFRS 1 *First-time Adoption of International Financial Reporting Standards* (hereinafter – the Standards). In accordance with these standards, a company that elects the cost method for measuring its investments in subsidiaries, jointly controlled companies and affiliated companies, in the separate financial statements (stand-alone financial statements) is permitted to measure these investments on the date of transition to IFRS at their fair value in accordance with IAS 39 or at their carrying value according to previous GAAP. Furthermore, a dividend received from subsidiaries, jointly controlled companies and affiliated companies shall be recognized as income in the separate financial statements of the holding company. It was further provided that under certain circumstances the receipt of a dividend indicates impairment of the investment in the investee company.

   These standards shall apply to annual periods beginning on or after January 1, 2009 and is not anticipated to have an effect on the financial statements of the Company.

8. In the framework of the Improvements to IFRSs project, in May 2008 the IASB published and approved 35 amendments to various IFRS on a wide range of accounting issues. The amendments are divided into two parts: (1) Amendments that result in accounting changes for presentation, recognition or measurement purposes and (2) Terminology or editorial amendments that are expected to have either no or only minimal effects on accounting.

   Most of the amendments shall apply to periods beginning on or after January 1, 2009 and permit early adoption, subject to the specific conditions of each amendment and subject to the transitional provisions relating to a first-time adopter of IFRS.

   Adoption of improvements is not anticipated to have an effect on the financial statements of the Company.

9. *Items Eligible for Hedging*, amendment to IAS 39, *Financial Instruments: Recognition and Measurement* (hereinafter – the Amendment). The Amendment makes clear that an entity may designate as a hedged item changes in cash flows or fair value of a one-sided risk, meaning the risk of exposure to changes above or below a specified price or other defined variable. The Amendment also clarifies that inflationary components can be designated as a separate risk, on the condition that they form a contractually specified portion of the cash flows of an inflation-linked debenture, so that they are separately identifiable and reliably measurable, and if the other cash flows of the instruments are not affected by the inflationary component.

   The Amendment is effective retrospectively for annual periods beginning on or after July 1, 2009, with earlier application permitted, together with appropriate disclosure.

   Adoption of the amendment is not anticipated to have an effect on the financial statements of the Company.

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

**W. New standards and interpretations not yet adopted (cont'd)**

10. IFRIC 13, *Customer Loyalty Programs* (hereinafter – the Interpretation). In accordance with the Interpretation, when products and services are sold together with sale incentives (such as award credits or free products) the arrangement is considered a multiple-element arrangement and the proceeds received in its respect are to be allocated to the various components according to their fair value. The Interpretation shall be applied retroactively to periods beginning on or after July 1, 2008. Earlier application is permitted with appropriate disclosure.

    The interpretation is not anticipated to have an effect on the financial statements of the Company.

11. IFRIC 15, *Agreements for the Construction of Real Estate* (hereinafter – the Interpretation). The Interpretation provides guidance for examining whether transactions for the construction of real estate are subject to IAS 18, *Revenue*, by which revenue from the construction of real estate is recognized at the same time and according to the same method as revenue from the sale of a product or the rendering of a service, or are subject to IAS 11, *Construction Contracts*, by which revenue is recognized in accordance with the stage of completion of the real estate.
    The Interpretation is to be applied for annual periods beginning on or after January 1, 2009, on a retrospective basis. Earlier application is permitted with appropriate disclosure.

    The interpretation is not anticipated to have an effect on the financial statements of the Company.

12. IFRIC 16, *Hedges of a Net Investment in a Foreign Operation* (hereinafter – the Interpretation). The Interpretation refers to an investment in a foreign operation and provides guidance regarding the hedging of such an investment. Inter alia, the Interpretation refers to the nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated, where the hedging instrument is held in a group of companies and the accounting treatment of the capital reserve upon disposal of a foreign operation.
    The Interpretation shall apply to annual periods beginning on or after October 1, 2008. Earlier application is permitted with appropriate disclosure.

    The interpretation is not anticipated to have an effect on the financial statements of the Company.

13. IFRIC 17, Distributions of Non-cash Assets to Owners (hereinafter – the Interpretation). The Interpretation provides that the obligation of a company for the distribution of non-cash assets to owners is to be accounted for as a liability for the payment of a dividend and be measured at the fair value of the assets to be distributed with any changes in fair value until the date of distribution being recognized in equity. At the time of the distribution, any difference between the carrying amount of the assets and the amount of the liability is recognized in profit or loss, as a separate line item. The Interpretation is to be applied prospectively for annual periods beginning on or after July 1, 2009. Earlier application is permitted provided that IFRS 3 (Revised), IAS 27 (as revised in 2008) and IFRS 5 (as revised in this Interpretation) are applied at the same time.

    The interpretation is not anticipated to have an effect on the financial statements of the Company.

## Note 3 - Cash and Cash Equivalents

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| U.S. dollars | **6,846** | 8,377 |
| Other currencies | **1,384** | 686 |
| | **8,230** | 9,063 |

## Note 4 - Marketable Securities Held for Trading

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Mutual funds | **54** | 104 |
| Bonds | **726** | - |
| Preferred stocks 6.1% - 7% | **475** | 505 |
| | **1,255** | 609 |

## Note 5 - Marketable Securities Available For Sale

The Company invested in Auction Rate Securities (ARS) that are securities issued by local authorities, higher education institutions and others for long terms, for the purpose of the securitization of their assets. These securities were classified in the past as short-term held for trading securities. The Company reexamined their classification and reached the conclusion that the aforementioned securities should have been classified on the date of purchase as short-term available for sale securities. Accordingly, US$3,019 thousand was reclassified as at December 31, 2007. The said classification did not have an effect on the Company's statement of income and/or shareholders' equity.

In light of current market conditions, the Company received a valuation regarding ARS in the amount of US$2,660 thousand that it holds as at December 31, 2008. The valuation was prepared by external, independent appraisers having suitable professional skills. The Company included the decline in fair value in the amount of US$315 thousand in a capital reserve as at December 31, 2008. In accordance with the valuation, the change in fair value of the aforementioned securities is due to changes in current market conditions and in the liquidity of the markets, and is not due to financial difficulties or liquidity problems of the instrument's issuer.

Furthermore, management of the Company assesses that it will not be possible to realize the said securities at their stated value in the short-term, and it intends to hold them for the long-term or until their value rises back to their stated value. Therefore and in accordance with IAS 39, the Company did not recognize impairment of the securities. The balance of the securities as at December 31, 2008 was presented as long-term available for sale securities.

## Note 6 - Short-Term Deposits

Deposits in dollars, bearing interest at an annual rate of approximately 3%-4.5%.

## Note 7 - Trade Accounts Receivable

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Local | **215** | 177 |
| Abroad (mainly in dollars) | **3,501** | 4,100 |
| | **3,716** | 4,277 |

## Note 8 - Other Accounts Receivable

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Government institutions | **1** | - |
| Prepaid expenses and sundry | **78** | 145 |
| | **79** | 145 |

## Note 9 - Inventory

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Raw and packing material | **1,583** | 1,492 |
| Work-in-process | **153** | 185 |
| Finished products | **336** | 305 |
| | **2,072** | 1,982 |

## Note 10 - Other Investment

Represents the Company's share holdings in Champs Technologies Co. (hereinafter- Champs) (formerly: Payton Asia Planar Magnetics) of 10.7% (includes 3.74% held by a subsidiary Payton Planar Holdings (1996) Ltd.).

# Note 11 - Property, Plant and Equipment, Net

| | Machinery and equipment | Motor vehicles | Computers and Office equipment | Improvements in leasehold | Land and Buildings | Total |
|---|---|---|---|---|---|---|
| | $ thousands | | | | | |
| **December 31, 2008** | | | | | | |
| **Cost** | | | | | | |
| Balance as of January 1, 2008 | **1,828** | **102** | **529** | **368** | **746** | **3,573** |
| Acquisitions | **208** | **56** | **116** | **16** | **167** | **563** |
| Disposals | **-** | **(54)** | **(8)** | **-** | **-** | **(62)** |
| Balance as of December 31, 2008 | **2,036** | **104** | **637** | **384** | **913** | **4,074** |
| **Accumulated depreciation** | | | | | | |
| Balance as of January 1, 2008 | **1,461** | **33** | **441** | **301** | **-** | **2,236** |
| Depreciation for the year | **97** | **16** | **70** | **31** | **13** | **227** |
| Disposals | **-** | **(22)** | **(6)** | **-** | **-** | **(28)** |
| Balance as of December 31, 2008 | **1,558** | **27** | **505** | **332** | **13** | **2,435** |
| Carrying amounts as of December 31, 2008 | **478** | **77** | **132** | **52** | **900** | **1,639** |
| **December 31, 2007** | | | | | | |
| **Cost** | | | | | | |
| Balance as of January 1, 2007 | 1,616 | 105 | 496 | 360 | - | 2,577 |
| Acquisitions | 212 | 10 | 34 | 8 | 746 | 1,010 |
| Disposals | - | (13) | (1) | - | - | (14) |
| Balance as of December 31, 2007 | 1,828 | 102 | 529 | 368 | 746 | 3,573 |
| **Accumulated depreciation** | | | | | | |
| Balance as of January 1, 2007 | 1,348 | 22 | 393 | 271 | - | 2,034 |
| Depreciation for the year | 113 | 16 | 48 | 30 | - | 207 |
| Disposals | - | (5) | - | - | - | (5) |
| Balance as of December 31, 2007 | 1,461 | 33 | 441 | 301 | - | 2,236 |
| Carrying amounts as of December 31, 2007 | 367 | 69 | 88 | 67 | 746 | 1,337 |

## Note 12 - Deferred Taxes

| | Property, plant and equipment | Carry-forward tax deductions and losses | Non-current liabilities for employee benefits | Other | Total |
|---|---|---|---|---|---|
| | | | $ thousands | | |
| Balance as at January 1, 2007 | 3 | 73 | 42 | 49 | 167 |
| Changes in 2007 | 31 | (73) | 4 | (7) | (45) |
| Balance as at December 31, 2007 | 34 | - | 46 | 42 | 122 |
| Changes in 2008 | **(21)** | **-** | **(8)** | **(3)** | **(32)** |
| Balance as at December 31, 2008 | **13** | **-** | **38** | **39** | **90** |

## Note 13 - Trade Payables

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Israeli suppliers | **414** | 429 |
| Foreign suppliers | **1,033** | 1,141 |
| Post-dated checks payable | **35** | 14 |
| | **1,482** | 1,584 |

## Note 14 - Other Payables

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Employees and related benefits | **396** | 409 |
| Related parties | **398** | 1,242 |
| Other payables and accrued expenses | **259** | 357 |
| | **1,053** | 2,008 |

# Note 15 - Employee Benefits

**A.** Israeli labor laws and agreements require the Company to pay severance pay to dismissed or retiring employees (including those leaving their employment under certain other circumstances). The calculation of the severance pay liability was made in accordance with labor agreements in force and based on salary components which, in management's opinion, create entitlement to severance pay.

**B.** The Israeli company's severance pay liabilities to its employees are funded partially by regular deposits with recognized pension and severance pay funds in the employees' names and by purchase of insurance policies and are accounted for as defined benefit plans.

**C.** **Employees benefits are comprised as follows:**

| | December 31 2008 | December 31 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Present value of defined benefit obligation | **378** | 371 |
| Fair value of individual assets | **(226)** | (247) |
| Recognized liability for defined benefit obligations | **152** | 124 |

**Liability for defined benefit obligations**

The Group makes contributions to defined benefit plans that provide pension benefits for employees upon retirement.

**A.** **Post-employment benefit plans – defined benefit plan**

**(1)** **Movements in the present value of the defined benefit obligations**

| | 2008 | 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Defined benefit obligations as at January 1 | **371** | 319 |
| Benefits paid | **(15)** | (20) |
| Current service costs and interest costs | **75** | 34 |
| Changes in respect of foreign exchange differences | **4** | 31 |
| Actuarial (gains) losses | **(57)** | 7 |
| Defined benefit obligation as at December 31 | **378** | 371 |

# Note 15 - Employee Benefits (cont'd)

## A. Post-employment benefit plans – defined benefit plan (cont'd)

### (2) Movements in individual assets

| | 2008 | 2007 |
|---|---|---|
| | $ thousands | $ thousands |
| Fair value of individual assets as at January 1 | **247** | 124 |
| Contributions paid | **35** | 29 |
| Present value of contribution | **-** | (10) |
| Benefits paid | **(10)** | (8) |
| Expected return on individual assets | **15** | 8 |
| Changes in respect of foreign exchange differences | **3** | 12 |
| Asset return expense | **52** | (1) |
| Actuarial gains (losses) | **(116)** | 93 |
| Fair value of individual assets as at December 31 | **226** | 247 |

### (3) Expenses recognized in the income statement

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| Current service costs | **45** | 12 |
| Interest cost | **30** | 22 |
| Expected return on individual assets | **(15)** | (8) |
| Asset return expense | **(52)** | 1 |
| Present value of contributions | **-** | 10 |
| Net actuarial losses (gains) in the year | **59** | (86) |
| | **67** | (49) |
| The expense is recognized in the following line items in the income statement: | | |
| Cost of sales | **32** | (23) |
| Development expenses | **21** | (15) |
| Selling and marketing expenses | **2** | (1) |
| Administrative expenses | **12** | (10) |
| | **67** | (49) |

### (4) Actual return

| | 2008 | 2007 |
|---|---|---|
| Actual return on individual assets | **(57)** | 11 |

### (5) Principal actuarial assumptions:

a. The calculations are based on the following demographic assumptions about the future characteristics of current employees who are eligible for benefits:

i. Mortality rates are based on Ministry of Finance insurance circular 2007-3-6, reflecting the latest mortality assumptions in Israel, including future mortality improvements. This is a change from 2007 report which used circular 2007-1-3, the impact is negligible.

ii. Disability rates are based upon table of the pension circular 2007-3-6 of the Ministry of Finance.

# Note 15 - Employee Benefits (cont'd)

**A. Post-employment benefit plans – defined benefit plan (cont'd)**

**(5) Principal actuarial assumptions: (cont'd)**

a. (cont'd)

iii. The leave rate assumed has been based upon analysis of the Company's experience.

- The following rates were used for employees who leave with entitlement to benefits:

| Years of service | Rate |
|---|---|
| 0 | 0.0% |
| 1 - 9 | 2.5% |
| 10 + | 1.0% |

- The following rates were used for employees who leave without entitlement to benefits:

| Years of service | Rate |
|---|---|
| 0 | 5.0% |
| 1 - 9 | 2.5% |
| 10 + | 1.0% |

b. In view of the small size of the Company and the limited number of years experience currently available, these assumptions were felt to be reasonable. With the progress of time and the consequent accumulation of experience, these assumptions should be periodically reviewed.

c. The calculations are based on the following financial assumptions:

i. The discount rate used is based on the yield of fixed-interest Israeli government bonds with duration equal to the duration of the gross liabilities:

| Valuation Date | Discount Rate |
|---|---|
| **December 31, 2008** | **3.60%** |
| December 31, 2007 | 3.59% |

ii. The future salary increase is assumed to be 3% p.a.

iii. The real rate of growth of the accrued balance in individual savings plans for policies issued before January 1, 2004 is assumed to be 0.0%. p.a. (this reflects the policy wording, which allocates earnings on the severance pay to the Tagmulim portion of the policy) and 3.0% net return for other policies.

## Note 16 - Investments in Subsidiary Companies

**Details of the subsidiaries, their activities and the Company's interest therein as at December 31, 2008:**

**A. Payton Planar Holdings (1996) Ltd. (hereinafter "Payton Holdings"):**

The Company holds 89% of the equity of Payton Holdings (an Israeli company).
Payton Holdings holds 3.74% of the paid up share capital of Champs. (See Note 10). Until December 31, 2006, the investment in Payton Holdings constitutes a loan given by the Company to Payton Holdings, which is linked to the CPI bearing interest at an annual rate of 2%. On January 1, 2007, the loan was converted to a capital note which is not linked to the CPI and does not bear any interest.

**B. Payton America Inc. (hereinafter "Payton America"):**

During the year 1998, the Company, through its wholly-owned U.S. subsidiary, Payton America, acquired from Mr. Alex Estrov all the shares of MTC, another U.S. corporation, following which MTC merged into Payton America. Payton America manufactures and sells Planar transformers and inductors.

## Note 17 - Commitments, Contingent Liabilities and Liens

The Company has a commitment for a monthly rent of about $21 thousand and $6 thousand for its premises in Israel up to 2014 and 2018 accordingly.

## Note 18 - Financial Risk Management

**A. Overview**

The Group has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (including currency, interest and other market price risks)

This note presents information about the Group's exposure to each of the above risks, and the Group's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework.

# Note 18 - Financial Risk Management (cont'd)

## B. Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and investment securities.

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Credit evaluations are performed on all customers requiring credit over a certain amount. The Company has credit risk insurance for most of its customers exceeding a scope of operations of $10 thousand per year. Approximately 34 percent of the Group's revenue is attributable to sales transactions with two principal customers.

## C. Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

## D. Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

<u>Currency risk</u>
Since most of the Group's sales are in US dollar, the Group's gross profit is exposed to the changes in exchange rates of the US dollar in relation to the NIS and to the Chinese currency with regards to labor costs and costs of raw material. The Company rarely uses derivatives as a tool for hedging.

<u>Interest rate risk</u>
Investments are made only in bank deposits and marketable securities. The Group's exposure to market risk for changes in interest rates relates primarily to cash and cash equivalents and short-term deposits which are in US dollars bearing interest rates given by banks of approximately 3%-4.5% which changes from time to time.

# Note 19 - Financial Instruments

## A. Credit risk

### (1) Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

| | December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | Carrying amount | |
| | $ thousands | $ thousands |
| Cash and cash equivalents | **8,230** | 9,063 |
| Available-for-sale financial assets | **2,660** | 3,019 |
| Held for trading financial assets | **1,255** | 609 |
| Short-term deposits | **4,499** | 3,185 |
| Trade accounts receivable | **3,716** | 4,277 |
| Other accounts receivable | **26** | - |
| | **20,386** | 20,153 |

The aforementioned balances are presented under the items of cash and cash equivalents, short-term deposits, trade receivables, other receivables and marketable securities.

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

| | December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | Carrying amount | |
| | $ thousands | $ thousands |
| Israel | **215** | 177 |
| Asia | **1,646** | 1,481 |
| Europe | **1,001** | 1,540 |
| America | **854** | 1,079 |
| | **3,716** | 4,277 |

The Group's two most significant customers account for $620 thousand and $173 thousand of the receivables carrying amount at December 31, 2008 (December 31, 2007: $ 1,422 thousand and $300 thousand, respectively).

# Note 19 - Financial Instruments (cont'd)

**A. Credit risk (cont'd)**

**(2) Aging of debts and impairment losses**

The aging of trade receivables at the reporting date was:

| | December 31 | | December 31 | |
|---|---|---|---|---|
| | 2008 | 2008 | 2007 | 2007 |
| | Gross | Impairment | Gross | Impairment |
| | $ thousands | $ thousands | $ thousands | $ thousands |
| Not past due | **2,434** | **-** | 2,768 | - |
| Past due 0-30 days | **794** | **-** | 1,108 | - |
| Past due 31-120 days | **488** | **-** | 401 | - |
| | **3,716** | **-** | 4,277 | - |

**B. Liquidity risk**

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

| | December 31, 2008 | | | |
|---|---|---|---|---|
| | Carrying amount | Contractual cash flows | 6 months or less | 6-12 months |
| | $thousands | | | |
| **Non-derivative financial liabilities** | | | | |
| Trade payables | **1,482** | **1,482** | **1,482** | **-** |
| Other payables | **893** | **893** | **893** | **-** |
| | **2,375** | **2,375** | **2,375** | **-** |

| | December 31, 2007 | | | |
|---|---|---|---|---|
| | Carrying amount | Contractual cash flows | 6 months or less | 6-12 months |
| | $thousands | | | |
| **Non-derivative financial liabilities** | | | | |
| Trade payables | 1,584 | 1,584 | 1,580 | 4 |
| Other payables | 1,838 | 1,838 | 1,838 | - |
| | 3,422 | 3,422 | 3,418 | 4 |

# Note 19 - Financial Instruments (cont'd)

## C. Linkage and foreign currency risk

### (1) The exposure to linkage and foreign currency risk

The Group’s exposure to linkage and foreign currency risk was as follows based on notional amounts:

| | December 31, 2008 | | | |
|---|---|---|---|---|
| | **Dollar** | **NIS** | ***Other** | **Total** |
| | **$thousands** | | | |
| **Current assets:** | | | | |
| Cash and cash equivalents | **6,846** | **470** | **914** | **8,230** |
| Marketable securities and deposits | **5,754** | **-** | **-** | **5,754** |
| Trade and other receivables | **3,202** | **215** | **325** | **3,742** |
| **Non-current assets:** | | | | |
| Marketable securities | **2,660** | **-** | **-** | **2,660** |
| **Current liabilities:** | | | | |
| Trade and other payables | **(1,292)** | **(1,050)** | **(33)** | **(2,375)** |
| | **17,170** | **(365)** | **1,206** | **18,011** |

| | December 31, 2007 | | | |
|---|---|---|---|---|
| | **Dollar** | **NIS** | ***Other** | **Total** |
| | **$thousands** | | | |
| **Current assets:** | | | | |
| Cash and cash equivalents | 8,377 | 34 | 652 | 9,063 |
| Marketable securities and deposits | 6,813 | - | - | 6,813 |
| Trade and other receivables | 3,588 | 195 | 494 | 4,277 |
| **Non-current assets:** | | | | |
| Deposits | 5 | - | - | 5 |
| **Current liabilities:** | | | | |
| Trade and other payables | (1,537) | (1,861) | (24) | (3,422) |
| | 17,246 | (1,632) | 1,122 | 16,736 |

* Mainly Euro.

# Note 19 - Financial Instruments (cont'd)

## C. Linkage and foreign currency risk (cont'd)

### (1) The exposure to linkage and foreign currency risk (cont'd)

Information regarding the CPI and significant exchange rates:

| | Year ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| | Rate of change | | Reporting date spot rate | |
| | % | % | NIS | NIS |
| 1 US dollar | **(1.14)** | (8.97) | **3.802** | 3.846 |
| CPI (in points) | **3.76** | 3.40 | **110.4** | 106.4 |

### (2) Sensitivity analysis

A strengthening of the NIS against the following currencies as at December 31, 2008 and an increase in the CPI would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2007.

| | December 31, 2008 | |
|---|---|---|
| | Equity | Profit or loss |
| | $ thousands | $ thousands |
| Increase in the exchange rate of: | | |
| 5% in the NIS | **-** | **(18)** |
| 5% in the Euro | **-** | **57** |

| | December 31, 2007 | |
|---|---|---|
| | Equity | Profit or loss |
| | $ thousands | $ thousands |
| Increase in the exchange rate of: | | |
| 5% in the NIS | - | (162) |
| 5% in the Euro | - | 55 |

A weakening of the US$ against the above currencies as at December 31 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

# Note 19 - Financial Instruments (cont'd)

**D. Interest rate risk**

**(1) Profile**

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

| | December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | Carrying amount | |
| | $ thousands | $ thousands |
| **Fixed rate instruments** | | |
| Financial assets | **8,171** | 10,422 |

**Variable rate instruments**
The Company does not have variable rate instruments

**(2) Fair value sensitivity analysis for fixed rate instruments**

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit or loss.

**E. Fair value**

**Fair values versus carrying amounts**

The carrying amounts of certain financial assets and liabilities, including cash and cash equivalents, trade receivables, other receivables, other short-term investments, trade payables and other payables are the same or proximate to their fair value.

# Note 20 - Share Capital

**A. Composition**

| | Number of shares | | |
|---|---|---|---|
| | Authorized | Issued and paid | |
| | December 31, 2008 and 2007 | | |
| Ordinary shares of NIS 1 each | **20,000,000** | **17,670,775** | 17,670,775 |

In June 1998 the Company completed an offering (on the Euro-NM) to the public of 5,150,000 ordinary shares comprising 29.26% of the Company's issued and outstanding share capital subsequent to such issue, in consideration for 360,500,000 BEF (before issue expenses) (December 31, 2008 and 2007: 29.14%).

# Note 20 - Share Capital (cont'd)

**B. Option plan**

In 2001, the Company granted share appreciation rights (SARs) in the amount of $875 thousand to a bank at the exercise price of EURO 1.74 per share. The number of shares to be issued was determined based on the ratio between the value of the benefit and the share price on the exercise date.
The options were exercisable to shares until August 31, 2008.

Furthermore, the bank was granted the right to convert the above mentioned agreement into a non-recurring commission, under certain circumstances that are contingent on the occurrence of future events. The Company did not consider the occurrence of these contingent events as probable.

In November 2006 the bank gave notice of an exercise on net issuance of 50% of the SARs granted equal to 70,775 ordinary shares at the same date.

In August 2008, the options and the right to conversion expired.

# Note 21 - Income Statement Data

**A. Revenues**

1. Revenues

| | For the year ended December 31 | |
|---|---|---|
| | **2008** | **2007** |
| | **$ thousands** | **$ thousands** |
| Export | **14,657** | 18,431 |
| Local | **598** | 526 |
| | **15,255** | 18,957 |

2. Principal customers

The sales revenues include sales to principal customers (which make up in excess of 10% of the sales of the Company):

| | For the year ended December 31 | |
|---|---|---|
| | **2008** | **2007** |
| | **%** | **%** |
| Customer A | **19** | 20 |
| Customer B | * | 20 |
| Customer C | **15** | * |

* Less than 10% of the Group's consolidated sales.

## Note 21 - Income Statement Data (cont'd)

### B. Cost of sales

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| Materials consumed* | **5,102** | 5,822 |
| Salaries and related benefits | **2,982** | 2,745 |
| Depreciation | **136** | 143 |
| Other manufacturing expenses | **1,144** | 783 |
| | **9,364** | 9,493 |

* Includes inventory write-off of $50 thousand and $57 thousand for the years ended December 31, 2008 and 2007, respectively.

Includes purchases from a principal supplier (which make up in excess of 10% of the purchases of the Company):

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | % | % |
| Supplier A | **63** | 60 |

### C. Selling and marketing expenses

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| Salaries and related benefits | **443** | 419 |
| Distribution commissions | **485** | 702 |
| Advertising and marketing | **120** | 89 |
| Exhibits and travel abroad | **184** | 146 |
| Other | **48** | 83 |
| | **1,280** | 1,439 |

### D. General and administrative expenses

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| Salaries and related benefits | **466** | 419 |
| Office rent, maintenance and communications | **110** | 108 |
| Depreciation | **91** | 64 |
| Professional services | **109** | 93 |
| Management fee | **984** | 1,038 |
| Other | **279** | 241 |
| | **2,039** | 1,963 |

# Note 21 - Income Statement Data (cont'd)

**E. Financial result**

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| **Financing income** | | |
| Interest income from bank deposits | **307** | 511 |
| Income from marketable securities held for trading | **-** | 75 |
| Income from marketable securities available for sale | **114** | - |
| Other | **28** | - |
| | **449** | 586 |
| **Financing expenses** | | |
| Bank charges and others | **28** | 32 |
| Loss from marketable securities held for trading | **45** | - |
| Exchange rate differences, net | **159** | 115 |
| Interest on transactions with parent company | **38** | 34 |
| | **270** | 181 |

**F. Transactions with related parties**

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| Selling and marketing | **264** | 244 |
| Management fees* | **984** | 1,038 |
| Financing expenses | **38** | 34 |
| Acquisition of fixed assets | **34** | 10 |

Regarding balances with related parties - see Note 14.

* Management fees to the parent company are paid in respect of the salaries of the management, including the Chief Executive Officer, the production director and other senior workers, according to an agreement with the parent company (see Note 2L).

# Note 22 - Income Taxes

**A. Measurement of results for tax purposes under the Income Tax Law (Adjustments for Inflation) - 1985 (the "Adjustments Law")**

In accordance with the Adjustments law, the results for tax purposes are measured in real terms, based on the changes in the CPI.

On February 26, 2008, the Income Tax Law (Adjustments for Inflation) (Amendment No. 20) (Restriction of Period of Application) - 2008 ("the Amendment") was passed by the Knesset. According to the Amendment, the Adjustments Law will no longer be applicable subsequent to the 2007 Tax Year, except for the transitional provisions whose objectives area to prevent distortion of the taxation calculations.

In addition, according to the amendment, commencing the 2008 tax year, the adjustment of income for the effects of inflation for tax purposes will no longer be calculated. Additionally, depreciation on protected assets and carryforward tax losses will no longer be linked to the Index, with these balances being adjusted to the Index through the end of the 2007 Tax Year, and linkage thereon ceasing from the 2008 Tax Year onwards.

**B. Amendment to the Income Tax Ordinance**

On July 25, 2005, the Knesset passed the Law for the Amendment of the Income Tax Ordinance (No. 147 and Temporary Order) – 2005 (hereinafter – Amendment 147). The Amendment provides for a gradual reduction in the company tax rate in the following manner: in 2006 the tax rate was 31%, in 2007 the tax rate was 29%, in 2008 the tax rate will be 27%, in 2009 the tax rate will be 26% and from 2010 onward the tax rate will be 25%. Furthermore, as from 2010, upon reduction of the company tax rate to 25%, real capital gains will be subject to tax of 25%.

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

The Company currently qualifies as an “Industrial Company” under the above law. As such, it is entitled to certain tax benefits, mainly the right to deduct share issuance costs for tax purposes in the event of a public offering, and to amortize know-how acquired from third parties.

**D. Tax benefits under the Law for the Encouragement of Capital Investments - 1959 ("the Investment Law")**

In March 2005, the Knesset approved a reform of the Investment Law. The primary changes are as follows:

- Companies that meet the criteria of the Alternative Path of Tax benefit receive those benefits without prior approval. In addition, there is no requirement to file reports with the Investment Center. Audit takes place via the Income Tax Authorities as part of the tax audits. Request for pre-ruling is possible.
- For any expansion of investment, a company is required to invest within three years, additional production machinery and equipment as a certain percentage of its existing production machinery and equipment.

# Note 22 - Income Taxes (cont'd)

**D. Tax benefits under the Law for the Encouragement of Capital Investments - 1959 ("the Investment Law") (cont'd)**

Beginning 2006 tax year, the Company meets the criteria of the Alternative Path of Tax and it prepares its tax reports according to the Investment Law.

The Company is located in "Development Area A" and in "Other Area" (center of the country).
The principle tax benefits granted are:

a. Development Area A: Exemption from corporate tax for a period of 10 years or a reduced tax rate of 11.5% for the same period. (See "c" hereinafter)

b. Other Area: Exemption from corporate tax for two years and a reduced tax rate of 25% for the next five years.

c. In the event of distribution by the Company of a cash dividend out of retained earnings which were tax exempt due to its Privileged Enterprise status, the Company would have to pay a 25% corporate tax on the amount distributed, and a further 15% withholding tax would be deducted from the amounts distributed to the recipients.

d. Should the Company derive income from sources other than the "Privileged Enterprise" during the relevant period of benefits such income will be taxable at regular corporate tax rates.

**E. Final tax assessments**

The Company's final income tax assessments up to and including the 2003 tax year are considered to be final.

**F. Income taxes recognized in the income statement**

| | For the year ended December 31 | |
|---|---|---|
| | **2008** | **2007** |
| | **$ thousands** | **$ thousands** |
| Current taxes | **520** | 929 |
| Deferred tax expense (see Note 12) | **32** | 45 |
| | **552** | 974 |

# Note 22 - Income Taxes (cont'd)

### G. Reconciliation of effective tax rate

The report to the Israeli tax authorities is according to the financial statements in NIS.

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

| | For the year ended December 31 | |
|---|---|---|
| | **2008** | **2007** |
| | **$ thousands** | **$ thousands** |
| Tax rate | **27%** | 29% |
| Profit before tax | **2,050** | 5,886 |
| Income tax using the domestic corporations tax rate | **554** | 1,707 |
| Additional tax in respect of foreign subsidiaries | **31** | 63 |
| Non-deductible expenses and tax exempt income, net | **30** | (53) |
| Tax exempt income due to Approve Enterprise status | **(1)** | (317) |
| Differences in basis of measurement for financial reporting and for tax purposes | **(108)** | (414) |
| Others | **46** | (12) |
| | **552** | 974 |

# Note 23 - Earnings Per Share

### Basic earnings per share

The calculation of basic and diluted earnings per share at December 31, 2008 was based on the net profit attributable to ordinary shareholders of $1,498 thousand (2007: $4,912 thousand) and a weighted average number of ordinary shares outstanding of 17,671 thousand (2007: 17,671 thousand) calculated as follows:

## Note 23 - Earnings Per Share (cont'd)

**Net profit attributable to ordinary shareholders**:

| | For the year ended December 31 | |
|---|---|---|
| | 2008 | 2007 |
| | $ thousands | $ thousands |
| Profit for the year | **1,498** | 4,912 |
| Profit attributable to ordinary shareholders | **1,498** | 4,912 |

**Weighted average number of ordinary shares (basic)**
In thousands of shares

| | December 31 | |
|---|---|---|
| | 2008 | 2007 |
| Issued ordinary shares at January 1 | **17,671** | 17,671 |
| Weighted average number of ordinary shares at December 31 | **17,671** | 17,671 |

**Diluted earnings per share**

The calculation of diluted earnings per share at December 31, 2008 was based on profit attributable to ordinary shareholders of $1,498 thousand (2007: $4,912 thousand) and a weighted average number of ordinary shares outstanding after adjustment for the effects of all dilutive potential ordinary shares of 17,671 thousand (2007: 17,671 thousand), calculated as follows:

**Weighted average number of ordinary shares (diluted)**
In thousands of shares

| | December 31 | |
|---|---|---|
| | 2008 | 2007 |
| Weighted average number of ordinary shares (basic) | **17,671** | 17,671 |
| Weighted average number of ordinary shares (diluted) at December 31 | **17,671** | 17,671 |

## Note 24 - Segment Reporting

**Geographical - location of customers**

Segment information, is presented in respect of the Group's geographical segments, which is based on the Group's management and internal reporting structure.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers.

# Note 24 - Segment Reporting (cont'd)

**Geographical - location of customers (cont'd)**

Segment results, assets and liabilities include items directly attributed to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly interest-bearing loans and corporate assets.

No business segment information is required as the Company operates on a single business segment - planar transformers.

| | For the year ended December 31, 2008 | | | |
|---|---|---|---|---|
| | Europe and Israel (mainly Europe) | America | Asia | Total |
| | $ thousands | $ thousands | $ thousands | $ thousands |
| Segment revenues | 5,332 | 3,983 | 5,940 | 15,255 |
| Segment result | 655 | 488 | 728 | 1,871 |
| Net financial result | | | | 179 |
| Income taxes | | | | (552) |
| Net profit for the year | | | | 1,498 |
| Segment assets | 2,553 | 1,858 | 3,095 | 7,506 |
| Unallocated assets | | | | 17,082 |
| Total assets | | | | 24,588 |
| Segment liabilities | 1,603 | 1,084 | 1,616 | 4,303 |
| Unallocated liabilities | | | | 9 |
| Total liabilities | | | | 4,312 |
| Segment depreciation and amortization | 80 | 59 | 88 | 227 |
| Segment capital expenditure | 384 | 179 | - | 563 |

# Note 24 - Segment Reporting (cont'd)

## Geographical - location of customers (cont'd)

| | For the year ended December 31, 2007 | | | |
|---|---|---|---|---|
| | Europe and Israel (mainly Europe) | America | Asia | Total |
| | $ thousands | $ thousands | $ thousands | $ thousands |
| Segment revenues | 6,040 | 4,096 | 8,821 | 18,957 |
| Segment result | 1,746 | 1,184 | 2,551 | 5,481 |
| Net financial result | | | | 405 |
| Income taxes | | | | (974) |
| Net profit for the year | | | | 4,912 |
| Segment assets | 2,853 | 1,814 | 3,073 | 7,740 |
| Unallocated assets | | | | 16,352 |
| Total assets | | | | 24,092 |
| Segment liabilities | 1,677 | 1,053 | 2,260 | 4,990 |
| Unallocated liabilities | | | | 9 |
| Total liabilities | | | | 4,999 |
| Segment depreciation and amortization | 66 | 45 | 96 | 207 |
| Segment capital expenditure | 265 | 745 | - | 1,010 |

## Note 25 - Critical Accounting Estimates and Assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

1. Allowance for doubtful accounts

   The financial statements include specific provisions for doubtful debts, which, in management's opinion, adequately reflect the loss included in those debts whose collection is doubtful. Doubtful debts, which according to management's opinion are unlikely to be collected, are write-off from the Company's books, based on a management resolution. Management's determination of the adequacy of the provision is based on an evaluation of the risk, by considering the available information on the financial position of the debtors, the volume of their business, an evaluation of the security received from them and past experience.
   As at December 31, 2008 and 2007 no allowance was recorded. (See also Note 19A).

2. Pension benefits

   This applies where the Group's accounting policy is to recognize any actuarial gains or losses immediately through the income statement.

   The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the expected long-term rate of return on the relevant plan's assets and the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

   The Group determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Group considers the interest rates of fixed interest Israeli government bonds with duration equal to the duration of the liability.

   Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in Note 15.

3. Deferred tax assets

   The Group recognizes deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. The Group regularly reviews its deferred tax assets for recoverability, based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and the implementation of tax planning strategies. If the Group is unable to generate sufficient future taxable income in certain tax jurisdictions, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, the Group could be required to eliminate a portion of the deferred tax asset resulting in an increase in its effective tax rate and in adverse impact on operating results.