NOVA MEASURING INSTRUMENTS LTD
Form 20-F/A
June 12, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 20-F/A
Amendment No. 1

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) or (g)
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from ________ to _________

Commission File Number 0-030668

NOVA MEASURING INSTRUMENTS LTD.
(Exact name of Registrant as specified in its charter)

Nova Measuring Instruments Ltd.	**Israel**
(Translation of Registrant's name into English)	(Jurisdiction of incorporation or organization)

Weizmann Science Park, Building 22, 2nd Floor, Ness-Ziona 76100, Israel
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	**Name of each exchange on which registered**
None	None

Securities registered or to be registered pursuant to Section 12(g) of the Act:
Ordinary Shares, nominal value NIS 0.01 per share

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

15,308,544 Ordinary Shares, NIS 0.01 nominal (par) value per share, as of December 31, 2004

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 x

EXPLANATORY NOTE

Nova Measuring Instruments Ltd. (the Company) is filing this Amendment No. 1 (the Amendment) to its Annual Report on Form 20-F for the year ended December 31, 2004, which was originally filed on June 28, 2005 (the Original Filing), to reflect the amendment and restatement of its financial statements for the year ended December 31, 2004. The Company has amended and restated its financial statements for the year ended December 31, 2004 with respect to revenues recognized in connection with the sale of NovaScan systems which included an option to upgrade the systems capabilities and the sale of NovaScan systems which included a trade-in option. As explained more fully in Note 15 to our Consolidated Financial Statements contained elsewhere in this report, after filing the Original Filing, the Company determined that the recognition of revenues relating to these systems was not consistent with generally accepted accounting principles. The primary effects of the restatement are to reduce the Company s 2004 revenues to $36.8 million from previously reported revenues of $40.9 million and to reduce the Company s previously reported net profit for 2004 of $1.5 million to a net loss of $1.4 million. Accordingly, to reflect the effects of the restatement, information in the following sections of this report has been revised: Part I, Item 3, Key Information; Part I, Item 4, Information on the Company; Part I, Item 5, Operating and Financial Review and Prospects; and Part I, Item 8, Financial Information. In addition, the information under Part II, Item 15 has been revised as a result of management s re-evaluation of the Company s disclosure controls and procedures.

Except as required to reflect the effects of the restatement for the items above, the Company has not made any modifications or updates to the Original Filing on Form 20-F. Information not affected by the restatement remains unchanged and reflects the disclosures made at the time of the Original Filing. This Amendment does not describe other events occurring after the Original Filing, including exhibits, or modify or update those disclosures affected by subsequent events. This Amendment should be read in conjunction with the Company s filings made with the SEC subsequent to the filing of the Original Filing, as information in such reports and documents may update or supersede certain information contained in this Amendment. Accordingly, this Amendment only amends and restates Part I, Items 3, 4, 5, 8 and Part II, Item 15 of the Original Filing, in each case, solely as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby. We have, however, also revised and expanded our discussion of our revenue recognition policies. In addition, currently dated certificates of the Company s President and Chief Financial Officer have been attached as Exhibits 12.1, 12.2, 13.1 and 13.2. The entire Original Filing, excluding exhibits other than 12.1, 12.2, 13.1 and 13.2, has been refilled on this Form 20-F/A.

TABLE OF CONTENTS

Introduction

In this Annual Report, the "Company," "Nova," "we" or "our" refers to Nova Measuring Instruments Ltd. and its consolidated subsidiaries, when the context requires.

The consolidated financial statements and selected consolidated financial data as of December 31, 2000, 2001, 2002, 2003 and 2004 and for each of the years in the five-year period ended December 31, 2004 (the Consolidated Financial Statements), included in this Annual Report have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

Our Functional Currency

Unless otherwise indicated, all amounts herein are expressed in United States dollars ("U.S. dollars," "dollars," "USD," "US$" or "$").

The currency of the primary economic environment in which we operate is the U.S. dollar, since substantially all our revenues to date have been denominated in U.S. dollars and over 50% of our expenses are in U.S. dollars or in New Israeli Shekels linked to the dollar. Transactions and balances denominated in dollars are presented at their original amounts. Non-dollar transactions and balances have been re-measured into dollars as required by the principles in Statement No. 52 of the Financial Accounting Standards Board (FASB) of the United States of America. All exchange gains and losses from such re-measurement are included in the net financial income when they arise.

Cautionary Statement Regarding Forward-Looking Statements

Certain information contained herein, which does not relate to historical financial information, may be deemed to constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words or phrases will likely result, are expected to, will continue, is anticipated, estimate, project, believe, plan , or similar expressions identify forward looking sta Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results and those presently anticipated or projected. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. We undertake no obligation to release publicly any revisions to these forward looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Among the factors that could cause our actual results in the future to differ materially from any opinions or statements expressed with respect to future periods are competitive industry conditions and the ability to forecast the needs of the semiconductor industry with respect to the very cyclical nature of the industry and the very fast pace of technology evolutions. Various other factors that could cause our actual results to differ materially are set forth in Risk Factors starting on page 3 and elsewhere herein.

PART I

Item 1. Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

Selected Financial Data

The following selected consolidated financial data as of December 31, 2003 and 2004 and for the years ended December 31, 2002, 2003 and 2004 have been derived from our audited Consolidated Financial Statements included with this report. These financial statements have been prepared in accordance with U.S. GAAP. The consolidated financial data with respect to 2004 set forth below have been restated to reflect adjustments to our consolidated financial statements contained in our Annual Report on Form 20-F for the year ended December 31, 2004 filed with the United States Securities and Exchange Commission on June 28, 2005. *See* Note 15 to our Consolidated Financial Statements elsewhere in this report for further detail. The consolidated selected financial data as of December 31, 2000, 2001 and 2002 and for the years ended December 31, 2000 and 2001 have been derived from other consolidated financial statements not included in this Form 20-F that were also prepared in accordance with U.S. GAAP and audited by an independent registered public accounting firm. The selected consolidated financial data set forth below should be read in conjunction with and are qualified by reference to Item 5, Operating and Financial Review and Prospects and the Consolidated Financial Statements and notes thereto and other financial information included elsewhere in this Form 20-F/A.

Summary of Consolidated Financial Data

	Year ended December 31,				
	2000	2001	2002	2003	2004
					(As restated)
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenues	$ 48,463	$ 21,171	$ 20,371	$ 26,688	$ 36,806
Cost of revenues	23,478	16,470	13,353	16,535	21,111
Gross profit	24,985	4,701	7,018	10,153	15,695
Operating expenses:					
Research and development expenses, net	13,878	13,253	9,894	8,561	8,665
Sales and marketing expenses	7,998	6,852	6,950	6,534	6,647
General and administrative expenses	3,186	3,032	1,797	1,898	2,331
Other operating expenses (income)	-	1,025	1,478	(2,203)	-
Total operating expenses	25,062	24,162	20,119	14,790	17,643
Operating loss	(77)	(19,461)	(13,101)	(4,637)	(1,948)
Financing income, net	2,858	2,587	144	425	528
Other expenses					
Net loss	$ 2,781	$ (16,874)	$ (12,957)	$ (4,212)	$ 1,420
Earnings (loss) per share:					
Basic earnings (loss) per share	$ 0.20	$ (1.16)	$ (0.88)	$ (0.28)	$ (0.09)

	Year ended December 31,				
Diluted earnings per share	$ 0.19	-	-	-	
Shares used in calculation of basic earnings (loss) per share	13,580	14,578	14,786	14,994	15,259
Shares used in calculation of diluted earnings per share	14,691				

- 2 -

	December 31,				
	2000	2001	2002	2003	2004
					(As restated)
	(in $ thousands)				
Consolidated Balance Sheet Data:					
Working capital	61,270	45,529	34,574	30,350	25,709
Total assets	81,825	59,564	49,008	47,918	49,966
Shareholders' equity	62,619	47,006	35,677	32,336	31,581

Risk Factors

Risks Related to Our Business and Our Industry

Because substantially all our current sales are dependent on a single product line, factors that adversely affect the pricing and demand for this product line could substantially reduce our sales.

Although we have expanded our product offering, we are still currently dependent on a single integrated process control product line targeting the chemical mechanical polishing market. We expect revenues from this product line to continue to account for a substantial portion of our revenues for at least the next year. As a result, factors adversely affecting the pricing of or demand for integrated process controls for the chemical mechanical polishing equipment field, such as competition and technological change, would substantially reduce our sales.

The markets we target are highly cyclical and it is difficult to predict the length and strength of any downturn or expansion period.

The semiconductor capital equipment market and industries are highly cyclical and in 2004 experienced significant expansion. During the first quarter of 2005, however, the market and industries changed direction and exhibited the first signs of a downturn. Although we rely on market research companies, we cannot predict the length and strength of this downturn or any other downturn or expansion. We have only a limited ability to reduce expenses during any industry downturn because of the need for significant ongoing expenditures related to engineering, research and development and worldwide customer service and support operations. Accordingly, we incurred losses in the first quarter of 2005 during this current downturn and we may incur losses during future downturns.

Our inability to reduce spending during a protracted slowdown in the semiconductor industry could reduce our prospects of sustaining profitability.

Historically, we have derived all of our revenues, and we expect to continue to derive all of our revenues, from sales of our products and related services to the semiconductor industry. Our business depends in large part upon capital expenditures by semiconductor manufacturers, which in turn depend upon the current and anticipated demand for semiconductors. The semiconductor industry has experienced severe and protracted cyclical downturns, characterized by slowing product demand, inventory surpluses, accelerated erosion of average selling prices and production overcapacity. These downturns, including the current one, have materially reduced demand for the type of capital equipment and process technology that we offer and our sales and revenues have declined. In addition, our ability to reduce expenses in response to any downturn or slowdown in the rate of capital investment by manufacturers in these industries may be limited because of:

- our continuing need to invest in research and development,
- our capital equipment requirements, and
- our extensive ongoing customer service and support requirements worldwide.

If we do not respond effectively and on a timely basis to rapid technological change, our ability to attract and retain customers could be diminished, which would hurt our sales and ability to remain competitive.

The semiconductor manufacturing industry is characterized by rapid technological change, new product introductions and enhancements and evolving industry standards. Our ability to remain competitive and generate sales revenue will depend in part upon our ability to develop new and enhanced systems at competitive prices in a timely and cost-effective manner and to accurately predict technology transitions. Because new product development commitments must be made well in advance of sales, new product decisions must anticipate the future demand for products. If we fail to correctly anticipate future demand for products, our sales and competitive position would suffer. In addition, the development of new measurement technologies, new product introductions or enhancements by our competitors could cause a decline in sales or loss of market acceptance of our existing products.

We may not be able to develop or market new products, which could slow or prevent our growth.

Our business plan requires the introduction of several new product lines. Our plans to introduce process control products for photolithography, etch and other processes will require development of new capabilities. Some of these projects are in the early stages of development, and we cannot be certain that we will be able to develop or bring to market these new product lines or, if we do, that these products will be well received or profitable. If we are unable to successfully introduce new product lines, our future growth could be adversely affected.

New product lines that we may introduce in the future may contain defects, which will require us to allocate time and financial resources to correct.

Our new product lines may contain defects when first introduced. If there are defects, we will need to divert the attention of our personnel from our product development efforts to address the detection and correction of the defects. In the past, no liability claims have been filed against us for damages related to product defects, and we have not experienced any material delays as a result of product defects. However, we cannot assure you that we will not incur these costs or liabilities or experience these lags or delays in the future. Moreover, the occurrence of such defects, whether caused by our products or the products of another vendor, may result in significant customer relations problems and injury to our reputation and may impair the market acceptance of our products.

We have had a history of losses and may incur future losses.

Since our inception in 1993, we have incurred net losses in every year other than in 1998 and 2000 and may incur a net loss in 2005 or in future years. As of December 31, 2004, we had an accumulated deficit of $41.8 million and incurred a loss of $3.8 million in the first quarter of 2005 due to a significant reduction in sales volumes. We plan to continue similar levels of our aggregate product development, sales and marketing and administrative expenses over the next 12 months. Accordingly, to achieve profitability in 2005, we will need to significantly increase our sales. In the future, our sales may not grow and we may not achieve profitability.

Because we have a limited operating history with one product line, our historical results may not be indicative of our future results, and it is difficult to evaluate our business and prospects.

Our first system for chemical mechanical polishing applications was developed and introduced to the market in October 1995. Because this is the only product line with which we have significant manufacturing and marketing experience and because of our focus on the development and introduction of new products, our past operating results may not be indicative of our future results. Companies in an early stage of product development frequently have higher risks and encounter unexpected expenses and difficulties. These risks, expenses and difficulties apply particularly to us because the semiconductor manufacturing business is a rapidly evolving market characterized by technological advances. The uncertainty of our future performance increases the risk that the value of your investment will decline.

Our dependence on a single manufacturing facility magnifies the risk of an interruption in our production capabilities.

We have only one manufacturing facility, which is located in Ness-Ziona, Israel. Any event affecting this site, including natural disaster, labor stoppages or armed conflict, may disrupt or indefinitely discontinue our manufacturing capabilities and could significantly impair our ability to fulfill orders and generate revenues, thus negatively impacting our business.

We experience quarterly fluctuations in our operating results, which may adversely impact our stock price.

Our quarterly operating results have fluctuated significantly in the past, and we expect this trend to continue. A principal reason is that we derive a substantial portion of our revenue from the sale of a relatively small number of systems to a relatively small number of customers. As a result, our revenues and results of operations for any given quarter may decrease due to factors relating to the timing of orders by, and shipments of systems to, significant customers. Furthermore, our quarterly results are affected by the highly cyclical nature of the semiconductor capital equipment market and industries.

We also have a limited ability to predict revenues for future quarterly periods and face risks of revenue shortfalls due to our limited sales backlog in current periods. If the number of systems we actually ship, and thus the amount of revenues we are able to record in any particular quarter, is below our expectations, the adverse effect may be magnified by our inability to adjust spending quickly enough to compensate for the revenue shortfall.

We may not be able to expand our manufacturing capacity or marketing efforts quickly enough to support our future growth.

Because of our small size and our business strategy to aggressively increase our sales, we anticipate an increased demand on all of our resources. If we do not accurately estimate our need for personnel, manufacturing capacity or marketing and customer support, we may not be able to support our future growth.

We depend on a small number of large customers, and the loss of one or more of them would lower our revenues.

Our customer base is highly concentrated among a limited number of large customers, primarily because the semiconductor industry is dominated by a small number of large companies. We anticipate that our revenues will continue to depend on a limited number of major customers, although the companies considered to be our major customers and the percentage of our revenue represented by each major customer may vary from period to period. The loss of any of one of our major customers would adversely affect our sales and revenues. Furthermore, if any of our customers become insolvent or have difficulties meeting their financial obligations to us for any reason, we may suffer losses.

We operate in an extremely competitive market, and if we fail to compete effectively, our revenues and market share will decline.

Although the market for integrated process control systems used in semiconductor manufacturing is currently concentrated and characterized by relatively few participants, the semiconductor capital equipment industry is intensely competitive. We compete with Nanometrics Inc., Therma-Wave Inc. and Rudolph Technologies Inc., which manufacture and sell integrated process control systems. In addition, we compete with established manufacturers of conventional stand-alone measurement equipment, such as KLA-Tencor Corp., and original semiconductor equipment manufacturers, such as Tokyo Electron Ltd. Established companies, both domestic and foreign, compete with our product line, and new competitors are entering our market. Many of our competitors have greater financial, engineering, manufacturing and marketing resources than we do. If a particular customer selects a competitor s capital equipment, we expect to experience difficulty in selling to that customer for a significant period of time. A substantial investment is required by customers to evaluate, test, select and integrate capital equipment into a production line. As a result, once a manufacturer has selected a particular vendor s capital equipment, we believe that the manufacturer generally relies upon that equipment for the specific production line application and frequently will attempt to consolidate its other capital equipment requirements with the same vendor. We believe that our ability to compete successfully depends on a number of factors both within and outside of our control, including:

the contribution of our equipment to our customers' productivity;

our product quality and performance;

our global technical service and support;

the return on investment (ROI) of our equipment and its cost of ownership;

the breadth of our product line; and

our success in developing and marketing new products.

If we fail to compete in a timely and cost-effective manner against current or future competitors, our revenues and market share will decline.

The ongoing consolidation in our industry may harm us if our competitors are able to offer a broader range of products and greater customer support than we can offer.

We believe that the semiconductor capital equipment market is undergoing consolidation. A number of suppliers have been acquired by larger equipment manufacturers. For example, in 2001 Therma-Wave Inc. acquired Sensys Instruments Corp., in 2002 Rudolph Technologies Inc. acquired ISOA Inc. and in 2003 Applied Materials acquired Boxer Cross Inc. In the first quarter of 2005, our primary competitor, Nanometrics Inc., entered into a merger agreement with August Technologies Inc. We believe that similar acquisitions and business combinations involving our competitors and customers may occur in the future. These acquisitions could adversely impact our competitive position by enabling our competitors and potential competitors to expand their product offerings and customer service, which could provide them an advantage in meeting customers needs, particularly with those customers that seek to consolidate their capital equipment requirements with a smaller number of vendors. The greater resources, including financial, marketing and support resources, of competitors involved in these acquisitions could permit them to accelerate the development and commercialization of new competitive products and the marketing of existing competitive products to their larger installed bases. Accordingly, such business combinations and acquisitions by competitors or customers could jeopardize our competitive position.

Because we are small, we depend on a small number of employees who possess both executive and technical expertise, and the loss of any of these key employees would hurt our ability to implement our strategy and to compete effectively.

Because of our small size and our reliance on employees with both executive and advanced technical skills, our success depends significantly upon the continued contributions of our officers and key personnel. All of our key management and technical personnel have expertise, which is in high demand among our competitors, and the loss of any of these individuals could cause our business to suffer. We do not maintain life insurance policies for our officers and directors.

Our lengthy sales cycle increases our exposure to customer cancellations or delays in orders, which may result in obsolete inventory and volatile quarterly revenues.

Sales of our systems depend, in significant part, upon our customers adding new manufacturing capacity or expanding existing manufacturing capacity, both of which involve a significant capital commitment. We may experience delays in finalizing sales following initial system qualification while a customer evaluates and approves an initial purchase of our systems. In general, for new customers or applications, our sales cycle takes between 3 and 24 months to complete. During this time, we may expend substantial funds and management effort. Lengthy sales cycles subject us to a number of significant risks, including inventory obsolescence and fluctuations in operating results, over which we have little or no control.

Because of the technical nature of our business, our intellectual property is extremely important to our business, and our inability to protect our intellectual property would harm our competitive position.

As of December 31, 2004, we had obtained 40 U.S. patents and had 23 U.S. patent applications pending. In addition, we had obtained 19 foreign patents and had more than 70 foreign patent applications pending.

We cannot assure you that:

- pending patent applications will be approved;
- any patents will be broad enough to protect our technology, will provide us with competitive advantages or will not be challenged or invalidated by third parties; or
- the patents of others will not have an adverse effect on our ability to do business.

We also cannot assure you that others will not independently develop similar products, duplicate our products or, if patents are issued to us, design around these patents. Further, because patents may afford less protection under foreign law than is available under U.S. law, we cannot assure you that any foreign patents issued to us will adequately protect our proprietary rights.

In addition to patent protection, we also rely upon trade secret protection, employee and third-party nondisclosure agreements and other intellectual property protection methods to protect our confidential and proprietary information. Despite these efforts, we cannot be certain that others will not otherwise gain access to our trade secrets or disclose our technology.

There has been significant litigation involving intellectual property rights in the semiconductor and related industries and similar litigation involving Nova could force us to divert resources to defend against this litigation or deter our customers from purchasing our systems.

We have been, and may in the future be, notified of allegations that we may be infringing intellectual property rights possessed by others. In addition, we may be required to commence legal proceedings against third parties, which may be infringing our intellectual property, in order to defend our intellectual property. In the future, protracted litigation and expense may be incurred to defend ourselves against alleged infringement of third party rights or to defend our intellectual property against infringement by third parties. Adverse determinations in that type of litigation could:

- result in our loss of proprietary rights;
- subject us to significant liabilities, including treble damages in some instances;
- require us to seek licenses from third parties, which licenses may not be available on reasonable terms or at all; or
- prevent us from selling our products.

Any litigation of this type, even if we are ultimately successful, could result in substantial cost and diversion of time and effort by our management, which by itself could have a negative impact on our profit margin, competitive position and ability to develop and market new and existing products. For additional information on our intellectual property, including information regarding a civil action we recently commenced against Nanometrics Inc., see Intellectual Property starting on page 23 of this report.

We depend on a limited number of suppliers, and in some cases a sole supplier. Any disruption or termination of these supply channels may adversely affect our ability to manufacture our products and to deliver them to our customers.

We purchase components, subassemblies and services from a limited number of suppliers and occasionally from a single source. Disruption or termination of these sources could occur, and these disruptions could have at least a temporary adverse effect on our operations. To date, we have not experienced any material disruption or termination of our supply sources. A prolonged inability on our part to obtain components included in our systems on a cost-effective basis could adversely impact our ability to deliver products on a timely basis, which could harm our sales and customer relationships.

We are dependent on international sales, which expose us to foreign political and economic risks that could impede our plans for expansion and growth.

Our principal customers are located in the United States, Japan, Taiwan and South Korea and we produce our products in Israel. International operations expose us to a variety of risks that could seriously impact our financial condition and impede our growth. For instance, trade restrictions, changes in tariffs and import and export license requirements could adversely affect our ability to sell our products in the countries adopting or changing those restrictions, tariffs or requirements. This could reduce our sales by a material amount.

Because we derive a significant portion of our revenues from sales in Asia, our sales could be hurt by the instability of Asian economies.

A number of Asian countries have experienced political and economic instability. For instance, Taiwan and China have had a number of disputes, as have North and South Korea, and Japan has for a number of years experienced significant economic instability. We have a subsidiary in Taiwan and we have significant customers in Japan and South Korea. An outbreak of hostilities or other political upheaval or economic downturns in these or other Asian countries would likely harm the operations of our customers in these countries, causing our sales to suffer.

A large number of our ordinary shares continue to be owned by a relatively small number of shareholders, whose future sales of our stock, if substantial, may depress our share price.

If our principal shareholders sell substantial amounts of our ordinary shares, including shares issued upon the exercise of outstanding options, the market price of our ordinary shares may fall. As of December 31, 2004 we had 15,308,544 ordinary shares outstanding, of which 10,216,270 shares were held by nine shareholders.

Because five of our shareholders control approximately 54% of our ordinary shares, they can control the outcome of matters submitted to a vote of our shareholders, including the election of directors.

As of April 30, 2005, five of our shareholders controlled approximately 8.3 million, or 54%, of our ordinary shares. As a result, and although we are currently not aware of any voting agreement between such shareholders, if these shareholders voted together or in the same manner, they would have the ability to control the outcome of corporate actions requiring shareholder approval. Even if these five shareholders do not vote together, each has the ability to influence the outcome of corporate actions requiring shareholder approval. For additional information on our major shareholders, see Major shareholders on page 46.

Risks Related to Operations in Israel

Potential political, economic and military instability in Israel may adversely affect our growth and revenues.

Our principal offices and manufacturing facilities and many of our suppliers are located in Israel. Although most of our sales are currently being made outside Israel, political, economic and military conditions in Israel directly affect our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. Conflicts between Israel and Palestinian militant groups have been ongoing. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. The resumption of hostilities in the region, and the on-going tension in the region, have a negative effect on the stability of the region which might have negative effect on our business and harm our growth and revenues. For further detail see Political and economic conditions in Israel starting on page 38.

Our operations may be disrupted by the obligation of key personnel to perform military service.

Some of our executive officers and employees in Israel are obligated to perform up to 36 days of military reserve duty annually. This time-period may be extended by the Minister of Defense or in the event of a declared national emergency. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees due to military service. To date, our operations have not been materially disrupted as a result of these military service obligations, and no executive officer or key employee was recruited for any significant time period. Any disruption in our operations due to such obligations would adversely affect our ability to produce and market our existing products and to develop and market future products.

Because most of our revenues are generated in U.S. dollars, but a significant portion of our expenses is incurred in New Israeli Shekels, our profit margin may be seriously harmed by inflation and currency fluctuations.

We generate most of our revenues in U.S. dollars, but incur a significant portion of our expenses in New Israeli Shekels, commonly referred to as NIS. As a result, we are exposed to risk to the extent that the rate of inflation in Israel exceeds the rate of devaluation of the NIS in relation to the dollar or if the timing of this devaluation lags behind inflation in Israel with respect to such expenses that might increase as a result of inflation in Israel. In that event, the dollar cost of our operations in Israel will increase and our dollar measured results of operations will be adversely affected. Our operations also could be adversely affected if we are unable to hedge against currency fluctuations in the future. Accordingly, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of the dollar against the NIS. These measures, however, may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

We participate in government programs under which we receive tax and other benefits. These programs impose restrictions on our ability to use the technologies developed under these programs. In addition, the reduction or termination of these programs would increase our costs.

We receive conditional grants from the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade for research and development programs that meet specified criteria. We are also eligible to receive tax benefits under Israeli law for capital investments that are designated as approved enterprises . To maintain our eligibility for these programs and tax benefits, we must continue to meet certain conditions, including paying royalties related to grants received and making specified investments in fixed assets. Some of these programs also restrict our ability to manufacture particular products and transfer particular technology, which was developed as part of the approved enterprises , outside of Israel, by requiring approval of the research and development committee nominated by the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade under applicable law. Such approval may be given only if the recipient abides by all the provisions of the law and related regulations. Approval to manufacture products outside of Israel or consent to the transfer of technology, if requested, might not be granted.

If we fail to comply with these conditions in the future, the benefits received could be cancelled. We could also be required to pay increased taxes or refund any benefits previously received, adjusted for inflation and interest. In 2003 and 2004, we recorded an aggregate of $2.3 million and $1.9 million, respectively, in conditional grants under Israeli government programs. As of December 31, 2004, our contingent liability to the Office of the Chief Scientist for grants received was approximately $4.0 million. See also Note 7A to our consolidated financial statements contained elsewhere in this report. From time to time, we submit requests for new grants from the Office of the Chief Scientist and for expansion of our approved enterprise programs. These requests might not be approv