The Network Professional's Choice

BATM Telco Systems

Annual Report 2004

Directors and Advisers

Directors

P. Sheldon	Chairman, Non-executive
Dr. Z. Marom	Chief executive
O. Bar-Ner	Finance director
Dr. D. Kaznelson	Non-executive
D. Goldman	Non-executive
A. Zochovitzky	Non-executive
K. Gavish	Non-executive

Registered office

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Kfar Netter 40593.

Company Number

520042813

Auditors

Brightman Almagor & Co.
a member firm of
Deloitte Touche Tohmatsu
1 Azriely Center,
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Israel

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Bankers

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Chairman's Statement

Review of the Period

In my statement last year and interim statement for 2004, I indicated that we could look forward to an improved trading performance. Our results for 2004 fully justify those predictions and confirm the upward trend in activity for which we have been positioning ourselves during the severe conditions of the last few years. Our strategy of developing innovative products to the market and strategic partnerships with major customers, combined with a rigorous control of expenditure and focus on margin improvement, have all combined to produce a significant improvement in our results.

We were particularly proud to have been awarded "Best Performing Supplier" status by Nokia, confirming our rigorous approach to the standards of our products.

Our cash position remains extremely strong.

2004 NOKIA QUALITY AWARD
BEST PERFORMING SUPPLIER

Financial Performance

Turnover for the period was $41,218,000 (2003: $37,054,000), reflecting an increase of 11% compared with the prior year. This increase is primarily related to increased demand for new VOIP products and our successful OEM relationships, particularly with Nokia.

Gross profit was $18,206,000 (2003: $11,638,000) reflecting an increase of $6,568,000 or 56%. This increase was the result of the higher turnover for the year and improved gross profit margin. As a percentage of turnover, gross profit margin was 44.1 % (2003: 31.4% and excluding a provision for write down inventory of $3,283,000: 40.2%).

This increase was primarily related to a favorable shift in product mix in the Edgelink product family. Inventory write-down in 2003 related to legacy products in the US and did not recur in 2004.

Selling, general and administrative expenses were $13,044,000 during 2004 compared with $13,431,000 in 2003 reflecting a 3% decrease. We continue with the tight cost control programme that was instigated in 2003 whilst taking care to maintain both high quality customer service and an efficient operating environment.

Gross research and development expenditure in this period was $10,823,000 (2003: $11,247,000). However, after contributions from the Israeli Chief Scientist and from the European Community, net research and development expenditure was $9,909,000 (2003: $10,119,000). Although there was a small decrease (2%) in net spending on research and development, our focused effort on key IP development projects was not compromised. The decrease was primarily because we needed less spending to keep certain maturing product lines fresh.

Operating loss, before goodwill amortization amounted to $4,747,000 (2003: loss $11,912,000) a reduction of $7,165,000 or 60% compared with last year.This improvement in operating results is a result of the increase in gross profit and turnover. Additionally, improved inventory management in 2004 avoided the need for significant inventory write-off in contrast with 2003.

Chairman's Statement

Financial income was $1,702,000 (2003: $1,775,000) and reflected a decrease of 4%.This decrease resulted from a slightly reduced level of average cash, short-term cash investments and long-term cash investments compared with 2003.

The loss after taxes amounted to $ 12,781,000 (2003: loss $20,221,000), giving a loss per Share of 3.29 cents (2003: loss 5.21 cents).

The balance sheet remains strong with cash and near-cash investments of $50.7 million at the year-end (June 2004: $49.5m; December 2003: $51.1m) comprised as follows: Cash and deposits, up to three months duration, of $1.1 million; short-term deposits and bonds, up to one year, of $46.5 million; and long-term bond for more than one year of $3.1 million.

Investment

As indicated in our interim statement the company has benefited from additional income of $ 410,000 from the sale of our 49.9% holding in Eldor Computers Limited.

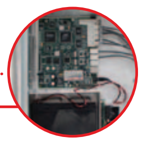
Research and development

Our Research and Development efforts are targeted at the technology revolution presently occurring in the communications industry. Some of our exciting new products designed to meet these emerging requirements are as follows:

VoIP – (Voice over Internet Protocol)

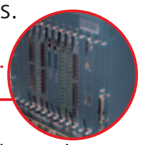
Plans are underway to introduce a new product for small to medium size businesses in June of this year. This product will allow carriers to provide voice and data services over one IP link. Additional interfaces to support multiple links as well as European standards are scheduled for release in the second half of this year.

We continue to enhance our residential solutions to address the needs of this rapidly expanding market. Additional LAN ports as well as support for wireless deployment are also planned for this year.



FTTH – (Fiber to the Home)

We are working to release a new customer premise gateway product to allow cost effective deployment of outdoor solutions. We already have a competing local exchange carrier committed to deploy this product. We continue to add features to integrate the customer premise gateways into our Ethernet switches.



Carrier Class Ethernet

There are many initiatives in progress to address the transitional issues that carriers are faced with as they begin to migrate to IP networks while continuing to maintain their TDM networks. We are expanding our portfolio of products to provide Carrier Class Ethernet solutions. We are certifying multiple platforms for deployment at carriers' central office locations and we are adding capabilities to carry both IP and TDM traffic over Ethernet links. Our support for Ethernet ring deployment is expanding with redundancy functionality that is comparable to traditional transport protocols.

Chairman's Statement

Sales and Marketing

VoIP

We have launched a product aimed at meeting the needs of residential customers of the new VoIP service providers. These providers offer customers with broadband connections a full residential telephone service delivered through their broadband connection over IP. Our product converts the signal from their existing telephones into IP and the IP voice traffic back into speech. It is provided by the service operator to the customer as part of the service. Our residential VoIP product continues to expand its customer base. With the success of 3 major deployments in North America during 2004 (Sun Rocket, US Datanet and one other) we expect the number of major deployments to grow further in 2005. We are also exploring similar opportunities for Voice over Broadband in the International markets.

OEM

Earlier this year we announced a new OEM relationship with Alcatel. This is in line with our previously announced strategy to build relationships with major telecom suppliers. We continue both to expand these relationships as well as work to find new integrators for our carrier class Ethernet based platforms. In 2004, our overall OEM business grew 150% compared with 2003.

Carrier class Ethernet

During 2004, we experienced increased interest in our Carrier Class Ethernet based platforms. The global demand to provide multiple services, especially video services by telecom companies is accelerating the migration from traditional TDM and ATM networks to new all IP networks. Recently, we were selected to provide platforms for this service by 3 providers (one in the US, one in Europe and one in the Far East). We will continue our focus on this growing market in 2005 both in the US and internationally.

Appreciation

At a time when we have reversed a declining trend and enter a period of what we believe will be renewed growth in the Company's activities, I would like to pay tribute to the commitment and efforts of all of our employees over the last few difficult years.

I would particularly like to extend my gratitude to my executive board colleagues, led by Dr. Zvi Marom. They have shown considerable skill in identifying the correct areas of focus for the Company and demonstrated enormous energy in carrying the Company through a most difficult period. I would also like to thank my non-executive board colleagues for their counsel and strategic support, which has been invaluable.

Daniel Goldman, who has been a non-executive director of the company since 1999, has indicated that, in order to be able to concentrate on his growing commercial interests, he will not be offering himself for re-election at the Annual General Meeting. I would like to place on record our deepest thanks for his contribution to the Board during his period of office.

Chairman's Statement

Outlook

We have entered the new financial year in a spirit of quiet optimism. Our improved trading performance is continuing and our relationships with our customers have never been stronger. Our products have proven their quality and reliability in a highly challenging environment. We are firmly based, in every area of our operations, to take advantage of the opportunities that are presenting themselves in our industry, particularly the growth of Voice over IP and the use of Broadband.

I have every expectation that 2005 will prove to be the year in which the Company demonstrates that it has returned to a pattern of growth and profitability.

Peter Sheldon
17 March 2005

Brightman Almagor

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Auditors' Report To the Members of BATM Advanced Communications ltd.

We have audited the balance sheets of BATM Advanced Communications Ltd. ("the Company") and the consolidated balance sheets of the Company and its subsidiaries ("the Group") as at December 31, 2004 and 2003 and the related profit and loss accounts of the Company and the Group and the statements of cash flows of the Group for the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and the Group as at December 31, 2004 and 2003, and the results of operations of the Company and the Group and the cash flows of the Group for the years ended December 31, 2004 and 2003 in accordance with generally accepted accounting principles in Israel. Such accounting principles, as applicable to these financial statements are identical, in all material respects, to generally accepted accounting principles in the United Kingdom, except as indicated in Note 22.

Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu
Israel, March 17, 2005

Consolidated Profit And Loss Accounts

	Note	Year ended December 31,	
		2004	2003
		US$ in thousands, (except per share data)	
Turnover	3	41,218	37,054
Cost of sales		23,012	(*) 25,416
Gross profit		18,206	11,638
Operating expenses			
Research and development costs		10,823	11,247
Less – participation	15.a	914	1,128
Research and development costs, net		9,909	10,119
Selling, general and administrative expenses	4	13,044	(*) 13,431
Amortization of goodwill	10	9,898	9,898
Total operating expenses		32,851	33,448
Operating loss	5	(14,645)	(21,810)
Financial income, net	7	1,702	1,775
Other income, net		423	15
Loss before taxes on income		(12,520)	(20,020)
Taxes on income	21	(142)	(60)
Loss after taxes on income		(12,662)	(20,080)
Group's share in net loss of associated company	10	(119)	(141)
Loss for the year		(12,781)	(20, 221)
Loss per share (in cents)	8	(3.29)	(5.21)

(*) Reclassified

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

Profit And Loss Accounts Of The Company

	Note	Year ended December 31, 2004	2003
		US$ in thousands	
Turnover	3	17,226	10,842
Cost of sales		10,227	(*) 6,853
Gross profit		6,999	3,989
Operating expenses			
Research and development costs		5,358	4,038
Less – participation	15.a	914	1,128
Research and development costs, net		4,444	2,910
Selling, general and administrative expenses	4	3,617	(*) 3,803
Total operating expenses		8,061	6,713
Operating loss	5	(1,062)	(2,724)
Financial income, net	7	1,795	1,969
Other income, net		420	15
Income (loss) before taxes on income		1,153	(740)
Taxes on income	21	(150)	(60)
Income (loss) after taxes on income		1,003	(800)
Company's share in net loss of subsidiaries and associated company	10	(13,784)	(19,421)
Loss for the year		(12,781)	(20,221)

(*) Reclassified

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

Consolidated Balance Sheets

	Note	December 31, 2004	December 31, 2003
		US$ in thousands	
Fixed assets			
Tangible assets, net	9	10,587	10,228
Goodwill	10	2,475	12,373
Total fixed assets		13,062	22,601
Current assets			
Stocks	12	7,425	7,683
Debtors	13	9,779	8,323
Short term investments		46,478	8,406
Cash and cash equivalents		1,153	3,318
		64,835	27,730
Creditors: amounts falling due within one year	14	13,223	10,546
Net current assets		51,612	17,184
Long Term Investments	10		
Long term investments		3,098	39,403
Investments in associated company		-	1,339
Investments in other companies		3,688	3,688
		6,786	44,430
Total assets less current liabilities		71,460	84,215
Non-current liabilities			
Severance pay fund, net of provision	11	(376)	(359)
Net assets		71,084	83,856
Capital and reserves	17		
Share capital	16	1,177	1,177
Additional paid-in capital		397,549	397,540
Foreign currency translation adjustment		16	16
Profit and loss account		(327,658)	(314,877)
Shareholders' funds		71,084	83,856

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

Z. Marom
Chief Executive Officer

O. Bar-Ner
Chief Financial Officer

Balance Sheets Of The Company

	Note	December 31, 2004	December 31, 2003
		US$ in thousands	
Fixed tangible assets		2,612	1,522
Current assets			
Stocks	12	2,443	2,675
Debtors	13	7,532	6,043
Short term investments		46,478	8,406
Cash and cash equivalents		375	2,717
		56,828	19,841
Creditors: amounts falling due within one year	14	8,682	5,388
Net current assets		48,146	14,453
Long Term Investments	10		
Long term investments		3,098	39,403
Investments in subsidiaries		15,739	(*) 25,721
Investments in associated company		-	1,339
Investments in other companies		3,688	3,688
		22,525	70,151
Total assets less current liabilities		73,283	86,126
Non-current liabilities			
Liabilities for subsidiaries	10	(1,875)	(*) (1,961)
Severance pay fund, net of provision	11	(324)	(309)
Total Non-current liabilities		(2,199)	(2,270)
		71,084	**83,856**
Capital and reserves	17		
Share capital	16	1,177	1,177
Additional paid-in capital		397,549	397,540
Foreign currency translation adjustment		16	16
Profit and loss account		(327,658)	(314,877)
Shareholders' funds		**71,084**	**83,856**

(*) Reclassified

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

Consolidated Statements Of Cash Flows

	Note	Year ended December 31, 2004	Year ended December 31, 2003
		US$ in thousands	
Net cash outflow from operating activities	18	(1,924)	(4,884)
Investing activities			
Proceeds from repayment of loan from associated company		477	-
Acquisition of fixed tangible assets		(1,767)	(869)
Proceeds from sale of fixed tangible assets		-	23
Proceeds from (investment in) short term bank investments		1,040	(4,594)
Investment in long term bank deposits		-	(2,000)
Net cash outflow from investing activities		(250)	(7,440)
Financing activities			
Exercise of share based options by employees		9	123
Net cash inflow from financing activities		9	123
Decrease in cash and cash equivalents		(2,165)	(12,201)
Cash and cash equivalents at the beginning of the year		3,318	15,519
Cash and cash equivalents at the end of the year	19	**1,153**	**3,318**

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

Notes To The Financial Statements

Note 1 - General

a. The Company was incorporated in Israel in January 1992. The Company is engaged in the research and development, production and marketing of data communication products in the field of local and wide area networks and premises management systems.

b. The industry in which the Company and its subsidiaries (the "Group") operate is characterized by rapid technological development in a highly competitive environment. The Company depends on a limited number of suppliers and for some components and subcontracting services, a sole supplier. Any disruption or termination of the suppliers' operations may adversely affect the Company's production capabilities.

c. Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Note 2 - Significant Accounting Policies

The principal accounting policies, which have been consistently applied throughout the relevant years, are as follows:

a. Accounting principles

The financial statements are prepared in accordance with GAAP Israel. Such principles, as applicable to these financial statements, are identical in all material respects, to United Kingdom GAAP, except as indicated in Note 22.

b. Presentation of financial information

The financial information has been prepared under the historical cost convention in US Dollars ("dollar" or "$"). The dollar is the functional currency of the Group. Transactions and balances denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are translated into dollars. All exchange gains and losses arising from the translation of monetary balance sheet items are reflected in the profit and loss account as they arise.

Notes To The Financial Statements

Note 2 - Significant Accounting Policies (Cont.)

c. Consolidated financial information

The consolidated financial statements include the financial statements of the Company and those companies over whose operations the Company has effective control ("the subsidiaries"). The results of subsidiaries are included from date of acquisition. Inter company balances and transactions are eliminated on consolidation.

d. Cash Flows

The financial statements do not include a statement of cash flows on a stand-alone basis for the Company since, in the opinion of Management; it would not add significant information to the financial statements.

e. Goodwill

The excess of cost over the Group's share of the net book value of the subsidiaries at the date of acquisition, which cannot be assigned to an identifiable asset, is recorded as goodwill and is amortized over a five to ten-year period based on the straight-line method. Any excess cost that can be assigned to a specific asset is amortized over the same period as that asset.

For impairment of long-lived assets, see k below.

f. Exchange rates and linkage basis

Balances in or linked to currencies other than the dollar are included at the rate of exchange prevailing at the balance sheet date. Details of the changes in the rates of exchange of non-dollar currencies relative to the dollar are as follows:

	As at December 31,	
	2004	2003
Change in the year – increase (decrease)		
New Israeli Shekel	1.65%	8.18%
Pound Sterling	7.57%	11.24%
Euro	7.96%	20.45%

g. Revenue recognition

Revenue from product sales is generally recorded on delivery to the customer, provided that no significant vendor obligations remain outstanding and collection of the related receivable is deemed probable by management.

h. Research and development costs

Research and development costs, net of related grants, are expensed as incurred.

Notes To The Financial Statements

Note 2 - Significant Accounting Policies (Cont.)

i. Cash and cash equivalents

Cash and cash equivalents include deposits in banks with an original maturity of three months or less.

j. Marketable securities

Marketable securities are presented in accordance with principles set by standard 44 of the Institute of Certified Public Accountants in Israel.

k. Fixed assets

Fixed assets are presented at cost less accumulated depreciation and amortization. Depreciation is calculated based on the straight-line method, at annual rates sufficient to write off the assets over their estimated useful lives. In respect of the leasehold improvements, amortization is calculated over the period of the lease, assuming any extension options are exercised.

Rates of depreciation and amortization are as follows:	**%**
Computers and manufacturing equipment	10-33
Motor vehicles	15
Office furniture and equipment	10
Building	2

Management reviews long-lived assets on a periodic basis, as well as when such a review is required based upon relevant circumstances, to determine whether events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. An impairment charge is recorded in the event the carrying amount of an asset exceeds its recoverable value. According to Standard No. 15 of the Israeli Accounting Standards Board, “Impairment of Assets”, an asset’s recoverable value is the higher of the asset’s net selling price and the asset’s value in use, the latter being equal to the asset’s discounted expected cash flows.

l. Stocks

Stocks are stated at the lower of cost and net realizable value. Cost is determined on the “first-in-first-out” basis in respect of raw materials. Finished goods and work in progress are stated at cost, which includes direct labor costs, subcontractors and certain other indirect costs.

m. Investments

Investments in subsidiaries in the Company’s balance sheets and the Group’s investments in a company in which the Group had no effective control but had, until July 2004 “significant influence” (“the associated company”), are presented under the equity method i.e., the investments are presented at cost, plus (less) the share in the net earnings (losses) of the respective entities or other changes in equity which have occurred since acquisition or establishment of the companies.

Notes To The Financial Statements

Note 2 - Significant Accounting Policies (Cont.)

m. Investments (Cont.)

The excess of cost over the share of the net book value of subsidiaries and associated company at the date of acquisition that cannot be directly allocated to a specific asset is amortized over a five to ten-year period based on the straight-line method. Any excess cost that can be allocated to a specific asset is amortized over the same period as such asset. For impairment of long-lived assets, see k above

n. Provision for doubtful debts

The provision for doubtful debts is made in respect of specific debts, the recoverability of which, according to management estimation, is in doubt.

o. Fair value of financial instruments

A financial instrument is defined as cash, evidence of an ownership interest in an entity, or a contract that impose on one entity a contractual obligation either to deliver cash or receive cash or another financial instrument to or from a second entity. Examples of financial instruments include cash and cash equivalents, marketable securities, securities held to maturity, trade accounts receivable, loans, investments, trade accounts payable, accrued expenses, options and forward contracts.

At December 31, 2004 and 2003 the fair market value of the Company's financial instruments did not materially differ from their respective book value.

p. Recent accounting pronouncements by the Israeli accounting standards board

Accounting Standard No. 19 "Taxes on Income" – In July 2004, the Israeli Accounting Standard Board published Accounting Standard No. 19 "Taxes on Income" (the "Standard") which is based on IAS No. 12. The Standard established the guidelines for recognizing, measuring, presenting and disclosing taxes on income in the financial statements. The Standard is effective for financial statements relating to reporting periods commencing on, or after, January 1, 2005. Management estimates that the application of the provisions of the Standard is not expected to have a material effect on the Company's financial position and results of operations.

q. Reclassification

Certain previously reported amounts have been reclassified in these financial statements in order to conform with the 2004 financial statements presentation.

Notes To The Financial Statements

Note 3 - Turnover

Analysis by geographic market (by destination):

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Europe	14,592	9,228	12,876	6,872
America (mainly North America)	23,755	24,086	3,978	2,144
Israel	2,196	1,571	136	120
Far East	610	2,125	236	1,706
Other	65	44	-	-
	41,218	37,054	17,226	10,842

For the year ended December 31, 2004, three customers constitute approximately 37% of the total consolidated turnover, each constituting more than 5%. The major one constitutes -21%. (For the year ended December 31, 2003: four customers, 37% and 15% respectively). For the year ended December 31, 2004 three customers constitute approximately 82% of the Company's turnover. The major one constitutes 49%. (For the year ended December 31, 2003 two customers, 40% and 27%, respectively).

Note 4 - Selling, General And Administrative Expenses

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Selling expenses	9,425	10,025	2,350	2,612
General and administrative expenses	3,619	3,406	1,267	1,191
	13,044	**13,431**	**3,617**	**3,803**

Notes To The Financial Statements

Note 5 - Operating Loss

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Arrived at after charging				
Directors' remuneration (excluding executives)	66	70	66	70
Depreciation and amortization (1)	11,306	11,609	489	512
Auditors' remuneration	140	180	40	40

(1) Including, in the consolidated financial statements for each of the years ended December 31, 2004 and 2003, amortization of goodwill in the amount of $9,898 thousand.

Note 6 - Employees

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2004	2003	2004	2003
	US$ in thousands except employee numbers		US$ in thousands except employee numbers.	
a. The average monthly number of employees during each year, including directors, was:	209	242	90	81
b. Staff costs for all employees, including directors, consist of:				
Wages and salaries	9,286	10,204	2,905	2,669
Wage related expenses	3,063	2,661	1,224	709
	12,349	**12,865**	**4,129**	**3,378**
c. Executive Directors' emoluments:				
CEO and CFO	**619**	**390**	**363**	**316**

Notes To The Financial Statements

Note 7 - Financial Income, Net

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Interest income, net	1,758	1,623	1,798	1,561
Gain from marketable securities	27	102	27	102
Exchange rate differences, net	(83)	50	(30)	306
	1,702	**1,775**	**1,795**	**1,969**

Note 8 - Loss Per Share

Loss per share is based on the loss for the year and the weighted average number of shares in issue throughout each year. The number of shares used in the calculation for 2004 was 388,486,036 (2003 – 388,167,140).

Notes To The Financial Statements

Note 9 - Tangible Assets, Net (Consolidated)

	Building	Computers and manufacturing equipment	Motor vehicles	Offic furniture and equipment	Leasehold improvements	Total
	US$ in thousands					
Acquisition Cost						
At January 1, 2003	7,530	8,716	81	983	126	17,436
Acquisitions	171	665	15	18	-	869
Disposals	-	(83)	(77)	-	-	(160)
At December 31, 2003	7,701	9,298	19	1,001	126	18,145
Acquisitions	936	793	-	38	-	1,767
At December 31, 2004	8,637	10,091	19	1,039	126	19,912
Accumulated depreciation						
At January 1, 2003	350	5,375	12	436	103	6,276
Charge for the year	148	1,464	2	95	2	1,711
Disposals	-	(59)	(11)	-	-	(70)
At December 31, 2003	498	6,780	3	531	105	7,917
Charge for the year	161	1,147	3	94	3	1,408
At December 31, 2004	659	7,927	6	625	108	9,325
Net book value						
At December 31, 2004	**7,978**	**2,164**	**13**	**414**	**18**	**10,587**
At December 31, 2003	**7,203**	**2,518**	**16**	**470**	**21**	**10,228**

Notes To The Financial Statements

Note 10 - Investments In Subsidiaries And Associated And Other Companies

a.1. Details of investments in companies are as follows:

	Country of incorporation	Percentage shareholding at December 31, 2004	December 31, 2004	December 31, 2003
			US$ in thousands	
Subsidiaries (b. below)				
Telco Systems Inc.	U.S.A	100%	5,442	15,998
Batm Real Estate Ltd.	Israel	100%	6,458	6,693
Netwiz Ltd	Israel	100%	3,781	2,981
Others, net		100%	58	49
			15,739	**25,721**
Associated company (c. below)				
Eldor Computers Ltd. (1)	Israel	-	**-**	**1,339**
Other companies				
Netstar Technology Corporation	Taiwan	15.94%	3,087	3,087
Lynx Photonic Networks Inc	Israel	2.87%	601	601
			3,688	**3,688**
			19,427	**30,748**

(1) On July 2004 the Company sold its investment in Eldor Computers Limited (cost $743,000) in exchange for 430,000 marketable shares in Taldor Computer Systems Ltd valued at the date of sale at $1,153,000, giving a profit of $410,000, included in other income and the full repayment of the loan granted to that company.

a.2. Details of liabilities due to subsidiaries are as follows:

	Country of incorporation	Percentage shareholding at December 31, 2004	December 31, 2004	December 31, 2003
			US$ in thousands	
Subsidiaries (b. below)				
Batm GMBH.	Germany	100%	1,506	1,667
Others, net		100%	369	294
			1,875	**1,961**

Notes To The Financial Statements

Note 10 - Investments In Subsidiaries And Associated And Other Companies (Cont.)

b. Composition of investment and liabilities in subsidiaries:

	Company	
	December 31,	
	2004	2003
	US$ in thousands	
Net assets at the date of acquisition	18,767	18,764
Goodwill at original cost	335,739	335,739
Company's shares of post-acquisition losses (1)	(355,385)	(341,720)
Foreign currency translation adjustments	16	16
Long-term inter-company account	14,727	10,961
	13,864	**23,760**

(1) After the amortization of goodwill of $9,898 thousand, for each of the years ended December 31, 2004 and 2003.

c. Composition of investment in associated company (Eldor):

	Consolidated and Company	
	December 31,	
	2004	2003
	US$ in thousands	
Net liabilities at the date of acquisition	-	(297)
Goodwill	-	1,631
Loan	-	476
Company's shares of post-acquisition losses	-	(471)
	-	**1,339**

Notes To The Financial Statements

Note 11 - Severance Pay Fund, Net Of Provision

	Consolidated		Company	
	December 31,		December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Amount funded for severance pay	183	203	183	203
Less - liability	(559)	(562)	(507)	(512)
	(376)	**(359)**	**(324)**	**(309)**

The Group's liability for severance pay is fully provided pursuant to local laws or respective agreements. Part of the Group's liability is funded through amounts deposited with severance pay funds and insurance policies. The insurance policies are owned by the Company and have been entered into by the Company on behalf of individual employees. The amounts accumulated with the insurance company and the savings funds are not under the Company's control or management, and therefore are not reflected in the Company's balance sheet.

Note 12 - Stocks

	Consolidated		Company	
	December 31,		December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Raw materials	3,588	3,200	854	1,067
Work-in-progress	611	778	219	502
Finished goods	3,226	3,705	1,370	1,106
	7,425	**7,683**	**2,443**	**2,675**

Notes To The Financial Statements

Note 13 - Debtors

	Consolidated		Company	
	December 31,		December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Trade debtors (1)	8,436	6,981	2,612	1,645
Participation in research and development:				
Government of Israel	151	228	151	228
Others	234	193	234	193
Related parties	-	-	3,982	3,484
Value added tax	370	213	370	213
Tax authorities	29	111	-	90
Prepaid expenses and other debtors	559	597	183	190
	9,779	**8,323**	**7,532**	**6,043**

(1) Net of provision for doubtful accounts in the consolidated financial statements for the year ended December 31, 2004 and 2003 of $830 thousand and $707 thousand respectively (Company: $479 thousand for each of the two years).

Note 14 - Creditors: Amounts Falling Due Within One Year

	Consolidated		Company	
	December 31,		December 31,	
	2004	2003	2004	2003
	US$ in thousands		US$ in thousands	
Trade creditors	7,618	4,795	4,379	1,547
Wages and related accruals	1,757	1,859	808	701
Related parties	364	358	3,068	2,851
Value added tax	127	13	-	-
Other creditors and accruals	3,357	3,521	427	289
	13,223	**10,546**	**8,682**	**5,388**

Notes To The Financial Statements

Note 15 - Commitments And Contingencies

a. Royalties

The Company and one of its subsidiaries are committed to pay royalties to the Office of the Chief Scientist of the Government of Israel ("Chief Scientist") on proceeds from the sale of products for which the Chief Scientist has provided research and development grants. The royalties are up to the amount of 100%-150% of the grants received (in dollar terms). The royalties payable are at a rate of 3%, for the first three years of product sales; 4%, for the following three years, and 5%, thereafter. The total amount of grants received, net of royalties paid or accrued, as at December 31, 2004 was $6,619 thousand (December 31, 2003 - US$ 6,482 thousand).

Total royalty expenses to the Chief Scientist for the years ended December 31, 2004 and 2003 were $ 341 thousand and $ 57 thousand, respectively. These amounts were included in cost of sales.

In March 2004, the Chief Scientist conducted a review of a prior research and development grants received by the Company Following such review and several negotiations held by the Company with the Chief Scientist's, the Chief Scientist's has requested the repayment of approximately $344 thousands granted by him in the past, part of which was already deducted by it from grants due to the Company. The Company believes the demand is without merit and intends to defend itself against such demand vigorously. The Company's exposure in respect of the above claim is $229 thousands.

b. Lease commitments

The premises of the Group are rented for various periods through 2010 under operating leases. The total future minimum annual rental payment under the above leases, at rates in effect at December 31, 2004, is as follows:

	US$ in thousands
2005	1,140
2006	870
2007	867
2008	867
2009 and thereafter	2,339

c. Stamp duties

There is a potential exposure of the payment of approximately $ 2 million, representing stamp duties connected with some placements made by the Company in the past. According to the position of the Company's legal consultants, in contrast to the position of the Companies' Registrar, an obligation to pay stamp duties arises only when a stamped document exists, and since the placements were not accompanied by a stamped issuance report, such obligation does not exist.

The Company has not provided for such an amount in its financial statements.

Notes To The Financial Statements

Note 15 - Commitments And Contingencies (Cont.)

d. Investment in Telco Inc.

The receiver of an entity from which the Company acquired the investment in Telco Inc., has filed a law suit against Telco for the repayment of certain amounts he claims due to it by Telco. Management of the company is of the opinion that the provision included in the financial statements substantially covers Telco's exposure with this respect.

Note 16 - Share Capital

The share capital of the Company is as follows:

	December 31, 2004		December 31, 2003	
	Authorized	Issued and fully paid	Authorized	Issued and fully paid
Ordinary shares of NIS 0.01 par value	1,000,000,000	388,533,713	1,000,000,000	388,450,380

a. The shares of the Company are traded on the London Stock Exchange.

b. During 2003, the company issued 666,581 shares to employees, in connection to its Share Options Schemes (see below), for a total consideration of $123 thousand.

c. During 2004, the company issued 83,333 shares to employees, in connection to its Share Options Schemes (see below), for a total consideration of $9 thousand.

Share option schemes

A. General Terms

1. 1996 Share Option Schemes

In June 1996 the Company established a Share Option Scheme ("1996 Share option scheme"), which provides for the grant of options and super options, to all eligible directors and employees of the Group or service providers selected by the Board of Directors of the Company ("the eligible employees"). The amount payable for each share is the value, which the Board may, in its absolute discretion, decide, provided that it is not lower than the par value of the share. The aggregate number of unissued shares over which options may be granted under the 1996 Share option scheme on any date of grant is limited to:

a. 5% of the ordinary share capital of the Company then in issue, when aggregated with the number of shares issued and remaining issuable in respect of rights granted (other than super options) within the previous 10 years under the 1996 Share option scheme and any other option scheme operated by the Company or any associated company, or;

Notes To The Financial Statements

Note 16 - Share Capital (Cont.)

b. 10% of the ordinary share capital of the Company then in issue when aggregated with the number of shares issued or remaining issuable in respect of rights granted within the previous 10 years under the scheme or any other option scheme and profit sharing scheme operated by the Company or any associated company.

Any option granted to an eligible employee is limited and takes effect so that the aggregate market value of the shares subject to that option, taken together with the aggregate market value of any other shares which the employee has acquired and which he may acquire on the exercise of any rights granted to him within the previous 10 years to acquire shares under the 1996 Share option scheme and under any other share option scheme operated by the Company or any associated company cannot exceed 8 times his relevant emoluments.

Any option which is not a super option will be limited and take effect so that the aggregate market value of the shares subject to that option must not exceed 4 times the eligible employee's relevant emoluments.

Any super option will be limited and take effect so that the aggregate market value of the shares subject to that option must not exceed 8 times the eligible employee's relevant emoluments.

The exercise of an option may be made subject to the attainment by the Company of a specified level of profits and/or any other objective conditions in relation to the financial performance of the Company, which are considered by the Board to be a fair measure of the performance of the participant.

An option is exercisable in whole or in part, but may not be exercised prior to the expiry of a minimum period, determined by the Board, and not later than the expiry date set by the Board, which shall be no later than the tenth anniversary of the grant of the option, except in the case of super options granted to service providers, which will not be exercisable until 5 years from its grant.

2. 2004 Share option schemes

In November 2004 the Company established a new Share Option Scheme ("2004 Share option scheme"). The Options shall be valid for a period of ten years from the date of grant and thereafter expire. The vesting period pursuant to which options shall vest, and the Grantee thereof shall be entitled to pay for and acquire the exercised shares, shall be such that all options shall be fully vested on the first business day following the passing of three years from the date of grant, as follows: 20% of such options shall vest on the first anniversary of the adoption date, a further 30% on the second anniversary, and 50% on the third anniversary of the adoption date.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 16 - SHARE CAPITAL (CONT.)

SHARE OPTION SCHEMES

B. OPTIONS GRANTED

Since December 1997, the Board of Directors approved the grant of options to certain employees and service providers of the Company. The options generally vest over various periods of three to five years.

The following table summarizes data with respect to the option plans:

	For the year ended December 31,			
	2004		2003	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
Outstanding as of beginning of year	10,026,632	£1.2123	10,658,461	£1.5885
Granted	1,300,000	0.1748	2,349,000	0.1065
Exercised	(83,333)	0.1025	(666,581)	0.1103
Forfeited	(2,305,834)	0.8116	(2,314,248)	2.1397
of year Outstanding as of end	**8,937,465**	**1.1751**	**10,026,632**	**1.2123**
Options exercisable as of end of year	**5,045,519**	**£1.7454**	**4,358,294**	**£1.8821**

	Outstanding as at December 31, 2004			Exercisable as at December 31, 2004	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
NIS 0.01	178,210	5.083	NIS 0.01	142,568	NIS 0.01
£0.1025 - £0.795	6,874,827	7.242	0.1778	3,106,023	0.2183
£1 - £1.705	63,881	5.815	1.1845	53,881	1.2113
£3.725 - £4.4	1,333,047	5.468	4.3550	1,325,547	4.3581
£4.5 - £6.875	487,500	5.548	5.5072	417,500	5.4755
	8,937,465			**5,045,519**	

Weighted Average Grant-Date Fair Value

The weighted average grant-date fair value of the 1,300,000 and 2,349,000 options granted during 2004 and 2003 amounted to £0.17 and £0.10 per option, respectively.

Notes To The Financial Statements

Note 17 - Reconciliation Of Movements In Shareholders' Funds

	Share capital	Additional paid-in capital	Foreign currency translation adjustment	Profit and loss account	Total
	US$ in thousands				
As at January 1, 2003	1,175	397,419	16	(294,656)	103,954
Exercise of options by employees	2	121			123
Loss for the year				(20,221)	(20,221)
As at December 31, 2003	1,177	397,540	16	(314,877)	83,856
Exercise of options by employees (*)	-	9			9
Loss for the year				(12,781)	(12,781)
As at December 31, 2004	**1,177**	**397,549**	**16**	**(327,658)**	**71,084**

(*) less than $1 thousand

Note 18 - Reconciliation Of Net Loss For The Year To Net Cash Outflow From Operating Activities

	Consolidated	
	Year ended December 31,	
	2004	2003
	US$ in thousands	
Loss for the year	(12,781)	(20,221)
Group's share in loss of associated company	119	141
Amortization of goodwill	9,898	9,898
Depreciation and amortization	1,408	1,711
Increase in severance pay fund, net of provision	17	29
Decrease in stocks	258	5,763
Decrease (increase) in debtors	(1,456)	402
Increase (decrease) in creditors	2,677	(1,092)
Gain from selling an Investment in associated company	(410)	-
Gain from marketable securities	(27)	(102)
Interest incurred on investments	(1,627)	(1,453)
Interest incurred on loan for affiliate	-	(27)
Loss on disposal of fixed assets	-	67
Net cash outflow from operating activities	**(1,924)**	**(4,884)**

Notes To The Financial Statements

Note 19 - Analysis Of Cash And Cash Equivalents (Consolidated)

	US$ in thousands
Balance at December 31, 2003	**3,318**
Net cash outflow	**(2,165)**
Balance at December 31, 2004	**1,153**

Note 20 - Non Cash Activities

On July 2004 the Company sold its investment in Eldor Computers Limited (cost $743,000) in exchange for 430,000 marketable shares in Taldor Computer Systems Ltd valued at the date of sale at 1,153,000, giving a profit of $410,000, included in other income.

Note 21 - Taxes On Income

a. Taxation under various laws:

The Company and its Israeli subsidiaries are assessed under the provisions of the Income Tax Law (Inflationary Adjustments), 1985, pursuant to which the results for tax purposes are measured in Israeli currency in real terms in accordance with changes in the Israeli CPI. The Company and its subsidiaries are assessed for tax purposes on an unconsolidated basis.

In accordance with U.S. tax law, Telco Systems made an election to amortize a substantial part of the excess cost paid in its acquisition over a period of 15 years.

b. "Industrial Company"

The Company is an "industrial company" as defined in the Israeli Law for the Encouragement of Industry (Taxes) 1969, and, as such, is entitled to certain tax benefits, mainly increased depreciation rates, the right to claim public issuance expenses and the amortization of patents and other intangible property rights as a deduction for tax purposes.

c. "Approved Enterprise"

The production facilities of the Company have been granted "approved enterprise" status in three separate programs under the Law for the Encouragement of Capital Investments, 1959, as amended. Under this law, income attributable to each of these programs (in a manner prescribed in such law and its regulations) is fully exempt from tax for eight to ten years.

Such period of benefits commences on the first year in which the enterprise generates taxable income (The expiry date of the period of benefits is limited to the earlier of twelve years from commencement of production or fourteen years from the date of the approval.) The period of benefits of the first program commenced in 1992 and ended in 2000.

Notes To The Financial Statements

Note 21 - Taxes On Income (Cont.)

c. "Approved Enterprise" (Cont.)

One of the Israeli subsidiaries has also been granted an Approved Enterprise status for the construction of the Company's plant at Yokneam, on terms similar to the above mentioned.

In the event of a distribution of a cash dividend out of tax-exempt income, as above, the Company will be liable to corporate tax at a rate of 10%-25% (depending on the percentage of foreign shareholders in the Company's equity), in respect of the amount distributed.

Income derived from sources other than the "approved enterprises" is taxable at the regular corporate tax rate of 35% in 2004 and 36% in 2003 (regular "Company Tax"). The regular Company Tax rate is to be gradually reduced to 30% until 2007 (34% in 2005, 32% in 2006 and 30% in 2007).

d. Tax assessments

The Company has received final tax assessments for the years up to and including the 2002 tax year. The subsidiaries have not been assessed for tax since their incorporation.

Note 22 - Material Difference Between Israeli And Uk GAAP

The material difference between Israeli and UK GAAP, as applicable to the Group's financial statements, is the accounting treatment with regard to employees share option schemes. Israeli GAAP does not require any reflection in the financial statements for the difference, if any, at the date of the award, between the fair value of the share and the exercise price of the option. Under UK GAAP (UITF 17) such a difference is charged to the profit and loss account, basically over the vesting period of the options.

Had the Company applied UK GAAP, the loss and the loss per share, for the year ended December 31, 2004, would have increased by $714 thousand and $0.18 per share, respectively (2003 – the loss and the loss per share increased by $1,340 thousand and $0.3 per share, respectively).

Directors' report

Financial Statements

The directors present their report together with the audited financial statements for the year ended 31 December 2004.

Principal Activities and review of the business

BATM's main activities are the research and development, production and marketing of data and telecommunication products in the field of local and wide area networks. The operations of the business are reviewed in full in the Chairman's Statement on pages 1-4.

Results and dividends

The results of the year are set out in the consolidated profit and loss account. After providing $9,898,000 amortization of goodwill for the year, we recorded a loss of $12,781,000. No dividend is being declared for the year.

Directors

The following served as directors during the year.

Peter Sheldon FCA, (63), **non-executive Chairman**, is a Chartered Accountant and International Business Consultant. He is a former finance director of Hambros Bank and has held positions as Chairman and Director of a number of publicly quoted and private companies. He is currently Honorary President of a major UK Charity and his only other commercial appointment is as Non-executive Chairman of Video Domain Technologies Ltd a private Israeli video technology company. He has been a member of the Board of BATM since 1998 and became Chairman in October 1999.

Dr. Dan Kaznelson, M.D., D.M.D. (63), **Senior non-executive**, is a Physician, a former Lecturer at The Tel-Aviv University, a self-educated Database Systems Analyst and Programmer, and a reserve Colonel in the Israel Defense Forces. He has held positions as Chairman and Director of a number of private and publicly quoted companies. He has been a member of the Board of BATM since 1996 and is at present Chairman of the Audit and Remuneration Committees.

Daniel Goldman (35), **non-executive**, is the manager of an Israel based international private equity firm-D.G.Goldman Investments Ltd. He is currently a director of a number of private technology companies in Israel, Europe and the USA as well as being Chairman of Invu Inc, a UK software company quoted on AIM. He is also a director of the Puma II Fund- a technology biased private equity fund. He has been a member of the Board of BATM since 1999.

Directors' report

Directors (Cont.)

Dr. Zvi Marom (50), **Chief Executive Officer,** founded BATM in 1992. He holds degrees in Engineering and Medicine. Prior to establishing BATM, he was the head of the Electronic faculty of the Israeli Open University and senior consultant to several industrial and academic institutions. He graduated in excellence from the naval academy and served in combat command posts. He was awarded the Techmark "Technology Man of the Year" award from the London Stock Exchange in 2000.

Ofer Bar-Ner (40), **Chief Financial Officer** and interim President Telco Systems, joined BATM in 1999. From 1996 he was Chief Financial Officer of Silver Arrow LP, a subsidiary of Elbit Systems and EL-OP, and between 1989 and 1993 he was group manager in the finance Department of Elbit. He graduated in Industrial Engineering and Management from the Technion in Haifa and has an MBA and MA in accounting from Northeastern University in Boston, MA.

Ariella Zochovitzky (48), **CPA, non-executive public external director**, is the general manager & partner of C.I.G. Capital Investments Group Ltd. She is currently a director of a number of public and private companies in Israel including Gazit Globe (1982) Ltd., New Applicom Ltd., Pension Funds at Israel Discount Bank Ltd., Scitex Ltd., Inspire Investments Ltd and Elco Holdings Ltd. She has been a member of the Board of BATM since September 2004.

Koti Gavish (61), **non-executive public external director**, is the Chief Executive Officer of Eihut Capital market Ltd. He is currently a director of a number of public and private companies in Israel including Libber Infrastructure Industries Ltd., Pegasus Technologies Ltd., Ampa Ltd., Superior Cables Ltd., Spark Enterprise Ltd and the Provident Funds of Bank Mercantil Discount Ltd. He has been a member of the Board of BATM since September 2004.

Corporate Governance

Compliance

The Board supports the principles of corporate governance outlined in the Combined Code on Corporate Governance (Code). This statement describes the manner in which the company has applied the principles set out in Section 1 of the code.

The directors consider that throughout the financial year the company has complied with the requirements of Section 1 of the Code, with the exception of A.1.2 in relation to matters specifically reserved for board decision, and A.1.4 in relation to the company secretary.

The Board

The Board generally meets every three months. This is in compliance with Israeli company legislation. There is not a formal schedule of matters specifically reserved to the Board for decision, as set out in A.1.2 of the Code, however, provisions in the Israeli company legislation set out the responsibilities and duties of, and areas of decision for, the Board. These provisions have been fully complied with.

The Board comprises seven directors, five of whom are non-executive directors, under the chairmanship of Peter Sheldon. The Chief Executive is Dr. Zvi Marom. The senior non-executive director is Dr. Dan Kaznelson. All the directors are of a high calibre and standing. The biographies of all the members of the Board are set out on pages 30 and 31. Dr. Zvi Marom, Daniel Goldman, Dr. Dan Kaznelson, Peter Sheldon and Ofer Bar-Ner hold shares in the company and their shareholdings are set out on page 37. All the non-executive directors are independent of management and not involved in any business or other relationship, which could materially interfere with the exercise of their independent judgment.

The induction of newly elected directors into office is the responsibility of the senior independent director (presently Dr. Dan Kaznelson). The new directors receive a memorandum on the responsibilities and liabilities of directors as well as presentations of all activities of the company by senior members of management and a guided tour of the company's premises.

The CEO regularly invites all directors to visit the company premises and its manufacturing facilities. Once per month each director receives a "Flash report" on the company's activities, and information on the performance of the company and a report on the trading and quarterly results of the company are provided at every board meeting. Once per year a budget is discussed and approved by the Board for the following year. All directors are properly briefed on issues arising at Board meetings and any further information requested by a director is always made available.

Under Israeli law it is not a mandatory requirement for a company to have a secretary and the company does not therefore have a formally appointed secretary. However, Mr. Arthur Moher, who is also one of the company's legal advisers, provides the company with all the functions of company secretary and all the directors have access to Mr. Moher's services. The directors are therefore of the opinion that the spirit of A.1.4 of the Code has been complied with.

The directors may take independent professional advice at the company's expense in furtherance of their duties. Independent outside counsel is always present at Board meetings and Board committee meetings.

Corporate Governance

Relations with Shareholders

The company's management generally meets with the institutional shareholders after the publication of its financial statements. The Board supports the use of the annual general meeting to communicate with private investors.

Nominations Committee

The Board has a nominations committee which is chaired by Peter Sheldon. Individuals nominated as directors are elected by the shareholders in general meeting. Executive and non-executive directors are elected by the shareholder's General Meeting for a term of one year. Non-executive public "external" directors, as defined by Israeli Company Law are appointed and elected for a mandatory term of three years, which is renewable for a further term of three years. The re-appointment of a director must be approved by the shareholders in general meeting.

Directors' Remuneration

The Board has a Remuneration Committee, which is chaired by Dr. Dan Kaznelson. Information about the service contracts of the executive directors and the remuneration of directors is set out in the Remuneration Report on page 36 and 37.

Accountability and Audit

Auditors

Brightman Almagor & Co., a member firm of Deloitte Touche Tohmatsu, have expressed their willingness to continue in office and a resolution to re-appoint them will be proposed at the annual general meeting.

Audit Committee

The company has an Audit Committee, which consists of four out of the five non-executive directors, Dr. Dan Kaznelson (Chairman), Mr. Daniel Goldman, Mrs. Ariella Zochovitzky and Mr. Koti Gavish.

The Audit Committee meets a minimum of twice a year and the internal and external auditors also attend the meetings. The Audit Committee adheres to the functions and requirements prescribed to it by the Israeli Companies Act and Israeli law. The Chairman of the Audit Committee maintains close contact with the company on a weekly basis.

The "Market Abuse Directive"

The Board of Directors has established a committee in order to study the draft "Market Abuse Directive" and to supervise the implementation of the guidelines laid down in the "Market Abuse Directive".

Internal Control

The Board of directors has overall responsibility for ensuring that the company maintains adequate systems of internal control. To this end, in accordance with Israeli Company Law requirements, the company's Board of Directors appointed Mr. Ezra Yehuda, CPA, as an independent internal auditor, after he was interviewed and recommended by the Audit Committee, as prescribed by Israeli corporate law. The internal auditor reports to the Audit Committee, and is responsible for ensuring that the company is run according to good corporate practice.

Risk management is currently reviewed on an ongoing basis by the Board as a whole.

The key features of the financial controls of the company include a comprehensive system of financial reporting, budgeting and forecasting, and clearly laid down accounting policies and procedures. The Board of the company is furnished with detailed financial information on a monthly basis.

Directors' Remuneration

Statement of Directors' Responsibilities

After making enquiries, the Directors have a reasonable expectation that the Company and its subsidiaries have adequate resources to continue in operational existence for the foreseeable future. For this reason, they have adopted the going concern basis in preparing the financial statements.

Company law requires the Directors to prepare financial statements for each financial period, which give a true and fair view of the state of affairs of the Company and the group, and of the profit and loss of the group for the period. In preparing these financial statements, the Directors are required to: select suitable accounting policies and then apply them consistently; make judgments and estimates that are reasonable and prudent; state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the group and to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Environmental Policy

The Directors recognize the importance of the Company meeting its environmental objectives.

The Company's environmental policy is to:

- Meet the statutory requirements placed on it;
- Adopt good environmental practice in respect of premises, product development and manufacturing, and consumption of resources;
- Aim to recycle as much of its waste products as it is economically practicable to do.

The Company has begun implementing the recommendations of ROHS (The Restriction of Hazardous Substances in Electrical and Electronic Equipment (ROHS) Directive (2002/95/EC), and as from year 2006, all its products will be fully ROHS compatible.

Remuneration Committee and Remuneration Report

The remuneration committee consists of three out of the five non-executive directors. As presently constituted, the committee consists of Dr. Dan Kaznelson, Daniel Goldman and Koti Gavish. Dr. Dan Kaznelson serves as chairman. The committee is responsible for recommendation to the board of the remuneration strategy and policy of the company for determining the short and long-term incentive pay structures for the executive directors. With the exception of the "public external" non-executive directors who serve for a period of three years in accordance with Israeli company law, all directors have to be re-elected by the shareholders at AGM, if proposed for re-election.

Directors' Remuneration

In accordance with Israeli company law, the Board recommends and the general meeting of the Company is asked to approve, the remuneration of the executive and non-executive directors of the company, after it has been first approved by the company's Remuneration Committee. The remuneration of the executive and non-executive directors of the company for the year ended 31 December 2004 was as follows:

Executive Directors in 2004

Dr. Zvi Marom - CEO - earned a basic salary of $200,000 and social benefits as are normally granted by employers in Israel. An annual bonus, based on the rate of increase in net profit of each year, is also payable, the terms having been approved at the Company's last AGM on 7, September 2004. No bonus was payable in respect of either 2003 or 2004.

Ofer Bar-Ner - CFO - earned a basic salary of $132,000 per year plus social benefits during his relocation to the USA when serving as interim CEO of Telco. After his return to Israel, his salary was adjusted back to its previous level of $83,000. The amount below includes a special grant covering the expenses of Mr. Bar-Ner's relocation to the USA. This grant was approved by the shareholders at the previous AGM.

	2004 Salary and Benefits US$ in thousands	2003 Salary and Benefits US$ in thousands
Dr. Zvi Marom	263	242
Ofer Bar-Ner	356	148

Non-executive directors in 2004

The non-executive Chairman is remunerated at a rate of $18,000 per annum, plus $3,000 for each Board or other meeting attended. Dr. Dan Kaznelson and Daniel Goldman, are paid $9,000 per annum and $1,500 per meeting respectively. Mrs. Ariella Zochovitzky and Mr. Koti Gavish, the public external directors, were remunerated in accordance with Israeli Company Law provisions for such appointees. In addition they received a remuneration package of 200,000 share options each per annum, as approved by the Shareholders Annual Meeting at the time of their election as directors.

The Chairman's remuneration reflects both his responsibility and the fact that, as a resident of the UK, he has to travel to Israel for board meetings. These fees were arrived at by reference to fees paid by other companies of similar size and complexity and reflected the amount of time that non-executive directors are expected to devote to the company's activities during the year.

	2004 Fees US$ in thousands	2003 Fees US$ in thousands
Peter Sheldon	36	35
Dr. Dan Kaznelson	15	14
Daniel Goldman	15	15
Ariella Zochovitzky	2	-
Koti Gavish	2	-

Directors' Remuneration

Directors' interest in shares

The directors of the company are listed below together with their beneficial interests in the shares of the company at the beginning and end of the financial year.

	0.01 NIS Ordinary Shares fully paid	0.01 NIS Ordinary Shares fully paid
	2004	2003
Dr. Zvi Marom	101,750,900	101,750,900
Daniel Goldman	-	-
Dr. Dan Kaznelson	135,300	135,300
Peter Sheldon	100,000	100,000
Ofer Bar-Ner	58,600	58,600

Directors' options (Accumulated)

	Number of options	Number of options
	2004	2003
Dr. Zvi Marom *	700,000	400,000
Ofer Bar-Ner **	333,333	2,000,000

***** The grant is of :

a. 400,000 options exercisable into 100,000 ordinary shares of the company per year commencing on July 1, 2000 and on July 1, of every subsequent year. Each option vests and is exercisable 24 months from the date of each grant, at a price equal to the then current market price less ten per cent.

b. The additional 300,000 options granted at an exercise price of £0.20 per share these options will vest at a rate of 100,000 options annually on July 1st of each year commencing from July 1, 2004.

****** The options vested fully on January 1, 2004 at exercise price of £0.2648.