The Network Professional's Choice

BATM

Telco Systems

Annual Report 2003

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

Registered office

22 Hamelaha Street
Rosh Ha'ayn 48091
Israel

Company Number

520042813

Auditors

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

Financial Advisers & Stock brokers

Dresdner Kleinwort Wasserstein
20 Fenchurch Street
London EC3P 3DB
UK

Shore Capital
Bond Street House
14, Clifford Street
London W1X 1RE
UK

Corporate Solicitors in Israel

Rami Lehavi and Co.
20 Hachashmal Street
Tel-Aviv
Israel

Corporate Solicitors in the UK

Fladgate Fielder
25 North Row
London W1R 1DJ
UK

Bankers

Bank Hapoalim
Belinson, 1 Denmark Street
Petach-Tikva
Israel

Registrars

Capita Registrars
The Registry
74 Beckenham Road
Beckenham
Kent
BR3 4TU
UK

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Chairman's Statement

Review of the Period

As I predicted in my annual statement last year and our interim statement for the year under review, 2003 was a difficult and challenging one for our industry and no less for BATM. However, it was also the year in which the first signs of recovery began to appear, signs which have begun to be reflected in our results. Continuing tight control of margins and expenditure has played its part in offsetting the lower level of sales achieved, whilst our maintenance of the valuable research and development programme, relevant to the needs of our customers, has opened up new sales opportunities for us.

Fundamental to the steps we have taken during the recession in our industry has been the preservation of cash and we have ended the year, once again, with the majority of our cash resources intact.

Financial Performance

Turnover for the period was $37,054,000 (2002: $48,661,000), a decrease of 24% on the prior year. This decrease is primarily related to lower sales of legacy products in the U.S. market, which declined by 49% against 2002. However, a general improvement was seen in the second six months of the year and turnover for the second half of 2003 increased 7% compared with the first half of 2003. We are particularly encouraged to report that during the second half of 2003, turnover of our EdgeLink products experienced a 32% increase compared with the first half of 2003.

Gross profit margin improved to 40.7% of turnover (2002: 39.8%) excluding a provision for write down inventory of $3,283,000 (2002: $166,000). This increase was primarily related to higher gross profit on newly designed EdgeLink products. The inventory write down is mostly related to our legacy products in the U.S..

Selling, general and administrative expenses were $13,598,000 during 2003 compared with $17,535,000 in 2002 reflecting a 22% decrease. This lower spending trend was reflected in both the first and second halves of the year which were 27% and 16% lower than the previous respective periods. Reductions in non-core expenditure and strict spending controls contributed to this reduction.

Gross research and development expenditure in this period was $11,247,000 (2002: $12,779,000). However, after contributions from the Israeli Chief Scientist and from the European Community, net research and development expenditure was $10,119,000 (2002: $12,185,000). The reduction in research and development expense reflected strict cost controls and a more focused effort on key projects for the immediate future.

Operating loss, before goodwill amortization and write down of investment and inventory, amounted to $8,629,000 (2002: loss $10,333,000) a reduction of $1,704,000 or 16% compared with last year.

Financial income was $1,775,000 (2002: $1,388,000), reflecting higher average interest rates on a slightly reduced level of cash and other investment balances.

The loss after taxes amounted to $20,221,000 (2002: loss $20,570,000), giving a loss per share of 5.21 cents (2002: loss 5.31 cents).

The balance sheet remains strong with cash and cash investments of $51.1 million at the year-end comprised as follows: Cash and deposits, up to three months duration of $3.3 million; short-term deposits, up to one year of $8.4 million; and long-term deposits for more than one year of $39.4 million.

Research and Development

During 2003, we continued to make progress on several new IP products. We completed a new version of our T5 Compact with Target Identifier (TID) capability for internal use by carriers in their networks. Also in 2003, our OTM1000 OC3 terminal multiplexer successfully passed Telcordia testing and completed the OSMINE process. We continued to provide enhancements on our EdgeLink HUB to include STS and OC3 capability in 2004. The T (Titan) family continues to expand with new members such as our T5G and T6Pro with improved, extended and unique telecom features. More are expected to be added during 2004 in order to create a complete IP access based solution for carriers and providers.

CHAIRMAN'S STATEMENT

SALES AND MARKETING

Although turnover in 2003 was less than 2002, we experienced some signs of an improving trend as the year progressed. Turnover of our EdgeLink family of products in the second half of 2003 was 32% greater than the first half of 2003. This increase was primarily related to early success of our new EdgeLink HUB product with some new customers. Our strategy of focusing on major customers paid off in 2003 when we were selected to provide our EdgeLink 100 and EdgeLink HUB M13 multiplexer products to a new major U.S. carrier customer. In addition, we continue to see more customers evaluating these and other products in their laboratories.

Our first SONET product, the OTM 1000 terminal multiplexer, introduced in early 2003 has completed initial testing at some carrier customers. This product, which has received early industry recognition, allows service providers to optically deliver a combination of traditional T1 and T3 services and Ethernet services to their customers' demarcation points. We continue to work to increase the number of major customers we are serving in our main markets. We shall also continue to address the smaller carriers in the U.S. who are recovering from the downturn while maintaining our primary focus on the major carriers.

During 2003, our new T5 Compact was approved for use by a major carrier. In addition, the T5 Compact with Target Identifier (TID), one of our new IP platforms, is now in a customer's laboratory. These products will increase our penetration of the carriers' internal IP networks.

Beginning in 2004, we have increased our focus on the VoIP market where significant technology advances will change the way that service providers do business. Our Access201 and Access211 VoIP Media Gateway products employ superior quality voice technology to provide an effective solution for service providers to migrate their customers to IP-based networks. These products are designed to fit the new Voice Over Network (VON) model.

We continue to add more platforms to complement our Ethernet based Fiber To The Home solutions. The T6Pro and other new members of the fiber based T5C family of products will position us to provide a comprehensive solution from the carriers' central office to the customer site. Our unique solutions offer both active and passive Ethernet based technology for easier and more cost effective fiber based services.

We continue to develop other trading relationships in the telecom sector most notably with Nokia as it expands its 3G activity.

OUTLOOK

2004 to date is showing a continuation of the positive trend that appeared in the latter part of last year. Our products are increasingly being selected for evaluation and subsequent adoption after rigorous testing in a highly competitive and demanding market-place and we have some important contract wins under our belt. The nature of our customer base is such that there is an inevitable time-lag between the introduction of new products and resultant increased sales activity. However, the improving climate in our industry, combined with the manner in which we have positioned ourselves, suggests that we have witnessed the bottom of the downtown of the last few years and that we can now look forward to a resumption of growth in sales.

Peter Sheldon

26 March 2004

AUDITORS' REPORT

TO THE SHAREHOLDERS 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, 2003 and 2002 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, 2003 and 2002. 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, 2003 and 2002, and the results of operations of the Company and the Group and the cash flows of the Group for the years ended December 31, 2003 and 2002 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 21.

Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu
Israel, March 16, 2004

BATM Advanced Communications

Consolidated Profit and Loss Accounts

	Note	Year ended December 31, 2003	2002
		US$ in thousands, (except per share data)	
Turnover	3	37,054	48,661
Cost of sales		25,249	29,440
Gross profit		**11,805**	**19,221**
Operating expenses			
Research and development costs		11,247	12,779
Less – participation	15.a	1,128	594
Research and development costs, net		10,119	12,185
Selling, general and administrative expenses	4	13,598	17,535
Amortization of goodwill	10	9,898	9,303
Write-down of an investment	10 a (1)	-	2,000
Total operating expenses		**33,615**	**41,023**
Operating loss	5	**(21,810)**	**(21,802)**
Financial income, net	7	1,775	1,388
Other income (expenses), net		15	(9)
Loss before taxes on income		**(20,020)**	**(20,423)**
Taxes on income (tax benefit)	20	(60)	4
Loss after taxes on income		**(20,080)**	**(20,419)**
Group's share in net loss of associated company	10	(141)	(151)
Loss for the year		**(20,221)**	**(20,570)**
Loss per share (in cents)	8	**(5.21)**	**(5.31)**

The accompanying notes are an integral part of these financial statements

BATM Advanced Communications

Profit and Loss Accounts of the Company

	Note	Year ended December 31, 2003	2002
		US$ in thousands	
Turnover	3	10,842	14,528
Cost of sales		6,791	8,613
Gross profit		**4,051**	**5,915**
Operating expenses			
Research and development costs		4,038	4,115
Less – participation	15.a	1,128	561
Research and development costs, net		2,910	3,554
Selling, general and administrative expenses	4	3,865	3,501
Write down of an investment	10 a (1)	-	2,000
Total operating expenses		**6,775**	**9,055**
Operating loss	5	**(2,724)**	**(3,140)**
Financial income, net	7	1,969	961
Other income (expenses), net		15	(8)
Loss before taxes on income		**(740)**	**(2,187)**
Taxes on income	20	(60)	(3)
Loss after taxes on income		**(800)**	**(2,190)**
Company's share in net loss of subsidiaries and associated company	10	(19,421)	(18,380)
Loss for the year		**(20,221)**	**(20,570)**

The accompanying notes are an integral part of these financial statements

BATM Advanced Communications

Consolidated Balance Sheets

	Note	December 31, 2003	December 31, 2002
		US$ in thousands	
Fixed assets			
Tangible assets, net	9	10,228	11,160
Goodwill, net	10	12,373	22,271
Total fixed assets		**22,601**	**33,431**
Current assets			
Stocks	12	7,683	13,446
Debtors	13	8,323	8,725
Short term investments		8,406	3,682
Cash and cash equivalents		3,318	15,519
		27,730	**41,372**
Creditors: amounts falling due within one year	14	10,546	11,638
Net current assets		**17,184**	**29,734**
Long Term Investments	10		
Long term deposits		39,403	35,978
Investments in associated company		1,339	1,453
Investments in other companies		3,688	3,688
		44,430	**41,119**
Total assets less current liabilities		**84,215**	**104,284**
Non-current liabilities			
Severance pay fund, net of provision	11	(359)	(330)
Net assets		**83,856**	**103,954**
Capital and reserves	17		
Share capital	16	1,177	1,175
Additional paid-in capital		397,540	397,419
Foreign currency translation adjustment		16	16
Profit and loss account		(314,877)	(294,656)
Shareholders' funds		**83,856**	**103,954**

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, 2003	December 31, 2002
		US$ in thousands	
Fixed tangible assets		1,522	1,299
Current assets			
Stocks	12	2,675	3,670
Debtors	13	13,543	8,257
Short term investments		8,406	3,682
Cash and cash equivalents		2,717	13,937
		27,341	29,546
Creditors: amounts falling due within one year	14	5,388	3,682
Net current assets		**21,953**	**25,864**
Long Term Investments	10		
Long term deposits		39,403	35,978
Investments in subsidiaries		16,260	35,995
Investments in associated company		1,339	1,453
Investments in other companies		3,688	3,688
		60,690	77,114
Total assets less current liabilities		**84,165**	**104,277**
Non-current liabilities			
Severance pay fund, net of provision	11	(309)	(323)
Net assets		**83,856**	**103,954**
Capital and reserves	17		
Share capital	16	1,177	1,175
Additional paid-in capital		397,540	397,419
Foreign currency translation adjustment		16	16
Profit and loss account		(314,877)	(294,656)
Shareholders' funds		**83,856**	**103,954**

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

Consolidated Statements of cash flows

	Note	Year ended December 31, 2003	2002
		US$ in thousands	
Net cash outflow from operating activities	18	(4,884)	(2,959)
Investing activities			
Repayment of loan to associated company		-	1,069
Acquisition of fixed tangible assets		(869)	(509)
Proceeds from sale of fixed tangible assets		23	28
Proceeds from (investment in) short term investments		(4,594)	1,245
Investment in long term bank deposits		(2,000)	(35,222)
Net cash outflow from investing activities		**(7,440)**	**(33,389)**
Financing activities			
Exercise of options and shares by employees		123	177
Repayment of short-term credit, net		-	(7)
Net cash inflow from financing activities		**123**	**170**
Decrease in cash and cash equivalents		(12,201)	(36,178)
Cash and cash equivalents at the beginning of the year		15,519	51,697
Cash and cash equivalents at the end of the year	19	**3,318**	**15,519**

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 Group depends on a limited number of suppliers for some components and at times 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 in Israel. Such principles, as applicable to these financial statements, are identical in all material respects, to United Kingdom GAAP, except as indicated in Note 21.

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 in thousands. 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.

c. Consolidated financial information
The consolidated financial statements include the financial statements of the Company and those companies over whose operation 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 at the same rate as that asset.
Management reviews investments for impairment whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable based on estimated future undiscounted cash flows. If so indicated, an impairment loss would be recognized for the difference between the carrying amount of the investment and its fair value.

Notes to the Financial Statements

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

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,	
	2003	2002
Change in the year – increase (decrease)		
New Israeli Shekel	8.18%	(6.78) %
Pound Sterling	11.24%	11.19 %
Euro	20.45%	18.56 %

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.

I. Cash equivalents

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

J. 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

K. 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.

Notes to the Financial Statements

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

l. Investments

Investments in subsidiaries in the Company's balance sheets and the Group's investments in a company in which the Group has no effective control but has "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.

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 at the same rate as such asset.

m. 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.

n. 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 available for sale, securities held to maturity, trade accounts receivable, loans, investments, trade accounts payable, accrued expenses, options and forward contracts.

At December 31, 2003 and 2002 the fair market value of the Company's financial instruments did not materially differ from their respective book value.

Notes to the Financial Statements

NOTE 3 - TURNOVER

Analysis by geographic market (by destination):

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Europe	9,228	8,926	6,872	6,140
Americas (mainly North America)	24,086	34,693	2,144	5,747
Israel	1,571	2,246	120	450
Far East	2,125	2,771	1,706	2,191
Other	44	25	-	-
	37,054	48,661	10,842	14,528

For the year ended December 31, 2003, four customers represented approximately 37% of the total consolidated turnover, each represented more than 5%. The major one represented 15%. (For the year ended December 31, 2002: three customers, 37% total and the major one represented 19%). For the year ended December 31, 2003, two customers represented approximately 40% of the Company's turnover. The major one represented 27%. (For the year ended December 31, 2002 four customers, 41% total and the major one represented 12%).

NOTE 4 - SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Selling expenses	10,192	13,341	2,674	2,022
General and administrative expenses	3,406	4,194	1,191	1,479
	13,598	17,535	3,865	3,501

NOTE 5 - OPERATING LOSS

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Arrived at after charging				
Director's remuneration (excluding executives)	70	92	70	92
Depreciation and amortization (1)	11,609	11,980	512	521
Write-down of an investment (2)	-	2,000	-	2,000
Auditors' remuneration	160	160	40	50

(1) Including, in the consolidated financial statements for the years ended December 31, 2003 and 2002, amortization of goodwill in the amount of $9,898 and $9,898, respectively.

(2) See Note 10 a (1).

Notes to the Financial Statements

NOTE 6 - EMPLOYEES

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
a. The average monthly number of employees during each year, including directors, was:	242	261	81	95
b. Staff costs for all employees, including directors, consist of:				
Wages and salaries	10,204	14,047	2,669	3,043
Wage related expenses	2,661	3,647	709	745
	12,865	**17,694**	**3,378**	**3,788**
c. Director's emoluments:				
CEO and CFO	**390**	**369**	**316**	**291**

NOTE 7 - FINANCIAL INCOME, NET

	Consolidated		Company	
	Year ended December 31,		Year ended December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Interest income, net	1,623	1,478	1,561	1,336
Gain (loss) from marketable securities	102	(38)	102	(38)
Exchange rate differences, net	50	(52)	306	(337)
	1,775	**1,388**	**1,969**	**961**

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 2003 was 388,167,140 (2002 – 387,248,601).

Notes to the Financial Statements

NOTE 9 - TANGIBLE FIXED ASSETS (Consolidated)

	Building	Computers and manufacturing equipment	Motor vehicles	Office furniture and equipment	Leasehold improvements	Total
	US$ in thousands					
Acquisition Cost						
At January 1, 2002	7,530	8,405	175	795	116	17,021
Acquisitions	-	311	-	188	10	509
Disposals	-	-	(94)	-	-	(94)
At December 31, 2002	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
Accumulated depreciation						
At January 1, 2002	202	3,572	58	327	92	4,251
Charge for the year	148	1,803	11	109	11	2,082
Disposals	-	-	(57)	-	-	(57)
At December 31, 2002	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
Net book value						
At December 31, 2003	**7,203**	**2,518**	**16**	**470**	**21**	**10,228**
At December 31, 2002	**7,180**	**3,341**	**69**	**547**	**23**	**11,160**

(*) In December 2003 the Company signed an agreement to acquire a building in Netanya, Israel. The total amount of the acquisition was $1,000 and was fully paid by May 2004.

Notes to the Financial Statements

NOTE 10 - INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED AND OTHER COMPANIES

A. Details of investments in companies are as follows:

	Country of incorporation	Percentage shareholding at December 31, 2003	December 31, 2003	December 31, 2002
			US$ in thousands	
Subsidiaries (b. below)				
Telco Systems Inc.	U.S.	100%	8,498	28,476
BATM Plant Ltd.	Israel	100%	6,693	6,889
Others, net		100%	1,069	630
			16,260	35,995
Associated company (c. below)				
Eldor Computers Ltd.	Israel	49.9%	1,339	1,453
Other companies				
Netstar Technology Corp. (1)	Taiwan	15.94%	3,087	3,087
Lynx Photonic Networks Inc.	Israel	2.87%	601	601
			3,688	3,688
			21,287	41,136

(1) In 2002 Netstar issued 19.9% of its share capital to a third party for consideration of approximately $4,300. As a result, the Company's share in Netstar decreased to 15.94%. Since the new issuance in 2002 reflected, according to Management's estimates, a decrease in Netstar's value, the Company wrote-down $2,000 of its investment in Netstar.

B. Composition of investment in subsidiaries:

	Company December 31, 2003	Company December 31, 2002
	US$ in thousands	
Net assets (liabilities) at the date of acquisition	18,764	18,764
Goodwill at original cost	335,739	335,739
Company's shares of post-acquisition earnings (losses) (1)	(341,720)	(322,440)
Foreign currency translation adjustments	16	16
Long-term inter-company account	3,461	3,916
	16,260	35,995

(1) After the amortization and write-off of goodwill of $9,898 and $9,898, for the years ended December 31, 2003 and 2002, respectively.

Notes to the Financial Statements

NOTE 10 - INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED AND OTHER COMPANIES (Cont.)

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

	Consolidated and Company	
	December 31,	
	2003	2002
	US$ in thousands	
Net liabilities at the date of acquisition	(297)	(297)
Goodwill	1,631	1,631
Loan (1)	476	449
Company's shares of post-acquisition losses (2)	(471)	(330)
	1,339	1,453

(1) The loan is linked to the Israeli consumer price index and bears annual interest of 4.5%. The loan, including interest, is payable upon demand by the Company.

(2) Includes amortization of goodwill of $326 for each of the years ended December 31, 2003 and 2002. The net goodwill in the financial statments for the years ended December 31, 2003 and 2002 was $435 and $761, respectively.

d. Composition of investments in other companies:

	Consolidated and Company	
	December 31,	
	2003	2002
	US$ in thousands	
Lynx Photonic Networks Inc.	601	601
Netstar Technology Corp.	3,087	3,087
	3,688	3,688

NOTE 11 - SEVERANCE PAY FUND, NET OF PROVISION

	Consolidated		Company	
	December 31,		December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Amount funded for severance pay	203	163	203	163
Less - liability	(562)	(493)	(512)	(486)
	(359)	(330)	(309)	(323)

The Company's liability for severance pay is fully provided pursuant to Israeli law. Part of the 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.

Notes to the Financial Statements

NOTE 12 - STOCKS

	Consolidated		Company	
	December 31,		December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Raw materials	3,200	4,890	1,067	1,717
Work-in-progress	778	1,193	502	682
Finished goods	3,705	7,363	1,106	1,271
	7,683	13,446	2,675	3,670

NOTE 13 - DEBTORS

	Consolidated		Company	
	December 31,		December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Trade debtors (1)	6,981	7,247	1,645	1,133
Participation in research and development:				
Government of Israel	228	315	228	315
Others	193	-	193	-
Related parties	-	-	10,984	6,232
Value added tax	213	93	213	93
Tax authorities	111	189	90	175
Prepaid expenses and other debtors	597	881	190	309
	8,323	8,725	13,543	8,257

(1) Net of provision for doubtful accounts in the consolidated financial statements for the year ended December 31, 2003 and 2002 was $707 and $764, respectively (Company: $479 and $350, respectively).

NOTE 14 - CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Consolidated		Company	
	December 31,		December 31,	
	2003	2002	2003	2002
	US$ in thousands		US$ in thousands	
Trade creditors	4,795	5,238	1,547	796
Wages and related accruals	1,859	1,701	701	595
Related parties	358	331	2,851	1,947
Value added tax	13	45	-	-
Other creditors and accruals	3,521	4,323	289	344
	10,546	11,638	5,388	3,682

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 between 100%-150% of the grants received.
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, 2003 was $6,482 (December 31, 2002 - $ 6,280).

Total royalty expenses to the Chief Scientist for the years ended December 31, 2003 and 2002 were $57 and $89, respectively. These amounts were included in selling expenses.

In March 2004, the Office of the Chief Scientist ("Chief Scientist") conducted a review of a prior research and development grant received by the company in the amount of $1,100 and concluded that certain conditions of the grant had not been satisfied. Accordingly, the Chief Scientist has made a demand on the company to repay the entire amount. The Company believes the demand is without merit and intends to defend itself against such demand vigorously. No provision is included in the financial statements with respect to the Chief Scientist's demand.

B. LEASE COMMITMENTS

The premises of the Company and its subsidiaries 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, 2003, is as follows:

Year	US$ in thousands
2004	1,156
2005	1,110
2006	867
2007	867
2008 and thereafter	3,207

C. LEASE VEHICLES

The Company leases vehicles under operating lease agreement, which expire on May 2006. The minimum rental payments are as follows:

Year	US$ in thousands
2004	348
2005	348
2006	145

Vehicle lease expense amounted to $330 and $348 for the years 2003 and 2002, respectively.

D. STAMP DUTIES

There is a potential exposure of the payment of approximately NIS 8 million, representing stamp duties connected with some placements made by the Company in the past. According to the position of the Company's legal advisers, 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 16 - SHARE CAPITAL

The share capital of the Company is as follows:

	December 31, 2003		December 31, 2002	
	Authorized	Issued and fully paid	Authorized	Issued and fully paid
Ordinary shares of NIS 0.01 par value	1,000,000,000	388,450,380	1,000,000,000	387,783,799

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

b. During 2002, the Company issued 965,775 shares to employees and service providers, in connection with its Share Options Schemes (see below) and in connection with the Employee stock purchase plan, for a total consideration of $177.

c. During 2003, the Company issued 666,581 shares to employees and service providers, in connection with its Share Options Schemes (see below), for a total consideration of $123.

Share option schemes

A. General Terms

The Company has established a 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 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 scheme and any other option scheme operated by the Company or any associated company, or;

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 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.

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 from three to five years.

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

	For the year ended December 31,			
	2003		2002	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
Outstanding as of beginning of year	10,658,461	£1.5885	8,430,111	£2.659
Granted	2,349,000	0.1065	3,914,316	0.4181
Exercised	(666,581)	0.1103	(279,466)	0.046
Forfeited	(2,314,248)	2.1397	(1,406,500)	5.054
Outstanding as of end of year	**10,026,632**	1.2123	**10,658,461**	1.5885
Options exercisable as of end of year	**4,358,294**	**£1.8821**	**4,367,692**	**£1.8316**

	Outstanding as at December 31, 2003			Exercisable as at December 31, 2003	
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	6.083	NIS 0.01	106,926	NIS 0.01
£0.1025 - £0.795	7,691,494	7.802	0.2254	2,663,562	0.2142
£1 - £1.705	68,881	6.879	1.1711	48,881	1.2247
£3.725£ - £4.4	1,279,047	6.415	4.3523	959,050	4.3473
£4.5 - £6.875	809,000	6.576	5.9017	579,875	5.8683
	10,026,632			**4,358,294**	

Weighted Average Grant-Date Fair Value

The weighted average grant-date fair value of the 2,349,000 and 3,914,316 options granted during 2003 and 2002 amounted to £0.10 and £0.60 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, 2002	1,173	397,244	16	(274,086)	124,347
Exercise of options and shares by employees	2	175			177
Loss for the year				(20,570)	(20,570)
As at December 31, 2002	1,175	397,419	16	(294,656)	103,954
Exercise of options and shares 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**

NOTE 18 - RECONCILIATION OF NET LOSS FOR THE YEAR TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	Consolidated	
	Year ended December 31,	
	2003	2002
	US$ in thousands	
Loss for the year	(20,221)	(20,570)
Company's share in loss of associated company	141	151
Amortization of goodwill	9,898	9,898
Write-down of investment	-	2,000
Depreciation and amortization	1,711	2,082
Increase in severance pay fund, net of provision	29	35
Decrease in stocks	5,763	7,581
Decrease in debtors	402	9,567
Decrease in creditors	(1,092)	(12,955)
Loss (gain) from marketable securities	(102)	38
Interest incurred on investments	(1,453)	(798)
Interest incurred on loan for affiliate	(27)	3
Loss on disposal of fixed assets	67	9
Net cash outflow from operating activities	**(4,884)**	**(2,959)**

Notes to the Financial Statements

NOTE 19 -ANALYSIS OF CASH AND CASH EQUIVALENTS

	US$ in thousands
Balance at December 31, 2002	15,519
Net cash outflow	(12,201)
Balance at December 31, 2003	3,318

NOTE 20 -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 has 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.

One of the Company's Israeli subsidiaries has also been granted an Approved Enterprise status for the construction of the Company's plant at Yokneam, at 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 for corporate tax at a rate of 10%-25% (depending on the percentage of foreign shareholders in the Company's equity), with respect to the amount distributed.

Income derived from sources other than the "approved enterprises" is taxable at the regular corporate tax rate of 36% in 2003 and 2002.

d. Tax assessments

The Company has received final tax assessments for the years up to and including the 1999 tax year. The subsidiaries have not been assessed for tax since their incorporation.

NOTE 21 -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, 2003, would have increased by $1,340 and $0.3 per share, respectively (2002 – the loss and the loss per share increased by $1,330 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 2003.

Principal Activities and review of the business

BATM's main activities are the research and development, production and marketing of data communication 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 1-2.

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 $20,221,000. No dividend is being declared for the year.

Directors

The following served as directors during the year.

Peter Sheldon FCA, (62), 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. (62), 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, Remuneration and Nominations Committees.

Daniel Goldman (34), 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 based private equity fund. He has been a member of the Board of BATM since 1999.

Dr. Zvi Marom (49), 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 (39), 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.

Adi Alon (38), resigned as a non-executive director on June 30, 2003 following his relocation to USA.

DIRECTORS' REPORT

FIXED ASSETS

The movement in tangible assets is shown in note 9 to the financial statements.

CHARITABLE DONATIONS

The Group made charitable donations of $3 during the year.

AUDIT COMMITTEE

The Company has an Audit Committee, which consists of two out of the three non-executive directors, Dr. Dan Kaznelson and Mr. Daniel Goldman. Mr. Adi Alon also served on this committee until his resignation on June 30, 2003

AUDITORS

Brightman Almagor & Co., a member 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.

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 five directors, three 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. Mr. Adi Alon was also a non-executive director for part of the year.

All the directors are of a high calibre and standing. The biographies of all the members of the Board are set out on pages 24. 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 30. 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 members of the Board receive a memorandum on the responsibilities and liabilities of directors on their appointment to the Board. There are also presentations to the directors on the activities of the Company. The CEO regularly invites the 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.

The Board has established a nominations committee, headed by Dr. Dan Kaznelson. Individuals nominated as directors by the committee are subsequently presented to the shareholders in general meeting for election. Executive and non-executive directors are elected by the shareholder’s General Meeting for a term of one year. Non-executive public “external” directors are elected for a term of three years, which is renewable for a further term of three years. The re-election of a director must be approved by the shareholders in general meeting.

Corporate Governance

Director's 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 29-30.

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.

Accountability and Audit

The Board has an Audit Committee of three non-executive directors, chaired by Dr. Dan Kaznelson. The Audit Committee meets a minimum of twice a year and the 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.

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.

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.

Corporate Governance

Environmental Policy

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

Its environmental policy is to:

A. Meet the statutory requirements placed on it;

B. Adopt good environmental practice in respect of premises, product development and manufacturing, and consumption of resources;

C. Aim to recycle as much of its waste products as it is economically practicable to do.

Remuneration Report

The remuneration committee consists of two out of the three non-executive directors. As presently constituted, the committee consists of Dr. Dan Kaznelson, and Daniel Goldman. Dr. Dan Kaznelson serves as chairman. Adi Alon was a member of this committee until his resignation from the board. 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 Dr. Marom, all directors' service contracts are terminable within one year. Dr. Marom's contract extends for two-year renewable periods, considered by the Board to be necessary in the light of his major contribution to the Company's activities.

Non-executive directors in 2003

The non-executive Chairman is remunerated at a rate of $18 per annum, plus $3 for each Board or other meeting attended. The three other non-executive directors, with the exception of Mr. Adi Alon (part year), are paid $9 per annum and $1.5 per meeting respectively. 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. The non-executive directors each agreed to a reduction in their contracted rates of remuneration for the six months of the year.

Mr. Adi Alon, the Public external Director, was remunerated in accordance with Israeli Company Law provisions for such appointees.

Executive Directors in 2003

Dr. Zvi Marom- CEO- earned a basic salary of $200 and social benefits as are regularly common 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, June 2002. No bonus was payable in respect of either 2002 or 2003.

Ofer Bar-Ner-CFO- earned a basic salary of $132 and social benefits.

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 Audit Committee. The remuneration of the executive and non-executive directors of the Company for the year ended 31 December 2003 and 31 December 2002 was as follows (in US $ in thousands):

Executive Directors

	2003	2002
	Salary and Benefits	Salary and Benefits
Dr. Zvi Marom	242	213
Ofer Bar-Ner	148	156

Non Executive Directors

	2003	2002
	Fees	Fees
Peter Sheldon	35	38
Dr. Dan Kaznelson	14	17
Daniel Goldman	15	20
Adi Alon	6	17

Remuneration Report

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.

	2003	2002
	0.01 NIS Ordinary Shares fully paid	0.01 NIS Ordinary Shares fully paid
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)

	2003	2002
	Number of options	Number of options
Dr. Zvi Marom *	400,000	300,000
Ofer Bar-Ner **	2,000,000	2,000,000

* The grant is of 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.

** (1) The vesting date for the above options held by Ofer Bar-Ner is on January 2004 at an exercise price of £0.375.

(2) The above figure is correct as of December 31, 2003. On January 4, 2004 the Company's audit and remuneration committee as well as the board approved the granting of an additional living allowance increase to Ofer Bar-Ner for the years 2003 and 2004 against which he surrendered 1,666,666 options to the Company.