

METAL-TECH LTD.

CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2008

METAL-TECH LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2008

U.S. DOLLARS IN THOUSANDS

INDEX

	<u>Page</u>
Independent Auditors' Report	2
Consolidated Balance Sheets	3 - 4
Consolidated Income Statements	5
Consolidated Statements of Changes in Equity	6
Consolidated Statements of Cash Flows	7 - 8
Notes to Consolidated Financial Statements	9 - 48

INDEPENDENT AUDITORS' REPORT**To the Shareholders of****METAL-TECH LTD.**

We have audited the accompanying financial statements of Metal-Tech Ltd. and its subsidiaries ("the Group"), which comprise the consolidated balance sheets as of December 31, 2008 and 2007 and the consolidated income statements, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of December 31, 2008 and 2007, and of its financial performance and its cash flows for the years then ended, in accordance with International Financial Reporting Standards.

Beer Sheva, Israel
April 27, 2009**KOST FORER GABBAY and KASIERER**
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

ASSETS	Note	December 31,	
		2008	2007
CURRENT ASSETS:			
Cash and cash equivalents	4	12,012	5,939
Restricted cash	5	3,150	6,561
Available for sale investments	6	28	95
Trade receivables	7	11,153	10,543
Other accounts receivable	8	5,343	9,973
Inventories	9	47,902	69,527
		<u>79,588</u>	<u>102,638</u>
NON-CURRENT ASSETS:			
Investment in joint ventures	11	-	4,183
Deferred finance costs	2b	377	528
Property, plant and equipment	10	29,616	26,022
		<u>29,993</u>	<u>30,733</u>
<u>Total assets</u>		<u>109,581</u>	<u>133,371</u>

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

CONSOLIDATED BALANCE SHEETS

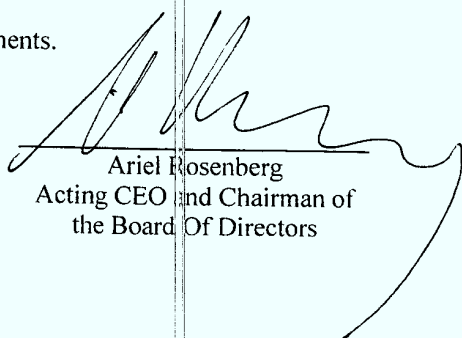
U.S. dollars in thousands

	Note	December 31,	
		2008	2007
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Short-term bank credit	12	10,562	11,381
Short-term loans and current maturities	13	16,923	17,130
Trade payables		17,435	26,044
Income taxes payable		6,317	8,823
Other accounts payable	14	5,834	8,123
		<u>57,071</u>	<u>71,501</u>
NON-CURRENT LIABILITIES:			
Long-term loans	15	6,220	6,436
Employee benefit obligations	16	241	477
Deferred tax liabilities	17	79	38
		<u>6,540</u>	<u>6,951</u>
<u>Total liabilities</u>		<u>63,611</u>	<u>78,452</u>
EQUITY:			
Equity attributable to the equity holders of the Company-	20		
Issued capital		2,399	2,399
Share premium		23,892	23,892
Other reserves		624	425
Retained earnings		16,051	25,176
		<u>42,966</u>	<u>51,892</u>
Minority interests		3,004	3,027
<u>Total equity</u>		<u>45,970</u>	<u>54,919</u>
<u>Total liabilities and equity</u>		<u>109,581</u>	<u>133,371</u>

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

April 27, 2009

Date of approval of the
financial statements


Ariel Rosenberg
Acting CEO and Chairman of
the Board of Directors

CONSOLIDATED INCOME STATEMENTS**U.S. dollars in thousands (except share and per share data)**

	Note	Year ended December 31,	
		2008	2007
Revenues	24a,b	138,333	136,713
Cost of sales before write-down of inventories	23a	127,518	114,471
Gross profit before write-down of inventories		10,815	22,242
Write-down of inventories	23a	7,501	2,500
Gross profit		3,314	19,742
Research and development expenses ,net	23b	1,497	1,991
Selling and marketing expenses	23c	1,454	775
General and administrative expenses	23d	7,914	4,661
<u>Total operating expenses</u>		10,865	7,427
Operating profit (loss)		(7,551)	12,315
Finance costs	23e	(3,559)	(3,651)
Finance income	23e	449	1,357
Other income		545	219
Share of profit (loss) of joint ventures including impairment loss	2a,c	1,593	(6,891)
Profit (loss) before tax		(8,523)	3,349
Income tax expense	17	41	4,084
Loss for the year		<u>(8,564)</u>	<u>(735)</u>
Attributable to:			
Equity holders of the Company		(9,125)	(2,008)
Minority interests		561	1,273
		<u>(8,564)</u>	<u>(735)</u>
Basic and diluted loss per share attributable to Ordinary equity holders of the Company		<u>(0.24)</u>	<u>(0.05)</u>
Weighted average number of shares used in computing basic and diluted net loss per share attributable to Ordinary equity holders of the Company		<u>38,376,923</u>	<u>38,376,923</u>

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

U.S. dollars in thousands

	Attributable to equity holders of the Company						
	Share capital	Share premium	Other reserves	Retained earnings	Total	Minority interests	Total equity
Balance as of January 1, 2007	2,399	23,892	(136)	28,373	54,528	1,754	56,282
Net loss on cash flow hedges	-	-	(85)	-	(85)	-	(85)
Foreign currency translation	-	-	140	-	140	-	140
Net income for the year recognized directly in equity	-	-	55	-	55	-	55
Profit (loss) for the year	-	-	-	(2,008)	(2,008)	1,273	(735)
Total recognized income (expense) for the year	-	-	55	(2,008)	(1,953)	1,273	(680)
Cost of share based payment	-	-	506	-	506	-	506
Dividend paid	-	-	-	(1,189)	(1,189)	-	(1,189)
Balance as of December 31, 2007	2,399	23,892	425	25,176	51,892	3,027	54,919
Net gain on cash flow hedges	-	-	85	-	85	-	85
Net income for the year recognized directly in equity	-	-	85	-	85	-	85
Profit (loss) for the year	-	-	-	(9,125)	(9,125)	561	(8,564)
Total recognized income (expense) for the year	-	-	85	(9,125)	(9,040)	561	(8,479)
Cost of share based payment	-	-	114	-	114	-	114
Dividend paid to minority interest	-	-	-	-	-	(584)	(584)
Balance as of December 31, 2008	2,399	23,892	624	16,051	42,966	3,004	45,970

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,	
	2008	2007
<u>Cash flows from operating activities:</u>		
Loss for the year	(8,564)	(735)
Adjustments required to reconcile net loss to net cash provided by (used in) operating activities (a)	14,176	(9,211)
Net cash provided by (used in) operating activities	5,612	(9,946)
<u>Cash flows from investing activities:</u>		
Purchase of property, plant and equipment	(6,116)	(7,193)
Proceeds from sale of property, plant and equipment	411	54
Proceeds from disposal of investment in joint venture	5,737	-
Investment in joint ventures	-	(1,420)
Decrease (increase) in restricted cash	3,411	(4,663)
Investment in available for sale securities	-	(9,996)
Proceeds from sales of available for sale securities	-	10,743
Net cash provided by (used in) investing activities	3,443	(12,475)
<u>Cash flows from financing activities:</u>		
Dividend paid	(731)	(249)
Dividend paid to minority interest	(584)	-
Proceeds from short and long-term loans	10,267	19,457
Repayment of short and long-term loans	(11,116)	(7,662)
Increase (decrease) in short-term bank credit, net	(818)	1,059
Net cash provided by (used in) financing activities	(2,982)	12,605
Increase (decrease) in cash and cash equivalents	6,073	(9,816)
Cash and cash equivalents at the beginning of the year	5,939	15,755
Cash and cash equivalents at the end of the year	12,012	5,939

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,	
	2008	2007
(a) <u>Adjustments required to reconcile net loss to net cash provided by (used in) operating activities:</u>		
Income and expenses not involving cash flows:		
Depreciation	2,306	1,756
Amortization of deferred finance costs	151	151
Share of losses (earnings) of joint ventures including impairment	(1,593)	6,891
Gain on sale of equity interest	(604)	-
Loss on marketable securities	67	-
Gain on sale of property, plant and equipment	(195)	-
Employee benefit obligations	(236)	55
Accrued interest and foreign exchange differences on short and long-term liabilities, net	426	(118)
Cost of share based payments	114	506
Deferred taxes	41	2,068
Other	(94)	(31)
	<u>383</u>	<u>11,278</u>
Changes in operating assets and liabilities:		
Decrease (increase) in trade receivables, net	(610)	2,777
Decrease (increase) in other accounts receivable	4,646	(8,858)
Decrease (increase) in inventory	21,625	(28,525)
Increase (decrease) in trade payables	(8,609)	11,422
Increase (decrease) in related parties, net	7	(801)
Increase (decrease) in other accounts payable	(3,266)	3,496
	<u>13,793</u>	<u>(20,489)</u>
	<u>14,176</u>	<u>(9,211)</u>
(b) <u>Supplemental disclosure of cash flows activities:</u>		
Interest received	<u>242</u>	<u>714</u>
Interest paid	<u>1,756</u>	<u>1,485</u>
Income taxes paid	<u>4,012</u>	<u>2,654</u>
(c) <u>Non-cash activities:</u>		
Dividend payable	<u>-</u>	<u>940</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 1:- GENERAL**

a. Company description:

Metal-Tech Ltd., an Israeli corporation located in Ramat-Hovav ("the Company") and its subsidiaries ("the Group") manufacture, process and market high purity and quality Tungsten and Molybdenum oxide and powders. In addition, the Group is engaged in research and development in the fields of metallurgy, recycling and fuel conservation.

b. The Group is currently dependent on one main supplier for Molybdenum raw material, which is the minority shareholder in the Company's subsidiary in Mongolia. According to the establishment agreement of the subsidiary in Mongolia, the supplier is obligated to provide its Molybdenum concentrates solely to the subsidiary and the Mongolian subsidiary is obligated to sell all of its production of Molybdenum to the company for an amount not less than 1,800 ton of Molybdenum per year. If the supplier should be unable or unwilling to continue to sell the Group raw materials in required volumes or on a timely basis, any resulting supply delays could result in the loss of sales, which could materially and adversely affect operating results. See also Note 2 (b).

c. During the fourth quarter of 2008, there was a decline in the worldwide market price of Molybdenum of approximately 70% accompanied by a reduction in the Company's sales of Molybdenum. Due to the continued weakness in the market price, the Company decided in February 2009 to temporarily suspend its production in its Mongolian plant and rearrange the credit line with the main supplier and the minority shareholder in the Company's subsidiary in Mongolia, see also Note 2 (b). This production hiatus will be used for upgrading production lines and limited maintenance, while continually assessing the market conditions and other strategic alternatives. Employees have been released for several months' unpaid leave, and are available to be recalled at any time. The Company estimates that this temporary suspension will not have a significant adverse effect on its liquid resources. Regarding the impact on inventories and property, plant and equipment - see Notes 9 and 10, respectively.

NOTE 2:- INVESTMENTS IN SUBSIDIARIES AND JOINT VENTURES

	Country of incorporation	December 31	
		2008	2007
		%	
Uzmetal Technology Ltd. (a)	Uzbekistan	-	50
Shim Technology Ltd. (b)	Mongolia	70	70
Metek Metal-Tech SA (c)	Switzerland	100	100
BIT Metal BV (c)	Netherland	-	50
Metal- Tech CZ (c)	Czech	80	80
Jar Ltd. - Inactive	Russia (Birubijan autonomous region)	100	100
Soltek Ltd. - Inactive	Israel	100	100

a. Uzmetal Technology Ltd. ("Uzmetal"):

In March 2000, the Company together with AGMK and UzKTZM (two Uzbek companies) established Uzmetal. The equity interest in Uzmetal is as follows: the Company-50%, UzKTZM-30% and AGMK-20%. The Company financed and managed the construction of a plant in Uzbekistan which was completed in 2002.

Uzmetal processed raw materials at the AGMK site and sold its production of Molybdenum to the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 2:- INVESTMENTS IN SUBSIDIARIES (Cont.)**

Uzmetal relied solely on AGMK's mine for its supply of raw materials. The Uzbek government issued a decree according to which Uzmetal had exclusivity for all Molybdenum-contained materials extracted from AGMK's mine. The exclusivity was also set forth in the contract between Uzmetal and AGMK. In July 2006 the Uzbek government issued another decree resulting in the cancellation of the exclusivity clause in the contract between the companies. AGMK ceased supplying Uzmetal with materials, and asked Uzmetal to sign the agreement annulment. Uzmetal refused to sign. AGMK applied to the court for its approval of the annulment. Due to the lack of raw materials, Uzmetal ceased its principal operations in July 2006.

In January 2007, the court approved the annulment of the agreement. Uzmetal appealed and lost and then Uzmetal appealed to the Uzbek Supreme Court. In August 2007, the court declared Uzmetal bankrupt. In October 2007, the Appellate court rejected the Company's claims with respect to cancelling a previous ruling made and did not accept that the Company is a creditor of Uzmetal, while it did accept that the Uzbek shareholders are creditors of Uzmetal. In addition, the court decided to start a liquidation process.

Until June 30, 2006, Uzmetal was consolidated in the Company's financial statements. As of July 1, 2006, the Company did not solely control Uzmetal. The autopilot mechanism was eliminated due to the cancellation of the exclusivity clause, the expiration of the distribution agreement and the cessation of Uzmetal's operations. The Company does not have the decision making power to obtain the majority of the benefits of the activities of Uzmetal, but it had joint control. Accordingly, for the period commencing July 1, 2006 and ending December 31, 2007, Uzmetal as a jointly controlled entity was accounted for in the consolidated financial statements using the equity method.

As a result of the court decisions that the Company is no longer a creditor of Uzmetal in 2007, the Company in 2007 recorded its share of the losses of Uzmetal and a provision for impairment for the entire carrying amount of its investment in Uzmetal in the aggregate amount of \$ 7,619. In 2008 the Company adjusted the provision relating to the activity of Uzmetal, and recorded income in the amount of \$ 713.

The Company does not have any further obligations or liabilities relating to Uzmetal.

b. Shim Technology Ltd . ("Shim-Tech"):

In September 2003, the Company together with Erdenet Co. Ltd. ("Erdenet"), a Mongolian mining Company, established Shim-Tech. The equity interest in Shim-Tech is as follows: the Company-70% and Erdenet -30%. In May 2004, the Company entered into an agreement with Shim-Tech under which the Company undertook to obtain financing and manage the procurement, planning, construction and supply of peripheral equipment in a project for the construction of a Molybdenum production plant in Mongolia, for a total amount of \$ 23,850. The project was to be financed as follows: (i) 30%- equity invested by the shareholders; (ii) 34%-Company credit; (iii) 36%-National Mongolian bank credit through a transfer from an Israeli bank secured by the Israeli Foreign Trade Risks Insurance Corporation Ltd. ("IFTRIC") for 7 years. Erdenet signed a guarantee in favor of the Israeli bank in respect of any amounts that have been secured by IFTRIC to an amount of \$ 10,000. This guarantee was recorded at its fair value as a deferred finance cost which is amortized on a straight-line basis over the term of the loan.

During 2008 the Company invested in Shim Tech additional equity in the amount of \$2,784 with no corresponding investment by Erdenet or dilution of Erdenet's interest. Accordingly, the Company recorded a loss in the amount of \$835 which was charged to the equity holders of the Company with a corresponding credit to income for minority interest in the income statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 2:- INVESTMENTS IN SUBSIDIARIES (Cont.)**

The construction of the first production line of the plant was completed in 2006. The construction of the second production line of the plant has not yet been completed as of December 31, 2008. Shim-Tech is engaged also in trading, commercial and intermediary activities in Molybdenum concentrate within the Group and with Erdenet. Erdenet has undertaken to supply, for 22 years starting in 2004, its molybdenum concentrates solely to Shim-Tech and Shim-Tech is obligated to sell all of its production of Molybdenum to the Company for an amount not less than 1,800 ton of Molybdenum per year. The purchases from Erdenet are determined by market price.

As per the addition to the aforesaid agreement, the parties have agreed on a penalty/reward mechanism regarding the quantities of concentrate that will be supplied by Erdenet on an annual basis. The Company and Erdenet are involved in discussions regarding charge and credits related to this mechanism for 2007 and 2008, including the arranging of the credit line that Erdenet extended to Shim-Tech as a supplier (as stated in Note 1(b)). In the opinion of the Company's management, it is not expected that the final outcome of these discussions will have a material negative effect on its financial statements.

As described in Note 1(c), subsequent to the balance sheet date, Shim Tech temporarily suspended its production.

c. Metek Metal-Tech SA. ("MTSA"):

Metek Metal-Tech SA, a Swiss corporation, was established and commenced operations in November 2004. MTSA is engaged in managing the Group's sales and marketing activities of manufactured products outside of Israel.

During 2006, MTSA established a subsidiary in Czech. MTSA holds 80% of this subsidiary. The Czech subsidiary was engaged in operating a pilot of a spent catalyst recycling plant. In 2009, the Company decided to cease operations of this pilot plant. The equipment in the plant will be transferred to the Company's plant in Israel. The Company has determined that no provision for impairment loss is required.

During 2006, MTSA established a JV in the Netherland, Bit Metal BV, with a local partner for the purpose of trading other metals such as silicon metal and tin concentrate- see Note 11. MTSA owns directly a 49% interest and an additional 1% indirectly through an association established by the partners. The Company jointly controls this JV and accounts for its interest in the JV using the equity method.

As part of the establishment agreement, MTSA provided Bit Metal B.V a subordinated loan of \$ 3,000 in order to secure a credit line from the bank. The loan bears interest at Libor + 1%.

On August 1, 2008, Metal –Tech Switzerland sold its equity interest in BIT Metals BV to the other partner. The loan with accrued interest in the amount of \$3,354 was repaid. The equity in earnings until the date of sale amounted to \$ 880 and the gain on the sale was \$604 (include in other income).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES**

Basis of preparation:

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") on a historical cost basis, except for derivative financial instruments and available-for-sale investments that are measured at fair value.

As of 1 January, 2008, the Group has adopted IFRIC Interpretation 11 insofar as it applies to consolidated financial statements. This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The Group amended its accounting policy accordingly. The Group has not issued instruments caught by this interpretation.

Except for the adoption of IFRIC 11 described above the accounting policies applied are consistent with those of the previous financial year:

a. Significant accounting judgments, estimates and assumptions:

The preparation of the Group's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amount of an asset or liability in the future.

Estimates and assumptions:

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Depreciation of property, plant and equipment:

Property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives. Changes in the expected level of usage and technological developments could impact the economic useful lives and the residual values of these assets, therefore future depreciation charges could be revised.

Impairment of non-financial assets:

The Group assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. Non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows. Changes in the estimated future cash flows as well as the discount rate could impact the determination of the recoverable amount.

Inventories:

Inventories are measured at the lower of cost or net realizable value. The Company periodically evaluates the condition and age of inventories and their estimated realizable value. The Company records appropriate provisions for write-downs, which are subject to changes based on current market conditions, see Note 9 for further details.

Deferred tax assets:

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies. Further details are given in Note 17.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)****b. Principles of consolidation:**

The consolidated financial statements include the accounts of the Company and its controlled subsidiaries. Significant intercompany transactions and balances, and unrealized profits are eliminated in consolidation.

The financial statements of subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies.

Minority interest represents the portion of net profit and net assets not held by the Group and are presented separately in the income statement and within equity in the balance sheet.

c. Functional and reporting currency:

The consolidated financial statements are presented in U.S. dollars, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currency of the foreign operations, BIT Metals B.V., is Euro. As at the reporting date, the assets and liabilities of BIT Metals B.V. are translated into the presentation currency of the Company (the U.S. dollar) at the rate of exchange ruling at the balance sheet date and its income statements is translated at weighted average exchange rates for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. The Company sold its investment in this entity in August 2008, (see Note 2(c)), and accordingly, the deferred cumulative amount in equity relating to this entity was recognized in the income statement.

d. Cash and cash equivalents:

The Company considers all highly liquid investments originally purchased with maturities of three months or less to be cash equivalents.

e. Restricted cash:

Restricted cash is primarily invested in certificates of deposit, which mature within one year and serve as collateral for short-term loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Financial instruments:

(a) Financial assets - initial recognition

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

The Group has not designated any financial assets as at fair value through profit or loss, and for all reported periods had no held to maturity investment.

Financial assets are recognized initially at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way purchases) are recognized on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

The Group's financial assets include cash and short-term deposits, trade and other receivables, loan and other receivables, quoted and unquoted financial instruments, and derivative financial instruments.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification as follows:

1. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such financial assets are carried at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the loans and receivables are derecognized or impaired, as well as through the amortization process.

2. Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any other categories. After initial measurement, available-for-sale financial assets are measured at fair value with unrealized gains or losses recognized directly in equity until the investment is derecognized, at which time the cumulative gain or loss recorded in equity is recognized in the income statement, or determined to be impaired, at which time the cumulative loss recorded in equity is recognized in the income statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Financial instrument: (Cont.)

(b) Financial liabilities - initial recognition

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

The Group has not designated any financial liabilities as at fair value through profit or loss.

Financial liabilities are recognised initially at fair value and in the case of loans and borrowings, directly attributable transaction costs.

The Group's financial liabilities include trade and other payables, short-term bank credit, loans and borrowings and derivative financial instruments.

Subsequent measurement

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate method.

Gains and losses are recognized in the income statement when the liabilities are derecognized as well as through the amortization process.

(c) Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the consolidated balance sheet if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

(d) Fair value of financial instruments

The fair value of financial instruments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For financial instruments where there is no active market, fair value is determined using valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

(e) Amortized cost of financial instruments

Amortized cost is computed using the effective interest method less any allowance for impairment and principal repayment or reduction. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Financial instrument: (Cont.)

(f) Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(g) Derecognition of financial instrumentsFinancial assets:

A financial asset is derecognized when the rights to receive cash flows from the asset have expired.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

Derivative instruments:

Derivative instruments are recognized as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship.

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk associated with a forecasted transaction), the effective portion of the gain or loss on the derivative instrument is recognized directly in equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion is recognized in the income statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Financial instrument: (Cont.)

The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

For those derivatives designated as hedges and for which hedge accounting is desired, the hedging relationship is formally designated and documented at its inception. This documentation identifies the risk management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how effectiveness will be measured throughout its duration. Such hedges are expected at inception to be highly effective in offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the reporting period for which they were designated.

g. Inventories:

Inventories are valued at the lower of cost or net realizable value. Net realizable value is based on estimated selling price less any further costs expected to be incurred to complete and make the sale. Cost is determined as follows:

Raw materials - using the "first-in, first-out" method.

Work-in-progress and finished goods - Raw materials as above; labor and overhead - an average based on normal operating capacity.

h. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation and impairment losses and net of investment grants. Investment grants are recorded at the time the Company is entitled to such grants. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets at the following annual rates:

	<u>%</u>
Buildings	2.5 – 6.5
Machinery and equipment	10 – 20
Computers and peripheral equipment	20 – 33
Office furniture and equipment	6 – 20
Motor vehicles	15 – 20

i. Borrowing costs:

Borrowing costs directly attributable to the acquisition and construction of property and equipment that necessarily takes a substantial period of time to get ready for its intended use are capitalized as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

j. Impairment of non-financial assets:

The Company evaluates the need to record an impairment of the carrying amount of non-financial assets whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of asset's fair value less costs to sell and its value in use. In measuring value in use, the estimated future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the income statement.

k. Taxes on income:

Taxes on income in the income statement comprise current and deferred taxes. The tax results in respect of current or deferred taxes are carried to the income statement except to the extent that the tax arises from items which are recognized directly in equity. In such cases, the tax effect is also carried to the relevant item in equity.

1. Income taxes:

The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date as well as adjustments required in connection with the tax liability in respect of previous years.

2. Deferred taxes:

Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes, except in a limited number of exceptions. Deferred taxes are carried directly to equity if the tax relates to items that are taken to equity.

Deferred tax balances are measured at the tax rates that are expected to apply to the period when the taxes are taken to the income statement or to equity, based on tax laws that have been enacted or substantively enacted by the balance sheet date. The amount for deferred taxes in the income statement represents the changes in said balances during the reported period, excluding changes attributable to items carried directly to equity.

Taxes that would apply in the event of the sale of investments in investees have not been taken into account in computing the deferred taxes, as long as the sale of the investments in investees is not expected in the foreseeable future. Also, deferred taxes that would apply in the event of distribution of earnings by investees as dividends have not been taken into account in computing the deferred taxes, since the distribution of dividends does not involve an additional tax liability or since it is the Company's policy not to initiate distribution of dividends that triggers an additional tax liability.

Deferred tax assets and deferred tax liabilities are presented in the balance sheet as non-current assets and long-term liabilities, respectively. Deferred taxes are offset if there is a legally enforceable right to set off a current tax asset against a current tax liability and the deferred taxes relate to the same taxpayer and the same taxation authority.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

1. Employee benefits liability:

1. Short-term employee benefits:

Short-term employee benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

2. Post-employment benefits:

The Company operates a defined benefit plan for severance pay pursuant to Israel's Severance Pay Law. Under the law, Israel resident employees are entitled to receive severance pay upon involuntary termination of employment, or upon retirement, which is calculated based on the most recent monthly salary at the time of termination, multiplied by the number of years of employment.

The Company funds its liability for severance pay by monthly payments to pension funds and insurance companies ("plan assets"). The plan assets include profits accumulated up to the balance sheet date. The plan assets may be withdrawn only in accordance with Israel's Severance Pay Law or labor agreements.

The cost of providing severance pay is determined using the projected unit credit method. Actuarial gains and losses are recognized immediately in the income statement in the period in which they occur.

The liability recognized in the balance sheet represents the present value of the defined benefit obligation reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

m. Share-based payment transactions:

Employees (including senior executives) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ('equity-settled transactions').

The cost of equity - settled transactions with employees is measured by reference to the fair value on the date of grant. The fair value is determined by an external valuer using an appropriate pricing model, further details of which are given in Note 21.

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

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- n. Revenue recognition:

Sale of goods

The Group generates revenues mainly from the sale of Tungsten and Molybdenum oxide and powders. The Group does not grant a right of return to its customers.

Revenues from Tungsten and Molybdenum oxide and powders sales are recognized when the significant risks and benefits of ownership are transferred to the buyer, it is probable that the economic benefits associated with the transaction will flow to the Group, and the amount of revenues can be measured reliably.

Interest income]

Interest income is recognized as interest accrues (using the effective interest method). Interest income is included in finance income in the income statement.

- o. Research and development:

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognized only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the asset and the ability to measure reliably the expenditure during the development.

During the period of development, the asset is tested for impairment annually. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortization and accumulated impairment losses. Amortization of the asset begins when development is complete and the asset is available for use. It is amortized over the period of expected future sales.

- p. Interest in a joint venture:

The Group has interests in joint ventures which are jointly controlled entities. A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, and a jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venture has an interest. The Group accounts for its interest in the joint venture using the equity method. The financial statements of the joint venture are prepared for the same reporting year as the Company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

When the Group contributes or sells assets to the joint venture, any portion of gain or loss from the transaction is recognized based on the substance of the transaction. When the Group purchases assets from the joint venture, the Group does not recognize its share in the profits of the joint venture from the transaction until it resells the assets to an independent party.

After application of the equity method, the Group determines whether it is necessary to recognize an additional impairment loss of the Group's investment in its joint ventures. The Group determines at each balance sheet date whether there is any objective evidence that the investment in the joint venture is impaired. If this is the case, the Group calculates the amount of impairment as being the difference between the fair value of the joint venture and the acquisition cost and recognizes the amount in the income statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

q. Government grants:

Government grants are recognized where there is reasonable assurance that the grant will be received and the Company will comply with the attached conditions. Where the grants relate to assets such as fixed assets, they are presented as a deduction from the carrying amount of the asset.

Government grants from the Office of the Chief Scientist in Israel for funding research and development activities that include a liability to pay royalties to the State depending on future sales from development are recognized upon receipt as a liability if an outflow of economic benefits from the research activity is probable and will lead to sales entitling the State to royalties. Amounts paid as royalties are recognized as settlement of liability. When no such economic benefits are probable, the receipts from the grant are deducted from research and development costs in the income statement. In such event, the royalty liability is accounted for as a contingent liability pursuant to IAS 37 until the date on which the liability is recognized once all the above conditions are met.

r. Basic and diluted earnings per share:

Basic and diluted earnings per share are presented in accordance with IAS 33, "Earnings per Share". Basic earnings per share have been computed using the weighted average number of Ordinary shares outstanding during the period. Diluted earnings or loss per share are computed based on the weighted average number of Ordinary shares outstanding during each period, plus the effect of potential Ordinary shares considered outstanding during the period, except if the effect of such potential Ordinary shares is anti-dilutive.

s. Exchange rates and linkage basis:

- Assets and liabilities in or linked to foreign currencies are included in the financial statements according to the representative exchange rate as published by the Bank of Israel at balance sheet date.
- Assets and liabilities linked to the Israeli Consumer Price Index (CPI) are included in the financial statements according to the relevant index for each asset or liability.

Data regarding exchange rate of Euro and New Israeli Shekels (NIS) in relation to the U.S dollar:

As of	Exchange rate of Euro	Exchange rate of NIS
December 31, 2008	0.718	3.802
December 31, 2007	0.679	3.846
December 31, 2006	0.759	4.225
Changes during the year	%	%
2008	5.7	(1.1)
2007	(10.5)	(9.0)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- t. Standards issued but not yet effective:

IAS 23 (Revised), "Borrowing Costs":

A revised, IAS 23 "Borrowing Costs" was issued in March 2007, and becomes effective for financial years beginning on or after January 1, 2009. The Standard has been revised to require capitalization of borrowing costs when such costs relate to a qualifying asset. The Company believes adoption of the revised Standard is not expected to have a material effect on its financial position, results of operations and cash flows since the Company presently has a policy of capitalizing borrowing costs as part of the cost of qualifying assets.

IAS 1 (Revised) "Presentation of Financial Statements":

The revised IAS 1, "Presentation of Financial Statements" was issued in September 2007 and becomes effective for financial years beginning on or after January 1, 2009. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of income and expense recognized in the income statement, together with all other items of recognized income and expense, either in one single statement, or in two linked statements.

The effect of the adoption of IAS 1 (Revised) will require the Company to present the above disclosures in the financial statements.

IFRS 3 (Revised) "Business Combinations" and IAS 27 (Revised) "Consolidated and Separate Financial Statements":

The revised standards were issued in January 2008 and become effective for financial years beginning on or after July 1, 2009. IFRS 3R introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. IAS 27R requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IFRS 3R and IAS 27R must be applied prospectively and will affect future acquisitions and transactions with minority interests.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- t. Standards issued but not yet effective: (Cont.)

IFRS 8 – Operating Segments:

IFRS 8 (“the Standard”) deals with operating segments and replaces IAS 14. The Standard is effective for annual financial statements for periods beginning after January 1, 2009. Earlier application is permitted. The provisions of the Standard will be applied retrospectively.

The Standard determines that an entity will adopt a management approach in reporting on the financial performance of the operating segments. The segment information would be the information that is internally used by management in order to assess its performance and allocate resources to the operating segments.

Furthermore, information is required to be disclosed about the products or services (or group of products and similar services) from which the entity derives its revenues, the countries in which these revenues or assets are derived and major customers.

The Company is evaluating the impact of this Standard on its disclosures in the financial statements.

IFRS 2 – Share-based Payment:

Pursuant to an amendment to IFRS 2 (“the amended Standard”), the definition of vesting terms will only include service conditions and performance conditions, and the cancellation of a grant that includes non-vesting conditions by the Company or the counterparty, will be accounted for by way of acceleration of vesting and not by forfeiture. The Standard will be applied retrospectively for financial statements for periods beginning on January 1, 2009. Earlier application is permitted.

Vesting conditions include service conditions which require the counterparty to complete a specified period of service and performance conditions which require specified performance targets to be met. Conditions that are other than service and performance conditions will be viewed as non-vesting conditions and must therefore be taken into account when estimating the fair value of the instrument granted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected to be material.

IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations:

Pursuant to an amendment to IFRS 5, when the parent company decides to sell part of its holdings in a subsidiary whereby following the sale, the parent company will maintain a percentage of holding that does not confer control, for example, rights entitling to significant influence, all of that subsidiary’s assets and liabilities will be classified as held for sale when the criteria in IFRS 5 are met, including disclosures for discontinued operations. The amendment to IFRS 5 will be prospectively adopted starting from the financial statements for periods beginning on January 1, 2010. Earlier application is permitted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected to be material.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- t. Standards issued but not yet effective: (Cont.)

IAS 19 - Employee Benefits:

Pursuant to an amendment to IAS 19, other long-term benefits will include employee benefits that are due in the short-term and are not expected to be utilized within one year of the end of the period qualifying for the benefits, such as cumulative benefits in respect of vacation pay and sick leave that are not expected to be used within one year of the balance sheet date. Accordingly, these benefits are now required to be recognized in the financial statements based on an actuarial calculation taking into account future salaries and discounted to present value. The amendments will be retrospectively adopted starting from the financial statements for periods beginning on January 1, 2009. Earlier application is permitted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected to be material.

IAS 20 - Government Grants:

Pursuant to an amendment to IAS 20, an interest-free / low interest loan received by a company from a government will be accounted for upon initial recognition and in subsequent periods pursuant to the provisions of IAS 39, "Financial Instruments: Recognition and Measurement". Accordingly, the loan will be initially measured at fair value and discounted at market interest. The difference between the loan amount received and the fair value will be accounted for thereafter as a Government grant according to the provisions of the Standard. The Standard will be prospectively adopted starting from the financial statements for periods beginning on January 1, 2009 for Government loans received subsequent to that date. Earlier application is permitted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected to be material.

NOTE 4:- CASH AND CASH EQUIVALENTS

	Annual interest Rate *)	December 31,	
	%	2008	2007
Cash in banks		2,507	500
Short-term deposits	0.3- 1.75	9,505	5,439
		12,012	5,939

*) As of December 31, 2008.

NOTE 5:- SHORT-TERM RESTRICTED CASH

	Annual interest Rate *)	December 31,	
	%	2008	2007
In U.S. dollars	1.3	3,150	6,561

The restrictions are to be released in accordance with the repayment schedule of short-term bank credit and short-term loans during 2009.

*) As of December 31, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 6:- AVAILABLE FOR SALE INVESTMENTS

	Annual interest Rate *)	December 31,	
	%	2008	2007
Marketable securities	4.8	28	95

The securities are presented at fair market value. In 2008, the Company recorded a loss in the amount of \$67 in the income statement, as the investment had been determined to be impaired.

*) As of December 31, 2008.

NOTE 7:- TRADE RECEIVABLES

	December 31,	
	2008	2007
Foreign	11,646	10,645
Domestic - Israel	198	101
	11,844	10,746
Less - allowance for doubtful accounts	691	203
	11,153	10,543

Trade receivables are not interest bearing and are generally on 30-90 day terms.

The movement in the allowance for doubtful accounts:

At January 1, 2007	184
Charge for the year	19
At December 31, 2007	203
Charge for the year	488
At December 31, 2008	691

The aging analysis of trade receivables is as follows:

	Neither past due nor impaired	Past due but not impaired					
		< 30 days	30 – 60 days	60 – 90 day	90 – 120 day	>120 days	
December 31, 2008	11,153	3,542	2,516	893	1,421	1,748	1,033
December 31, 2007	10,543	4,604	3,046	1,186	689	788	230

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 8:- OTHER ACCOUNTS RECEIVABLE**

	December 31,	
	2008	2007
Government authorities (principally VAT)	4,134	8,249
Prepaid expenses	538	450
Advances to suppliers	365	542
Deferred finance costs	151	151
Employees	29	-
Income receivable	-	67
Other	126	514
	<u>5,343</u>	<u>9,973</u>

NOTE 9:- INVENTORIES

	December 31,	
	2008	2007
Raw materials	20,299	22,117
Work in progress	3,540	5,116
Finished goods	24,063	42,294
	<u>47,902</u>	<u>69,527</u>

In 2008 due to declines in market prices of its principal products (see Note 1(c)), the Group recorded write-downs of inventories in the amount of \$ 7,501 (2007- \$ 2,500). Of these write-downs, \$ 3,931 relates to inventories on hand as of December 31, 2008.

As for charges, see Note 19.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10:- PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Machinery and equipment	Computers and peripheral equipment	Office furniture and equipment	Motor vehicles	Total
Cost:						
Balance as of January 1, 2008	5,037	31,061	480	527	628	37,733
Additions during the year	620	4,923	154	325	94	6,116
Disposals during the year	-	(165)	(4)	-	(153)	(322)
Balance as of December 31, 2008	5,657	35,819	630	852	569	43,527
Accumulated depreciation :						
Balance at January 1, 2008	1,878	9,186	232	178	237	11,711
Additions during the year	193	1,866	112	54	81	2,306
Disposals during the year	-	(7)	(1)	-	(98)	(106)
Balance as of December 31, 2008	2,071	11,045	343	232	220	13,911
Depreciated cost at December 31, 2008	3,586	24,774	287	620	349	29,616
Cost:						
Balance as of January 1, 2007	4,538	24,965	266	320	538	30,627
Additions during the year	499	6,096	214	207	177	7,193
Disposals during the year	-	-	-	-	(87)	(87)
Balance as of December 31, 2007	5,037	31,061	480	527	628	37,733
Accumulated depreciation :						
Balance as of January 1, 2007	1,710	7,755	177	151	190	9,983
Additions during the year	168	1,431	55	27	75	1,756
Disposals during the year	-	-	-	-	(28)	(28)
Balance as of December 31, 2007	1,878	9,186	232	178	237	11,711
Depreciated cost at December 31, 2007	3,159	21,875	248	349	391	26,022

- (1) As of December 31, 2008 and 2007, investment grants received amounted to \$ 5,151 and \$ 5,219 and related accumulated depreciation amounted to \$ 4,304 and \$ 4,156, respectively.
- (2) Rights in real estate in Israel:
The Company's plant in Israel is located on land leased from the Israel Land Administration. The leases are for periods ending in 2042. The Company prepaid the lease payments, which are being amortized over the term of the lease.
- (3) Plant under construction as of December 31, 2008 amounted to \$5,543 and is included primarily in machinery and equipment.
- (4) Due to the decline in prices of the Group's principal products (see Note 1(c)) and the general worldwide crises in financial and other markets, the recoverable amounts of the Group's property, plant and equipment were estimated and no impairment loss was identified. The recoverable amounts were estimated based on value in use. The calculations of value in use considered management's estimates of future cash flows, based on budgets, which cash flows were discounted at an appropriate pre-tax discount rate (15%).
- (5) As for charges, see Note 19.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 11:- INVESTMENT IN JOINT VENTURES**

- a. In 2007 the Company had a 50% interest in Uzmetal, and a 50% interest in BIT Metals. As of December 31, 2007 the entire investment in Uzmetal had been written off - see Note 2(a). The investment in BIT was sold on August 1, 2008 - see Note 2(c).

The Group's share of the assets, liabilities, income and expenses of the jointly controlled entity as of December 31, 2008 and 2007 and for the years then ended, which are accounted for in the consolidated financial statements by the equity method, are as follows:

	December 31,	
	2008	2007
Share of the joint ventures' balance sheets:		
Current assets	-	12,842
Non-current assets	-	80
Current liabilities	-	(10,517)
Non current liabilities	-	(1,500)
Net assets	-	905
Share of the joint ventures' revenues, expenses and profit:		
Revenues	24,505	28,944
Expenses	(23,625)	(28,216)
Net earnings	880	728
Carrying amount of the investment *)	-	905
Carrying amount of loans to investee*)	-	3,278
	-	4,183

*) For further details regarding the loans and the realization of the investment, see Note 2(c).

- b. In 2008 the company adjusted provision relating to the activity of Uzmetal, and recorded an income in the amount of \$ 713.
- c. Regarding a joint venture agreement with a company in Chile, see Note 19(i).

NOTE 12:- SHORT-TERM BANK CREDIT

	Annual interest rate *)	December 31,	
	%	2008	2007
U.S. dollars	LIBOR+0.7-1.7	7,021	8,363
NIS	PRIME+1.7-3.5	3,541	3,002
Euro	LIBOR+1.5-2.0	-	16
		10,562	11,381

*) As of December 31, 2008.

- (1) As of December 31, 2008, the Company has an unused credit line in the amount of \$ 680.
- (2) As for collateral, see Note 19.
- (3) As for an agreement with the banks regarding a conversion of short-term facilities to a loan subsequent to balance sheet date, see Note 25(c).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 13:- SHORT-TERM LOANS AND CURRENT MATURITIES OF LONG-TERM LOANS

	Annual interest Rate *)	December 31,	
	%	2008	2007
In U.S. dollars	LIBOR+1.5-1.75	14,760	16,364
In NIS	PRIME+1.5	837	-
Current maturities of long-term loans		1,326	766
		<u>16,923</u>	<u>17,130</u>

*) As of December 31, 2008.

As for collateral, see Note 19.

NOTE 14:- OTHER ACCOUNTS PAYABLE

	December 31,	
	2008	2007
Employees and payroll accruals	1,254	957
Dividend payable	209	940
Accrued liabilities	2,885	3,743
Advances from customers	694	2,039
Related parties	209	202
Other	583	242
	<u>5,834</u>	<u>8,123</u>

NOTE 15:- LONG-TERM LOANS

a. Composed as follows:

	Annual interest Rate *)	December 31,	
	%	2008	2007
Loans from banks:			
U.S. dollar (1)	4.5-6.1	7,132	6,788
Less - current maturities		1,326	766
		5,806	6,022
Other long-term loans:			
NIS - unlinked (2)	-	414	414
		<u>6,220</u>	<u>6,436</u>

*) As of December 31, 2008.

- (1) This loan was provided in connection with the construction of the plant in Mongolia. The loan is to payable in equal semi-annual installments for seven years commencing in 2006, see also Note 2(b).
- (2) Capital notes due to the Company's shareholders bear no interest and have no maturity date. There is no material difference between the carrying amounts of those loans to their fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 15:- LONG-TERM LOANS (Cont.)**

- b. The long-term loans from banks are repayable in the following years subsequent to the balance sheet date:

	<u>2008</u>	<u>2007</u>
First year - current maturities	1,326	766
Second year	1,484	1,164
Third year	1,645	1,304
Fourth year	1,302	1,447
Fifth year and thereafter	1,375	2,107
	<u>5,806</u>	<u>6,022</u>
	<u>7,132</u>	<u>6,788</u>

- c. As for collateral, see Note 19.

NOTE 16:- EMPLOYEE BENEFIT OBLIGATIONS

- a. Post-employment benefits:

According to the labor laws and Severance Pay Law in Israel, the Company is required to pay compensation to an employee upon dismissal or retirement or to make current contributions in defined contribution plans pursuant to Section 14 to the Severance Pay Law, as specified below. The Company's liability is accounted for as a post-employment benefit. The computation of the Company's employee benefit liability is made in accordance with employment contracts based on the employee's salary and employment term which establish the entitlement to receive the compensation.

The post-employment employee benefits are normally funded by contributions to defined benefit plans or as defined contribution plans as detailed below.

- b. Defined contribution plans:

Section 14 to the Severance Pay Law, 1963 applies to part of the compensation payments, pursuant to which the fixed contributions paid by the Group into pension funds and/or policies of insurance companies release the Group from any additional liability to employees for whom said contributions were made. These contributions represent defined contribution plans.

	<u>Year ended December 31,</u>	
	<u>2008</u>	<u>2007</u>
Expenses in respect of defined contribution plans	<u>335</u>	<u>244</u>

- c. Defined benefit plans:

The Group accounts for that part of the payment of compensation that is not covered by contributions in defined contribution plans, as above, as a defined benefit plan for which an employee benefit liability is recognized and for which the Group deposits amounts in central severance pay funds and in qualifying insurance policies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 16:- EMPLOYEE BENEFIT OBLIGATIONS (Cont.)

c. Defined benefit plans: (Cont.)

1. Amounts recognized in the consolidated income statement in respect of the defined benefit plan are as follows:

	Year ended December 31,	
	2008	2007
Cost of current services	133	103
Interest	36	36
Expected return on plan assets	(11)	(12)
Net actuarial gain recognized during the year	(16)	(5)
Total expense included in the consolidated income statement	<u>142</u>	<u>122</u>

2. The plan (assets) liabilities, net:

	December 31,	
	2008	2007
Defined benefit obligation	486	690
Fair value of plan assets	(245)	(213)
Total liabilities, net	<u>241</u>	<u>477</u>

3. The amount included in the balance sheet in respect of the defined benefit plan for severance pay is as follows:

	December 31,	
	2008	2007
Net liability as of January 1,	477	422
Expense recognized in the consolidated income statement	142	122
Contribution paid	(231)	(74)
Benefits paid	(160)	-
Exchange differences	13	7
Net liability as of December 31,	<u>241</u>	<u>477</u>

4. The actuarial assumptions used are as follows:

	2008	2007
	%	%
Discount rate	3.1	3.6
Expected rate of return on funds	3.6	4.1
Future salary increase	3	3
Inflation	1.9	2.8
Rate of employee turnover, disability early retirement	see 5	see 5

5. The rates of employee turnover are 13%, 8% and 5% withdrawal rates until attaining age of 40, 50 and retirement age, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 17:- INCOME TAX EXPENSE**

a. Israeli income tax:

1. Income Tax (Inflationary Adjustments) Law, 1985:

According to the law, until 2007, the results for tax purposes were adjusted for the changes in the Israeli CPI.

In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Starting 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. The amendment to the law includes, inter alia, the elimination of the inflationary additions and deductions and the additional deduction for depreciation starting 2008.

As explained in Note 3, the financial statements of the Company are measured in U.S. dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the net income shown in the financial statements.

2. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

On April 1, 2005, an amendment to the Law came into effect (the "Amendment") and has significantly changed the provisions of the Law (the "Old Law"). Generally, investment programs of the Company that have already obtained approval for an Approved Enterprise by the Israeli Investment Center will continue to be subject to the Old Law's provisions.

Regarding the "alternative benefits" track, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. Such an enterprise is a "Beneficiary Enterprise," rather than the previous terminology of Approved Enterprise. The period of tax benefits for a new Beneficiary Enterprise commences in the "Year of Commencement." This year is the later of: (1) the year in which taxable income is first generated by the Company, or (2) the Year of Election.

If a company requested the "alternative benefits" track for an Approved Enterprise under the Law, it is precluded from filing a Year of Election notice for a Beneficiary Enterprise for three years after the year in which the Approved Enterprise was activated (the "Cooling Period"). The Company has elected the status of a Beneficiary Enterprise under the Amendment for its fourth plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 17:- INCOME TAX EXPENSE (Cont.)**

a. Israeli income tax: (Cont.)

According to the Old Law, the Company is entitled to investment grants (at percentages mentioned below of investment cost) and also to a tax benefit, which grants the Company a tax exemption for a period of two years and a reduced tax rate of 10%-25% (depending on the level of foreign investments in the Company) for a period of five years. According to the Amendment, the Company is entitled to tax benefits, which grants the Company a tax exemption for a period of ten years. Pursuant thereto, the income of the Company derived from the following "Approved Enterprise" and "Beneficiary Enterprise" programs will be eligible for these benefits for periods stated below:

1. Benefit period for the first program commenced in 1989 and expired in 2002. The investment grants received for this program were 38% of investment cost.
2. Benefit period for the second program commenced in 1994 and has expired in 2007. The investment grants received for this program were 36% of investment cost.
3. Benefit period for the third program commenced in 1999 and is to expire in 2012. The investment grants received for this program were 24% of investment cost.
4. Benefit period for the fourth program commenced in 2006 and is to expire in 2017. This plan is tax exempt for a period of ten years.

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the above law, regulations published there under and the letters of approval for the specific investments in "Approved Enterprises" and "Beneficiary Enterprise". In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest.

As of December 31, 2008, management believes that the Company is meeting all of the aforementioned conditions.

The period of tax benefits, detailed above, is subject to limits of the earlier of 12 years from the commencement of production or the year of election, or 14 years from receiving the approval, whichever is earlier.

Since the Company is operating under more than one program and since part of its taxable income is not entitled to tax benefits under the abovementioned law and is taxed at the regular tax rate, its effective tax rate is the result of a weighted combination of the various applicable tax rates.

By virtue of this law, the Company is entitled to claim accelerated depreciation on equipment used by the "Approved Enterprise" during five tax years.

If tax-exempt profits are distributed to shareholders they would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative system of benefits, currently 25% for an "Approved Enterprise" and for "Beneficiary Enterprise".

Income from sources other than the "Approved Enterprise" or "Beneficiary Enterprise" during the benefit period will be subject to tax at the regular rate prevailing at that time.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 17:- INCOME TAX EXPENSE (Cont.)**

a. Israeli income tax: (Cont.)

The Company's retained earnings as of December 31, 2008, an amount of \$4,591 is tax-exempt and attributable to its Approved Enterprise programs. If such tax-exempt income is distributed in a manner other than upon complete liquidation of the Company, it would be taxed at the reduced corporate tax rate applicable to such profits (currently 25%) and an income tax liability of up to \$1,148 would be incurred as of December 31, 2008.

In addition, as a result of the amendment, tax-exempt income attributed to the Beneficiary Enterprise, will subject the Company to taxes upon any distribution manner including complete liquidation. As of December 31, 2008, the Company had \$3,107 of tax-exempt income attributed to its Beneficiary Enterprise plan. In case of distribution or complete liquidation of the Company, it would be taxed at the reduced corporate tax rate of 25% and an income tax liability of up to \$ 777 would be incurred as of December 31, 2008.

3. The Company is an "industrial company" under the Law for the Encouragement of Industry (Taxation), 1969 and as such is entitled to certain tax benefits, including a deduction of the purchase or certain intangible property rights at the rate of 12.5% per year beginning with the first year the Company used such intangible property rights and the deduction of its public offering expenses over three years.

b. Corporate tax structure:

Taxable income of Israeli companies is subject to tax at the rate of 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

- c. Non-Israeli subsidiaries are taxed according to the applicable laws in their countries of residence. In Mongolia, the current applicable tax rate is graded at the rate of 10% (2007: 10%) up to taxable income of MNT 3,000 million (\$ 2,367) and 25% (2007: 25%) for taxable income in excess of MNT 3,000 million (\$2,367). In Switzerland, the Company entered into a special tax program according to which its effective tax rate for the income derived from foreign sources will be 9.6%.

d. Tax assessments:

Final tax assessments:

The Company received final tax assessments through 2005. The subsidiary, Shim-Tech, received final tax assessments through 2005. The subsidiary, MTSA, has not received final tax assessments since its incorporation (2004).

e. Carry-forward losses for tax purposes and other temporary differences:

Carry-forward operating tax losses of the Company total approximately \$ 8,800 as of December 31, 2008. Carry-forward capital losses total approximately \$ 7,100 as of that date.

Deferred tax assets relating to the carry-forward operating losses of approximately \$ 2,200 and to other temporary differences of approximately \$ 1,900 were not recognized because it is not probable they can be utilized.

As of December 31, 2008, deferred tax liabilities associated with investments in subsidiaries and joint ventures which have not been recognized amounted to \$ 5,052, as their utilization in the foreseeable future is not probable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 17:- INCOME TAX EXPENSE (Cont.)

- f. Significant components of the Company's deferred tax assets (liabilities) are as follows:

	December 31,	
	2008	2007
Deferred tax liabilities		
Property, plant and equipment	(697)	(453)
Unrealized intercompany profits	(3)	-
	<u>(700)</u>	<u>(453)</u>
Deferred tax assets		
Inventory	188	18
Carry-forward tax losses	344	-
Unrealized intercompany profits	-	267
Other	89	130
	<u>621</u>	<u>415</u>
Total deferred tax liabilities, net	<u>(79)</u>	<u>(38)</u>

- g. Income tax expense consists of the following:

	Year ended December 31,	
	2008	2007
Current	-	2,016
Deferred	41	2,068
	<u>41</u>	<u>4,084</u>

- h. The difference between income taxes computed at statutory tax rate of the Company and income tax expense in the consolidated income statement is explained as follows:

	Year ended December 31,	
	2008	2007
Profit (loss) before tax	<u>(8,564)</u>	<u>3,349</u>
Tax calculated at statutory tax rate (2008- 27%; 2007- 29%)	(2,312)	971
Increase (decrease) due to:		
Different income tax rates of other countries	379	(1,189)
Temporary differences for which deferred taxes were not recorded	3,264	3,500
Non-deductible expenses	202	209
Differences in measurement basis (local currency for tax purpose and dollars in book)	(1,235)	-
Exemption income tax	(197)	-
Other	<u>(60)</u>	<u>593</u>
Income tax expense	<u>41</u>	<u>4,084</u>
Effective tax rate	<u>-</u>	<u>122%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 18:- RELATED PARTIES

- a. Transactions with related parties:

	Year ended December 31,	
	2008	2007
Employee benefits and fees:		
Shareholders (1)	542	411
Former CEO, director and share holder (1)(2)	69	709
CEO and director (3)	710	-
Directors not employed by the Company	118	108
Key management personnel	160	296
	<u>1,599</u>	<u>1,524</u>

- b. Compensation of related parties and key management personnel:

	Year ended December 31,	
	2008	2007
Short-term employee benefits	1,427	1,118
Post-employment benefits	392	78
Share-based payments (2)	(220)	328
Total compensation	<u>1,599</u>	<u>1,524</u>

- c. Balances with related parties:

	December 31,	
	2008	2007
Other accounts payable (4)	209	202
Dividend payable (5)	209	940
Loans to joint ventures (6)	-	3,278
Long- term loans (7)	414	414

- (1) In accordance with the employment agreements with the former CEO and the Chairman of the Board of Directors; both of whom are shareholders, according to which each is entitled to a bonus equal to 5% of the annual increase in the net profit of the Group subject to a maximum bonus cap of £ 450 thousands each (equal to three times their gross basic salary). There was no bonus in 2008 and 2007.
- (2) In March 2008 the Company CEO resigned his positions as CEO and a director. As part of the severance agreement, the parties agreed that the former CEO would receive a one-time grant of \$324, mainly in consideration for a non-competition clause. As a result of his resignation, the Company recorded an expense of \$324 and reversed the expense in respect of the options granted to the former CEO in 2007 that had not vested at the date of his resignation.
- (3) In April 2008 the Company entered into an agreement with a new CEO who shall also be a Director, whereby he is entitled to annual compensation of \$387, as well as an annual bonus contingent upon the financial results after twelve months in office. In addition, the CEO was granted stock options, a portion of which vested immediately, and a portion conditional upon performance and vesting, see Note 21. The agreement further states that in the event his employment as CEO is terminated, he will be entitled to one year's salary as a termination benefit. On March 15, 2009, the new CEO resigned his position as CEO and director and therefore he is entitled to a termination benefit of up to approximately \$ 300.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 18:- RELATED PARTIES (Cont.)**

- (4) Amounts owed to shareholders on a current account basis, bear no interest and have no maturity date.
- (5) See Note 20 (b).
- (6) Amounts owed by BIT bearing interest at LIBOR+1%. The loan was provided to BIT in order to secure a credit line from the bank. The loan with accrued interest totaling \$3,354 was repaid in full on August 1, 2008 as part of the agreement for the sale of the investment in BIT Metals BV.
- (7) See Note 15(a) (2).

NOTE 19:- COMMITMENTS AND CONTINGENT LIABILITIES

- a. In accordance with the provisions of the Law for the Encouragement of Capital Investments, 1959, the Company and its subsidiaries in Israel received grants from the State of Israel in respect of investments in their plants (see Note 10). The conditions in the letters of approval extending the grants from the State of Israel primarily include the requirements that the investments be made according to the approved plan and that at least 30% of the investments be financed by outstanding share capital. Non-fulfillment of these conditions would require the refund of the grants linked to the Consumer Price Index in Israel from the date of receipt plus interest. To guarantee fulfillment of the conditions for receiving the grants, the Company and its subsidiaries have recorded floating charges on all of their assets in favor of the State of Israel. In the opinion of management, as of December 31, 2008, the Company and its subsidiaries are meeting the required conditions.

- b. Charges:

As collateral for the Company's liabilities, fixed charges have been placed on motor vehicles and inventory.

Certain bank loans are collateralized by fixed charge on the Company's share capital and goodwill and a floating charge (a continuing charge on the Company's present and future assets but permitting the Company to dispose of such assets in the ordinary course of business) on all of the assets of the Company and its subsidiaries.

- c. Royalty commitments:

Royalties to the Office of the Chief Scientist ("OCS"):

Under the research and development agreement of the Company with the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the OCS research and development grants received, linked to the U.S. dollar plus interest on the outstanding amount received based on the 12-month LIBOR rate at the date of grants received. The Company is obligated to repay the Israeli Government for the grants received only to the extent that there are sales of the funded products.

The Company did not accrue any royalties for each of the three years in the period ended December 31, 2008 as no revenues were recorded.

As of December 31, 2008, the Company had a contingent obligation to pay royalties in the amount of approximately \$ 1,041. This obligation will be recorded when payment becomes probable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 19:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

- d. Regarding the bonus to former CEO and Chairman of the Board of Directors, see Note 18.
- e. In July 2006, the Uzbek government issued a regulation resulting in cancellation of the exclusivity clause in the contract between Uzmetal and AGMK, its main supplier. AGMK ceased supplying Uzmetal with materials, and asked Uzmetal to sign the annulment agreement, which Uzmetal refused to do. AGMK applied to a court of law for its approval of the annulment. The court approved the annulment of the agreement. Uzmetal appealed and lost. During 2007, Uzmetal appealed to the Uzbek Supreme Court. In August 2007, the court reached a decision and declared Uzmetal bankrupt. In October 2007, the Appellate court has rejected the Company's claims with respect to cancelling a previous ruling made and not accepted that the Company is a creditor of Uzmetal while it accepted that the Uzbek shareholders are creditors of Uzmetal. In addition, the court has decided to start a liquidation process. The Company, on the advice of its legal counsel is considering its actions.
- f. M TSA is committed to pay marketing and operating commissions to certain advisors at a rate of 0.7% and 3% of the gross amount of purchases of the Mongolian subsidiary from its main supplier of Molybdenum raw material, which is the minority shareholder of the Mongolian subsidiary. Commission expenses recorded in the cost of sales were \$ 2,246 for the year ended December 31, 2008 (2007-\$2,532).
- g. Open purchase orders and capital commitments:
As of December 31, 2008, commitments for the purchase of property and equipment and inventory total approximately \$ 498 (2007- \$8,641).
- h. During the course of 2007 three separate legal actions were filed in the Beer Sheva District Court, all three similar in their content, yet for different financial amounts. All three have been filed claiming illnesses caused by the exposure to contaminants in the air and water caused by the factories in the Ramat Hovav Industrial Park, and all filed against the Ramat Hovav Local Council and the State of Israel, The first action, filed by nine plaintiffs, is for \$12,100, including special damages, loss of future earnings, refund of legal fees and punitive damages. The second action, filed by 19 plaintiffs, is for \$14,200. The third action, filed by 54 plaintiffs, is in the amount of \$37,300. The Ramat Hovav Local Council in turn named Metal-Tech as a third party to these actions. On October 30, 2008, the Company filed a writ of defense as a third party defendant named by the Ramat Hovav Council, and on February 1, 2009, as a third party defendant named by the State of Israel. It is the opinion of the Company's legal counsel that these lawsuits will continue for many years until a final verdict will be given.
In view of the above and owing to various reasons including the fact that the claims are convoluted and based on arguments of ecological damage and given the large number of parties involved (and the difficulty to estimate the distribution of responsibilities among them, if any), the exposure of substantially all of the plaintiffs to other risk factors, the factual, scientific and legal issues that need deciding, the difficulty in determining and proving the existence/non existence of a causal relation and the absence of an accurate amount of the damage, at this stage, the Company and its legal counsel are unable to assess the whether the plaintiffs' position regarding the issue of the claims' specific causal relation will eventually be accepted. Accordingly, no provision was included in respect of these claims in the financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 19:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

- i. In July 2008 the Company entered into a joint venture (JV) MOU with a company incorporated under the laws of the Republic of Chile (The partner). The Company and the partner each own 50% of the JV.

The JV was established for the purpose of participating in "Corporation Nacional del Cobre de Chile" (Codelco) bid for technological development for slag processing. The Company develops the technology needed for the bid, the total cost of the development cost is estimated at \$11,000 and includes the estimated value of the technology that the Company will invest, in JV. The partner will participate in financing the technological development up to the amount of \$5,500 in two phases.

As of December 31, 2008, the Company recorded expenses in the amount of \$341 and the partner paid the Company \$333 according to the financing schedule. This amount from the partner has been recorded as a liability due to the uncertainty of success in the bidding process.

NOTE 20:- EQUITY

- a. The share capital is composed as follows:

	<u>Authorized</u> <u>December 31, 2008 and 2007</u>	<u>Issued and</u> <u>outstanding</u>
Ordinary shares of NIS 0.2 par value each	<u>100,000,000</u>	<u>38,376,923</u>

The Company's shares are traded on the London Stock Exchange Alternative Investment Market ("AIM"), under the symbol "MTT".

- b. Dividends:

In accordance with resolutions approved by the shareholders in meetings held in May 2007 the Company declared dividends in the amount of \$ 1,189, of which \$249 was paid in July 24, 2007. An additional \$731 was paid during 2008 and the balance of \$ 209 is presented as a liability.

NOTE 21:- SHARE-BASED PAYMENTS PLANS

- a. The expense recognized for employee services received during the year is shown in the following table:

	<u>2008</u>	<u>2007</u>
Expense arising from equity-settled share-based payment transactions recorded in:		
Cost of goods sold	169	102
General and administrative expenses *)	<u>(55)</u>	<u>404</u>
Total expense arising from share-based payment transactions	<u>114</u>	<u>506</u>

*) Net of reversal of expense of \$303 due to forfeiture of options of former CEO, see Note 18.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 21:- SHARE-BASED PAYMENTS PLANS (cont.)**

b. Description of the Company's Options Plan

1. 2007 Israeli Option Plan

In 2007, the Company adopted the 2007 Israeli Option Plan (the "2007 Plan"), which complies with the Israeli tax reforms. Qualified options are held in trust until the later of 24 months from the date of grant of the options, or the vesting of the options based on a vesting schedule determined by a committee appointed by the Company's Board of Directors. 1,918,846 options were reserved for issuance as of December 31, 2007 under this plan. As of December 31, 2008, 613,301 options remain available for grant under the 2007 Plan and 785,191 options were forfeited. Each option under the plan is exercisable into one ordinary share at an exercise price of £1.3. The 2007 Plan expires in June 2017. Two third of the options under the 2007 plan are exercisable over a 24-months period and one third of the options are exercisable over 36- months period, from the date of grant. The fair value of the options granted was £0.748 (\$1.5).

2. 2008 Israeli Option Plan- A

On September 17, 2008, the Company's Board of Directors approved a grant of 1,017,500 options to the new CEO (see Note 18). Each option under the plan is exercisable into one Ordinary share at an exercise price of 0.62 Pence. The vesting conditions for 508,750 options (sub plan 1) are time-based and for 508,750 options (sub plan 2) are time based as well as performance based.

Subplan 1- options vest semi-annually over four years from April 14, 2008.

Subplan 2 - options vest semi-annually over four years from April 14, 2008 and are also subject to an earnings per share ("EPS") performance target of an annual increase in EPS of 10% in relation to the Company's EPS as of December 31, 2007 and measured in each vesting date on the basis of the most recent semi- annual or annual published financial results of the Company.

The weighted average fair value of each option granted is £0.13 (\$0.232) (see c below).

As described in Note 18, the acting CEO resigned his position as CEO in 2009 and therefore all unvested options expired.

3. 2008 Israeli Option Plan – B

On November 20, 2008 the Company's Board of Director approved a grant of 2,500,000 options to the Company's employees, 183,504 options remain available for grant under this plan. Each option under the plan is exercisable into one Ordinary share at an exercise price of 18.5 pence.

The options vest in eight equal semi annual tranches, starting the on first anniversary of the grant date (4.5 years in total) subject to meeting certain market conditions.

In order to determine the number of options which should actually vest at the end of every 6 months (the "Vesting Date"), the amount of options which are scheduled to vest on each Vesting Date, together with options which were carried forward from the previous Vesting Date, if at all, will be multiplied by two percentage factors, which will be determined based on meeting two criteria, as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 21:- SHARE-BASED PAYMENTS PLANS (cont.)**

b. Description of the Company's Options Plan (cont.)

1. First, the percentage of options which will vest on each Vesting Date will depend on Total Shareholder Return (share price appreciation plus dividends ("TSR")) as follows:
 - (a) 100% if TSR is 20% or more on an annualized basis from the date of grant;
 - (b) 50% if TSR is at least 10% on an annualized basis from the date of grant;
 - (c) 0% if TSR is less than 10% on an annualized basis from the date of grant; and pro rata on a straight line basis if TSR is between 50% and 100%.
2. The amount of vested options calculated pursuant to the TSR criteria will then be multiplied by a further percentage factor, which depends on Earning per Share Growth ("EPSG"), as follows:
 - (a) 100% if EPSG is 10% or more on an annualized basis from the date of grant;
 - (b) 50% if EPSG is at least 5% on an annualized basis from the date of grant;
 - (c) 0% if EPSG is less than 5% on an annualized basis from the date of grant; and pro rata on a straight line basis if EPSG is between 50% and 100%.

TSR and EPSG will be measured semi-annually. Share price will be defined as the average closing price for all trading days in the last month of the half year.

Each measurement will apply to all previous vesting periods, on a cumulative basis. In other words, options not vested on a certain Vesting Date as a result of the above calculations, shall be carried forward to the following scheduled Vesting Date and added to the scheduled number of options due on such following Vesting Date. The number of such added options together with the number of such scheduled Options shall form the basis for the above calculations at the following Vesting Date and so forth through the last Vesting Date.

The weighted average fair value of options granted is £0.06 (\$0.09).

The options will expire after 10 years from vesting commence date.

- c. The following table lists the inputs to the models used for the three plans for the years ended December 31, 2008 and 2007:

	2008		2007
	A	B	
Dividend yield (%)	1.07	-	1.2
Expected volatility (%)	44.72-48.41	45.53-75.79	34.3
Risk-free interest rate (%)	3.74-4.51	1.77-5.18	4.4
Post vest cancellation rate (%)	-	9.8	6.4
Suboptimal factor	2.76	2.51	2.7
Weighed average share price (€)	0.38	0.185	1.4
Model used	Binomial	Monte-Carlo	Binomial

The assumptions used are based on historical data of the company and comparable companies as the Company is traded for four years. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

The options granted are equity-settled plans and the fair value is measured at the grant date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 21:- SHARE-BASED PAYMENTS PLANS (cont.)**

d. Movements in the year:

The following table illustrates the number (No.) and weighted average exercise prices (WAEP) of, and movements in, share options during the year:

	2008		2007	
	No.	WAEP	No.	WAEP
Outstanding as of January 1	1,305,545	£ 1.3	-	£ -
Granted during the year	3,333,996	£ 0.32	1,305,545	£ 1.3
Forfeited during the year	(785,191)	£ 1.3	-	£ -
Outstanding as of December 31	<u>3,854,350</u>	<u>£ 0.45</u>	<u>1,305,545</u>	<u>£ 1.3</u>
Exercisable as of December 31	<u>-</u>		<u>-</u>	

The weighted average remaining contractual life for the share options outstanding as of December 31, 2008 is 8.9 years (2007- 9.5 years).

The weighted average fair value of options granted during 2008 was £ 0.08 (\$0.131) (2007- £ 0.748 (\$ 1.5)).

e. The options granted to employees under those plans were offered to employees who are not "controlling shareholders" as the term is defined in the Income Tax Ordinance in Israel, through a trustee, based on Section 102 to the Income Tax Ordinance.

NOTE 22:- FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

a. The Group's principal financial liabilities, other than derivatives, are comprised of bank credit, bank loans and trade payables. The main purpose of these financial instruments is to raise financing for the Group's operations. The Group has various financial assets such as trade receivables and cash, which arise directly from its operations.

The Group also enters into derivative transactions, primarily forward currency and options contracts. The purpose is to manage the currency risks arising from the Group's operations and its sources of finance.

It is, and has been throughout 2008 and 2007, the Group's policy that no trading in derivatives shall be undertaken.

The main risks arising from the Group's financial instruments are cash flow interest rate risk, liquidity risk, foreign currency risk and credit risk. The Company's management reviews and agrees on policies for managing each of these risks which are summarized below.

Interest rate risk:

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's debt obligations with floating interest rates. As of December 31, 2008, approximately 22% (2007- 20%) of the Group's borrowings is at a fixed rate of interest. Due to the fact that the Group's long-term borrowings bear a fixed rate of interest, no major exposure exists. The following is sensitivity to a reasonably possible change in interest rates with all other variables held constant: an increase/decrease of 1% in the interest rate will result in decrease/increase in profit of the Company of approximately \$ 256 (2007-\$ 270).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 22:- FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Cont.)

Foreign currency risk:

As of December 31, 2008, approximately 26% (2007-29%) of the Group's financial assets and 23% (2007-21%) of the Group's financial liabilities were on currencies other than the functional currency of the relevant entity. As such, changes in foreign exchange rates should have a limited impact on the Group's financial performance. The Group has not presented a sensitivity analysis to a reasonably possible change due to immateriality.

The Group also has transactional currency exposures. Such exposure arises from sales or purchases by an operating unit in currencies other than the Company's functional currency. Approximately 12% of the Group's sales are denominated in currencies other than the functional currency of the operating unit making the sale, whilst almost 90% of costs are denominated in the unit's functional currency. See (d) for further details on derivatives financial instruments.

Credit risk:

The Group trades mostly with recognized, creditworthy third parties. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 7. There are no significant concentrations of credit risk within the Group.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short term deposits, short-term and long-term restricted cash and trade receivables.

Cash and cash equivalents are invested in U.S. dollars and in NIS with major banks in Israel and abroad. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

Liquidity risk:

The Group monitors its risk to a shortage of funds. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank overdrafts and bank loans.

b. Concentration of liquidity risk:

The table below presents the maturity profile of the Group's financial liabilities based on contractual undiscounted payments:

December 31, 2008:

	Less than one year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	> 5 years	Total
Short-term bank credit	10,562	-	-	-	-	-	10,562
Loans from banks	15,597	-	-	-	-	-	15,597
Trade payables	17,435	-	-	-	-	-	17,435
Other accounts payable	12,151	-	-	-	-	-	12,151
Long term loans	1,658	1,739	1,819	1,392	1,413	418	8,439
	<u>57,403</u>	<u>1,739</u>	<u>1,819</u>	<u>1,392</u>	<u>1,413</u>	<u>418</u>	<u>64,184</u>

December 31, 2007:

	Less than one year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	> 5 years	Total
Short-term bank credit	11,381	-	-	-	-	-	11,381
Loans from banks	16,364	-	-	-	-	-	16,364
Trade payables	26,044	-	-	-	-	-	26,044
Other accounts payable	16,946	-	-	-	-	-	16,946
Long term loans	1,167	1,496	1,559	1,621	2,197	456	8,496
	<u>71,902</u>	<u>1,496</u>	<u>1,559</u>	<u>1,621</u>	<u>2,197</u>	<u>456</u>	<u>79,231</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 22:- FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Cont.)**

c. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, short-term restricted cash, trade receivables, other accounts receivable, short-term bank credit, short term loans, trade payables and other accounts payable approximate their fair value due to the short-term maturity of such instruments.

The fair value of available for sale marketable securities is determined by reference to quoted bid prices at the close of business on the balance sheet date.

The carrying amounts of the Group's short-term loans approximate their fair value as the interest rates are variable.

The fair value of long- term loan received with fixed interest in the carrying amount of \$ 7,132 is \$ 7,280, based on the computation of the present value of cash flows using interest rate currently available for loan with similar terms (2007- \$ 6,788, \$ 7,093, respectively).

d. Derivative financial instruments:

To hedge against the risk of changes in the value of cash flows resulting from forecasted transactions of foreign currency receipts related to sales during the year, the Company has instituted a foreign currency cash flow hedging program. The Company hedges portions of its forecasted receipts denominated in Euros with forward contracts or with put and call options. These forward contracts and options are designated as cash flow hedges. It is the Group's policy to negotiate the terms of the hedge derivatives to match the terms of the hedged item to maximize hedge effectiveness.

In 2007, the Company entered into the following transactions in derivatives:

Thirteen forward contracts and options, each for the exchange of a range of € 300 thousand - € 700 thousand into dollars at rates of \$ 1.341-\$ 1.53, which are to be carried out at the beginning of each month during the period from January 3, 2008 to January 4, 2009.

The Company recognized profit of \$ 56 and loss of \$ 198 during the years ended December 31, 2008 and 2007, respectively, related to the forward exchange contracts and options.

e. Capital management:

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder value. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 23:- SUPPLEMENTARY INFORMATION TO THE CONSOLIDATED INCOME STATEMENT

- a. Cost of sales before write-down of inventories:

	Year ended December 31,	
	2008	2007
Materials	108,178	100,266
Salaries and related benefits	5,746	2,820
Depreciation	2,192	1,591
Maintenance and repairs	1,839	1,934
Electricity, water and gas	2,114	1,588
Packaging, transportation and shipping	2,253	1,677
Other	5,196	4,595
	<u>127,518</u>	<u>114,471</u>
Write -down of inventories *)	<u>7,501</u>	<u>2,500</u>

*) See Note 9.

- b. Research and development expenses, net:

Subcontractors	456	1,103
Salaries and related benefits	817	869
Supplies and materials	104	73
Other	141	98
	<u>1,518</u>	<u>2,143</u>
Less – research and development grants	<u>(21)</u>	<u>(152)</u>
	<u>1,497</u>	<u>1,991</u>

- c. Selling and marketing expenses:

	Year ended December 31,	
	2008	2007
Commissions	628	435
Salaries and related benefits	724	204
Travel	57	44
Other	45	92
	<u>1,454</u>	<u>775</u>

- d. General and administrative expenses:

Salaries and related benefits	2,896	2,323
Professional fees	1,190	1,024
Business development	1,121	418
Communications	345	165
Travel	631	178
Doubtful accounts	488	19
Other	1,243	534
	<u>7,914</u>	<u>4,661</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 23:- SUPPLEMENTARY INFORMATION TO THE CONSOLIDATED INCOME STATEMENT
(Cont.)

e. Finance costs and finance income:

	Year ended December 31,	
	2008	2007
Finance costs:		
Interest in respect of loans	(1,922)	(1,736)
Bank commissions and other expenses	(123)	(177)
Loss from derivative	-	(198)
Foreign exchange differences	(1,363)	(1,389)
Amortization of deferred finance costs	(151)	(151)
	<u>(3,559)</u>	<u>(3,651)</u>
Finance income:		
Interest in respect of deposits	272	763
Foreign exchange differences	44	389
Interest in respect of loan to a joint venture	77	205
Gain from derivative	56	-
	<u>449</u>	<u>1,357</u>
	<u><u>(3,110)</u></u>	<u><u>(2,294)</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 24:- REVENUES BY GEOGRAPHIC AREAS AND MAJOR CUSTOMERS**

The Group manages its business on a basis of one reportable segment.

- a. Revenues classified by geographical destinations based on the customer location:

	Year ended December 31,	
	2008	2007
United States	33,386	32,595
China	4,768	13,700
Japan	26,525	10,434
Korea	26,253	42,089
Europe	34,255	29,388
Israel	454	937
South Africa	5,015	3,415
India	5,970	-
Others	1,707	4,155
	<u>138,333</u>	<u>136,713</u>

- b. Information about sales to major customers (as a percentage of total revenues):

	Year ended December 31,	
	2008	2007
Customer A	<u>9%</u>	<u>3%</u>
Customer B	<u>19%</u>	<u>8%</u>
Customer C	<u>6%</u>	<u>18%</u>

- c. The Company's long-lived assets by geographic area are as follows:

	December 31,	
	2008	2007
Israel	8,572	7,252
Mongolia	20,814	18,542
Czech Republic	229	214
Switzerland	1	14
	<u>29,616</u>	<u>26,022</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

NOTE 25:- SUBSEQUENTS EVENTS

- a. On March 15, 2009, the Company CEO resigned his position. The Chairman of the Board will temporarily fill this position until a replacement is found.
- b. Regarding the suspension of production in its Mongolian plant, see Note 1(c).
- c. Subsequent to the balance sheet date, the Company reached an agreement with the banks, whereby it would convert short-term credit into a loan in the amount of \$4,000 that will be paid in 24 equal monthly installments.
As collateral for this loan, the Swiss subsidiary, Metal Tech SA, will supply a bank guarantee for the amount of the loan that will be reduced back to back against the loan payments. In addition, the Swiss subsidiary will supply an unlimited guarantee in favor of the Israeli banks.

In addition, the Company committed itself to the following covenants:

1. The ratio of trade receivables and inventory with total short term bank credit will not fall below certain ratio.
2. Limitations as to declaration of dividends.
3. There will be no change in holdings of subsidiary companies without prior approval of the banks.

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