

ITL Optronics Inc.



Valuation of Identified Intangible Assets of

Fraser Volpe LLC.

As of December 28, 2007

- PRIVATE AND CONFIDENTIAL -

March 2008

Mr. Shahar Armon, CFO
ITL Optronics Ltd.
Israel

Dear Mr. Armon,

Valuation of Identified Intangible Assets of Fraser Volpe LLC

As of December 28, 2007

The accompanying report summarizes our estimation of the Fair Market Values as of December 28, 2007 (hereinafter the “**Transaction Date**” or the “**Valuation Date**”), of certain identified intangible assets of Fraser Volpe LLC (hereinafter “**FV**” or “the **Company**”) acquired by ITL Optronics Inc. (hereinafter “**ITL**”). We understand the results of our analysis will assist ITL management in allocating the purchase price paid to the assets and liabilities acquired for financial reporting purposes as required under Israeli GAAP.

This valuation report is intended solely for the information and use of the management of ITL (“**Management**”), its independent certified public accounting firm, its legal counsel, and in documents filed with the Securities and Exchange Commission. It is not to be used, circulated, quoted, or otherwise referred to for any other purpose, including, but not limited to, the registration, purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in a registration statement or any other document.

For financial reporting purposes, Fair Market Value (FMV) is defined as the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. We determined Fair Market Value assuming the ongoing use of the assets in the existing business. Accordingly, the conclusions reached in this valuation are meaningful only for the specific purpose of this engagement as stated above.

The identifiable intangible assets valued include: Brand Name, Developed Technology, and Supply Agreement. **All current assets, tangible assets, other assets, and goodwill associated with the acquisition, were not subject to independent valuation in this report.**

In the course of our valuation, we used financial and other information, including prospective financial information, valuations and other balance items adjustments provided to us by ITL Management we believe to be reliable. Our conclusions are dependent on such information being

complete and accurate in all material respects; however, we have not examined such information and, accordingly, do not express an opinion or any other form of assurance thereon.

Summary of findings

Based on our analysis, we recommend for your consideration the following Fair Market Values for the identified intangible assets:

Asset	Fair Value	Amortization period (years)	Valuation Method
Brand Name	831	10	<i>Relief from Royalty</i>
Developed Technology	2,243	10	<i>Income Approach</i>
Supply Agreement	654	4	<i>Income Approach</i>

Our procedures did not include investigation of, and we assume no responsibility for, the titles to, or any liens against, the subject assets. Furthermore, we assume there are no hidden, unapparent, or unexpected conditions that could affect the value of the assets and accept no responsibility for discovering such conditions.

Sincerely,



Variance Economic Consulting Ltd.

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1. OVERVIEW

1.1 Background

ITL is a fully owned subsidiary of ITL Optronics Ltd., a public company with its shares traded on the Tel Aviv Stock Exchange (TASE) since 1993, acting in the military Defense Electronics and Electro-Optics field. ITL provides advanced solutions for today's combat scenarios. ITL's integrated in-house capabilities include C4I, Modern Infantry soldier suits & Smart electro-optical systems.

On December 7, 2007 ITL signed a purchase and redemption agreement with FV and its shareholders. In consideration for the purchase, ITL paid approximately \$8 million in consideration for 72.6% sharing ratio. On December 28, 2007 the purchase transaction was completed.

FV, headquartered in Warminster, Pennsylvania U.S, is engaged in the design, development and manufacture of gyro-stabilized electro-optic systems.

1.2 Purpose and Scope

Variance Economic Consulting Ltd. ("Variance") has performed an independent analysis with respect to the Fair Value of certain identified intangible assets acquired, as required under the provisions of Israeli GAAP as of December 28, 2007, the Transaction Date.

Fair Market Value is defined as the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

We understand this appraisal will provide ITL Management with a basis for its allocation of the purchase price for financial reporting purposes. Our appraisal comprised of certain identifiable intangible assets, including **Brand Name, Developed Technology and Supply Agreement**. **All current assets, tangible assets, other assets, and goodwill associated with the acquisition, were not subject to independent valuation in this report.**

1.3 Sources of Information

Our analysis is based on information provided by ITL Management as well as FV management, including:

- Purchase and Redemption Agreement
- Due Diligence report
- FV financial reports for the years 2005-2007
- FV 2008 budget as well as FV management projections

- Supply agreements summaries
- Discussions with ITL and FV managements

We have not audited this data, and have not independently assessed this data for accuracy and reasonableness beyond a general assessment of market conditions. Therefore, we express no opinion regarding the accuracy of the revenue forecasts provided by Management and used in this analysis. Our conclusion is dependent on such information being complete and accurate in all material respects.

2. TRANSACTION OVERVIEW

2.1 Description of the Transaction

The Purchase and Redemption Agreement (the “**Agreement**”) is made as of December 7, 2007 by and between ITL (the “**Buyer**”) and Fraser-Volpe LLC, the members of FV and Joseph Volpe (all together “**the Sellers**”).

According to the agreement, ITL shall be issued a 45% percentage interest and a 72.6% sharing ratio in exchange for the consideration as described below.

2.2 Summary of Total Consideration

In consideration for the above ITL agreed to pay and deliver to Sellers:

- \$5,547,500 in cash.
- Direct transaction costs of approximately \$0.7 million.
- ITL transferred the manufacturing assets and liabilities of its Minden plant as well as its plant net income in exchange to the interest issued. The fair value of this plant and its activity, as of the Transaction Date, based on an independent valuation analysis, is approximately \$1.7 million.

The total consideration paid in connection with the Transaction, as provided by ITL management, is summarized below:

Total Consideration	
As of December 28, 2007	
(\$'000s)	
Cash Payment	5,547
Transaction costs	653
Plant net income and Assets	1,717
Total Consideration	7,917

In addition, ITL agreed to provide FV with a loan in the principal amount of \$1,000,000 in exchange for ITL note. The loan is bearing an interest of 6% per year.

2.3 Acquisition Drivers

US accounts for 46% of the world defense purchases and 50% of the electro optic market. Therefore, US market is the largest single market for ITL products with hundreds of dollars potential. In 2004, ITL Management adopted new strategic plan targeting the US market as a crucial for ITL. After

examining various alternatives to get the US market, Management decided that acquiring a local US company is the preferred strategy to penetrate the US market and started reviewing target companies. After reviewing few companies, FV was selected as target acquisition and on October 2006, the parties signed a letter of intend.

The reasons for selecting FV are summarized bellow:

- **Marketing Channel** – FV has a proven marketing channel to strategic clients in the US armed forces (army, AF, SOCOM).In addition, FV is an authorized supplier of the US Department of Defense.
- **Developed technology** – FV has a proven EO technology with a wide range of products, which can be immediately expended with ITL products.
- **Domestic Plant** – FV has domestic plant in US with all the certifications needed (ISO9001)
- **Synergies** – there are many synergies between FV and ITL, which can generate operational costs saving, R&D merged programs, and short time to increase market demand.
- **Other** – Local US company enables potential future m&a as well as US public offering.

3. BUSINESS OVERVIEW

3.1 Company's overview

Fraser-Volpe LLC headquartered in Warminster, Pennsylvania is principally engaged in the design, development and manufacture of gyro-stabilized electro-optic systems. Fraser-Volpe LLC provides technical solutions to stabilized and unstabilized electro-optical - mechanical systems and products for military and commercial markets.

The company's operation consists of the development, manufacture and sale of sophisticated sighting systems designed primary for military application. The principal market for its products is the US and foreign militaries.

The Company's products and production processes comply with the strictest quality standards. The company's 2,000 m2 facility in Warminster, PA.(North of Philadelphia) is ISO 9001 Certified.

The company's viewing systems are used by the United States Army, Federal Bureau of Investigation, United States Drug Enforcement (DEA), Agency of Tobacco and Firearms (ATF), United States Coast Guard, Department of Homeland Security, Bureau of Immigration and Customs Enforcement and other Law Enforcement Organizations and Military Agencies throughout the world.

The company is an authorized supplier of the US Department of Defense.

3.2 Products

Fraser-Volpe pioneered the FIRST generation of active image stabilized binoculars. For over 35 years, the company provides high-quality optical viewing devices.

The M25 stabilized binocular was developed for the U.S. Army. From this model, Fraser-Volpe developed an entire line of gyro-stabilized binoculars. The Gyro-Stabilized product line is referred to as STEDY-EYE® products, which includes more than 15 different models. The STEDY-EYE® Observer, Navigator and Mariner are all direct descendents of the military M25 model. The M25 is the only gyro-stabilized binocular that is Type Classified Standard by the U.S. Army.

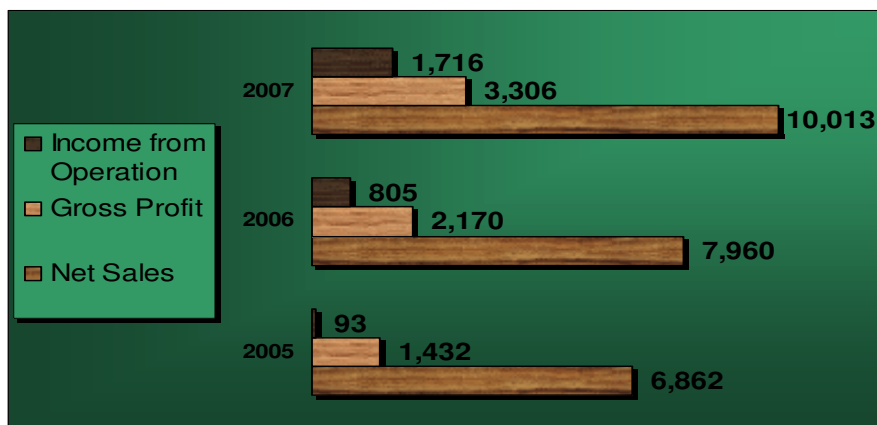


3.3 Financial Analysis

Income Statements

The following table presents the statement of operations of FV for the years ended on December 31, 2005 to 2007:

	31/12/2005	31/12/2006	31/12/2007
Net Sales	6,862	7,960	10,013
COGS	5,430	5,790	6,707
Gross Profit	1,432	2,170	3,306
<i>Gross Margin</i>	21%	27%	33%
General and Administrative	1,339	1,365	1,590
Total Operating Expenses	1,339	1,365	1,590
Income from Operation	93	805	1,716



Revenues – Revenues increased from \$6.9 million in 2005 to \$10 million in 2007, reflecting an increase of 46% during those two years. The increase in revenues in 2007 is mainly attributed to an increase of demand for Stedy Eye products by variety of clients. Revenues from sales to U.S army accounts for 67% of total revenues in 2007, while in 2005-2006 it was accounted as 80%.

Cost of Revenues – Cost of revenues as a percent of revenues decreased from 79% in 2005 to 67% in 2007, due to decrease in sales to U.S army portion from the total revenues. Cost of revenues from sales to US army is higher then sales to others. Cost of revenues includes R&D expenses of approximately \$220 thousands per year, which are mainly attributed to maintenance of the company current technology and modifications of products to client needs.

General and Administrative expense – G&A expenses as a percent of revenues decreased from 20% of total revenue in 2005, to 17% in 2006.

Operating Income – The operating income of the Company has improved throughout the period due to the increase in revenues in on hand and the improvement in COGS. The operating margins have improved from 1% in 2005 to 17% in 2007.

The following chart presents the trend over the last three years:

Balance Sheet

The following table presents FV balance sheet as of December 31, 2006 and 2007 (in 000's \$):

	31/12/2006	31/12/2007
Cash	16	10
Accounts Receivables	661	1,818
Inventory	1,812	2,607
Other Current Assets	23	425
Total Current Assets	2,512	4,860
Property and Equipment, net	201	175
Goodwill	4,090	4,090
Loan Acquisition Costs	4	0
Total Net Assets	6,807	9,125
Subordinated notes payables, current portion	200	400
Line of credit	340	950
Accounts Payables	389	542
Customer Deposits	65	41
Accrued Expenses	258	1,057
Deferred Revenues		
Total Current Liabilities	1,252	2,990
Subordinated notes payables	2,104	1,725
Membership Interests	3,451	4,410
Total Liabilities and Owners' Equity	6,807	9,125

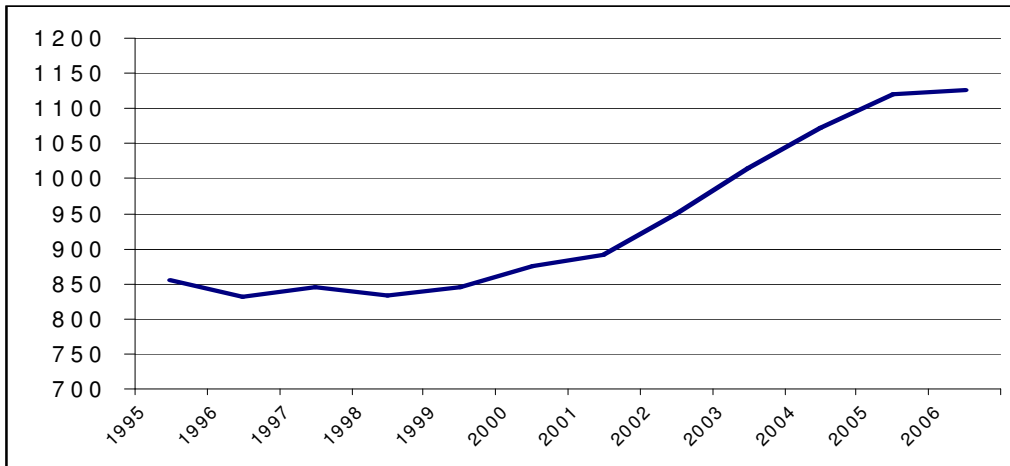
The following table presents the adjustments in FV membership interest as was provided to us by Management:

Membership Interest	
As of December 28, 2007	
(\$'000s)	
Book Balance	4,410
Plus: ITL Plant Assets	66
Less: Goodwill	4,090
Total Consideration	386

4. MARKET OVERVIEW

4.1 Defense

The following table presents the worldwide defense expenditure during the last decade (\$B):



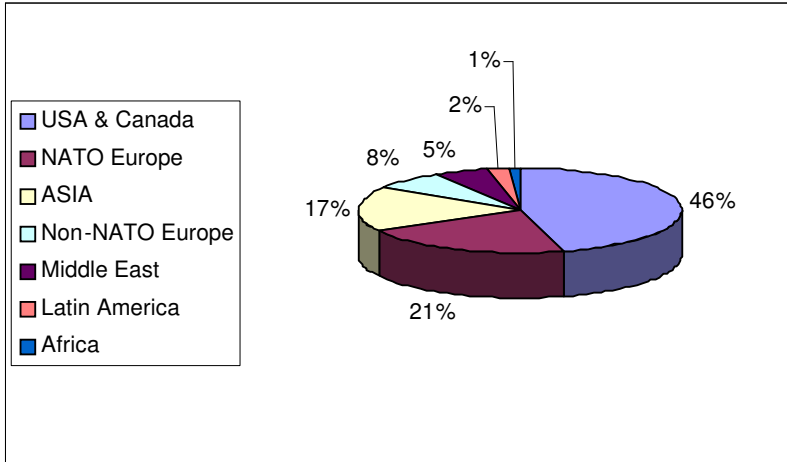
Source: Sipri 2007

During the years 1995 to 2000, total worldwide defense expenditure was approximately 850 billion per annum. From 2000 to 2006, worldwide defense expenditure grew by over 30% with an annual growth rate of approximately 5%.

Our review shows that operational margin in the defense industry ranges between 2%-12%.

4.2 Electro Optical Market

The EO market is estimated at \$6 billion and forecast to grow by 55% in the next decade and to reach \$9 billion. The following table presents the worldwide EO expenditure by region:



U.S market account for 46% of the EO market while Nato Europe accounts for 20% of the EO market.

4.3 Competitors

The significant competitors in the Company's market, to the best of its knowledge, are global companies such as: Litton systems Inc. THALES Weapons Group; ITT Night vision and SAGEM.

5. VALUATION ANALYSIS

5.1 Valuation and Allocation Theory

There are three traditional approaches employed in the valuation of an asset: the Cost Approach, the Market Approach, and the Income Approach. While valuing each intangible asset acquired, we considered each of those approaches and selected the method that was most appropriate for each asset analyzed.

Cost Approach

The Cost Approach is a valuation approach that uses the concept of replacement cost as an indicator of Fair Market Value. The premise of the Cost Approach is that a prudent investor would pay no more for an asset than the amount for which the asset could be replaced. Replacement cost, which refers to the cost to replace the property with like utility using current material and labor rates, establishes the highest amount a prudent investor would pay. To the extent that an existing asset will provide less utility than a new one, the value of that asset is less. Accordingly, replacement cost is adjusted for loss in value due to physical deterioration, functional obsolescence, and economic obsolescence.

Physical deterioration is the loss in value brought about by wear and tear, action of the elements, disintegration, use in service and all physical factors that reduce the life of an asset. Functional obsolescence is the loss in value due to changes in technology, discovery of new materials and improved manufacturing processes. Economic obsolescence is the loss in value caused by external forces such as legislative enactments, overcapacity in the industry, changes in supply and demand relationships in the market, etc. Obsolescence is typically measured by identifying excess operating costs, overcapacities or inadequacies of an asset.

Market Approach

The Market Approach is a valuation technique in which Fair Market Value is estimated based on market prices in actual transactions and on asking prices for assets currently available for sale. The valuation process is essentially that of comparison and correlation between the subject asset and other similar assets. Considerations such as location, time of sale, physical characteristics and conditions of sale are analyzed for comparable assets and are adjusted to indicate a current value of the subject asset.

Income Approach

The Income Approach is a technique in which Fair Market Value is estimated based on the cash flows that an asset can be expected to generate over its useful life. There are five basic steps in applying this approach. First, the annual after-tax cash flows the asset will generate over its remaining useful life

are estimated. Second, these cash flows are discounted to their present value equivalents using a rate of return that accounts for the relative risk of not realizing the estimated annual cash flows and for the time value of money. Third, the residual value of the asset at the end of its remaining useful life is estimated. Fourth, the estimated residual cash flow is discounted to its present value equivalent using a rate of return that is the same as the rate of return used in the second step. Finally, the present value equivalents of the estimated annual after-tax cash flows are summed and then added to the present value of the residual cash flow to obtain an estimate of the asset's Fair Market Value.

According to Israeli Standard No. 30, an acquiring entity shall allocate the cost of the acquired assets to the individual assets and liabilities acquired on the basis of its fair value. The first step in the allocation process involves the discrete valuation of tangible assets, including current assets, plant and equipment and other assets. For the majority of current assets, net book value normally represents a good indicator of their Fair Value.

The second step involves the discrete valuation of intangible assets apart from goodwill including customer relationship and technology. The approach to the valuation of each intangible asset vary depending upon the nature of the asset, the business in which it is utilized, and the economic returns it is expected to generate.

An excess of the purchase price over the amounts assigned to tangible assets and separately recognized intangible assets acquired less liabilities assumed is an evidence of unidentified intangible asset.

5.2 Identification of the Intangible Assets

The valuation of intangible assets of acquired technology-based companies is particularly important since the most valuable assets of this type of company generally are not recorded on the balance sheet before acquisition. Intangibles that may exist at the time of the acquisition include: (a) base (or core), developed, and in-process technologies; (b) customer-related intangibles (such as a distribution network or a customer base); (c) trademark(s), trade name(s), and related intellectual property, and (d) covenants not-to-compete. To determine the fair value for each intangible asset, each assessment should consider specific factors to the asset, including (but not limited to) -

- The value of economic or monetary benefit to market participants.
- The remaining economic life.
- The relative risk profile.

The potential intangible assets were identified through an assessment of the economics of the transaction, a review of supporting documents and materials, and discussions with ITL and FV managements. As a result of our review, we identified the following intangible assets, which meet the criteria for separate recognition apart from goodwill:

Brand Name and Trade Marks

Trademarks are words, names, symbols, or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. Trademarks and trade names may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. Provided it is protected legally through registration or other means, a trademark or other mark acquired in a business is an intangible asset that meets the contractual- legal criterion. The owner of a trademark has the legal right to prevent competitors from using the same or similar mark in a manner that is likely to cause confusion in the minds of the consumer. The terms “brand” and “brand name” are often used as synonyms for trademarks and other marks. However the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark and its related trade name. A trade name includes not only the legal trademark but also the presentation and image that this intangible asset infers.

Brand name, trade names and trademarks have value to a firm in part because they allow consumers to easily identify with a firm, its products or its services, thereby enabling the firm to operate more profitably within the industry.

The FV trade name, including the name STEDY-EYE, is well perceived in the markets served as a provider of high-quality electro-optical devices. The Company was founded in 1972 and this reputation is well established. As of the Transaction Date, FV has two trademarks. The first trademark is for the name STEDY-EYE. The second is for the name STEDY-EYE, with an eye logo in place of the hyphen. The trademarks expire in February 2013. FV is a leading provider of electro optical systems and its brand is well established in the industry. Management believes that the FV brand has good reputation and it is perceived as quality and innovation of one of the forefront players. By acquiring FV, ITL would be able to utilize FV brand recognition since consumers in the industry can easily identify with a firm, its products or its services.

Based on our discussion with Management, we determined that FV trade name constitute value for the buyer. Hence, we identified FV brand name as identifiable and separable intangible assets.

Technology

As of the Transaction Date, FV has one main developed technology – STEDY-EYE®. The company specializes in developing and manufacturing sophisticated sighting systems designed primary for military application. The Gyro-Stabilized product line is referred to as STEDY-EYE® products, which includes more than 7 different models:

- M25 STABILIZED BINOCULAR
- OBSERVER STABILIZED BINOCULAR
- NAVIGATOR STABILIZED BINOCULAR
- MARINER STABILIZED BINOCULAR
- EYE-LINK



The STEDY-EYE® Observer, Navigator and Mariner are all direct descendents of the military M25 model. Management estimates projected sales for this product family are \$30 million with an estimated remaining economic life is 10 years.

As reported by Management, FV has no new technology under development process. R&D expenses are related to modifications to the current developed technology.

Based on our discussion with Management, we determined that FV current technology constitute value for the buyer. Hence, we identified FV current technology which consist of STEDY-EYE® product line as identifiable and separable intangible assets.

Supply Agreement

When an operating entity is sold, the target company is often party to agreements or relationships that are of material value to the acquirer. These may be supply agreements, distributor agreements and/or customer relationships, among others. To the extent future cash flow of the business would be negatively affected in the absence of these agreements or relationships, they would be deemed to have economic value. If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination meet the contractual- legal criterion for identification as intangible assets.

As of the Transaction Date, FV has main customer that contributed approximately 80% of its 2005 and 2006 revenues, and 67% of the 2008 revenues – US Army. The company won a five-year IDIQ

agreement with US Army in August 2004. Contract contains five ordering periods (2004 thru 2009) and has an additional order period covering 2010 and 2011.

Based on our analysis and discussion with Management, we determined that FV supply agreement (IDIQ Agreement) constitute value for the buyer. Hence, we identified FV Supply Agreement as identifiable and separable intangible assets.

5.3 Valuation of Intangible Assets

Brand Name

Brand names and trademarks are typically valued using the Relief from Royalty Method, which can be used to estimate the cash flows that a brand name and trademark can be expected to generate. The relief from royalty approach, a variation of the income approach, is a common and accepted valuation technique used to estimate the Fair Market Value of brand name. In the relief from royalty method, the value of the intangible asset is estimated by capitalizing the royalties saved due to the company's ownership of the intellectual property.

In our valuation analysis we used the following assumptions:

- **Expected Revenues** – the expected revenues are based on the budget provided by Management, which takes into account the Company's total revenues and revenues projected growth as estimated by Management.
- **Royalty Rate** - In order to determine the rate of royalty saving for the use of FV brand name, we searched several industry sources for royalty rates. We found royalty rates ranging from 0.25% to 5% of gross revenues in a sample of transactions involving the use of a brand name with an average of 3%. Therefore, we determined that the royalty rate should be similar to the average and used the average rate of 3% of gross revenues as the appropriate royalty rate for FV brand.
- **Income tax** - was then applied to get an annual royalty payment after tax. We assumed income tax in accordance with the US corporate tax code.

The annual royalty payments after tax were discounted to a present value at the Company's discount rate of 13%, represents the estimated fair value of the brand name. The detailed calculation of the fair value of FV brand name is included in **Appendix C** to this report.

Findings

Based on our analysis, ***the Fair Value of FV brand name*** is determined at **\$0.8 millions**

Developed Technology

The developed technology was valued using the income approach and from a market participant's point of view. Under the income approach, the fair value of the developed technology reflects the present value of the projected cash flows that will be generated by the current technology. By definition, the value of an asset can be estimated by discounting the expected future benefits (cash flow) that will accrue to the owner of the asset to present value using an appropriate discount rate.

Our valuation is based upon FV management's forecasts. The forecast includes STEDY-EYE revenues and the related expenses for the forecast period, 2008-2017. The forecasts were reviewed for reasonableness, and are included in our valuation models.

- **Revenues** – The forecasted revenues are based on Company's budget and Management's assumptions regarding the total units to be sold and the expected average price per unit. The forecasted revenues to be generated by the developed technology are assumed to be \$3.5 million in 2008 growing by 5% per year during the period ending in 2012. Thereafter, Management expected a decline in revenues due to a phase-out of this current technology as presents in the STEDY-EYE product line. The revenues forecast for the following years was determined after consultation with management in regards to the technology's expected revenues and remaining useful life.
- **Costs of revenues** – Assumptions were determined based on the Company's historical performance and on Management's projection. Cost of revenues was projected to be 60% of revenues.
- **General and Administrative expenses** - assumptions were determined based on the Company's historical performance and on Management's projection, as a percent of revenues. G&A expenses constitute approximately 18% of revenues in 2008 and thereafter, which are based on historical performance, including R&D expenses of approximately 3% of revenues. The Company's research and development expenses which were taken into account are only the ones focused on customization and integration of the technology and additions of minor features that are not considered as a substantial change in the technical characterization of the existing technology.
- **Income Tax** – we assumed income tax in accordance with the US corporate tax code to be 41%.

The revenues earned from developed technology represent the return on all the assets purchased, including tangible assets as well as identifiable intangible assets. To separately value the developed technology asset, the value and required rate of return for other identifiable intangible assets must be determined. The required return on these assets is then deducted (“charged”) from the cash flows generated by the customer relationship asset.

As part of our analysis, we determined individual rates of return applicable to each acquired asset and estimated the effective capital charge to be applied to the cash flows generated by the acquired developed technology as detailed in Appendix F.

In addition, we allowed for the theoretical tax benefits associated with amortization of the asset for income tax purposes.

We applied a discount rate of 13% to the developed technology asset. Detailed calculations of the fair value of FV developed technology are included in **Appendices D** to this report, respectively.

Findings

Based on our analysis, ***the Fair Value of FV developed technology*** is determined at **\$2.2 million**.

Supply Agreement

The fair value of supply agreement was estimated by discounting to present value, the cash flows that will be derived from the IDIQ agreement. The discounted cash flow method of the Income Approach explicitly recognizes that the current value of an asset is premised upon the expected receipt of future economic benefits. Analyzing the previous years' revenues, we found that approximately 70% of revenues are reoccurring from this specific agreement. Our valuation only includes revenues from these significant customer based on the agreement terms.

The following are the main assumption used in our supply agreement valuation:

- **Revenues** – we assumed revenues to be approximately \$7 million in 2008 and 2009 based on the customer orders, decreasing to be \$4.5 million and \$3 in 2010 and 2011, respectively.
- **Costs of revenues** – assumptions were determined based on the Company's historical performance and on Management's projection. Overall management believes that the cost of revenues as a percent of revenues is expected to be 70%. Customization costs were based on the Company's historical performance and on Management's projection, as a percent of revenues.
- **General and Administrative expenses** – assumptions were determined based on the Company's historical performance and on Management's projection, as a percent of revenues. G&A expenses constitute approximately 18% of revenues in 2008 and thereafter, which includes customization costs of approximately 3% of revenues.
- **Income Tax** – we assumed income tax in accordance with the US corporate tax code.

The revenues earned from developed technology represent the return on all the assets purchased, including tangible assets as well as identifiable intangible assets. To separately value the supply agreement asset, the value and required rate of return for other identifiable intangible assets must be determined. The required return on these assets is then deducted ("charged") from the cash flows generated by the customer relationship asset.

As part of our analysis, we determined individual rates of return applicable to each acquired asset and estimated the effective capital charge to be applied to the cash flows generated by the acquired developed technology as detailed in Appendix F.

In addition, we allowed for the theoretical tax benefits associated with amortization of the asset for income tax purposes.

We applied a discount rate of 13% to the supply agreement asset. A detailed calculation of the fair value of FV customer relationship is included in Appendix E.

Findings

Based on our analysis, *the Fair Value of FV supply agreement* is determined at **\$0.7 millions**

5.4 Remaining Economic Life

The estimated useful economic life for each intangible asset was based on consideration of the period over which ITL expects to receive economic benefit from the asset and on discussion with managements.

The remaining useful economic life of the identified asset is shown below:

Asset	Remaining useful life (in years)
Brand name	10
Developed technology	10
Supply Agreement	4

- The remaining useful life of FV Brand name is based on revenues projected period, as was provided by Management.
- The useful life of the developed technology is based on Management's estimates as to the life cycle of this technology – 13-15 years. Therefore, Management estimates that the technology (STEDY-EYE products family) remaining economic life is 10 years
- Management bases the useful life of the supply agreement on its termination terms as agreed in the agreement as well as Management believe of as to future orders.

6. CONCLUSION

In our opinion, the Fair Market value of the identifiable intangible assets acquired by ITL from FV and its amortization period is as follows (\$000):

Asset	Fair Value	Amortization period (years)	Valuation Method
Brand Name	831	10	<i>Relief from Royalty</i>
Developed Technology	2,243	10	<i>Income Approach</i>
Supply Agreement	654	4	<i>Income Approach</i>

Based on our analysis, we recommend for your consideration the following purchase price allocation:

Asset	Fair Value¹	% of Interest	Allocated Fair Value
Tangible Assets			
Net Assets 2	386	72.6%	280
Intangible Assets			
Trade Mark - Steady-Eye	831	72.6%	604
Developed Technology	2,243	72.6%	1,628
Supply Agreement	654	72.6%	475
Goodwill 3			4,930
Total Purchase Price			7,917

- (1) Excluding Tax reserve
- (2) Reflects the FMV of tangible assets, based on the management's assessment (see section 7.4).
- (3) Residual amount remaining unallocated to identifiable intangible assets.

APPENDIX A – Limiting Conditions

This report has been prepared solely for Management as requested under the Israeli GAAP, including discussions with ITL auditors, and should not be relied upon for any other purpose. Unless required by law, it shall not be provided to any third party without our prior written consent.

While our work has involved an analysis of financial reports, financial information and accounting records, our engagement does not include an audit in accordance with generally accepted auditing standards of FV existing business records. Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of any information provided by, and on behalf of ITL.

All detailed information and related supporting documents utilized by Variance in the process of purchase price allocation are maintained in Variance's work papers. These work papers are the property of Variance and are available for your review upon request. Variance shall have ownership (including, without limitation, copyright ownership) and all rights to use and disclose its ideas, concepts, know-how, methods, techniques, processes and skills and adaptations thereof (including, without limitation, generalized features of the sequence, structure and organization of any works of authorship) in conducting its business, and ITL shall not assert or cause to be asserted against Variance or its personnel any prohibition or restraint from so doing.

Projections are related to future events and based on assumptions, which may not necessarily remain valid for the whole of the relevant period. Consequently, this information cannot be relied upon to the same extent as that derived from audited accounts for completed accounting periods. We express no opinion as to how closely the actual results will correspond to those projected by Management.

The valuation of companies and businesses is not a precise science and the conclusions arrived at in many cases will be subjective and dependent on the exercise of individual judgment. Therefore, there is no indisputable single value and, as such, we normally express our opinion on the value as falling within a likely range. However, as our purpose requires the expression of a single value, we have adopted a value at the mid-point of our valuation range. While we consider our value/range of potential values to be both reasonable and defensible based on the information available to us, others may place a different value on the business.

Finally, the results of our valuation analysis do not constitute a Solvency Opinion or a Fairness Opinion and should not be relied upon as such. Furthermore, the analysis we perform should not be taken to supplant any procedures that you should undertake in your consideration of a transaction.

APPENDIX B – Cost of Capital Calculation

When applying the Income Approach, the costs are discounted to their present value equivalent using a rate of return that reflects the relative risk of the investment, as well as the time value of money. This return, known as the weighted average cost of capital, (“WACC”), is calculated by weighting the required returns on interest-bearing debt and common equity capital in proportion to their estimated percentages in an expected industry capital structure. We have determined that, as of the Analysis Date, the WACC of FV was approximately 13% as follow:

Fraser Volpe LLC			
Weighted Average Cost of Capital ("WACC")			
<hr/>			
A. Market Based Capital Structure			
Equity -		70.0%	
Debt		30.0%	
B. Cost of Equity			
Cost of Equity = $R_f + B \cdot (R_p) + S_{sp}$	=	16.30%	
R_f - Risk-free Rate 20 Years U.S Treasury bonds =		4.0%	
R_p - Equity Risk Premium. Incremental return demanded by an average investor =		7%	
B - Beta - a measure of the systematic risk or individual price volatility relative to the market =			1.4
S_{sp} - U.S. Small Stock Premium =		3%	
C. Cost of Debt			
Cost of Debt = $Bond\ Rate \cdot (1 - T)$	=	3.84%	
T - Effective Tax Rate =		41%	
B - Bond rate =		6.50%	
D. Weighted Average Cost of Capital ("WACC")			
			<u>Weighted</u>
Cost of Debt	3.84%	30.00%	1.15%
Cost of Equity	16.30%	70.00%	11.41%
			13.00%

(1) Long-term market risk premium

(2) Aerospace/Defense industry's Beta (Demodaran, January 2008)

(3) Average yield of BBB rated bond as of December 31, 2007

APPENDIX C – Fair Value of FV Brand Name

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenues	10,379	10,553	8,335	7,027	4,228	4,228	3,805	2,854	2,141	1,605
Royalty Rate	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Royalty Saving	311	317	250	211	127	127	114	86	64	48
Taxes	128	130	103	86	52	52	47	35	26	20
After Tax Royalty Savings	184	187	148	124	75	75	67	51	38	28
Discount Period	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
Present Value Factor	0.94	0.83	0.74	0.65	0.58	0.51	0.45	0.40	0.35	0.31
Present Value After Tax Royalty Savings	173	155	109	81	43	38	30	20	13	9
Fair Value Before Tax Benefit	672									
Tax Amortization Benefit	159									
Technology Fair Value	831									

APPENDIX D - Fair Value of FV Technology (STEDY-EYE line of products)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Net Sales	3,479	3,653	3,835	4,027	4,228	4,228	3,805	2,854	2,141	1,605
<i>Total Revenue Growth</i>		5%	5%	5%	5%	0%	-10%	-25%	-25%	-25%
Cost of Goods Sold	2,087	2,192	2,301	2,416	2,537	2,537	2,283	1,712	1,284	963
Gross Profit	1,391	1,461	1,534	1,611	1,691	1,691	1,522	1,142	856	642
<i>Gross Margin</i>	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
General and Administrative	626	657	690	725	761	761	685	514	385	289
Income (Loss) from Operation	765	804	844	886	930	930	837	628	471	353
<i>Operational Margin</i>	22%	22%	22%	22%	22%	22%	22%	22%	22%	22%
Taxes	314	329	346	363	381	381	343	257	193	145
Net Income	452	474	498	523	549	549	494	370	278	208
Cash Flow Adjustments :										
Charge on Tangible Assets	(57)	(60)	(64)	(68)	(74)	(71)	(63)	(47)	(35)	(26)
Charge on Intangible Assets	(85)	(86)	(93)	(98)	(115)	(108)	(93)	(69)	(49)	(33)
Free Cash Flow	310	328	341	356	360	370	338	254	193	149
Discount Period	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
Present Value Factor	0.94	0.83	0.74	0.65	0.58	0.51	0.45	0.40	0.35	0.31
Present Value of Free Cash Flows	292	273	251	232	208	189	153	102	68	47

Fair Value Before Tax Benefit	1,814
Tax Amortization Benefit	429
Supply Agreement Fair Value	2,243

APPENDIX E – Fair Value of FV IDIQ Supply Agreement

	2008	2009	2010	2011
Net Sales	6,900	6,900	4,500	3,000
Cost of Goods Sold	4,830	4,830	3,150	2,100
Gross Profit	2,070	2,070	1,350	900
<i>Gross Margin</i>	<i>30%</i>	<i>30%</i>	<i>30%</i>	<i>30%</i>
General and Administrative	1,242	1,242	810	540
Income (Loss) from Operation	828	828	540	360
<i>Operational Margin</i>	<i>12%</i>	<i>12%</i>	<i>12%</i>	<i>12%</i>
Taxes	339	339	221	148
Net Income	489	489	319	212
Cash Flow Adjustments:				
Charge on Tangible Assets	(113)	(113)	(75)	(51)
Charge on Intangible Assets	(168)	(163)	(109)	(73)
Free Cash Flow	208	213	134	88
Discount Period	0.5	1.5	2.5	3.5
Present Value Factor	0.94	0.83	0.74	0.65
Present Value of Free Cash Flows	195	177	99	58


Fair Value Before Tax Benefit	529
Tax Amortization Benefit	125
IDIQ Agreement Fair Value	654

APPENDIX F – Charges

The net income attributable to developed technology and supply agreement was charged to the following contributory assets: working capital, property and equipment, workforce and brand name. We assumed an after tax required return of 10% for working capital, 8% for fixed assets and 13% on the workforce employed. The charge used for brand name was the same as the royalty rate used, net of tax.

The following table presents the calculation of contributory assets to be charged:

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
Total Revenues	10,379	10,553	8,335	7,027	4,228	4,228	3,805	2,854	2,141	1,605	
Tangible Assets											
Net Working Capital											
Working Capital to Revenue (1)	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	
Total Return	10.00%	1,038	1,055	834	703	423	423	381	285	214	161
<i>NWC/Revenues</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	<i>1.5%</i>	
Fixed assets											
Beginning Balance	175	185	185	175	150	105	85	65	45	30	
Period Capital Expenditure	50	50	50	50	50	50	50	50	50	50	
Depreciation	-40	-50	-60	-75	-95	-70	-70	-70	-65	-55	
Ending Balance	185	185	175	150	105	85	65	45	30	25	
Average Balance	180	185	180	163	128	95	75	55	38	28	
Total Return	8.00%	14	15	14	13	10	8	6	4	3	2
<i>Fixed Assets/Revenues</i>	<i>0.1%</i>	<i>0.1%</i>	<i>0.2%</i>	<i>0.2%</i>	<i>0.2%</i>	<i>0.2%</i>	<i>0.2%</i>	<i>0.2%</i>	<i>0.1%</i>	<i>0.1%</i>	
Total Charge of Tangible Assets	1.6%	1.6%	1.7%	1.7%	1.7%	1.7%	1.7%	1.7%	1.6%	1.6%	
Brand Name	831	10									
Royalty Rate	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	
Tax Rate	41%	41%	41%	41%	41%	41%	41%	41%	41%	41%	
Total Charge of Brand Name	1.8%	1.8%	1.8%	1.8%	1.8%	1.8%	1.8%	1.8%	1.8%	1.8%	
Workforce	555	10									
Beginning Balance	555	504	449	393	338	282	227	171	116	60	
Amortization	51	55	55	55	55	55	55	55	55	55	
Ending Balance	504	449	393	338	282	227	171	116	60	5	
Average Balance	530	476	421	365	310	254	199	143	88	32	
Total Return	13.00%	69	62	55	47	40	33	26	19	11	4
Total Charge of Workforce	0.7%	0.6%	0.7%	0.7%	1.0%	0.8%	0.7%	0.7%	0.5%	0.3%	
Total Charge of Intangible Assets	2.4%	2.4%	2.4%	2.4%	2.7%	2.6%	2.4%	2.4%	2.3%	2.0%	



Recognizing your needs.
Realizing your vision.



Giza-Singer-Even | February 2008
Financial valuation
ITL Optronics Inc.

We have been commissioned by ITL Optronics Inc. (Hereinafter: "the Company" and/or "ITL") to provide an economic valuation of Company operations.

1. Restrictions on scope of work

In formulating its opinion, Giza-Singer-Even assumed and relied on the accuracy, completeness and currency of information obtained from the company, including financial data and forward-looking assessments. Giza-Singer-Even is not responsible for independent examination of the information it has obtained, and therefore has not conducted independent examination of said information, other than general, prima facie reasonability tests.

In this valuation we have referred, inter alia, to estimates and forecasts provided to us by Company management. Whenever we based our valuation on Company assessments or forecasts, this was explicitly indicated. These assessments are uncertain conjectures and expectations regarding the future, partially based on information available to the Company at the valuation date, as well as on various assumptions and expectations regarding the Company and many external factors, including the status of the market segment in which the Company operates, potential competition and state of the economy in general. Hence there is no certainty that these conjectures and expectations would materialize, in whole or in part.

Furthermore, whenever we did not indicate that we have based our valuation on Company assessment, we have based it on assessments and forecasts which reflect our views on various parameters, as well as on information available to us. Should these estimates not materialize, actual results may materially differ.

Financial valuation is not an exact science, and is supposed to reflect, in a reasonable and fair manner, the situation as of a given time, based on known data, assumptions and estimates made. Changes to major variables and/or to information may change the basis for these assumptions and, therefore, may also change the conclusions accordingly.

This opinion is not a due diligence and it does not purport to include all information, tests or any other information included in a due diligence, including checking of Group contracts and agreements .

Note that this opinion does not constitute legal advice or opinion. We have interpreted various documents reviewed solely for the purpose of this opinion.

The information in this valuation does not presume to include the complete information required by a potential investor, and is not intended to determine the value of Company operations for a specific investor. Different investors may have different goals, considerations and testing methods based on other assumptions, and accordingly the price they would be willing to pay will vary.

We concur to inclusion of and/or reference to this opinion, if needed, in any immediate report or any other report, including a prospectus, if and when issued with regard to the Company.

We have no personal interest in Group and/or Company shares, and our fee for this work is not contingent on the results of this valuation. Furthermore, there is no dependence of any kind between Giza-Singer-Even and the Company.

Giza-Singer-Even has received no indemnification from the Company for this valuation.

Based on clarifications of the company, the group of assets valued in this valuation complies with the standards set by FAS 141.

The valuation is current as of December 31, 2007.

2. Valuating company and valuator

Valuating company: Giza-Singer-Even Ltd. is a private business consulting firm, established in 2004. It is the result of the merger of Giza Financial Consulting, founded in 1985, and of Singer-Even, established in 1992. It is one of the largest, leading, independent financial consulting companies in Israel. Giza-Singer-Even provides consulting for its customers on: Business valuation and analysis, complex economic and financial models, financing strategy for companies and projects, development and implementation of innovative financing instruments (such as securitization), assistance in business and financing negotiations, business plan preparation, expert opinions and more. Its financing operations are performed via its subsidiary, Giza-Singer-Even Financing.

Valuator: This work was prepared by a team led by Mr. Yechiel Even.

Mr. Yechiel Even is a managing partner of Giza-Singer-Even Ltd.

As part of his position as manager of Giza-Singer-Even Ltd., Mr. Even provided consulting services for many public companies, a majority of institutional entities and underwriting companies, government and legal authorities etc. Mr. Even has provided, inter alia, economic valuations of dozens of public and private companies and has submitted expert opinions to the courts on economic and financing issues.

Details of Mr. Even's education:

Masters in Business Administration, Bar Ilan University, 1989.

BA in Economics and Business Administration, Bar Ilan University, 1987.

Giza-Singer-Even Ltd

3. Information sources used in preparation of this work:

- Internal operational reports (actual vs. planned) by ITL for 2006, 2007.
- ITL financial statements for 2005, 2006 and 2007.
- Financial statements and prospectus of the parent company, ITL Optronics Ltd for 2005-2006.
- ITL's 2008 budget.
- Background material and public information
- We have also met with Company management.

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ITL Company Description



- ITL was incorporated in 1992. The company is located in Louisiana, USA.
- The Company is a subsidiary of ITL Optronics Ltd., a public company (hereinafter: “**The parent Company**”)
- The parent company and its subsidiaries (hereinafter: “**The Group**”) are high-tech industrial companies. The companies are engaged in research, development, production and marketing of a range of products and advanced systems in the field of electronics and electro-optics, primarily intended for the defense industry in Israel and overseas.
- The Company has a facility in Louisiana used for production of Group products which the Company sells to overseas customers in the USA and to the Ministry of Defense by using FMF aid money.
- The Company has a staff of 25 and according to Company estimates, the facility in Louisiana has a production capacity of 5-6 million US\$ annually.

In order to respond to purchasing requisitions of the Israeli Ministry of Defense (using aid money), the Group has invested in previous years in setting up a production facility for its selected products in the USA, to be sold in the Israeli market. This investment was made via its subsidiary, ITL Inc. This move allowed the Company to receive significant orders from the IDF by using US aid money. Since "Americans buy from Americans", the Group has decided to establish and expand its capacity in this market by acquisition of another US-based company (Fraser-Volpe LLC, (hereinafter: "**Fraser**") which is an authorized supplier of the US Department of Defense), engaged in development, production and marketing of advanced electro-optical systems for the US Army and other defense units. Recognizing that the US market is one of the Company's significant markets in coming years, control of this company would allow the Company to bid for significant US tenders and procurement programs of others in this significant market.

As mentioned above, ITL has acquired Fraser in the USA. Following this acquisition, ITL has shutdown its Louisiana plant and transferred all operations and production lines to Fraser. According to the acquisition agreement Following the Closing, ITL will subcontract to Fraser, at no mark-up to ITL or its affiliates, its performance under any new FMF contracts and any other contracts ITL enters into for the manufacture in the United States of electro-optic military or paramilitary products except that, in the event ITL cannot perform new FMF contracts at or below Fraser historical costs, Fraser has the right to subcontract the FMF contract to an unrelated third party but shall assign all of the net income from such subcontract to ITL.

Therefore, all assets of ITL, including its FMF agreement, production line, inventory, existing order backlog etc. have been transferred to Fraser. ITL will no longer sell its electro-optical products via the Company, but only via Fraser.

In compiling this valuation, and in order to determine ITL's value as of the acquisition date, we have valued ITL as a going concern, which is to continue in its current form (as it did prior to acquisition of Fraser). We have chosen this method because all Company operations and assets of the acquisition date and all future sells (FMF contracts and sells for the US market) have been transferred to Fraser, with the exception of optional sales of non electro-optical products, which ITL may develop in the future, but which are not currently available to ITL.

The Company produces, markets and sells two products:



MARS

Innovative multi-purpose sight, combining a projection sight and laser pointer, which allows for operation under any ambient light conditions.



MARS On TAR-21 ("Tavor")



MARS On M-4

Products

Mini N/SEAS



Monocular night-vision system, leading its category world-wide, which allows for a range of uses including: head/helmet mounting, weapons mounting, manual use, diving etc. The system is also used for driving by combining a pair of devices in a custom head/helmet harness.



Dual configuration for driving



With X3 magnifier



Binocular Configuration



Mounted on weapon

Customers

The Company's market typically involves sales to ad-hoc customers, based on available budgets at the relevant time.

The Company's major customer is the Israeli Ministry of Defense, by use of FMF aid money. The Company also sells its products to occasional customers in Europe and the USA, with US sales made by a local distributor employed by the company.

| Competition

The Company operates in a global, highly-competitive market. There are multiple companies competing with different Company products; some are large corporations with significant resources, sometimes larger than the Company's, which operate electro-optical divisions, some of which are similar size to that of the Company.

The significant competitors in the Company's market, to the best of its knowledge, are global companies such as:

Litton systems Inc. THALES Weapons Group; ITT Night vision and SAGEM.

As for the Company, its major customer is the Israeli Ministry of Defense. Its other customers are occasional customers, or customers referred to it by the parent company in Israel.

2005-2007 Business results

	2005	2006	2007
revenues	3,432	3,442	2,890
COGS	2,912	2,791	2,061
GP	520	651	829
percentage of revenues	15.14%	18.91%	28.68%
G&A	638	499	443
S&M	93	111	65
OP	-212	40	321
Interest Income	-	-9	-8
Unrealized gain on assignment of future revenue	-	-	-1,406
income (loss) before income taxes	-212	49	1,735
percentage of revenues	-6.17%	1.42%	60.03%
income taxes (credit)	-110	9	677
income tax rate	52.01%	17.60%	39.02%
net income (loss)	-102	40	1,058

The Company's gross margin for 2003 and 2004 amounted to 41% and 44%, respectively, due to the product mix, which also included monocular sales.

| Business results 2005-2007

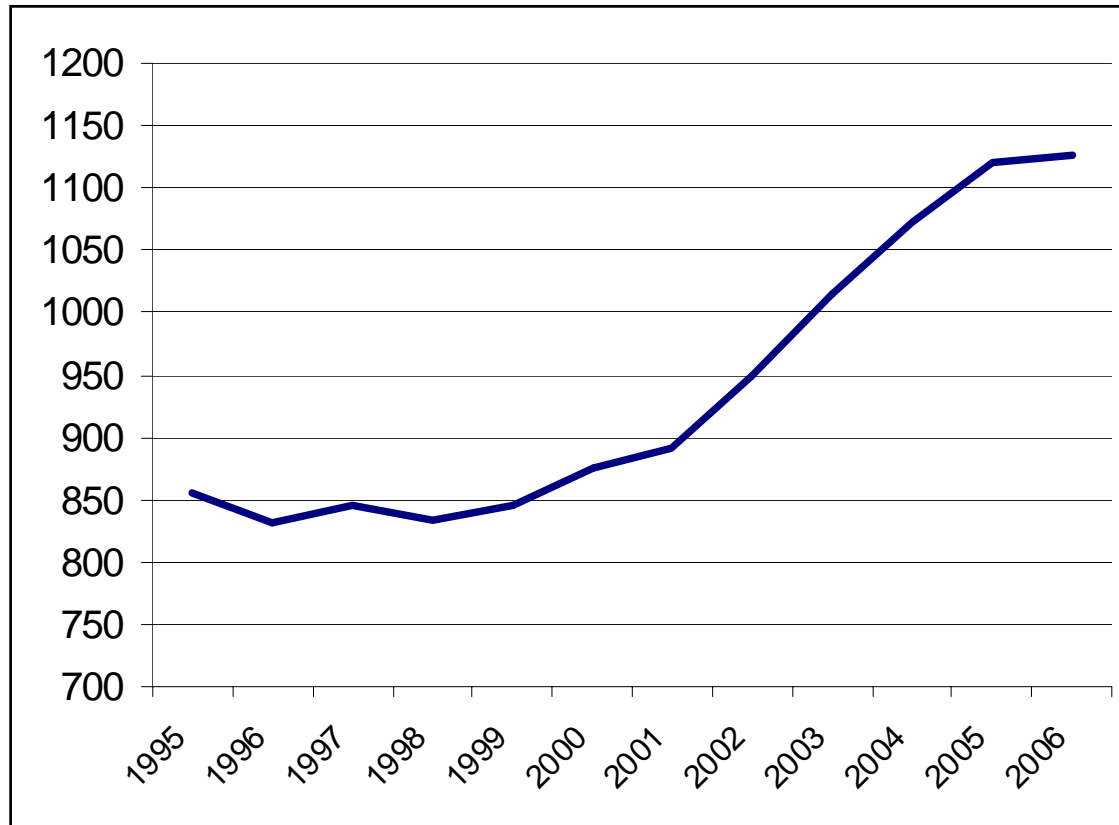
- In 2005-2006 the Company did not produced a monocular night vision system. This system has a higher gross margin than other Company products, which is the reason behind the decreased gross margin in these years. The Company estimates the typical gross margin, for sales of its 2 products, to be 25%.
- In the past, the Company was primarily based on Ministry of Defense sales and had no internal marketing resources.
- In 2006, the Group decided on a strategy involving acquisition of a US-based company which is an authorized supplier of the US Department of Defense – in order to penetrate the US market.

Business Environment

- The table shows the potential of the world defense market (in monetary terms).
- The table shows that half of global demand for Company products is in the USA – where the Company facility is located.
- As shown in slide 15 (business results), Company sales are at \$83 million annually; i.e., the Company has a large, untapped market potential – hence the chance to grow and improve efficiency.
- Market potential for the Company is estimated to be lower, since it is only able to sell 2 major products out of all Group products.

USA & Canada	\$103B	46%
NATO Europe	\$48B	21%
ASIA	\$38B	17%
<ul style="list-style-type: none"> • China • Japan • India • S. Korea • Australia • Taiwan • Indonesia 	<ul style="list-style-type: none"> • \$14B • \$10B • \$4.3B • \$3.6B • \$3B • \$1.6B • \$1.6B 	
Non-NATO Europe	\$17B	7.5%
<ul style="list-style-type: none"> • Russia 	<ul style="list-style-type: none"> • \$13B 	
Middle East	\$12B	5.5%
<ul style="list-style-type: none"> • Saudi Arabia • Israel 	<ul style="list-style-type: none"> • \$6.6B • \$3.5B 	
Latin America	\$4.8B	2%
<ul style="list-style-type: none"> • Brazil 	<ul style="list-style-type: none"> • \$2B 	
Africa	\$2.7B	1%
Total	\$227B	100%

World Military Expenditure (\$B)



- From 1995 to 2006 defense expenditure grew by over 25%.
- In the period 2000-2006 defense expenditure grew at an annual rate of 4.2%.

Constant 2005 dollars

Source: Sipri 2007



| Industry profit margins

- Our review shows that net profit margin in the defense industry ranges between 0%-8% (the Company's net profit margin is within this range).
- We should note that large customers – defense establishment of developed nations – do not allow the industry to generate too much profit on large projects, so that profit margins on such projects range between 4%-10%, depending on nature of the project and contract terms.

Valuation methodology



Overview:

- There are several analytical methods to estimate the economic value of a business, which may yield different results. Each of the methodologies has its own advantages and disadvantages, hence determining the valuation depends, to a large extent, on management estimates, owners' estimates, their experience as well as on the valuator's discretion.
- Conclusions of the valuers are based, inter alia, on detailed financial analysis and on qualitative components, some of which may not be directly quantified and are based on estimates and assumptions made, where there is uncertainty with regard to their actual materialization. Furthermore, they may rely on data from professional sources, such as: Assessments by an assessor for real estate and equipment.
- The commonly used method for company valuation is the discounted cash flow method (DCF). This valuation method is based on analysis of company operations as a "going concern". The basic economic assumption is that the most appropriate method for analysis of an active business is the one based on discounted cash flow, or the capacity of company assets to generate a revenue stream for its owners.



The Company valuation was prepared using DCF methodology

- In DCF analysis, the value of company operations is the present value of the free, unleveraged cash flow generated over the specified forecast period, plus the present value of the company at the end of this period. To this amount one must add the value of free assets not used in generation of business revenues (such as real estate, which the company may sell or lease). In order to derive the value of operation, one must deduct (add) the excess debt over cash (excess cash over debt).
- The basic principle underlying this analysis is that the company is an active, going concern which would operate indefinitely – hence the objective is to obtain the present value of forecasted cash flow to infinity.
- The basis for evaluation using this method is analysis and estimation of the capacity of the business to generate cash flow and improve profitability in the future. These cash flows are discounted using appropriate, different discount rates which provide a reasonable range of values for the company. This analysis must rely on detailed analysis of company operations by component, as well as on future assessments under different scenarios.

Valuation

- In compiling our valuation, we have regarded the Company as Stand Alone, i.e., we have valued its operations prior to acquisition of Fraser and prior to the strategy change when it decided to acquire a US-based company. In our valuation, we have ignored changes due to the aforementioned strategy change, such as discontinued investment in product marketing in 2007 and sale of the Louisiana facility.

- **Sales**

2008 – The Company backlog is currently at approximately \$830 thousand, composed of orders for products, spares and test equipment. Note that this amount is lower than in previous years. The decrease in order backlog is due to termination of the contract with the Ministry of Defense. Nevertheless, the Company estimates that five orders would be received, with sales spread over 34- years for total annual sales of \$3.7 million. For the sake of being conservative, we have assumed that the orders would be spread over 5 years, which is longer than the aforementioned Company forecast. We have also assumed that sales will be made in Q3 2008 only, pro-rated for its share of expected sales. Hence we have assumed total sales in 2008 to be \$2.23 million, the lowest total sales for the Company in recent years.

Forecast of 2008 sales, (in thousands \$):

Order backlog:	830
Further orders:	<u>1,400</u>
Total:	2,230

2009 – As previously mentioned, the company estimates five orders for the following 3-4 years amounting to an average of 3.7 million \$ a year. We have used a conservative forecast placing the sales of 2009 at the amount of 2,750\$ thousands.

Note that in 2005-2006 the Company sold at \$3.5 million annually, and for the sake of being conservative, we have assumed lower sales in 2008-2009.

- **Short-term growth**

For the period 2008-2012, we have assumed a 10% growth rate, as per industry growth forecasts and Company estimates. Company estimates are based, inter alia, on further orders assumed to be issued in coming years.

- **Gross margin**

According to business results in recent years and to Company estimate, we have assumed a gross margin of 25%.

- **General and administrative expenses**

The Company is undergoing a process to cut these expenses and improve efficiency. Though 2007 the Company had a CEO and Deputy CEO. In 2007 management was reduced to one CEO. The Company estimates this process would reduce general and administrative expenses by \$150 thousand.

We have further assumed 20% flexibility between general & administrative expenses and sales growth. General and administrative expenses in the industry are relatively fixed, and are not highly flexible via-a-vis sales growth.

- **Sales and marketing expenses**

Through 2007, the Company has not employed any marketing staff. The Company used external consultants in this field. As part of the improved efficiency process, we have assumed that the Company would employ a full-time marketing person. Employment cost for this person would increase sales and marketing expenses by \$55 thousand, such that sales and marketing expenses for 2008 would amount to \$120 thousand (compares to \$65 thousand in 2007).

We have also assumed 40% flexibility between sales & marketing expenses and sales growth. Most of the orders from the Company come from large entitles and repeat customers. The Company rarely uses any marketing commissions.

- **Amortization and investments**

The Company has made no investments over the past 2 years, and its remaining depreciation and amortization are almost zero. We have assumed that for the long term, depreciation equals investment.

Tax

According to Company guidance, we have assumed that the tax rate used for calculation of expected tax expenses over the forecast period, as well as in the long term, is the prevailing corporate tax rate in the USA (Federal Corporate Income Tax Rates). The UIS tax is progressive, with the following levels and tax rates (in thousands \$):

Taxable income over	Not over	Tax rate
0	50	15%
50	75	25%
75	100	34%
100	335	39%
335	10,000	34%
10,000	15,000	35%
15,000	18,333.33	38%
18,333.33	-----	35%

In addition, the state tax rate in Louisiana is 8%. From the above we have used the appropriate federal tax over 5 year model period, plus 8% state tax.

■ Cost of capital

The valuation model assumes a capital cost of 13.5%.

Below are details of calculation of the WACC for the Company:

Parameter	Assumption
Risk free rate	3.50%
Market yield rate	7%
BETA	1.3
Specific risk	2.50%
Expected return on equity	15.10%

The Company's BETA was determined after review of companies in the defense electronics industry. These companies are: Curtiss-Wright Corp., Teledyne Technologies Inc, Esterline Technologies Corp.

- **Long-term growth**

The valuation model assumes a permanent growth rate of 4.5%. This is a lower growth rate to short-term forecasts included in this work. In accordance with the Company's business results over past years, the decrease in its order backlog and growth in the defense market over the past 5 years – we have elected, for the sake of being conservative, to refer to the growth rate as set forth above.

| Expected cash flow

We have assumed the following sales forecast for the next 5 years, and the Residual value at the end of this period.

	2008	2009	2010	2011	2012	Residual Value
revenues	2,230	2,750	3,025	3,328	3,660	
gross profit	558	688	756	832	915	
percentage of revenues	25.00%	25.00%	25.00%	25.00%	25.00%	
G&A	393	401	409	417	426	
S&M	120	125	130	135	140	
income before income taxes	45	162	218	280	349	
net profit (loss)	45					
income taxes	21	76	102	132	147	
percentage of revenues	47%	47%	47%	47%	42%	
net income	24	86	115	148	203	2,352
income tax rate						
Discounted Cash Flow	22	71	84	95	115	1,331


The value of Company operations derived by discounting operation cash flow at a discount rate of 13.5% is:

1,718\$ thousand.

Below is the flexibility analysis for operation valuation vs. discount rate and long-term growth-rate:

Discount Rate \ Growth rate	14.50%	13.50%	12.50%
3.5%	1,413	1,573	1,769
4.5%	1,528	1,718	1,955
5.5%	1,668	1,898	2,195

- Below are revenue, net income and EBITDA multipliers derived from the Company valuation, based on 2007 business results:
 - ✓ Net income multiplier: 16.34
 - ✓ Revenue multiplier: 0.59
 - ✓ EBITDA multiplier: 12.36

Two King penguins are shown in profile, facing each other. The penguin on the left is looking towards the right, and the penguin on the right is looking towards the left. They have black heads with a prominent orange patch on the side, and white bodies with black wings. The background is a soft, out-of-focus grey.

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**Thank you
very much**