



# Oridion®

Smart Solutions One Breath at a Time™



We are dedicated to providing innovative technology for improving patient care around the world

## Oridion Systems Ltd.

**CEO Letter to Shareholders**

**November 2008**

**Dear Shareholder,**

I am pleased once again to be able to report improved results for Oridion. Revenues grew 25% for the third quarter, Oridion's 31st consecutive quarter-on-quarter growth. Revenue growth was 27% for the nine-month period ended September 30, 2008, compared with the same period in 2007. Operating income increased to USD 3.5 million, up by 20% for the first nine months of 2008. These results were achieved despite the strong currency fluctuations of the US Dollar against the Israeli Shekel and the Euro during the first nine months of this year.

### **Financial results in Q3 and first nine months of 2008**

	<b>Nine months ended September 30,</b>		<b>Three months ended September 30,</b>	
	<b><u>2008</u></b>	<b><u>2007</u></b>	<b><u>2008</u></b>	<b><u>2007</u></b>
U.S. dollars in thousands				
Revenues	33,970	26,660	12,015	9,627
Gross Profit	18,899	14,377	6,766	5,280
<i>Gross Margin</i>	<i>55.6%</i>	<i>53.9%</i>	<i>56.3%</i>	<i>54.8%</i>
Operating Expenses	15,393	11,447	5,036	3,760
<b>Operating Income</b>	<b>3,506</b>	<b>2,930</b>	<b>1,730</b>	<b>1,520</b>
<i>Operating Margin</i>	<i>10.3%</i>	<i>11.0%</i>	<i>14.4%</i>	<i>15.8%</i>
Financial income (expenses), net	(902)	203	(1,216)	398
Income tax benefits	1,092	-	-	-
<b>Net Income</b>	<b>3,696</b>	<b>3,133</b>	<b>514</b>	<b>1,918</b>
<b>EBITDA</b>				
Operating Income	3,506	2,930	1,730	1,520
Depreciation and amortization	1,062	1,034	335	316
<b>EBITDA</b>	<b>4,568</b>	<b>3,964</b>	<b>2,065</b>	<b>1,836</b>
<i>EBITDA Margin</i>	<i>13.4%</i>	<i>14.9%</i>	<i>17.2%</i>	<i>19.1%</i>

### **Revenues**

Company revenues for the third quarter of 2008 increased by 25% to USD 12.0 million compared to USD 9.6 million for the same period last year. Revenues for the nine-month period ended September 30, 2008, increased by 27% to USD 34.0 million compared to USD 26.7 million for the same period last year. Revenue growth continues to be driven by a general increase in demand from the market for Oridion capnography devices supplied by our leading OEM partners and an acceleration in usage of our patient-interface consumables. In general, our sustained revenue growth is primarily a consequence of increased awareness of the need to improve patient safety in hospital and pre-hospital settings and the related continuing stream of recommendations by important professional medical organizations for the use of capnography to improve standards of patient safety and patient care.

Revenue growth for the first nine months of 2008 was greater than usual, resulting from the partial resumption of sales to Physio-Control, who had a Federal Drug Administration (FDA) related voluntary cessation of shipments of their defibrillators to the US market in quarter one of 2007. As mentioned in previous quarterly reports of 2008, sales to Physio-Control resumed in the latter part of last year.

The proportion of our revenues generated by the sale of consumable products, which has been growing steadily over the past years, continued to increase further. Consumable revenues grew by 44% in the first nine months of the year and accounted for 42% of total revenues. Two years ago consumable revenue accounted for 33% of total revenues for the comparable nine-month period. The value creating programs that Oridion launched over the past few years for sustaining high consumables growth clearly are showing their impact. Oridion's network of independent consumables-focused distributors (the 'ODN') has become an important asset in our goals to continuously increase the consumption of consumables per monitoring device and to educate hospital environments in the benefits and usage of Capnography. In addition, the number of Company-sponsored and independent clinical studies by opinion leaders that were published during the first nine months of 2008 has more than doubled compared to the same period last year. The results of these studies, most of which are being published and presented at medical congresses, are providing further compelling evidence of the importance and benefits of capnography monitoring to improve patient safety, both in traditional settings, such as critical care and EMS (ambulance services), and in emerging environments, such as procedural sedation and pain management.

### **Gross Profit**

The Company's gross profit for the third quarter of 2008 increased to USD 6.8 million compared to USD 5.3 million for the same period last year. The gross profit for the nine-month period ended September 30, 2008, improved by 31% to USD 18.9 million compared to USD 14.4 million for the same period last year. The gross margin for the three-month period ended September 30, 2008, increased to 56.3% compared to 54.8% for the same period last year. The gross margin for the nine-month period ended September 30, 2008, improved to 55.6% compared to 53.9% for the same period last year. These increases are primarily due to the growth in revenues, continued success with productivity initiatives, increase in consumables as a percent of sales and, to a lesser extent, the effects of a weaker US Dollar against the Euro.

### **Operating Expenses**

Total operating expenses were USD 5.0 million for the third quarter of 2008 compared to USD 3.8 million for the same period last year. Operating expenses for the nine-month period ended September 30, 2008, were USD 15.4 million (45% of revenues) compared to USD 11.4 million for the same period last year (43% of revenues), an increase of 34%.

In fiscal year 2007, due to the unexpected Physio-Control situation, the Company delayed several planned initiatives in sales, marketing and R&D. Because of the expectation of strong revenue growth this year and the attractive future growth opportunities facing Oridion, many of these delayed initiatives have been released during 2008. The unusually high level of growth in operating expenses for the first nine months of 2008 is a result both of these additional investments and the appreciation of the Israeli Shekel against the US Dollar. Excluding the effects of the Shekel appreciation, which was very significant, the growth in operating expenses would have been 25% relative to the nine-month period of 2007.

### **Research and Development**

Research and development expenses increased to USD 1.2 million for the third quarter of 2008 compared to USD 0.8 million for the same period last year. R&D expenses for the nine-

month period ended September 30, 2008 were USD 3.4 million compared to USD 2.4 million for the same period last year.

The increase in R&D expenses is attributable to more intensive programs to enhance the proprietary technologies contained in the Company's hardware and consumable products, a significant strengthening of our IP portfolio, and the development of new and modified products aimed at expanding the use of Microstream<sup>®</sup> capnography, including further investments in the 'Smart Capnography' program (the latest product, 'IPI' – the Integrated Pulmonary Index – was launched last month at the American Society of Anesthesia Congress in Orlando, Florida).

### **Sales and Marketing**

Sales and marketing expenses for the third quarter of 2008 increased to USD 3.0 million compared to USD 2.4 million for the same period last year. Sales and Marketing expenses for the nine-month period ended September 30, 2008, were USD 9.3 million compared to USD 7.1 million for the same period last year.

This growth in expenses is primarily attributable to a further increase in the management and support of Oridion's ambitious clinical study programs aimed at demonstrating the compelling benefits and clinical value offered by the Company's CO<sub>2</sub> monitoring products. The expense growth also included: a strengthening of Oridion's product management activities; an increase in the support activities for Oridion's OEM and ODN partners in their educational and marketing efforts; more training sessions for the growing number of customers that have adopted Microstream<sup>®</sup> capnography; and additional personnel needed to implement these intensified programs. All of these efforts are aimed at increasing the usage rate of Oridion's products and capitalizing on the growing awareness in the relevant sectors of the healthcare community of the benefits of capnography monitoring.

### **General and Administration**

General and Administration expenses for the third quarter of 2008 increased to USD 0.9 million compared to USD 0.6 million for the same period of last year. General and Administration expenses for the nine-month period ended September 30, 2008, were USD 2.7 million compared to USD 2.0 million for the same period last year. The increases were mainly due to the appreciation of the Israeli Shekel against the US Dollar.

### **Operating Income**

Oridion earned an operating income of USD 1.7 million for the third quarter of 2008 compared to an operating income of USD 1.5 million for the same period last year.

The operating income for the nine-month period ended September 30, 2008 increased to USD 3.5 million compared to an operating income of USD 2.9 million for the same period last year, an increase of 20%. Despite this increase, the operating margin decreased marginally to 10.3% compared to 11.0% for the same period last year. It should be noted that excluding the US Dollar devaluation effect on operating expenses, the margin would have been approximately 3-4 percentage points higher for the nine-month period of 2008.

### **Financing activities**

Finance expenses, net, for the third quarter of 2008 were USD 1.2 million compared to a finance income of USD 0.4 million for the same period last year. Finance expenses for the nine-month period ended September 30, 2008, were USD 0.9 million compared to finance income of USD 0.2 million for the same period last year. The net expense this year is attributable to the high volatility of the foreign exchange markets, in particular the latest strong rebound during the third quarter 2008 of the US Dollar against the Israeli Shekel and the Euro. All changes in the fair value of currency hedging contracts are recorded in net finance expenses.

### **Income tax benefits**

No non-cash tax benefit was recorded for the quarter. A non-cash tax benefit income of USD 1.1 million was recorded for the nine-month period of 2008. The income benefit is the result of carry-forward losses, which are expected to be eliminated in several years, whereupon the Company's profits will be taxed. It is likely that the actual taxes going forward at that future time will be at single-digit rates owing to the Company's Approved Enterprise tax status.

### **Net Income**

Net income for the third quarter of 2008 decreased to USD 0.5 million compared to USD 1.9 million for the third quarter of 2007, owing to the substantial net negative finance expense. The net income for the nine-month period ended September 30, 2008 increased by 18% to USD 3.7 million compared to a net profit of USD 3.1 million for the same period of 2007.

### **Cash Flow**

Net cash provided by operating activities was USD 2.1 million for the nine-month period of 2008. The Company has increased its inventory levels, both for consumables and hardware, owing to its high growth rate and the demands of the market to have inventory "on the shelf". Net cash used in investing activities was USD 5.4 million owing to investments in marketable securities. Net cash provided by financing activities amounted to USD 0.2 million owing to the exercise of employee stock options. The net cash balance including marketable securities at the end of the period was USD 14.4 million.

### **Achievements and Events during Q3, 2008**

The following were noteworthy events and achievements during the third quarter of 2008:

- Oridion introduced the next in the series of Smart Capnography products, the Integrated Pulmonary Index ('IPI'), at the Annual Congress of the American Society of Anesthesiologists (October, 2008). The objective of the IPI is to provide patient caregivers, such as nurses, with a simple tool that enables them to more rapidly and accurately assess the status and trend of a patient's respiratory condition. The initial response to the IPI by leading clinicians and potential OEM partners participating at the Congress was highly enthusiastic. Once cleared by the FDA, the IPI will be offered as a standard feature on the current generation of Oridion OEM modules and on Oridion's Capnostream 20 monitor.
- Oridion's clinical studies program was extremely active in the quarter. Fifteen new US and international clinical papers were published or submitted for publication in Q3 alone. Most significant of these studies was our research on the new Integrated Pulmonary Index (IPI) [510(k) pending]. This study indicated that our new Smart Capnography IPI algorithm delivered results equivalent to expert bedside medical professionals assessing patients. The study was presented to the American Society of Anesthesiologists in Orlando, Florida.
- Oridion signed an OEM agreement with Spacelabs Healthcare, a leading global medical device and service company. Spacelabs will initially employ Oridion Microstream<sup>®</sup> capnography technology in its new, compact and ultra-lightweight patient monitoring system, Elance, which shortly will be launched. The addition of this partnership with Spacelabs Healthcare

demonstrates our ability to further broaden our already existing, strong portfolio of leading global OEM partners.

## Outlook

Our strong revenue growth for the quarter and the first nine months continues to reflect the positive developments that we are seeing in our markets. The resumption of hardware sales to Physio-Control during the first nine months of 2008, in comparison with the almost complete stop in orders that took place in the first nine months of 2007, has had an extra positive impact on our growth rates so far this year. With regard to the recent turmoil in financial markets worldwide, we have thus far not experienced any material impact on near-term demand in our markets. Accordingly, we are maintaining our revenue growth guidance of 25% for the full year 2008.

Oridion management has viewed 2008 as a year to invest more actively in R&D and sales and marketing after the relative lull in 2007. These efforts have substantially increased our product pipeline in hardware, consumables and "Smart Capnography", and have substantially strengthened our marketing programs. The resulting significant growth in operating expenses (excluding the US Dollar depreciation effect) is, therefore, an investment in future growth and reflects management's positive view of future market opportunities, both to expand the market and to carve out an increasingly strong leadership position for Oridion.

With regard to earnings, during the first nine months we have had to contend with the combination of the weak US Dollar and the strong Israeli Shekel. This situation resulted in significantly higher operating costs than expected. This quarter, the current financial market turmoil has resulted in a rebound of the Dollar relative to the Shekel, which is having a beneficial effect on our Shekel-denominated operating costs. On the other hand, there has been a decline in the Euro relative to the Dollar, which had a negative effect on our Euro-denominated revenues. These effects appear to be largely offsetting. As a result, we are maintaining our guidance of an operating margin for full-year 2008 of 12-13%.

Looking beyond 2008, we recognize that we are entering a period of major economic uncertainty that may lead to a prolonged economic recession worldwide. However, we take some comfort from the fact that demand in the healthcare industry in general, and in the medical-device (patient monitoring) market in particular, is typically less impacted by economic downturns than other sectors. Notwithstanding that, we would be surprised if there wasn't eventually some dampening of hospital/pre-hospital capital spending, with a possible softening in the demand for our OEM partners' products and systems.

Oridion's strong growth record, however, has not been based on the growth of the patient monitoring, defibrillator or medication-delivery markets that our partners operate in, as these are all mature markets. Our growth has been based on the penetration of capnography into these markets, which, despite our rapid growth, remain for the most part highly under-penetrated. Moreover, the growth drivers in the capnography market are, if anything, getting stronger. A major reason is the rapidly increasing body of compelling clinical evidence demonstrating the significant impact capnography has on improving patient care and patient safety.

This is why our consumables business, which now is over 40% of our revenues, has become a major engine of growth. This year, consumables have grown by 44% during the first nine months compared with the same period in 2007 and this part of our business should be largely unaffected - in the near-medium term - by potential softening in new device sales.

We believe, moreover, that the intensive programs we have underway to further improve the clinical value of our solutions (e.g. Smart Capnography), combined with our expectation for achieving significant new partnerships and revenue-generating agreements within the coming year, will not only measurably strengthen our leadership position but also help to mitigate the impact of any tightening of healthcare expenditures and to sustain continued growth in both our hardware and consumables businesses during the uncertain times ahead.

With regard to our future profitability, we are also looking to the future with confidence. We believe that the new capacity levels that we have reached this year in our operations – i.e., in R&D and sales and marketing – will enable us to achieve operating cost leverage as we grow revenues in the coming few years (naturally, the external environment is also imposing a very conservative approach to our future operating cost planning and management). Combined with the potential for improving gross margins as a result of expected positive developments in our product mix, we believe there are encouraging prospects for improved future profitability.

\* \* \*

We again thank our dedicated team of employees, who diligently strive to provide medical technologies and products of unparalleled capabilities and quality, and which make substantive improvements to patient safety.

We also continue to thank our shareholders and partners for their ongoing support and belief in Oridion. We are, of course distressed that Oridion's share price has recently suffered a sharp decline along with the general devastation occurring across the board to market valuations. It is small comfort that the price drop seems totally unrelated to Oridion's performance and outlook. Nevertheless, we will focus on what we can control, and that is to continue to build an ever more successful company and thereby eventually reward your support with increased shareholder value. We look forward to sharing our future successes with you.

**Sincerely,**



**Alan Adler**  
**Chairman of the Board of Directors and CEO**  
Jerusalem, Israel  
November 10, 2008

Certain statements made herein that are not historical are forward-looking. The words "estimate" "expect" "believe" and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties. Many factors could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including, among others, our ability to maintain profits, the market demands for our Capnography products, our ability to focus our team on the Capnography business, changes in general economic and business conditions, inability to maintain market acceptance to the Company's products, inability to timely develop and introduce new technologies, products and applications, rapid changes in the market for the Company's products, loss of market share and pressure on prices resulting from competition, introduction of competing products by other companies, inability to manage growth and expansion, loss of key OEM partners, factors effecting OEM partners' position in the market, inability to attract and retain qualified personnel, inability to protect the Company's proprietary technology.

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	September 30, 2008	December 31, 2007
	Unaudited	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	3,648	6,642
Short-term deposits	-	50
Marketable securities	10,792	7,498
Trade receivables	8,337	7,983
Other accounts receivable and prepaid expenses	1,080	982
Inventories	7,319	4,612
<u>Total</u> current assets	31,176	27,767
<b>LONG-TERM ASSETS:</b>		
Other accounts receivable and prepaid expenses	158	59
Deferred tax assets	5,393	4,300
Severance pay fund	2,351	1,814
Property and equipment, net	3,374	2,990
<u>Total</u> long-term assets	11,276	9,163
<u>Total</u> assets	42,452	36,930
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	5,127	3,634
Other accounts payable and accrued expenses	3,447	2,580
<u>Total</u> current liabilities	8,574	6,214
<b>ACCRUED SEVERANCE PAY</b>	3,142	2,521
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of NIS 0.01 par value -		
Authorized: 20,000,000 shares at September 30, 2008 and December 31, 2007; Issued and outstanding: 12,477,034 shares at September 30, 2008 and 12,299,523 shares at December 31, 2007		
	33	32
Additional paid-in capital	78,550	77,764
Accumulated other comprehensive income	2,457	4,399
Accumulated deficit	(50,304)	(54,000)
<u>Total</u> shareholders' equity	30,736	28,195
<u>Total</u> liabilities and shareholders' equity	42,452	36,930

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

## CONSOLIDATED STATEMENTS OF INCOME

U.S. dollars in thousands (except share and per share data)

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2008	2007	2008	2007	2007
	Unaudited		Unaudited		
Revenues	33,970	26,660	12,015	9,627	37,554
Cost of revenues	15,071	12,283	5,249	4,347	17,130
Gross profit	18,899	14,377	6,766	5,280	20,424
Operating expenses:					
Research and development	3,408	2,351	1,198	847	3,230
Selling and marketing	9,307	7,146	2,976	2,362	9,555
General and administrative	2,678	1,950	862	551	2,631
<u>Total operating expenses</u>	<u>15,393</u>	<u>11,447</u>	<u>5,036</u>	<u>3,760</u>	<u>15,416</u>
Operating income	3,506	2,930	1,730	1,520	5,008
Financial income (expenses), net	(902)	203	(1,216)	398	591
Income before tax benefit	2,604	3,133	514	1,918	5,599
Tax benefit	1,092	-	-	-	4,300
Net income	<u>3,696</u>	<u>3,133</u>	<u>514</u>	<u>1,918</u>	<u>9,899</u>
Basic net earnings per Ordinary share	<u>0.30</u>	<u>0.26</u>	<u>0.04</u>	<u>0.16</u>	<u>0.81</u>
Diluted net earnings per Ordinary share	<u>0.28</u>	<u>0.24</u>	<u>0.04</u>	<u>0.14</u>	<u>0.73</u>
Weighted average number of shares used for computing basic net earnings per share	<u>12,349,732</u>	<u>12,119,881</u>	<u>12,414,596</u>	<u>12,293,509</u>	<u>12,283,519</u>
Weighted average number of shares used for computing diluted net earnings per share	<u>13,381,293</u>	<u>13,363,955</u>	<u>13,384,151</u>	<u>13,575,529</u>	<u>13,470,972</u>

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Accumulated comprehensive income	Accumulated deficit	Total shareholders' equity
Balance as of January 1, 2007	27	76,446	-	(63,899)	12,574
Exercise of options, net	5	640	-	-	645
Stock-based compensation	-	678	-	-	678
Unrealized gain on marketable securities	-	-	4,399	-	4,399
Net income	-	-	-	9,899	9,899
Balance as of December 31, 2007	32	77,764	4,399	(54,000)	28,195
Exercise of options, net	1	251	-	-	252
Stock-based compensation	-	535	-	-	535
Unrealized loss on marketable securities	-	-	(1,942)	-	(1,942)
Net income	-	-	-	3,696	3,696
Balance as of September 30, 2008 (unaudited)	33	78,550	2,457	(50,304)	30,736

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30,		Year ended December 31,
	2008	2007	2007
	<b>Unaudited</b>		
<u>Cash flows from operating activities:</u>			
Net income	3,696	3,133	9,899
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation	587	529	722
Stock-based compensation expenses	475	505	540
Accrued interest on short-term bank deposits	-	-	(5)
Deferred tax assets	(1,093)	-	(4,300)
Accrued severance pay, net	84	85	95
Increase in trade receivables	(354)	(753)	(1,440)
Increase in other accounts receivable and prepaid expenses	(194)	(27)	(237)
Increase in inventories	(2,707)	(741)	(364)
Increase (decrease) in trade payables	1,404	(12)	(597)
Increase (decrease) in other accounts payable and accrued expenses	927	(842)	(639)
Interest income	-	(5)	-
Gain from sale of marketable securities	(711)	(2)	(372)
Net cash provided by operating activities	2,114	1,870	3,302
<u>Cash flows from investing activities:</u>			
Proceeds from sale of bank deposits	50	-	30
Investment in marketable securities	(5,958)	(2,616)	(3,238)
Proceeds from sale of property and equipment	-	-	1
Purchase of property and equipment	(881)	(688)	(935)
Proceeds from sale of marketable securities	1,433	113	511
Net cash used in investing activities	(5,356)	(3,191)	(3,631)
<u>Cash flows from financing activities:</u>			
Proceeds from exercise of options and issuance of shares, net	248	636	645
Net cash provided by financing activities	248	636	645
Increase (decrease) in cash and cash equivalents	(2,994)	(685)	316
Cash and cash equivalents at the beginning of the period	6,642	6,326	6,326
Cash and cash equivalents at the end of the period	3,648	5,641	6,642

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30,		Year ended December 31,
	2008	2007	2007
	<b>Unaudited</b>		
<u>Significant non-cash transactions:</u>			
Other accounts receivable in respect of exercise of options	4	-	-
Classification of other accounts payable to additional paid-in capital	60	-	138
Purchase of property and equipment	90	-	-

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**

Oridion Systems Ltd. ("the Company") is a holding company, which wholly-owns Oridion Medical 1987 Ltd. and all of its subsidiaries. The Company is a medical technology company based in Jerusalem, Israel and Needham, Massachusetts, U.S.A. The Company employs its patented Microstream technology in the development, manufacturing and marketing of products used in its business - Capnography - the non-invasive measurement of carbon dioxide contained in the exhaled breath to determine the adequacy of respiration.

### **NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2007, are applied consistently in these financial statements.

### **NOTE 3:- UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2008, are not necessarily indicative of the results that may be expected for the year ended December 31, 2008.

### **NOTE 4:- FAIR VALUE MEASUREMENTS**

The Company adopted SFAS No. 157, "Fair Value Measurements," (as impacted by FSP Nos. 157-1 and 157-2) effective January 1, 2008, with respect to fair value measurements of (a) non-financial assets and liabilities that are recognized or disclosed at fair value in the Company's financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities.

Under SFAS No. 157, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. SFAS No. 157 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy is broken down into three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

### NOTE 4:- FAIR VALUE MEASUREMENTS (Cont.)

Categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Assets and liabilities that are measured at fair value on a recurring basis:

At Oridion, effective January 1, 2008, fair value under SFAS No. 157 principally applied to financial asset and liabilities such as available-for-sale marketable securities. These items were previously and will continue to be marked-to-market at each reporting period; however, the definition of fair value used for these mark-to-markets are now applied using SFAS No. 157. The information in the following paragraphs and tables primarily addresses matters relative to these financial assets and liabilities. Separately, there were no material fair value measurements with respect to non-financial assets or liabilities that are recognized or disclosed at fair value in the Company's financial statements on a recurring basis subsequent to the effective date of SFAS No. 157.

Following is a description of the valuation methodologies used for the respective financial assets and liabilities measured at fair value.

Available-for-sale marketable securities:

Marketable securities are valued utilizing multiple sources, as the best individual price and the best source of information can change from one day to the next. Therefore, a weighted average price is used for these securities. Market prices are obtained for these securities from a variety of industry standard data providers, security master files from large financial institutions, and other third-party sources. These multiple prices are used as inputs into a distribution-curve-based algorithm to determine the daily fair value to be used. Oridion classifies treasury securities as level 1, while all other marketable securities are classified as level 2.

The following table provides information by level for assets and liabilities that are measured at fair value, as defined by SFAS No. 157, on a recurring basis.

Description	Fair value	Fair value measurements		
	September 30, 2008	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents	3,648	3,648	-	-
Available-for-sale marketable securities	10,792	4,787	6,005	-

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

---

**U.S. dollars in thousands**

### **NOTE 5:- NEW ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. This statement applies under other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued Staff Positions (FSPs) No. 157-1 and No. 157-2, which, respectively, remove leasing transactions from the scope of SFAS No. 157 and defer its effective date for one year relative to certain non-financial assets and liabilities. As a result, the application of the definition of fair value and related disclosures of SFAS No. 157 (as impacted by these two FSPs) was effective for Oridion beginning January 1, 2008 on a prospective basis with respect to fair value measurements of (a) non-financial assets and liabilities that are recognized or disclosed at fair value in the Company's financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. This adoption did not have a material impact on Oridion's consolidated results of operations or financial condition. The remaining aspects of SFAS No. 157 for which the effective date was deferred under FSP No. 157-2 are currently being evaluated by the Company. Areas impacted by the deferral relate to non-financial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis. This deferral applies to such items as non-financial assets and liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods) or non-financial long-lived asset groups measured at fair value for an impairment assessment. The effects of these remaining aspects of SFAS No. 157 are to be applied by Oridion to fair value measurements prospectively beginning January 1, 2009. The Company does not expect them to have a material impact on Oridion's consolidated results of operations or financial condition.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". SFAS No. 159 permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity reports unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected are recognized in earnings as incurred and not deferred. SFAS No. 159 also established presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 was effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for Oridion). At the effective date, an entity could elect the fair value option for eligible items that existed at that date. The entity was required to report the effect of the first re-measurement to fair value as a cumulative-effect adjustment to the opening balance of retained earnings. The Company did not elect the fair value option for eligible items that existed as of January 1, 2008.

In June 2007, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities" that required nonrefundable advance payments made by the Company for future R&D activities to be capitalized and recognized as an expense as the goods or services are received by the Company. EITF Issue No. 07-3 was effective for Oridion with respect to new arrangements entered into beginning January 1, 2008. The adoption

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### U.S. dollars in thousands

of EITF Issue No. 07-3 did not have a material impact on Oridion's consolidated results of operations or financial condition.

#### NOTE 5:- NEW ACCOUNTING PRONOUNCEMENTS (Cont.)

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141(R)). Under SFAS No. 141(R), an entity is required to recognize the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at their fair value on the acquisition date. It further requires that acquisition-related costs be recognized separately from the acquisition and expensed as incurred, restructuring costs generally be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period impact income tax expense. In addition, acquired in-process research and development (IPR&D) is capitalized as an intangible asset and amortized over its estimated useful life. The adoption of SFAS No. 141(R) will change our accounting treatment for business combinations on a prospective basis beginning in the first quarter of fiscal year 2009.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which will require increased disclosures about an entity's strategies and objectives for using derivative instruments; the location and amounts of derivative instruments in an entity's financial statements; how derivative instruments and related hedged items are accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities;" and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. Certain disclosures will also be required with respect to derivative features that are credit risk-related. SFAS No. 161 is effective for Oridion beginning January 1, 2009 on a prospective basis. The Company does not expect this standard to have a material impact on Oridion's consolidated results of operations or financial condition.

#### NOTE 6:- SIGNIFICANT CUSTOMERS

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2008	2007	2008	2007	2007
	Unaudited		Unaudited		Audited
	% of total revenues				
Customer A	28	29	28	28	26
Customer B	25	14	25	20	18
Customer C	7	8	5	6	10

## **INVESTOR RELATIONS CONTACTS**

Walter Tabachnik, Chief Financial Officer  
Elena Gerberg, Investor Relations

E-mail: [investor@oridion.com](mailto:investor@oridion.com)

Website: [www.oridion.com](http://www.oridion.com)

Phone: +972 2 589 9159

Address: Oridion Systems Ltd.  
P.O. Box 45025  
Jerusalem 91450, Israel

### **Next quarterly reporting**

**March 2, 2009**

Announcement of 4<sup>th</sup> quarter and fiscal year 2008 results



# Oridion®

Smart Solutions One Breath at a Time™



## **Corporate Headquarters/Israel**

Oridion Systems Ltd.  
P.O. Box 45025  
Jerusalem 91450  
7 Hamarpe Street, Building 5  
Jerusalem 97774  
Israel

Tel: +972 2 589 9111  
Fax: +972 2 582 5873  
Email: [investor@oridion.com](mailto:investor@oridion.com)

## **Commercial Headquarters/USA**

Oridion Capnography Inc.  
Needham Corporate Center  
160 Gould Street  
Suite 205  
Needham MA 02494  
USA

Tel: +1 781 453 0500  
Fax: +1 781 453 2722

[www.oridion.com](http://www.oridion.com)