



Oridion Systems Ltd.

CEO Letter to Shareholders

August 2007



When every breath counts



Oridion®

Dear Shareholder,

I am pleased once again to be able to report improved results for Oridion. Revenues grew 5% for the second quarter, Oridion's 26th consecutive quarter-on-quarter growth. Revenue growth was 9% for the six-month period ended June 30, 2007 compared with the same period in 2006. Operating income also grew in both periods and, at USD 1.4 million is up over 54% for the first six months of 2007. These results were achieved despite the continued voluntary cessation of shipments to the US market by one of our most important OEM partners, Medtronic Physio-Control. Oridion's financial results and other significant events and achievements for the quarter are provided in this report.

Financial results in Q2 and first half year, 2007

| | Six months ended June 30, | | Three months ended June 30, | |
|--|--------------------------------------|---------------------|--|---------------------|
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| U.S. dollars in thousands | | | | |
| Revenues | 17,033 | 15,683 | 8,624 | 8,227 |
| Gross Profit | 9,097 | 8,184 | 4,685 | 4,340 |
| <i>Gross Margin</i> | <i>53.4%</i> | <i>52.2%</i> | <i>54.3%</i> | <i>52.8%</i> |
| Operating Expenses | 7,687 | 7,270 | 3,931 | 3,711 |
| Operating Income from continuing operations | 1,410 | 914 | 754 | 629 |
| Net Income from continuing operations | 1,215 | 795 | 536 | 503 |
| Net Loss from discontinued operations | - | (502) | - | - |
| Net Income | 1,215 | 293 | 536 | 503 |
| EBITDA | | | | |
| Operating Income from continuing operations | 1,410 | 914 | 754 | 629 |
| Depreciation and amortization | 718 | 658 | 434 | 337 |
| EBITDA from continuing operations | 2,128 | 1,572 | 1,188 | 966 |
| <i>EBITDA Margin</i> | <i>12.5%</i> | <i>10.0%</i> | <i>13.8%</i> | <i>11.7%</i> |

Revenues

Company revenues for the second quarter of 2007 increased by 5% to USD 8.6 million compared to USD 8.2 million for the second quarter of 2006. Revenues for the six-month period ended June 30, 2007 increased by 9% to USD 17.0 million, compared to USD 15.7 million for the same period last year. Revenue growth is being driven by a general increase in demand from the market for Oridion capnography devices supplied by our leading OEM

partners and an increase in usage of our patient-interface consumables. This growth is despite Medtronic Physio-Control's voluntary suspension of sales into the US market, following an agreement with the Federal Drug Administration (FDA). Revenue growth continues to be 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 new recommendations by important professional medical organizations for the use of capnography to improve standards of patient safety and patient care. The portion of our revenues, generated by the sale of consumable products is higher than last year. Consumable sales represented 39% of total revenues for the first half of 2007 compared to 32% for the same period last year. Part of this increase is owing to no sales of devices (capnography modules) to Medtronic Physio-Control.

Gross Profit

The Company's gross profit for the second quarter of 2007 increased to USD 4.7 million compared to USD 4.3 million for the same period last year. This major increase is due mainly to the increase in sales, continued success with productivity initiatives, and the increase in consumables as a percent of sales. The gross margin for the three-month period ended June 30, 2007, improved to 54.3% compared to 52.8% for the same period last year. The gross margin for the six-month period ended June 30, 2007 improved to 53.4% compared to 52.2% for the same period last year.

Operating Expenses

Total operating expenses were USD 3.9 million for the second quarter of 2007 compared to USD 3.7 million for the second quarter of 2006. The Company continues to invest in marketing education materials, customer training and in existing and new products. The Company continues to increase efficiencies overall in order to remain cost effective. Operating expenses for the six-month period ended June 30, 2007 were USD 7.7 million (45.1% of revenues) compared to USD 7.3 million for the same period last year (46.4% of revenues).

Research and Development

R&D expenses remained steady at USD 0.7 million for the second quarter of 2007 as the Company continues to develop current products and embarked on new projects. Current R&D expenses include investments in enhancing the proprietary technology contained in the Company's consumable products, and in products that will expand the use of capnography in clinical settings in which CO₂ monitoring has in the past been very limited, for example, gastroenterology (and other procedural sedation environments) and pain management.

Sales and Marketing

Sales and marketing expenses for the second quarter of 2007 remained steady at USD 2.4 million compared with the second quarter of 2006. Current activities include the continuing management of an intensive program of clinical studies of Oridion's Capnography, aimed at demonstrating the unparalleled benefits and clinical value offered by the Company's CO₂ monitoring products. These expenses also include support activities for Oridion's OEM and ODN partners in their educational and marketing efforts, training sessions for the growing number of customers that choose to improve the standard of medical care with Microstream[®] capnography, and additional personnel needed to implement the new programs. These efforts are aimed at increasing the usage rate of Oridion's products for a wide range of patient-safety applications in the hospital and pre-hospital settings.

General and Administration

General and Administration expenses for the second quarter of 2007 increased to USD 0.7 million compared to USD 0.6 million for the same period of last year, mainly due to the implementation of a new ERP system in the Company.

Financing activities

Owing to the volatile rate of exchange between the US dollar (USD) and the New Israeli Shekel (NIS) beginning in 2007, the Company bought forward cover contracts for most of the year at a lower rate than the USD/NIS rate of exchange on June 30, 2007. All changes in the fair value of the contracts are recorded in net finance expenses.

Operating and Net Results

Oridion earned an operating income of USD 0.8 million for the second quarter of 2007. This compares to an operating income from continuing operations¹ of USD 0.6 million for the same period last year. The Company continued to improve its operating margins to 8.7% compared to 7.6% from continuing operations for the same period last year.

The operating income for the six-month period ended June 30, 2007 increased to USD 1.4 million compared to an operating profit of USD 0.9 million for the same period last year, resulting in an increase of the operating margin to 8.3% compared to 5.8% from continuing operations for the same period last year.

The consolidated net profit for the second quarter of 2007 remained constant at USD 0.5 million compared to the second quarter of 2006. The consolidated net income for the six-month period ended June 30, 2007 was USD 1.2 million compared to a consolidated net profit of USD 0.3 million for the same period of 2006.

Cash Flow

Net cash provided in operating activities was USD 1.1 million for the six-month period of 2007. Net cash used in investing activities was USD 2.5 million owing to investments in marketable securities. Net cash provided by financing activities amounted to USD 0.5 million owing to the exercise of employee stock options.

Achievements and Events during Q2, 2007

The following milestones were achieved during the second quarter of 2007 (and to date):

- Oridion and Nellcor, a business unit of Covidien, formerly a division of Tyco Healthcare, have established a new strategic alliance created to provide improved customer service and support. Under this new arrangement the entire line of Nellcor capnography filter lines will now be marketed exclusively through the Oridion Distribution Network (ODN). Previously, these consumable items were available through the Nellcor sales network. This new corporate strategic alliance allows each company to better focus on its primary mission.
Pulse oximetry monitoring continues to be the standard of care in monitoring a patient's oxygenation. Nellcor is the pioneer and the global market leader in pulse oximetry. They have long experience and expertise in marketing monitors that combine the benefits of their pulse oximetry with the ventilation monitoring of Oridion's Microstream[®] Capnography. By having the consumables marketed through the ODN, Nellcor customers will benefit by having greater access to Oridion's (and the ODN's) clinical support and on-going educational programs, as well as now having access to Oridion's entire line of consumable solutions.

¹ In February 2006, the Company announced it would be ceasing all activities concerning the Breath Testing business. As a consequence all BreathID activities in 2006 are presented in the current fiscal accounts as "discontinued operations".

- This summer, Oridion launched its Capnostream™ bedside monitor. This new 2-parameter bedside monitor (capnography/oximetry) is richly featured and is designed to be easily integrated into any central station and remote alarm network of monitors. It is primarily targeted for procedural sedation and pain management applications. The Capnostream's data storage and transfer features also offer, for the first time, exceptional power and convenience to the research community, which meets a previously unmet demand and enables essential clinical research to be efficiently carried out for use in Oridion's Microstream® market development programs.
- Oridion has also developed two important new software algorithms that will be available in the Capnostream™ and in licensed OEM products. These algorithms work together to reduce nuisance respiratory rate alarms by more than 55%. Nuisance alarm reduction was the most requested improvement in the pain-management PCA environment last year.
- In June 2007, BreathID Ltd., which had been a spin-off from Oridion in May 2006, had an Initial Public Offering (IPO) on the Tel Aviv Stock Exchange, in which it raised approximately USD 5.5 million. Oridion's shareholding of approximately 16.5% (post IPO) of the issued share capital of BreathID Ltd., at the current market price, is valued at approximately USD 3.5 million. Oridion's ability to sell BreathID shares is constrained by lock-up provisions until eighteen months from the first trading date. Previous to the spin-off of BreathID, Oridion had announced its strategic decision to divest its breath testing business in order to fully concentrate its resources and management attention on its profitable core capnography business (See note 2c of the attached Financial Statements).

Outlook

First half revenue growth, at 9%, is somewhat ahead of our annual guidance of 5-7% (we attribute the higher growth in the first quarter relative to the second as a normal quarterly variation). Our growth thus far this year has been achieved despite having had no shipments to Medtronic Physio-Control of our modules that integrate into their defibrillators. We continue to monitor the Medtronic Physio-Control situation very closely and are hoping to see the resumption of shipments of modules to them towards the end of Q3 2007, albeit initially at levels below that experienced previously. It remains uncertain as to when their U.S. shipments will again reach prior levels. Consumable sales to Medtronic Physio-Control for the first half year of 2007 have not only been unaffected by this situation but have experienced good growth.

Sales growth in our other OEM channels and through our Oridion Distribution Network has been strong and we expect this to continue for the remainder of the year. We hope to announce additional developments in our channel partnerships in the coming quarters that would further reinforce our growth prospects beyond 2007. Nevertheless, we believe it prudent to maintain the 5-7% growth guidance for fiscal year 2007 until the situation at Medtronic Physio-Control is clearer. We are also maintaining our operating margin guidance of 11-13% for this year.

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 strive to reward that support with increased shareholder value as Oridion constantly improves its financial performance. We look forward to sharing our future successes with you.

Sincerely,



Alan Adler
Chairman of the Board of Directors and CEO
Jerusalem, Israel
August 20, 2007

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

| | June 30, 2007 | December 31, 2006 |
|--|--------------------------|------------------------------|
| | Unaudited | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | 5,452 | 6,326 |
| Short-term deposits | 75 | 75 |
| Marketable securities | 3,009 | - |
| Trade receivables | 6,076 | 6,543 |
| Other accounts receivable and prepaid expenses | 706 | 804 |
| Inventories | 4,415 | 4,248 |
| <u>Total</u> current assets | 19,733 | 17,996 |
| SEVERANCE PAY FUND | 1,427 | 1,413 |
| PROPERTY AND EQUIPMENT, NET | 2,770 | 2,778 |
| <u>Total</u> assets | 23,930 | 22,187 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | 3,331 | 4,231 |
| Other accounts payable and accrued expenses | 2,971 | 3,357 |
| <u>Total</u> current liabilities | 6,302 | 7,588 |
| ACCRUED SEVERANCE PAY | 2,099 | 2,025 |
| SHAREHOLDERS' EQUITY: | | |
| Share capital: | | |
| Ordinary shares of NIS 0.01 par value - Authorized: 20,000,000 shares at June 30, 2007 and December 31, 2006; Issued and outstanding: 12,164,545 shares at June 30, 2007 and 11,809,858 shares at December 31, 2006 | 28 | 27 |
| Additional paid-in capital | 77,335 | 76,446 |
| Accumulated other comprehensive income | 850 | - |
| Accumulated deficit | (62,684) | (63,899) |
| <u>Total</u> shareholders' equity | 15,529 | 12,574 |
| <u>Total</u> liabilities and shareholders' equity | 23,930 | 22,187 |

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)

| | Six months ended June 30, | | Three months ended June 30, | | Year ended December 31, |
|---|------------------------------|-------------------|--------------------------------|-------------------|-------------------------------|
| | 2007 | 2006 | 2007 | 2006 | 2006 |
| | Unaudited | | Unaudited | | |
| Revenues | 17,033 | 15,683 | 8,624 | 8,227 | 34,637 |
| Cost of revenues | 7,936 | 7,499 | 3,939 | 3,887 | 16,255 |
| Gross profit | 9,097 | 8,184 | 4,685 | 4,340 | 18,382 |
| Operating expenses: | | | | | |
| Research and development, net | 1,504 | 1,418 | 743 | 714 | 2,734 |
| Selling and marketing | 4,784 | 4,529 | 2,446 | 2,373 | 9,220 |
| General and administrative | 1,399 | 1,323 | 742 | 624 | 2,607 |
| <u>Total operating expenses</u> | <u>7,687</u> | <u>7,270</u> | <u>3,931</u> | <u>3,711</u> | <u>14,561</u> |
| Operating income | 1,410 | 914 | 754 | 629 | 3,821 |
| Financial expenses, net | 195 | 119 | 218 | 126 | 125 |
| Net income from continuing operations | 1,215 | 795 | 536 | 503 | 3,696 |
| Net loss from discontinued operations | - | (502) | - | - | (502) |
| Net income | <u>1,215</u> | <u>293</u> | <u>536</u> | <u>503</u> | <u>3,194</u> |
| Basic earnings per share from continuing operations | 0.10 | 0.07 | 0.04 | 0.04 | 0.32 |
| Basic loss per share from discontinued operations | - | (0.04) | - | - | (0.04) |
| Total basic net earnings per Ordinary share | <u>0.10</u> | <u>0.03</u> | <u>0.04</u> | <u>0.04</u> | <u>0.28</u> |
| Diluted net earnings per share from continuing operations | 0.09 | 0.07 | 0.04 | 0.04 | 0.29 |
| Diluted net loss per share from discontinued operations | - | (0.04) | - | - | (0.04) |
| Total diluted net earnings per Ordinary share | <u>0.09</u> | <u>0.03</u> | <u>0.04</u> | <u>0.04</u> | <u>0.25</u> |
| Weighted average number of shares used for computing basic net earnings per share | <u>12,027,202</u> | <u>11,489,958</u> | <u>12,139,110</u> | <u>11,564,516</u> | <u>11,592,122</u> |
| Weighted average number of shares used for computing diluted net earnings per share | <u>12,953,015</u> | <u>12,785,261</u> | <u>13,096,652</u> | <u>12,879,918</u> | <u>12,788,619</u> |

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
U.S. dollars in thousands

| | <u>Share capital</u> | <u>Additional paid-in capital</u> | <u>Accumulated comprehensive income</u> | <u>Accumulated deficit</u> | <u>Total shareholders' equity</u> |
|--|--------------------------|---|---|--------------------------------|---|
| Balance as of January 1, 2006 | 26 | 75,134 | - | (67,093) | 8,067 |
| Exercise of options, net | 1 | 714 | - | - | 715 |
| Exercise of warrants | *) - | - | - | - | *) - |
| Stock-based compensation | - | 598 | - | - | 598 |
| Net income | - | - | - | 3,194 | 3,194 |
| Balance as of December 31, 2006 | 27 | 76,446 | - | (63,899) | 12,574 |
| Exercise of options, net | 1 | 557 | - | - | 558 |
| Stock-based compensation | - | 332 | - | - | 332 |
| Unrealized gain on marketable securities, net (see Note 2(a), 2 (c)) | - | - | 850 | - | 850 |
| Net income | - | - | - | 1,215 | 1,215 |
| Balance as of June 30, 2007 (unaudited) | <u>28</u> | <u>77,335</u> | <u>850</u> | <u>(62,684)</u> | <u>15,529</u> |

*) Represents an amount lower than \$ 1.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

| | Six months ended June 30, | | Year ended December 31, |
|---|--------------------------------------|-------------|------------------------------------|
| | 2007 | 2006 | 2006 |
| | Unaudited | | |
| <u>Cash flows from operating activities:</u> | | | |
| Net income | 1,215 | 293 | 3,194 |
| Adjustments required to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Loss from discontinued segment | - | 502 | 502 |
| Depreciation | 386 | 348 | 704 |
| Amortization of deferred stock compensation | 332 | 278 | 558 |
| Amortization of deferred stock compensation related to warrants issued to credit providers and others | - | 32 | 32 |
| Accrued severance pay | 60 | 106 | (79) |
| Decrease (increase) in trade receivables | 467 | (865) | (1,628) |
| Decrease (increase) in other accounts receivable and prepaid expenses | 111 | (146) | (247) |
| Increase in inventories | (167) | (964) | (1,706) |
| Increase (decrease) in trade payables | (900) | 399 | 914 |
| Increase (decrease) in other accounts payable and accrued expenses | (386) | 44 | 394 |
| Net cash provided by (used in) operating activities from continuing segment | 1,118 | 27 | 2,638 |
| Net cash used in operating activities from discontinued segment | - | (583) | (579) |
| Net cash provided by (used in) operating activities | 1,118 | (556) | 2,059 |
| <u>Cash flows from investing activities:</u> | | | |
| Investment in marketable securities | (2,159) | - | - |
| Purchase of property and equipment | (378) | (282) | (618) |
| Proceeds from short-term bank deposits, net | - | 1,845 | 2,542 |
| Net cash provided by (used in) investing activities from continuing segment | (2,537) | 1,563 | 1,924 |
| Net cash provided by investing activities from discontinued segment | - | 10 | 10 |
| Net cash provided by (used in) investing activities | (2,537) | 1,573 | 1,934 |
| <u>Cash flows from financing activities:</u> | | | |
| Short-term bank credit, net | - | 250 | - |
| Repayment of long-term loan | - | (2,500) | (2,500) |
| Proceeds from exercise of options and issuance of shares, net | 545 | 368 | 694 |
| Net cash provided by (used in) financing activities | 545 | (1,882) | (1,806) |
| Increase (decrease) in cash and cash equivalents | (874) | (865) | 2,187 |
| Cash and cash equivalents at the beginning of the period | 6,326 | 4,139 | 4,139 |
| Cash and cash equivalents at the end of the period | 5,452 | 3,274 | 6,326 |

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

| | Six months ended | | Year ended |
|--|-------------------------|-------------|-------------------|
| | June 30, | | |
| | 2007 | 2006 | 2006 |
| | Unaudited | | |
| (a) Significant non-cash transactions: | | | |
| Other accounts receivable in respect of exercise of options | 13 | 38 | 21 |
| (b) Supplemental disclosure of cash flow information: | | | |
| Cash paid during the period for: | | | |
| Interest | - | 43 | 143 |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2006, are applied consistently in these financial statements.

a. Investments in marketable securities:

The Company accounts for investments in marketable securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

Management determines the appropriate classification of its investments at the time of purchase and reevaluates such determinations at each balance sheet date.

The Company classifies all of its securities as available for sale. Available for sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in "accumulated other comprehensive income (loss)" in shareholders' equity. Realized gains and losses on sale of investments are included in earnings and are derived using the specific identification method for determining the cost of securities.

b. Change in method of accounting for inventory valuation:

On January 1, 2007, the Company elected to change its method of valuing its inventory to the first in first out ("FIFO") method, whereas in all prior years inventory was valued using the average cost method. The new method of accounting for inventory was adopted in connection with the introduction of the new Enterprise Resource Program into the Company. The Company believes that the FIFO method is preferable, since it will allow the Company to better manage its accounting for inventory costs.

Comparative financial statements for prior years have not been retrospectively adjusted due to immateriality.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- c. In 2006, Oridion transferred its BreathID business to a newly-formed company, BreathID Ltd. (BID), in which Oridion retained a 19.9% interest. In May 2007, BID raised approximately \$ 5.5 million in an Initial Public Offering (IPO) on the Tel Aviv Stock Exchange. Subsequent to the IPO, Oridion's interest in BID is approximately 16.5%. The ability of Oridion and of certain other shareholders to sell BID shares is restricted by lock-up provisions for a period of eighteen months from the date of the IPO.

Upon the IPO, the Company classified its investment in BID shares as "available for sale" according to Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). According to SFAS 115, an investment in equity securities that have readily determinable fair values and are classified as available for sale should be measured at fair value in the balance sheet, with changes in fair value being recorded in other comprehensive income and accumulated as a separate component of shareholders' equity. Pursuant to SFAS 115, shares that are expected to qualify for sale within one year of the balance sheet date are not considered restricted and can be recorded at fair value.

As of June 30, 2007, the total fair value of Oridion's interest in BID, based on the market price of the shares, is approximately \$ 3.45 million. Of this amount, shares for which the lock-up provisions end within one year from the balance sheet date are stated at fair value in the amount of \$ 0.86 million, and an unrealized gain of \$ 0.86 million, net of income taxes in the amount of \$ 0 million, has been reported in accumulated other comprehensive income in the statements of changes in shareholders' equity.

NOTE 3:- UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles 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 six-month period ended June 30, 2007, are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

INVESTOR RELATIONS CONTACTS

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Next quarterly report

November 12, 2007

Announcement of 3rd quarter 2007 results

