

Enabling technologies for improved medical care



Oridion Systems Ltd.
Letter to Shareholders
August 2003



- **40% Revenue Growth**
- **Net Loss Reduced**

Dear Shareholder,

I am pleased to report continued revenue growth for Oridion's second quarter of 2003 ending June 30. This is the sixth consecutive quarter in which Oridion has witnessed a material increase in revenues compared to correlating periods in previous years, due to an increasing demand for its products in a growing number of segments of the medical community. Following this increase in sales, Oridion's capnography business has successfully reached a break-even rate as planned.

Financial results in Q2, 2003

Revenues—

Company revenues for the second quarter increased by 40% to USD 4.8 million compared to USD 3.4 million for the second quarter of 2002. Revenues for the six month period ending June 30, 2003 increased by 40% to USD 8.1 million compared to USD 5.8 million for the same period last year. Revenue growth is mainly as a result of an increase in the number of customers and products in Oridion's Capnography business.

The gross margin for the second quarter was 44.2% compared to 45.7% for the second quarter of 2002. Although the gross margin in Oridion's capnography business increased, the overall gross margin decreased due to higher manufacturing expenses for Oridion's BreathID® system during the second quarter. The gross margin for the six-month period ending June 30, 2003 improved to 43.9% compared to 42.7% for the same period last year.

Research and Development—

R&D expenses increased to USD 0.8 million compared to USD 0.7 million for the second quarter of 2002.

Current Capnography R&D expenses include investments in developing a new OEM capnography model offering new capabilities in light of the growing demand by world leading medical device companies to integrate Oridion's Microstream® technology into their monitoring system. Capnography R&D expenses also include investments in the development of a new capnography product for use in new medical care settings.

Breath testing R&D expenses include investments in the ongoing development of additional breath tests for the BreathID® system. These new breath tests come in addition to Oridion's first three BreathID® breath tests already offered for sale in Europe. With each new breath test developed, Oridion is able to widen the platform ability of this system to non-invasively, and in 'real time', diagnose and manage a range of GI related diseases and other physiological conditions with just one device.

Sales and Marketing—

Sales and marketing expenses decreased to USD 2.2 million compared to USD 2.4 million for the second quarter of 2002. This reduction follows steps taken earlier this year by Oridion to consolidate a number of sales and marketing activities while increasing sales. Current expenses include:

In the *Capnography Business Unit*, sales and marketing expenses include numerous clinical studies for Oridion's Capnography products in a range of medical

environments in which a need for improved CO₂ monitoring has been clearly identified, such as in the growing instances of procedural sedation. The Company is also active in educating the medical community on the use of Microstream[®] technology and its ability to offer improved medical care and help save lives by providing medical personnel, in every medical setting, with the earliest possible indication of potential respiratory complications. Other activities include supporting Oridion's OEM partners in their marketing activities as Microstream[®] technology becomes increasingly in demand.

In the *Breath Testing Business Unit*, expenses include growing European sales and marketing activities of Oridion's Multi-Test BreathID[®] Breath Testing System. The Company now offers for sale in Europe the BreathID[®] system with three applications: the recently launched Liver Function breath test, a breath test for the measurement of Gastric Emptying Rate (GER) and a breath test for the detection of *Helicobacter pylori* (*H. pylori*) – the bacteria associated with peptic ulcers and gastric cancer.

General and Administration—

G&A expenses remained constant at USD 0.7 million compared to the second quarter of 2002.

Operating Loss—

The operating loss decreased to USD 1.6 million compared to USD 2.3 million for the second quarter of 2002.

Achievements and Events in Q2, 2003

In addition to improving its fiscal results, the Company achieved the following milestones during the second quarter of 2003:

- ***New OEM Product Launches***

Philips Medical Systems – a world leading medical device company and one of Oridion's leading OEM partners – recently launched a new Microstream[®] enabled multi-parameter patient safety monitor. This follows additional Microstream[®] enabled monitor launches earlier this year by a number of other medical device companies, such as world leader Siemens Medical Solutions and Japanese leader Fukuda Denshi. With an increase in both the range of Microstream[®] enabled products and the number of units sold, Oridion continues to strengthen its position as one of the world's leaders in the CO₂ monitoring market.

- ***New BreathID[®] Application***

Oridion launched its new Liver Function application in Europe. This is the third BreathID[®] application launched by Oridion, and can be used with the same Multi-Test BreathID[®] breath testing device as Oridion's first two applications: Oridion's Gastric Emptying Rate (GER) breath test and Oridion's *H. pylori* breath test. This new application - which helps offer physicians vital information regarding the severity of liver impairment and functional hepatic reserve - was developed by Oridion to assist physicians in the management of patients suffering from chronic liver diseases. These include patients with chronic viral hepatitis, type B and type C, patients with alcohol related liver disease and patients both before and after liver transplants.

- **Breath Testing Activities Revised**

Oridion is revising its worldwide breath testing activities, by refocusing its efforts towards widening the platform capability of its Multi-Test BreathID[®] Breath Testing System and by currently concentrating most of its marketing efforts in Europe. The Multi-Test BreathID[®] Breath Testing System has the ability to perform a variety of tests with the same device and has been warmly received by leading European physicians. Following marketing activities in the past six months in the US, the Company has concluded that offering only a single breath test, *H. pylori* breath test, for use with the system is not sufficient to justify the required level of sales and marketing activities. Oridion has therefore decided to postpone its US breath testing activities and expects this to result in a reduction in breath testing expenses for the remainder of the year.

Future Activities and Outlook

In its Capnography business unit, Oridion plans to continue launching new OEM products worldwide through its leading OEM partners and to complete the development of a new capnography module designed to offer improved CO₂ monitoring capabilities with lower costs.

In its Breath Testing business unit, Oridion expects to continue witnessing an increase in European evaluation requests and marketing activities for the Multi-Test BreathID[®] breath testing device and the three breath tests already launched by Oridion.

We thank our employees, shareholders and partners – all whom have contributed to what has truly been a group effort to become the technological leaders in our fields.

Best Regards,

George Yariv,
President and CEO
Boston, MA,
18th August 2003

Consolidated Income Statements

in USD 000's (except for share data)	Three months ended June 30 2002	Three months ended June 30 2003	Six months ended June 30 2002	Six months ended June 30 2003
Revenues from sales	3,423	4,805	5,817	8,143
Gross profit	1,566	2,123	2,481	3,571
Percent of Revenues	45.7%	44.2%	42.7%	43.9%
Operating Expenses	3,863	3,751	7,392	7,083
Operating loss (EBIT)	(2,297)	(1,628)	(4,911)	(3,512)
Net Loss	(2,208)	(1,767)	(4,740)	(3,612)
EBITDA	(1,989)	(1,405)	(4,302)	(3,064)
Basic loss per share (in actual numbers)	(0.21)	(0.17)	(0.45)	(0.34)

Consolidated Balance Sheet

	31-Dec-02	30-Jun-03
Assets		
Cash, Short Term Deposits and Marketable Securites	9,504	7,764
Inventories and Receivables	7,258	6,914
Long Term Investments	1,018	1,237
Fixed Assets	4,762	4,597
Total Assets	22,542	20,512
Liabilities & Shareholders Equity		
Curent Liabilities	4,235	5,473
Long Term Liabilities	1,757	2,073
Shareholder Equity	16,550	12,966
Total Liabilities & Shareholders Equity	22,542	20,512

Consolidated Cash Flow Statements

	Six months ended June 30 2002	Six months ended June 30 2003
Cash flow		
Cash flow from operating activity	(3,094)	(1,645)
Cash flow from Investing activity	9,325	(95)
Cash flow from finance activity	4	
Increase (Decrease), net	6,235	(1,740)
Cash and Cash Equivalent at the Beginning of the Period	7,959	9,504
Cash and Cash Equivalent at the End of the Period	14,194	7,764