

Enabling technologies for improved medical care



Oridion Systems Ltd.
Letter to Shareholders
August 2002



- **Record Second Quarter Results - 47% Revenue Growth**
- **Increase in Sales of Consumable Products**
- **Net Loss Reduced**

Dear Shareholder,

With the conclusion of Oridion's second quarter on June 30, the Company has been pleased to witness, for its second consecutive quarter, an increase in both consumable and total revenues, as well as many positive business developments. I am pleased to present you with these achievements and the Company's outlook for its future development.

Financial results in Q2, 2002

Revenues—

Company revenues for the second quarter increased by 47% to USD 3.4 million compared to USD 2.3 million for the second quarter of 2001. Revenues for the six month period ending June 30, 2002 increased by 40% to USD 5.8 million compared to USD 4.1 million for the same period last year. Growth in Company revenues has been driven by a number of factors. These factors include an increase in sales of Oridion's consumable products in all its markets, a trend already seen in Q1, the launch of a new product to a major OEM partner, and a strong increase in European and Japanese sales.

Gross margin for the second quarter of 2002 improved to 45.7% compared to 43.2% for the second quarter of 2001. The gross margin for the six-month period ending June 30, 2002 improved to 42.7% compared to 40.6% for the same period last year.

Sales of the Company's consumable products continued to increase and have more than doubled for the six-month period ending June 30, 2002 compared to the same period last year.

Research and Development—

R&D expenses decreased to USD 0.7 million for the second quarter of 2002 compared to USD 0.8 million for the second quarter of 2001 following completion of development of the Company's BreathID™ breath testing system and its first application – Oridion's patented *H. pylori* breath test.

R&D expenses for the second quarter of 2002 include the final development stages of Oridion's second BreathID™ application – a breath test to measure patients' gastric

emptying rate. R&D expenses also include the development of a new OEM capnography module, aimed at improving CO₂ monitoring accuracy while reducing costs.

Sales and Marketing—

Sales and marketing expenses for the three-month period ending June 30, 2002 remained steady at USD 2.4 million compared to the same period last year.

Current sales and marketing expenses include:

In the *Capnography Business Unit*, the Company's US direct sales team continues to support Oridion's OEM partners and maintain the steady growth in sales of Oridion's capnography products. One of the main objectives of this team is to increase the adoption and penetration rate of Oridion's consumable products.

To help achieve their goal of increasing the penetration rate of these and Oridion's other products, the direct sales team is active in signing new distribution agreements, and managing the Company's distributors. The direct sales team also works with Oridion's team of clinical consultants in educating the medical community on the benefits of Oridion's patented Microstream® technology and training customers on how to enjoy the advantages offered by Oridion's capnography products. Other expenses include increased OEM support for Oridion's partners in Europe and the management of growing distributor activities in Europe and Japan.

In the *Breath Testing Business Unit*, the Company has begun actively marketing its patented BreathID™ breath test system and ¹³C urea *H. pylori* breath test in Europe. To help promote awareness of its innovative breath testing diagnostic products, the Company has been active in numerous gastroenterology conferences and tradeshows, such as the prominent Digestive Disease Week (DDW) conference, recently held in the US and attended by leading gastroenterologists from across the globe.

General and Administration—

G&A expenses remained steady at USD 0.7 million compared to the same period last year.

Net Financial Income—

Net financial income decreased to USD 0.1 million for the second quarter of 2002 compared to USD 0.3 million for the second quarter of 2001 primarily due to the significant drop in USD interest rates.

Net Loss—

As the Company managed to increase revenues while at the same time reduce expenses, the net loss decreased to USD 2.2 million for the second quarter of 2002 compared to USD 2.6 million for the second quarter of 2001.

Achievements and Events in Q2, 2002

In addition to the improvement of its fiscal results, the Company is pleased to report achieving the following milestones during the second quarter of 2002:

Launch of New OEM Capnography Product

The Company launched a new capnography product to Philips Medical Systems - one the world's leading medical device companies and a long standing Oridion OEM partner. This new product will be integrated into Philips new patient safety monitoring system being released in the summer of 2002.

Increased Sales of Capnography Products in Europe and Japan

As the Company continues to strengthen its distribution network in Europe and Japan, it is pleased to witness sales of its capnography products in Europe and Japan double compared to the sales for same period last year.

Second BreathID™ Application Unveiled

Oridion unveiled its second BreathID™ application – new gastric emptying rate (GER) BreathID™ breath test, – at the recent Digestive Disease Week Conference in the US. This new test, currently for investigational use only, was designed by Oridion to assist physicians in quickly and accurately diagnosing the cause of gastrointestinal disorders. By measuring how long food takes to go through the stomach, this new BreathID™ application is expected to benefit large patient population groups such as those suffering from Dyspepsia, Diabetes and Parkinson's disease.

Supplies Begin to Largest Distributor for EMS Market in the US

Following the distribution agreement signed last quarter with Bound Tree Parr, LLC - the

largest distributor of medical devices to the US emergency medical services (EMS) market - Oridion has began supplying its Microcap® capnography monitor and consumable products following orders received from this distributor.

Additional Information Submitted to FDA

Oridion submitted additional information requested by the FDA in June this year, on the citrica contained in Oridion's *H. pylori* test kits. Following the regular FDA review procedure, the Company awaits the FDA's decision on its application for approval of the *H. pylori* test kit.

Educational Programs Begin for Key Markets and Patient Groups

The Company has recently started educational programs for a number of key markets and patient groups including the emergency medical services (EMS) and sufferers of asthma. With an increase in medical care provided under emergency circumstances, as well as an increasing number of asthma sufferers, the advantages offered by Oridion's capnography products become even more important in offering better medical care in these settings.

Future activities and Outlook

In our Capnography division, the Company expects upcoming launches by existing and new OEM partners.

In our Breath Testing division, we plan to increase the European sales of the BreathID™ *H. pylori* breath test and prepare for the US launch as we await final approval from the FDA. We also plan to launch our new gastric emptying rate BreathID™ breath test later this year in Europe.

The people at Oridion remain highly motivated to excel and surpass even their own previous achievements in offering the best capnography and diagnostic breath testing products available. Such motivation, cultivated by the basic human instinct to assist those less fortunate, give our work a sense of mission that we gladly undertake. We look forward to sharing our successes and achievements together with you, our valued shareholders.

Best Regards,

George Yariv,
President and CEO
Needham, MA, 20 August 2002

Consolidated Income Statements

in USD 000's (except for share data)	Three months ended June 30 2001	Three months ended June 30 2002	Six months ended June 30 2001	Six months ended June 30 2002
Revenues from sales	2,326	3,423	4,142	5,817
Gross profit	1,005	1,566	1,680	2,481
Percent of Revenues	43.2%	45.7%	40.6%	42.7%
Operating Expenses	3,932	3,863	8,531	7,392
Operating loss (EBIT)	(2,927)	(2,297)	(6,851)	(4,911)
Financial income (expenses), net	315	89	808	171
Net Loss	(2,612)	(2,208)	(6,)	(4,740)
EBITDA	(2,686)	(1,989)	(6,391)	(4,302)
Basic loss per share (in actual numbers)	(0.25)	(0.21)	(0.60)	(0.45)

Consolidated Balance Sheet

	Dec 31, 2001	June 30, 2002
Assets		
Current Assets	25,777	21,029
Property & Equipment, net	5,015	5,295
Total Assets	30,792	26,324
Liabilities & Shareholders Equity		
Current Liabilities	3,917	4,180
Long Term Liabilities	821	760
Shareholder Equity	26,054	21,384
Total Liabilities & Shareholders Equity	30,792	26,324

Consolidated Cash Flow Statements

	Six months ended June 30 2001	Six months ended June 30 2002
Cash flow		
Cash flow from operating activity	(7,991)	(3,130)
Cash flow from Investing activity	24,920	9,361
Cash flow from finance activity	751	4
Increase (Decrease), net	17,680	6,235
Cash and Cash Equivalent at the Beginning of the Period	4,762	7,959
Cash and Cash Equivalent at the End of the Period	22,442	14,194