

Enabling technologies for improved medical care



Oridion Systems Ltd.
Letter to Shareholders
May 2002



- **Record First Quarter Results - 32% Revenue Growth**
- **Increase in Sales of Consumable Products**
- **Operating Expenses and Net Loss Reduced**

Dear Shareholder,

Oridion's first quarter of 2002 ending March 31, has seen many positive developments, including an increase in both revenues and sales of consumable products together with a decrease in operating expenses. I am pleased to present you with the financial results for this period and an overall description of the Company's activities and achievements during this time.

Financial results in Q1, 2002

Revenues—

Company revenues for the first quarter increased by 32% to USD 2.4 million compared to USD 1.8 million for the first quarter of 2001. Oridion's investment last year, in establishing the Company's US direct sales team, has begun to result in increased sales and usage rates of Oridion's consumables in both new and existing clinical environments.

Gross margin for the first quarter improved to 38% compared to 37% for the first quarter of 2001.

Sales of the Company's consumable products in the first quarter increased substantially compared to the first quarter of 2001, and resulted in approximately 25% of total sales compared to 18% of total sales in the first quarter of 2001.

Research and Development—

R&D expenses decreased to USD 0.6 million compared to USD 1.2 million for the first quarter of 2001. The decrease in R&D expenses follows completion of the Company's BreathID™ breath testing system and an unexpected USD 0.3 million grant awarded to Oridion by the Office of the Chief Scientist of Israel for R&D activities in past years, which had not been previously accrued.

R&D expenses for the first quarter of 2002 include the ongoing development of a new diagnostic breath test for use with Oridion's BreathID™ breath testing system. Additional R&D expenses include the development of new OEM products and ongoing technical support for the growing number of leading medical device companies that have chosen

to integrate Oridion's enabling Microstream® technology in their patient safety monitoring systems.

Sales and Marketing—

Sales and marketing expenses decreased to USD 2.2 million compared to USD 2.6 million for the first quarter of 2001. The decrease in these expenses stem primarily from the reduction in regulatory costs, following the submission of applications to the FDA last year for the Company's BreathID™ system.

Current sales and marketing expenses include:

In the *Capnography Business Unit*, the Company's direct sales team continues to work together with the US team of clinical education specialists in an effort to support Oridion's OEM partners and maintain the steady growth in sales of Oridion's capnography products. These teams have been active in signing new distribution and purchase agreements, educating various segments of the medical community on the benefits of Oridion's products, managing an increasing number of distributors currently selling Oridion's products, and training Oridion's constantly growing number of customers on how to use Microstream® enabled products. The Company is pleased to see that the many efforts of these teams and the investments made by the Company last year in their establishment has begun to result in increased sales of Oridion's capnography consumables.

In the *Breath Testing Business Unit*, the Company launched the BreathID™ in selected European countries together with its first application – Oridion's patented ¹³C urea *H. pylori* breath test. In addition, the Company is preparing to launch a second BreathID™ application, which at this stage is for investigational use only. This new application is a breath test designed to monitor a patient's gastric emptying rate. By measuring how long the 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.

General and Administration—

Expenses decreased to USD 0.7 million compared to USD 0.8 million in the first quarter of 2001.

Net Finance—

Decreased to USD 0.1 million compared to USD 0.5 million for the first quarter of 2001 primarily due to the significant drop in USD interest rates.

Net loss—

Decreased to USD 2.5 million compared to USD 3.5 million for the first quarter of 2001.

Achievements and Events in Q1, 2002

In addition to improving its fiscal results, the Company achieved the following milestones during the first quarter of 2002:

Agreement Signed with Largest EMS Distributor in US

The Company signed a distribution agreement this quarter with Bound Tree Parr, LLC - the largest distributor of medical devices to the US emergency medical services (EMS) market. Under this agreement, Bound Tree will purchase for distribution Oridion's Microcap® series monitors and consumable products to the EMS customers that provide medical, rescue and transport services on land, sea and in the air.

OEM Agreement Signed with New Partner

The Company signed an OEM agreement with Ivy Biomedical Systems Inc. – a new Oridion partner and a manufacturer of patient monitoring systems. Under this agreement, Ivy will integrate Oridion's patented Microstream® capnography monitoring technology into its new VitalGuard™ physiological patient monitoring system – designed with a specific emphasis on monitoring newborn babies. Ivy distributes its monitoring systems through leading medical device companies, including Ohmeda Medical and it's infant care group of Datex Ohmeda.

New Guidelines for Capnography

According to new standards released by the American College of Emergency Physicians (ACEP), capnography monitoring is superior to pulse oximetry, esophageal detector and other forms of physical examination in detection the status of a patient's ventilation. These standards and others released by world-renowned medical care organizations such as the American Society of Anesthesiologists (ASA) and American Heart Association (AHA) are important tools in guiding the medical community on the use of capnography technology - and helping

emphasize the importance and need for Oridion's products.

European Expansion of Capnography

The Company recently signed a number of agreements for the distribution of its capnography products in Europe. Agreements have already been signed with distributors in France, UK, Italy, Spain, Belgium and Scandinavia, with more agreements expected to be signed in Germany, Switzerland, Holland, Greece and a number of additional Mediterranean countries.

BreathID™ Launched in Europe

The Company recently launched its BreathID™ breath testing system and *H. pylori* breath test in Europe. Sales of the BreathID™ and consumable products will be conducted via European distributors that are leading suppliers of laboratory *H. pylori* breath tests in their specific countries.

Future Activities and Outlook

Past activities undertaken by Oridion aimed at encouraging future growth have begun to result in an increased development pipeline, an increased product offering, and an increase in sales and use of our products.

Future plans include launching new capnography products with our new and existing OEM partners and to continue expanding our direct sales activities in the US, Europe and Japan. We also intend on signing additional distribution agreements in Europe for the BreathID™ as we continue to prepare for our US launch, which is scheduled to begin after we receive final FDA approval for the *H. pylori* test kit. In May 2002 we expect to unveil our new gastric emptying rate BreathID™ application, currently available for investigational use only.

In addition to launching these new products, the Company also plans to continue reducing its rate of net cash outflow according to plan.

It is gratifying to see all the hard work and perseverance begin to pay off. It is even more gratifying to hear an increasing number of cases in which patients have benefited from the medical technologies we have developed. These are reasons enough to make the effort to remain the best at what we do.

Best Regards,

George Yariv,
President and CEO
Boston, MA, 7 May

Consolidated Income Statements

in USD 000's (except for share data)	Three months ended March 31 2001	Three months ended March 31 2002
Revenues from Sales	1,816	2,394
Gross Profit	675	915
Percent of Revenues	37%	38%
Operating Expenses	4,591	3,529
Operating Loss (EBIT)	(3,916)	(2,614)
Financial Income (expenses), net	493	82
Net Loss	(3,518)	(2,532)
EBITDA	(3,697)	(2,313)
Basic Loss Per Share (in actual numbers)	(0.35)	(0.24)

Consolidated Balance Sheet

	Dec 31, 2001	March 31, 2002
Assets		
Cash, Short Term Deposits and Marketable Securites	18,107	15,895
Inventories and Receivables	7,670	6,977
Fixed Assets	5,015	5,056
Total Assets	<u>30,792</u>	<u>27,928</u>
Liabilities & Shareholders Equity		
Curent Liabilities	3,917	3,593
Long Term Liabilities	821	780
Shareholder Equity	26,054	23,555
Total Liabilities & Shareholders Equity	<u>30,792</u>	<u>27,928</u>

Consolidated Cash Flow Statements

	Three months ended March 31 2001	Three months ended March 31 2002
Cash Flow		
Cash Flow from Operating activity	(2,391)	(1,939)
Cash Flow from Investing activity	4,494	9,875
Cash Flow from Finance activity	513	-
Increase Net	<u>2,616</u>	<u>7,936</u>
Cash and Deposits at the Beginning of the Period	26,051	7,959
Cash and Deposits at the End of the Period	<u>28,667</u>	<u>15,895</u>