

HORMEL FOODS CORP /DE/
Form 10-Q
June 10, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended May 1, 2011

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 1-2402

HORMEL FOODS CORPORATION

(Exact name of registrant as specified in its charter)

Edgar Filing: **HORMEL FOODS CORP /DE/ - Form 10-Q**

Delaware

(State or other jurisdiction of incorporation or organization)

41-0319970

(I.R.S. Employer Identification No.)

1 Hormel Place

Austin, Minnesota

(Address of principal executive offices)

55912-3680

(Zip Code)

(507) 437-5611

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class		Outstanding at June 5, 2011
Common Stock	\$.0293 par value	267,207,133
Common Stock Non-Voting	\$.01 par value	-0-

Table of Contents

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1.

Financial Statements

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION May 1, 2011 and October 31, 2010

CONSOLIDATED STATEMENTS OF OPERATIONS Three and Six Months Ended May 1, 2011 and April 25, 2010

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' INVESTMENT Twelve Months Ended October 31, 2010
and Six Months Ended May 1, 2011

CONSOLIDATED STATEMENTS OF CASH FLOWS Six Months Ended May 1, 2011 and April 25, 2010

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

CRITICAL ACCOUNTING POLICIES

RESULTS OF OPERATIONS

Overview

Consolidated Results

Segment Results

Related Party Transactions

LIQUIDITY AND CAPITAL RESOURCES

FORWARD-LOOKING STATEMENTS

Item 3.

Quantitative and Qualitative Disclosures About Market Risk

Item 4.

Controls and Procedures

PART II - OTHER INFORMATION

Item 1.

Legal Proceedings

Item 1A.

Risk Factors

Item 2.

Unregistered Sales of Equity Securities and Use of Proceeds

Item 6.

Exhibits

SIGNATURES

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****HORMEL FOODS CORPORATION****CONSOLIDATED STATEMENTS OF FINANCIAL POSITION****(In Thousands of Dollars)**

	May 1, 2011 (Unaudited)	October 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 913,704	\$ 467,845
Short-term marketable securities	51,002	50,595
Accounts receivable	405,792	430,939
Inventories	810,388	793,771
Income taxes receivable	4,187	8,525
Deferred income taxes	71,438	70,703
Prepaid expenses	12,756	12,153
Other current assets	17,937	23,635
TOTAL CURRENT ASSETS	2,287,204	1,858,166
DEFERRED INCOME TAXES	53,534	72,426
GOODWILL	630,707	629,023
OTHER INTANGIBLES	136,603	141,522
PENSION ASSETS	64,128	61,272
INVESTMENTS IN AND RECEIVABLES FROM AFFILIATES	222,817	214,389
OTHER ASSETS	150,903	155,017
PROPERTY, PLANT AND EQUIPMENT		
Land	55,647	54,017
Buildings	738,892	729,718
Equipment	1,373,275	1,358,237
Construction in progress	43,971	45,283
	2,211,785	2,187,255
Less allowance for depreciation	(1,306,264)	(1,265,152)
	905,521	922,103
TOTAL ASSETS	\$ 4,451,417	\$ 4,053,918

Table of Contents

HORMEL FOODS CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(In Thousands of Dollars)

	May 1, 2011 (Unaudited)	October 31, 2010
LIABILITIES AND SHAREHOLDERS INVESTMENT		
CURRENT LIABILITIES		
Accounts payable	\$ 277,116	\$ 361,287
Accrued expenses	45,559	46,408
Accrued workers compensation	33,709	33,022
Accrued marketing expenses	89,947	76,552
Employee related expenses	156,962	187,116
Taxes payable	8,587	9,339
Interest and dividends payable	44,056	37,489
Current maturities of long-term debt	350,000	350,000
TOTAL CURRENT LIABILITIES	1,005,936	1,101,213
LONG-TERM DEBT, LESS CURRENT MATURITIES	250,000	0
PENSION AND POST-RETIREMENT BENEFITS	457,057	454,998
OTHER LONG-TERM LIABILITIES	95,176	91,068
SHAREHOLDERS INVESTMENT *		
Preferred stock, par value \$.01 a share authorized 160,000,000 shares; issued none		
Common stock, non-voting, par value \$.01 a share authorized 400,000,000 shares; issued none		
Common stock, par value \$.0293 a share authorized 800,000,000 shares; issued 267,418,190 shares May 1, 2011		
issued 265,963,080 shares October 31, 2010	7,835	7,793
Additional paid-in capital	19,963	0
Accumulated other comprehensive loss	(149,099)	(175,910)
Retained earnings	2,759,116	2,568,774
HORMEL FOODS CORPORATION SHAREHOLDERS INVESTMENT	2,637,815	2,400,657
NONCONTROLLING INTEREST	5,433	5,982
TOTAL SHAREHOLDERS INVESTMENT	2,643,248	2,406,639
TOTAL LIABILITIES AND SHAREHOLDERS INVESTMENT	\$ 4,451,417	\$ 4,053,918

* Shares and par values have been restated, as appropriate, to reflect the two-for-one stock split effected February 1, 2011.

See Notes to Consolidated Financial Statements

Table of Contents

HORMEL FOODS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	May 1, 2011	April 25, 2010*	May 1, 2011	April 25, 2010*
Net sales	\$ 1,959,041	\$ 1,699,782	\$ 3,880,599	\$ 3,427,229
Cost of products sold	1,632,814	1,419,315	3,180,367	2,828,375
GROSS PROFIT	326,227	280,467	700,232	598,854
Selling, general and administrative	160,136	146,782	305,297	292,314
Equity in earnings of affiliates	6,672	3,952	13,577	6,773
OPERATING INCOME	172,763	137,637	408,512	313,313
Other income and expense:				
Interest and investment income	1,972	1,423	2,413	1,866
Interest expense	(7,187)	(6,574)	(13,766)	(13,135)
EARNINGS BEFORE INCOME TAXES	167,548	132,486	397,159	302,044
Provision for income taxes	56,846	53,951	136,422	111,240
NET EARNINGS	110,702	78,535	260,737	190,804
Less: Net earnings attributable to noncontrolling interest	1,123	673	2,332	1,735
NET EARNINGS ATTRIBUTABLE TO HORMEL FOODS CORPORATION	\$ 109,579	\$ 77,862	\$ 258,405	\$ 189,069
NET EARNINGS PER SHARE:				
BASIC	\$ 0.41	\$ 0.29	\$ 0.97	\$.71
DILUTED	\$ 0.40	\$ 0.29	\$ 0.95	\$.70
WEIGHTED-AVERAGE SHARES OUTSTANDING:				
BASIC	267,207	267,187	266,868	267,182
DILUTED	272,847	271,157	272,293	270,941
DIVIDENDS DECLARED PER SHARE:	\$ 0.1275	\$ 0.1050	\$ 0.2550	\$ 0.2100

* Shares and per share figures have been restated to reflect the two-for-one stock split effected February 1, 2011.

See Notes to Consolidated Financial Statements

Table of Contents**HORMEL FOODS CORPORATION****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS INVESTMENT****(In Thousands, Except Per Share Amounts)****(Unaudited)**

	Hormel Foods Corporation Shareholders				Accumulated	Non-	Total
	Common	Treasury	Additional	Retained	Other	controlling	Shareholders
	Stock	Stock	Paid-in	Earnings	Comprehensive	Interest	Investment
			Capital		Income (Loss)		
Balance at October 25, 2009	\$ 7,828	\$ 0	\$ 0	\$ 2,318,390	\$ (203,610)	\$ 1,713	\$ 2,124,321
Comprehensive income							
Net earnings				395,587		4,189	399,776
Foreign currency translation					5,468	80	5,548
Deferred hedging, net of reclassification adjustment					33,372		33,372
Pension and other benefits					(11,140)		(11,140)
Comprehensive income						4,269	427,556
Purchases of common stock		(69,574)					(69,574)
Stock-based compensation expense			14,402				14,402
Exercise of stock options/nonvested shares	65	(308)	22,007				21,764
Shares retired	(100)	69,882	(36,409)	(33,373)			0
Declared cash dividends \$.42 per share*				(111,830)			(111,830)
Balance at October 31, 2010	\$ 7,793	\$ 0	\$ 0	\$ 2,568,774	\$ (175,910)	\$ 5,982	\$ 2,406,639
Comprehensive income							
Net earnings				258,405		2,332	260,737
Foreign currency translation					2,218	119	2,337
Deferred hedging, net of reclassification adjustment					16,292		16,292
Pension and other benefits					8,301		8,301
Comprehensive income						2,451	287,667
Purchases of common stock		(34,718)					(34,718)
Stock-based compensation expense			12,242				12,242
Exercise of stock options/nonvested shares	81	(150)	42,550				42,481
Shares retired	(39)	34,868	(34,829)				0
Distribution to noncontrolling interest						(3,000)	(3,000)
Declared cash dividends \$.255 per share				(68,063)			(68,063)

Edgar Filing: HORMEL FOODS CORP /DE/ - Form 10-Q

Balance at May 1, 2011 \$ 7,835 \$ 0 \$ 19,963 \$ 2,759,116 \$ (149,099) \$ 5,433 \$ 2,643,248

* Per share figures have been restated to reflect the two-for-one stock split effected February 1, 2011.

See Notes to Consolidated Financial Statements

Table of Contents

HORMEL FOODS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands of Dollars)
(Unaudited)

	May 1, 2011	Six Months Ended April 25, 2010	
OPERATING ACTIVITIES			29
<hr/>			

DILUTION

Purchasers of our ordinary shares in the rights offering will experience an immediate dilution of the net tangible book value per ordinary share. Our net tangible book value as of June 30, 2010 was approximately \$28,355, or \$2.73 per ordinary share (based upon 10,396,548 of our ordinary shares outstanding). Net tangible book value per share is equal to our total net tangible book value, which is our total tangible assets less our total liabilities, divided by the number of our ordinary shares outstanding. Dilution per share equals the difference between the amount per share paid by purchasers of ordinary shares in the rights offering and the net tangible book value per ordinary share immediately after the rights offering.

Based on an assumed offering of 4,584,369 ordinary shares at an assumed offering price of \$3.09 per share and after deducting estimated offering expenses payable by us of approximately \$150,000, and the application of the estimated \$14,850,000 of net proceeds from the rights offering and \$463,500 from the sale of 150,000 ordinary shares in a private placement to Ki Corporation Limited, a company owned by Mr. Nathan Kirsh, our principal shareholder and a director, our pro forma net tangible book value as of June 30, 2010 would have been approximately \$43,668,000 or \$2.84 per share. This represents an immediate increase in pro forma net tangible book value to existing shareholders of \$0.11 per ordinary share and an immediate dilution to purchasers in the rights offering of \$0.25 per ordinary share.

The following table illustrates this per share dilution assuming the completion of a private placement of 150,000 of our ordinary shares to Ki Corporation Limited at an assumed offering price of \$3.09 per share and a fully subscribed rights offering of 4,854,369 ordinary shares at the assumed subscription price of \$3.09 per share:

Subscription price	
Net tangible book value per ordinary prior to the rights offering	\$2.
Increase in net tangible book value per ordinary share attributable to the rights offering	\$0.
Pro forma net tangible book value per share after the rights offering	
Dilution in net tangible book value per share to purchasers	

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes incorporated or included elsewhere in this prospectus. The consolidated statements of operations data for the years ended December 31, 2007, 2008 and 2009 and the consolidated balance sheets data as at December 31, 2008 and 2009 are derived from our audited consolidated financial statements incorporated by reference in this prospectus. The consolidated statements of operations data for the years ended December 31, 2005 and 2006 and the consolidated balance sheets data as at December 31, 2005, 2006 and 2007 are derived from our audited consolidated financial statements that are not included or incorporated in this prospectus. The consolidated statement of operations data for the six months ended June 30, 2009 and 2010 and the consolidated balance sheet data as at June 30, 2010 are derived from our unaudited interim consolidated financial statements included elsewhere in this prospectus. Such financial statements have been prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. Our historical results are not necessarily indicative of results to be expected for any future period.

	Year Ended December 31,					Six Months Ended	
	2005(1)	2006(1)	(1)(2)	2008(2)	2009(2)	2009	2010
	(in thousands except per share data)						
Revenues	\$ 58,385	\$ 63,600	\$ 62,695	\$ 57,105	\$ 54,518	\$ 21,870	\$ 21,870
Cost of revenues	36,658	37,236	38,156	37,559	33,331	13,231	13,231
Gross profit	21,727	26,364	24,539	19,546	21,187	8,639	8,639
Operating expenses:							
Research and development, net	5,265	5,378	5,310	5,556	4,816	2,305	2,305
Selling and marketing, net	12,385	11,603	11,073	12,953	10,864	4,801	4,801
General and administrative	4,965	5,547	6,057	10,243	8,372	3,840	3,840
Impairment of goodwill and other intangible assets	-	-	-	2,772	-	-	-
Post employment and termination benefits	-	-	904	2,582	-	-	-
Total operating expenses	22,615	22,528	23,344	34,106	24,052	10,946	10,946
Operating income (loss)	(888)	3,836	1,195	(14,560)	(2,865)	(2,307)	(2,307)
Financial expenses, net	813	864	2,059	1,314	1,568	226	226
Income (loss) before income taxes	(1,701)	2,972	(864)	(15,874)	(4,433)	(2,533)	(2,533)

Income taxes (tax benefit)	(28)	943	276	3,066	864	(344)	(2
Income (loss) from continuing operations	(1,673)	2,029	(1,140)	(18,940)	(5,297)	(2,189)	(3
Income (loss) from discontinued operations, net	(1,538)	(1,219)	3,022	(13,662)	4,216	63	-
Net income (loss)	\$ (3,211)	\$ 810	\$ 1,882	\$ (32,602)	\$ (1,081)	\$ (2,126)	(3
Less: net income attributable to non-controlling interest	-	-	-	-	54	-	(1
Net income (loss) attributable to Magal's shareholders	\$ (3,211)	\$ 810	\$ 1,882	\$ (32,602)	\$ (1,135)	\$ (2,126)	(3
Basic and diluted net earnings (loss) per share from continuing operations	\$ (0.17)	\$ 0.20	\$ (0.11)	\$ (1.82)	\$ (0.52)	\$ (0.21)	(0
Basic and diluted net earnings (loss) per share from discontinued operations	(0.15)	(0.12)	0.29	(1.32)	0.41	0.01	-
Basic and diluted net earnings (loss) per share	\$ (0.32)	\$ 0.08	\$ 0.18	\$ (3.14)	\$ (0.11)	\$ (0.20)	(0
Weighted average number of ordinary shares used in computing basic net earnings per share	9,883	10,384	10,395	10,397	10,397	10,397	10
Weighted average number of ordinary shares used in computing diluted net earnings per share	9,900	10,442	10,431	10,397	10,399	10,399	10

(1) In December 2007, we disposed of our U.S. based video monitoring business. Accordingly, the operating results, balance sheet and cash flows relating to the video monitoring operations were presented in our statements of income, balance sheets and cash flows as discontinued operations, and the comparative operating results for prior years were reclassified.

(2) In September 2009, our Board of Directors resolved to discontinue the operations of the European integration subsidiary that we acquired in September 2007. The subsidiary was sold in December 2009. Accordingly, operating results and cash flows for the years ended December 31, 2007, 2008 and 2009, as well as the capital gain resulting from the sale, were reclassified to disclose the results of that subsidiary as discontinued operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our results of operations and financial condition should be read in conjunction with our interim unaudited consolidated financial statements and the related notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth in "Risk Factors."

Overview

We develop, manufacture, market and sell complex computerized security systems. Our systems are used in more than 75 countries to protect aircraft, national borders and sensitive facilities, including military bases, power plant installations, airports, postal facilities, prisons and industrial locations from terrorism, theft and other security threats. Our revenues are principally derived from:

- installation of comprehensive turnkey solutions for which revenues are generated from long-term fixed price contracts; and
- sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or pursuant to time-and-materials based contracts.

We believe that our new strategic plan that was adopted in June 2010 provides a foundation for the future growth in our revenues. This projected growth, which is not expected to be immediate, is based on the growing worldwide demand for perimeter security, especially in the BRIC countries. As part of our strategic plan, we intend to stimulate revenue growth by introducing new sales channels for our products as well as creating long-term alliances with large international integrators in order to increase the sales of our products to such integrators. We are also investing in research and development in order to maintain our leadership position in the perimeter intrusion detection systems, or PIDS, market. In addition, we intend to enter into new OEM agreements, purchase third party technologies or enter into mergers and acquisitions transactions in order to maintain and enhance our technological prominence. We also intend to increase our sales efforts for our perimeter solutions and turn-key projects in those territories where we see growing demand, such as the BRIC countries, and plan to improve our presence in these territories either through the establishment of local offices or through joint-ventures and partnering with local entities.

Business Challenges/Areas of Focus

Our primary business challenges and areas of focus include:

- continuing the growth of revenues and profitability of our perimeter security system line of products;
- enhancing the introduction and recognition of our new products into the markets;
- penetrating new markets and strengthening our presence in existing markets; and

- succeeding in selling our comprehensive turnkey solutions.

Our business is subject to the effects of general global economic conditions. If general economic conditions or economic conditions in key markets remain weak or weaken further, demand for our products could be adversely affected.

Key Performance Indicators and Sources of Revenues

Our management believes that our revenues, sources of revenues and operating income (loss) are among the key performance indicators for our business.

Our revenues from our perimeter products and turnkey projects segments for the six months ended June 30, 2009 and 2010 were as follows:

	Six Months Ended June 30,		2010	
	2009	% of	2010	% of
	Revenues	Total	Revenues	Total
	(In thousands)			
Revenues:				
Perimeter products	\$ 15,428	70.5 %	\$ 15,394	72.6 %
Turnkey projects	6,442	29.5	5,810	27.4
Total	\$ 21,870	100.0 %	\$ 21,204	100.0 %

The decline in revenues from turnkey projects was primarily due to the global slowdown that began at the end of 2008. The resulting decline in the number of tenders and actual orders for such projects began to impact our revenues in 2009 as we delivered on a lower backlog of orders. This trend continued into 2010. We have begun to see an upturn in the market and hope that this will continue into 2011.

Our operating loss from our perimeter products and turnkey projects segments for the six months ended June 30, 2009 and 2010 were as follows:

	Six Months Ended June 30,		2010	
	2009	% of	2010	% of
	Operating	Total	Operating	Total
	(In thousands)			
	loss	Loss	loss	loss
Operating loss:				
Perimeter products	\$ 1,179	51.1 %	\$ 1,727	52.5 %
Turnkey projects	1,128	48.9	1,560	47.5
Total	\$ 2,307	100.0 %	\$ 3,287	100.0 %

Our losses were primarily due to the global economic slowdown and the reduction in governments spending that began in the latter part of 2008. As orders and new projects were delayed, competition increased and margins were squeezed. We believe that this trend is beginning to reverse and that government spending in certain territories is returning to previous levels. To the extent this reversal continues, we believe that the combination of increased revenues and the impact of the cost saving measures we took in 2009 and 2010 will improve our profitability.

The following table reflects the geographic breakdown of our revenues for the six months ended June 30, 2009 and 2010:

	Six Months Ended June 30,		2010	
	2009	% of	2010	% of
	Revenues	Total	Revenues	Total
	(In thousands)			
Israel	5,434	24.8 %	5,386	25.4 %
Europe	4,722	21.6 %	3,349	15.8 %
North America	5,630	25.7 %	7,497	35.3 %
South and Latin America	1,521	7.0 %	1,945	9.2 %

Other	4,563	20.9 %	3,027	14.3 %
Total	\$ 21,870	100.0 %	21,204	100.0 %

Cost and Expenses

Cost of revenues. Our cost of revenues for perimeter products consists of component and material costs, direct labor costs, subcontractors costs, shipping expenses, overhead related to manufacturing and depreciation. Our cost of revenues for turnkey projects consists primarily of component and material costs, subcontractor costs, direct labor costs and overhead related to the turnkey projects. Our cost of revenues for “other” consists primarily of direct labor costs and material costs relating to our maintenance services.

Our gross margin is affected by the proportion of our revenues generated from perimeter products, turnkey projects and other. Our revenues from perimeter products generally have higher gross margins than our other segments.

Research and development expenses, net. Research and development expenses, net consists primarily of expenses for on-going research and development activities and other related costs.

Selling and marketing expenses. Selling and marketing expenses consist primarily of commission payments, compensation and related expenses of our sales teams, attendance at trade shows and advertising expenses and related costs for facilities and equipment.

General and administrative expenses. Our general and administrative expenses consist primarily of salary and related costs associated with our executive and administrative functions, legal and accounting expenses, allowances for doubtful accounts and bad debts and other miscellaneous expenses. Staff costs include direct salary costs and related costs, such as severance pay, social security and retirement fund contributions, vacation and other pay.

Depreciation and Amortization. The amount of depreciation and amortization attributable to our business segments for the six months ended June 30, 2009 and 2010 were as follows:

	Six Months Ended June 30, 2009 2010 (In thousands)	
Perimeter products	\$484	\$457
Turnkey projects	46	48
Total	\$530	\$505

Financial Expenses, Net. Financial expenses, net include exchange rate differences arising from changes in the value of monetary assets and monetary liabilities stated in currencies other than the functional currency of each entity, foreign currency forward contracts, interest charged on loans from banks as well as interest income on our cash and cash equivalents and short term investments.

Tax expense. Tax expense consists of federal, state and local taxes on the income of our business. We paid income taxes in 2009 in Germany and Mexico, but did not pay taxes elsewhere because of our operating losses.

Discussion of Critical Accounting Policies

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and the use of different assumptions would likely result in materially different results of operations. Critical accounting policies are those that are both most important to the portrayal of our financial position and results of operations and require management's most difficult, subjective or complex judgments. Although not all of our significant accounting policies require management to make difficult, subjective or complex judgments or estimates, the following policies and estimates are those that we deem most critical:

Revenue Recognition

We generate our revenues mainly from; (i) installation of comprehensive turnkey systems for which revenues are generated from long-term fixed price contracts; and (ii) sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or as time-and-materials based contracts.

Revenues from installation of comprehensive turnkey systems are generated from fixed-price contracts according to which the time between the signing of the contract and the final customer acceptance is usually over one year. Such contracts require significant customization for each customer's specific needs and, as such, revenues from this type of contract are recognized in accordance with ASC 605-35 Revenue Recognition -Construction-Type and Production-Type Projects" (formerly Statement of Position, or SOP, No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts"), using contract accounting on a percentage of completion method. Accounting for long-term contracts using the percentage-of-completion method stipulates that revenue and expense are recognized throughout the life of the contract, even though the project is not completed and the purchaser does not have possession of the project. Percentage of completion is calculated based on the "Input Method."

Turnkey costs include materials purchased to produce the solutions, related labor and overhead expenses and subcontractor's costs. The percentage to completion is measured by monitoring costs and efforts devoted using records of actual costs incurred to date in the project compared to the total estimated project requirement, which corresponds to the costs related to earned revenues. The amounts of revenues recognized are based on the total fees under the agreements and the percentage of completion achieved. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

We believe that the use of the percentage of completion method is generally appropriate as we have the ability to make reasonably

dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, executed contracts include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of termination for convenience. In most cases we expect to perform our contractual obligations and our customers are expected to satisfy their obligations under the contract.

Fees are payable upon completion of agreed upon milestones and subject to customer acceptance. Amounts of revenues recognized in advance of contractual billing are recorded as unbilled accounts receivable. The period between most instances of advanced recognition of revenues and the customers' billing generally ranges between one to six months. As of June 30, 2010, we had recorded \$4.8 million of such unbilled receivables.

Services and maintenance are performed under either fixed-price based or time-and-materials based contracts. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time-and-materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and for materials. Such service contracts are not in the scope of ASC 605-35, and accordingly, related revenues are recognized in accordance with SAB No. 104, as those services are performed or over the term of the related agreements provided that, an evidence of an arrangement has been obtained, fees are fixed and determinable and collectability is reasonably assured.

Deferred revenue includes unearned amounts under installation service contracts, service contracts and maintenance agreements.

Inventories

Inventories are stated at the lower of cost or market value. We periodically evaluate the quantities on hand relative to historical and projected sales volumes, current and historical selling prices and contractual obligations to maintain certain levels of parts. Based on these evaluations, inventory write-offs are provided to cover risks arising from slow-moving items, discontinued products, excess inventories, market prices lower than cost and adjusted revenue forecasts. Cost is determined as follows:

- Raw materials, parts and supplies - using the "first-in, first-out" method.
- Work-in-progress and finished products - on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

During the six months ended June 30, 2009 and 2010, we recorded inventory write-offs from continuing operations in the amounts of \$0.3 million and \$0.1 million, respectively. Such write-offs were included in cost of revenues.

Income taxes

We account for income taxes in accordance with ASC 740 "Income Taxes" (formerly SFAS No. 109, "Accounting for Income Taxes"). This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and we must establish a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of income.

At June 30, 2010, we had a deferred tax asset of \$0.3 million attributable to our subsidiaries. We had total estimated available carryforward tax losses of \$22.4 million with respect to our operations in Israel as of such date. As of December 31, 2009, we recorded a full valuation allowance on these carryforward tax losses due to the uncertainty of their future realization. As of June 30, 2010, our subsidiaries had estimated total available carryforward tax losses of \$9.6 million, which may be used as an offset against future taxable income for periods ranging between 12 and 20 years. As of December 31, 2009, we recorded a full valuation allowance for our subsidiaries' carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the "change

in ownership” provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Goodwill

Goodwill has been recorded as a result of past acquisitions and represents the excess of the cost over the net fair value of the assets of the businesses acquired. We operate in two operating segments, which also constitute our two reporting units (“Turnkey Projects” and “Perimeter Products”). Goodwill was allocated to the two reporting units. All remaining goodwill as of December 31, 2009 is allocated to the Perimeter Products reporting unit. We follow ASC 350, “Intangibles – Goodwill and Other” (originally issued as SFAS 142, “Goodwill and Other Intangible Assets”).

ASC 350 requires goodwill to be tested for impairment, at the reporting unit level, at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized. We perform our annual goodwill impairment test at December 31 of each year, or more often if indicators of impairment are present.

ASC 350 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair value is determined using discounted cash flows, based on the income approach, as we believe that this approach best approximates the reporting unit's fair value at this time. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reportable units.

The material assumptions used for the income approach for the six months ended June 30, 2010 were five years of projected net cash flows, a discount rate of 14.3% and a long-term growth rate of 1%. We considered historical rates and current market conditions when determining the discount and growth rates to use in our analysis. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our goodwill.

As required by ASC 820, "Fair Value Measurements and disclosures" (formerly SFAS 157, "Fair Value Measurements," we apply assumptions that market place participants would consider in determining the fair value of a reporting unit.

Impairment of long-lived assets

Our long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with ASC 360 "Property, Plant, and Equipment" (formerly SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets") whenever events or changes in circumstances indicate that the carrying amount of a group of assets may not be recoverable. Recoverability of a group of assets to be held and used is measured by a comparison of the carrying amount of the group to the future undiscounted cash flows expected to be generated by the group. If such group of assets is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value.

During the year ended December 31, 2009 and the six months ended June 30, 2010, no impairment losses were identified.

Functional currency and financial statements in U.S. dollars

We have determined that our reporting currency is the U.S. dollar. As of October 1, 2006, our functional currency changed from the U.S. dollar to NIS. Translation adjustments resulting from translating our financial

statements from NIS to the U.S. dollar are reported as a separate component in shareholders' equity. As of June 30, 2009 and 2010, our foreign currency translations totaled \$3.3 million and \$2.6 million, respectively.

Accordingly, as of June 30, 2010 and December 31, 2009, we recorded accumulated foreign currency translation income of approximately \$0.7 million and \$1.4 million, respectively, included in our balance sheets as part of "accumulated other comprehensive income." As of June 30, 2010 and December 31, 2009, foreign currency translation adjustments, net of \$4.6 million and \$3.8 million, respectively, were included under "accumulated other comprehensive income."

The first step in the translation process is to identify the functional currency for each entity included in the financial statements. The accounts of each entity are then "re-measured" in its functional currency. All transaction gains and losses from the re-measurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate.

After the re-measurement process is complete the financial statements are translated into the reporting currency, which is the U.S. dollar, using the current rate method. Equity accounts are translated using historical exchange rates. All other balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

Concentrations of credit risk

Financial instruments that are potentially subject to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term bank deposits, marketable securities, unbilled accounts receivable, trade receivables, long-term trade receivables and long-term loans.

Of our cash and cash equivalents, marketable securities and short-term and long-term bank deposits at June 30, 2010, \$1.8 million was deposited with major Israeli and U.S. banks; \$1.7 million was deposited with the Royal Bank of Canada and approximately \$1.3 million was deposited with other banks, mainly Deutsche Bank and BBVA Bancomer. Cash and cash equivalents deposited in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally these deposits maybe redeemed upon demand and therefore bear low risk.

The short-term and long-term trade receivables and the unbilled accounts receivable of our company and our subsidiaries are derived from sales to large and solid organizations located mainly in Israel, the United States, Canada, Mexico and Europe. We perform ongoing credit evaluations of our customers and to date have not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that we have determined to be doubtful of collection and in accordance with an aging policy. In certain circumstances, we may require letters of credit, other collateral or additional guarantees. During the six months ended June 30, 2009, no expenses related to doubtful accounts were recorded. During the six months ended June 30, 2010, we recorded \$348,000 of expenses related to doubtful accounts. As of June 30, 2010, our allowance for doubtful accounts amounted to \$0.9 million.

We have no significant off-balance sheet concentration of credit risks, such as foreign exchange contracts or foreign hedging arrangements, except derivative instruments, which are detailed below.

Derivative instruments

ASC 815, "Derivatives and Hedging" (formerly SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"), requires us to recognize all of our derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged.

To protect against the change in the forecasted foreign currency cash flows of certain sale arrangements resulting from changes in the exchange

rate, we have from time to time entered into forward contracts to hedge portions of our forecasted revenue and unbilled accounts receivable denominated in foreign currencies. For the six months ended June 30, 2009 we did not record any financial expense related to forward contracts. We recorded \$16,000 as financial gains related to forward contracts in the six months ended June 30, 2010.

Fair value of financial instruments

Effective January 1, 2008, we adopted ASC 820, "Fair Value Measurements and Disclosures" (formerly SFAS 157), except as it applies to the nonfinancial assets and nonfinancial liabilities subject to ASC 820-10-50-8A (formerly FSP 157-2). We chose to adopt the delay of the effective date of ASC 820 for one year for goodwill and customers related intangible assets. Effective January 1, 2009, we adopted ASC 820 for nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Includes other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Results of Operations

Our operating results have been negatively impacted during the last two years due to the global economic slowdown and the reduction in governments spending that began in the latter part of 2008. As orders and new projects were delayed, competition increased and margins were squeezed. We believe that this trend is beginning to reverse and that government spending in certain territories is returning to previous levels.

Due to the nature of our customers and products, our revenues are often generated from a relatively small number of large orders. Consequently, individual orders from individual customers can represent a substantial portion of our revenues in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our revenues and operating results may, therefore, vary substantially from period to period. Consequently, we do not believe that our revenues and operating results should necessarily be judged on a quarter-to-quarter comparative basis.

The following table presents certain financial data expressed as a percentage of revenues for the periods indicated:

	Six Months Ended June 30,	
	2009	2010
Revenues	100.0 %	100.0 %
Cost of revenues	60.5 %	65.6 %
Gross profit	39.5 %	34.4 %
Operating expenses:		
Research and development, net	10.5 %	10.2 %
Selling and marketing, net	22.0 %	21.4 %
General and administrative	17.6 %	18.3 %

Operating		
loss	(10.6 %)	(15.5 %)
Financial expenses,		
net	(1.0 %)	(3.1 %)
(Loss) before income		
taxes	(11.6 %)	(18.6 %)
Income taxes	1.6 %	0.1 %
Income (loss) from continuing operations	(10.0 %)	(18.5 %)
Income (loss) from discontinued operations, net	0.3 %	-
Net income		
(loss)	(9.7 %)	(18.5 %)

Six months Ended June 30, 2010 Compared with Six Months Ended June 30, 2009

Revenues. Revenues decreased by 3% to \$21.2 million for the six months ended June 30, 2010 from \$21.9 million for the six months ended June 30, 2009. Revenues from sales of perimeter systems amounted to \$15.4 million in 2009 and 2010. Revenues from sales of perimeter systems in Western Europe decreased in the 2010 period, while sales in the Canadian and U.S. markets increased in such period. Revenues from security turnkey projects decreased by 9.8% to \$5.8 million in 2010 from \$6.4 million in 2009, as fewer projects were performed in 2010 compared to 2009, primarily due to reduced spending for large scale tenders in the second half of 2009. We anticipate that our revenues will increase in the remainder of 2010 as a result of anticipated improvements in the global economy.

Cost of revenues. Cost of revenues increased by 5.2% to \$13.9 million for the six months ended June 30, 2010 from \$13.2 million for the six months ended June 30, 2009. The increase was primarily due to a less favorable mix of products and projects as well as the increase in the U.S. dollar value of our non-U.S. dollar denominated expenses as a result of changes in foreign currency exchange rates in 2010. Cost of revenues as a percentage of revenues increased from 60.5% in the six months ended June 30, 2009 to 65.6% in the six months ended June 30, 2010, primarily due to a less favorable mix of products and projects. Our cost of revenues as a percentage of revenues was adversely impacted by the devaluation in the average NIS/U.S. dollar exchange rate in 2010, as the percentage of our cost of revenues denominated in NIS is higher than the percentage of revenues denominated in NIS.

Research and development expenses, net. Research and development expenses, net decreased by 6.5% to \$2.2 million for the six months ended June 30, 2010 from \$2.3 million for the six months ended June 30, 2009. The decrease in research and development expenses is primarily attributable to the decrease in the number of our U.S. subsidiary's research and development staff due to the consolidation of the North American business into one unit in the second quarter of 2009. Research and development expenses, net amounted to 10.5% and 10.2% of revenues in the six months ended June 30, 2009 and 2010, respectively. We anticipate that our research and development expenses will not materially change during the remainder of 2010.

Selling and marketing expenses, net. Selling and marketing expenses, net decreased by 5.3% to \$4.5 million for the six months ended June 30, 2010 from \$4.8 million for the six months ended June 30, 2009. The decrease in selling and marketing expenses in 2010 was primarily due to the decrease in the number of our U.S. subsidiary's selling and marketing staff due to the consolidation of the North American business into one unit during the second quarter of 2009. Sales commissions also decreased in the 2010 period due to a different mix of revenues compared to the 2009 period. The decrease in selling and marketing expenses was offset in part by the appreciation of the average exchange rate of the NIS and the Canadian dollar against the U.S. dollar in 2010, which increased the U.S. dollar value of our NIS and Canadian dollar denominated expenses. Selling and marketing expenses, net amounted to 21.4% and 22.0% of revenues for the six months ended June 30, 2010 and 2009, respectively.

General and administrative expenses. General and administrative expenses increased from \$3.8 million for the six months ended June 30,

2009 to \$3.9 million for the six months ended June 30, 2010, an increase of 0.9%. The increase in general and administrative expenses in 2010 was primarily due to a \$0.3 million increase in the allowance for doubtful accounts in such period. In addition, stock option amortization expenses increased by \$0.3 million in the 2010 period due to a higher level of share-based compensation expenses under ASC 718 associated with the grant of options to management during the fourth quarter of 2009. The increase in general and administrative expenses is also attributable to the appreciation of the average exchange rate of the NIS and Canadian dollar against the U.S. dollar in 2010, which increased the U.S. dollar value of our NIS and Canadian dollar denominated expenses. The increase was partially offset by reduced legal and accounting costs as well as reduced salaries, mainly due to the consolidation of the North American business into one unit in the second quarter of 2009. General and administrative expenses amounted to 17.6% of revenues for the six months ended June 30, 2009 compared to 18.3% for the six months ended June 30, 2010.

Operating loss. We had an operating loss of \$3.3 million for the six months ended June 30, 2010 compared to an operating loss of \$2.3 million for the six months ended June 30, 2009. The operating loss of our perimeter products segment increased from \$1.2 million for the six months ended June 30, 2009 to \$1.7 million for the six months ended June 30, 2010, primarily as a result of an increase in the U.S. dollar value of our non- U.S. dollar denominated expenses due to changes in foreign currency exchange rates in 2010, as well as a less favorable mix of products. The operating loss of our turnkey projects segment increased from \$1.1 million for the six months ended June 30, 2009 to \$1.6 million for the six months ended June 30, 2010, primarily as a result of a less profitable mix of projects in 2010 as well as the lower volume of revenues while a significant amount of our expenses with respect to such segment's operations are fixed.

Financial expenses, net. Financial expenses, net, increased from \$0.2 million for the six months ended June 30, 2009 to \$0.7 million for the six months ended June 30, 2010, an increase of 191.6%. The increase was primarily due to an increase in foreign exchange losses, net that was offset in part by a gain from the sale of marketable securities.

Income taxes. We recorded an income tax benefit of \$344,000 for the six months ended June 30, 2009 compared to an income tax benefit of \$20,000 for the six months ended June 30, 2010, primarily as a result of valuation allowances recorded in 2010 with respect to our Canadian subsidiary's investment tax credit asset, due to the uncertainty of its future realization.

Seasonality

Our operating results are characterized by a seasonal pattern, with a higher volume of revenues towards the end of the year and lower revenues in the first part of the year. This pattern, which is expected to continue, is mainly due to two factors:

- our customers are mainly budget-oriented organizations with lengthy decision processes, which tend to mature late in the year; and
- due to harsh weather conditions in certain areas in which we operate during the first quarter of the calendar year, certain services are put on hold and consequently payments are delayed.

Our revenues are dependent on government procurement procedures and practices, and because we receive large product orders from a relatively small number of customers, our revenues and operating results are subject to substantial periodic variations.

Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets

We sell most of our products in North America, Europe and Israel. Our financial results, which are reported in U.S. dollars, are affected by changes in foreign currency. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non-U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel and Canada may be adversely affected by the appreciation of the NIS and the Canadian dollar against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies.

The appreciation of the NIS and the Canadian dollar in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked assets and the U.S. dollar amounts of any unlinked liabilities and increasing the U.S. dollar value of revenues and expenses denominated in other currencies. Conversely, the depreciation of the NIS and the Canadian dollar in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our liabilities which are payable in NIS or in Canadian dollars (unless such costs or payables are linked to the U.S. dollar). Such depreciation also has the effect of decreasing the U.S. dollar value of any asset that is denominated in NIS and Canadian

dollars or receivables payable in NIS or Canadian dollars (unless such receivables are linked to the U.S. dollar). In addition, the U.S. dollar value of revenues and expenses denominated in NIS or Canadian dollars would increase. Because foreign currency exchange rates fluctuate continuously, exchange rate fluctuations may have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

The following table presents information about the rate of depreciation or appreciation of the NIS against the U.S. dollar:

Year ended December 31,	NIS depreciation	
	(appreciation) rate %	
2005	6.8)
2006	(8.2)
2007	(9.0)
2008	(1.1)
2009	(0.7)

During the six months ended June 30, 2010, the rate of depreciation of the NIS against the U.S. dollar was 2.6%.

In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In the six months ended June 30, 2010, the Canadian dollar depreciated against the U.S. dollar by approximately 0.2%, while the Canadian dollar appreciated against the U.S. dollar by approximately 6.0 % in the six months ended June 30, 2009.

We recorded foreign currency exchange gains (losses), net of \$89,000 and \$(480,000) for the six months ended June 30, 2009 and 2010, respectively. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

To manage this risk, from time to time, we have entered into forward exchange contracts to hedge some of our foreign currency exposure relating to revenue and unbilled accounts receivable denominated in foreign currencies.

For the six months ended June 30, 2009 we did not record any financial expenses related to forward contracts transactions. We recorded \$16,000 in financial income related to forward contracts transactions in the six months ended June 30, 2010.

Liquidity and Capital Resources

From our inception until our initial public offering in March 1993, we financed our activities mainly through cash flow from operations and bank loans. In March 1993, we received proceeds of \$9.8 million from an initial public offering of 1,380,000 ordinary shares. In February 1997, we raised \$9.4 million from a follow-on offering of 2,085,000 ordinary shares and in April 2005, we raised an additional \$14.9 million from a follow-on offering of 1,700,000 ordinary shares. The proceeds from these offerings together with cash flow from operations and our credit facilities are our main sources of working capital.

Our working capital at December 31, 2009 and June 30, 2010, was \$20.5 million and \$ 16.9 million, respectively. Cash and cash equivalents amounted to \$11.9 million at December 31, 2009 compared to \$4.8 million at June 30, 2010. Short-term and long-term bank deposits and restricted bank deposits amounted to \$1.8 million at December 31, 2009 compared to \$3.0 million at June 30, 2010. Our cash and cash equivalents and short and long-term bank deposits are held mainly in U.S. dollars.

In June 2010, we adopted a new strategic plan in an effort to establish a viable path for the growth of our business. We decided to focus on our historical primary markets: perimeter products and solutions and turnkey projects. We appointed a new vice president - products for our perimeter products segment, who is focused solely on the sales of our products. We intend to increase revenues in this segment by locating new channels to promote and market our products, maintaining technology leadership, investing in our research and development activities, entering into OEM, agreements and by acquiring technologies or by mergers and acquisitions. We also intend to focus and improve our presence in emerging markets such as the BRIC countries in order to increase our exposure to small and medium size business opportunities for both our perimeter products and solutions and turnkey projects segments. We are also investing in our employees in order to enhance their professional skills and efficiency.

We expect that our research and development expenses in 2010 will be approximately \$4 million and that research and development expenses will be approximately the same in 2011. Our research and development plan for 2011 covers the following main areas:

- Sensor development - We intend to continue the development of new and innovative sensors based on existing, new and hybrid technologies. Most of the development will be based on in-house competencies, however we may acquire some know-how externally.
- Sensor improvements – We are conducting an ongoing program of improvement of our existing sensors in order to enhance performance, reliability and capability to source and produce and reduce cost.
- Security Management Systems – We intend to continue to develop our two levels of management systems:
 - o High-end systems – Physical security information management systems, mainly used as part of a turnkey solution, as a comprehensive command and control, or C&C solution, designed for entities requiring management of security, safety, site management and dispatching. These systems are designed to manage both daily routines and crisis situations.
 - o Low-end systems – Basic security management systems, or SMS, typically used for managing and controlling the PIDS of a site.

We are also developing an interface package to facilitate integration of our sensors into a third party SMS/C&C system.

- Video systems – We will continue to develop our video management software to improve the intelligent video analytics and cope with advanced video protocols such as regular IP streaming, megapixel and high definition video cameras.

To allow us to begin to implement our new strategic plan, on September 8, 2010, Ki Corporation Limited, a company owned by Mr. Nathan Kirsh, our principal shareholder and a director, provided us with a bridge loan in the principal amount of \$10.0 million. If not repaid within 180 days, the bridge loan will begin to accrue interest at the rate of LIBOR + 4% per year, calculated from the date of the loan and accumulated on a quarterly basis. However, if this rights offering occurs within 240 days from the date of the loan, the loan will not bear any interest. We believe that this is a favorable interest rate for the company, as the market interest rate for similar loans in Israel is approximately LIBOR + 6.7% per year. The loan is due and payable on January 10, 2012, and we have an option to extend the maturity date for an additional 60 days. Any interest will be paid together with, and in the same manner as, the principal, no later than the maturity date. We intend to use part of the proceeds from this rights offering for the repayment of the bridge loan, which amounts to \$10 million as of the date of this prospectus. We have undertaken to repay such amount within five business days after the successful completion of the rights offering.

We believe that our current cash and cash equivalents, including bank facilities, bank deposits, marketable securities and our expected cash flows from operations in 2010 will be sufficient to meet our cash requirements through 2011 and that the proceeds of this offering will permit us to fully implement our strategic plan in 2011. However, our liquidity could be negatively affected by a decrease in demand for our

products, including the impact of potential reductions in customer purchases that may result from the current general economic climate.

Cash Flows

The following table summarizes our cash flows for the periods presented:

	Six Months Ended June 30,	
	2009	2010
	(In thousands)	
Net cash provided by (used in) continuing operations	\$4,421	\$(3815)
Net cash used in discontinued operations	(410)	(17)
Net cash provided by (used in) operating activities	4,011	(3,832)
Net cash provided by (used in) investing activities	(7)	(1,383)
Net cash provided by (used in) financing activities	(162)	(2,002)
Effect of exchange rate changes on cash and cash equivalents	(528)	116
Increase (decrease) in cash and cash equivalents	3,314	(7,101)
Cash and cash equivalents at the beginning of the year	16,835	11,869
Cash and cash equivalents at the end of the year	\$20,149	\$4,768

Net cash provided by operating activities was approximately \$4.0 million for the six months ended June 30, 2009 compared to net cash used in operating activities of \$3.8 million for the six months ended June 30, 2010. Net cash provided by operating activities for the six months ended June 30, 2009 was primarily attributable to \$0.5 million of depreciation and amortization expenses, \$0.2 million of stock-based compensation expense, a decrease in trade receivables of \$6.5 million, a decrease of \$0.4 million in inventories, a decrease of \$1.9 million in unbilled accounts receivable, a \$0.2 million decrease in other accounts receivable and prepaid expenses, and a \$43,000 increase in accrued severance pay, which was offset in part by an increase of \$0.4 million in customer advances, a decrease of \$1.1 million in trade payables and a decrease of \$1.8 million in other accounts payable and other expenses. Net cash used in operating activities for the six months ended June 30, 2010 was primarily attributable to an increase in trade receivables of \$0.8 million, an increase in other accounts receivable of \$2.6 million, a decrease in trade payables of \$1.5 million and a decrease in other accounts payable and other expenses of \$1.2 million. This was offset in part by a decrease in inventories of \$0.5 million, an increase of \$3.5 million in customer advances, an increase in unbilled accounts receivables of \$1.0 million, \$0.5 million of depreciation and amortization expenses and \$0.6 million of stock-based compensation expense.

Net cash used in investing activities was approximately \$7,000 for the six months ended June 30, 2009 compared to approximately \$1.4 million for the six months ended June 30, 2010. In the six months ended June 30, 2009, we purchased \$0.9 million of property and equipment, which amount was offset in part by proceeds of \$0.9 million and \$31,000 from the sale of marketable securities and equipment, respectively. In the six months ended June 30, 2010, we purchased \$0.2 million of property, plant and equipment, \$31,000 of know-how and patents and invested \$3.0 million in a pledged deposit, which amounts were offset in part by proceeds of \$1.8 million from the sale of short-term bank deposits.

For the six months ended June 30, 2009, net cash used in financing activities was \$162,000, primarily attributable to the repayment of a \$314,000 long-term bank loan, which amount was offset in part by an increase of \$152,000 in short-term bank credits. For the six months ended June 30, 2010, net cash used in financing activities was \$2.0 million, primarily due to an increase of \$0.5 million in short-term bank

credits and the repayment of \$1.5 million of long-term bank loans.

We had capital expenditures of approximately \$0.9 million and \$0.2 million in the six month periods ended June 30, 2009 and 2010, respectively. These capital expenditures were principally for computers, other machinery and equipment and for expanding and renovating our facilities. We estimate that our capital expenditures for the remainder of 2010 will total approximately \$ 0.4 million, all of which will relate to our perimeter security and project segments. We expect to finance these expenditures primarily from our cash and cash equivalents, operating cash flows and our credit facilities. However, the actual amount of our capital expenditures will depend on a variety of factors, including general economic conditions and changes in the demand for our products.

Credit Lines and Other Debt

Short-term and long-term bank credit at June 30, 2009 and June 30, 2010 was \$25.4 million and \$8.4 million, respectively. Our highest level of short-term and long-term bank borrowings in the six month periods ended June 30, 2009 and 2010, was \$26.3 million and \$8.4 million, respectively. In December 2009, we determined to reduce our borrowings by utilizing funds that we previously used as deposits under our previous banking relationships and we also used the proceeds from the sale of our European subsidiary to reduce our indebtedness.

We currently have credit lines with Bank Leumi Le-Israel B.M., or BLL, Union Bank of Israel Ltd., or Union Bank, and Bank Hapoalim B.M totaling \$13.8 million in the aggregate (of which \$3.0 million is reserved exclusively for guarantees) and \$3.0 million was available at June 30, 2010. There are no restrictions as to our use of any of these credit lines. In January 2010, we entered into a new credit arrangement with these banks and granted the banks a first degree fixed charge over our registered but unissued share capital and goodwill and a first degree floating charge over all of our assets and rights. Our loans under these credit lines are denominated in dollars and NIS. As part of the restructuring of our credit arrangements, we have concluded and repaid in full all of our credit facilities with Mizrahi Tefahot Bank B.M. As of June 30, 2010, we are not under any obligation to maintain financial ratios or other terms in respect of our credit lines.

In addition, our subsidiaries currently have credit lines with the Royal Bank of Canada and Deutsche Bank, totaling \$2.6 million in the aggregate, of which \$ 0.4 million was available at June 30, 2010.

Our Canadian subsidiary, which is primarily engaged in sale of perimeter products and turnkey projects, has undertaken to maintain general covenants and the following financial ratios and terms in respect of its outstanding credit lines: a quick ratio of not less than 1.25:1; a ratio of total liabilities to tangible net worth of not greater than 0.75:1; and tangible net worth of at least \$9.0 million. As of June 30, 2010, our Canadian subsidiary was in compliance with these ratios and terms.

As of June 30, 2010, our outstanding balances under our credit lines in Israel consisted of:

- Short-term NIS-denominated loans of approximately \$6.9 million, bearing interest at an average rate of 5%;
- Long-term U.S. dollar-denominated loan of approximately \$0.8 million, bearing interest at an average rate of 1%;
- Long-term NIS-denominated loan of approximately \$0.08 million, bearing interest at an average rate of 3%; and
- Several bank performance and advance payment guarantees totaling approximately \$3.0 million, at an annual cost of 1%-1.5%.

As of June 30, 2010, the outstanding balances under the credit lines of our subsidiaries consisted of:

- Short-term Canadian dollar-denominated loan of approximately \$0.6 million, bearing interest at an average rate of 3.5%.
-

Several bank performance and advance payment guarantees totaling approximately \$1.6 million, at an annual cost of 0.85%-1.8%.

Contractual Obligations

The following table summarizes our minimum contractual obligations and commercial commitments as of June 30, 2010:

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-2 years	3-5 years	More than 5 years
(In thousands)					
Long-term bank debt obligations	\$ 877	\$ 661	\$ 181	\$ 35	\$ -
Operating lease obligations	3,203	728	554	504	1,417
Purchase obligations	-	-	-	-	-
Other long-term liabilities reflected on our balance sheet under U.S. GAAP	3,171	-	-	-	3,171
Total	\$ 7,251	\$ 1,389	\$ 735	\$ 539	\$ 4,588

In addition, we have guaranteed advance payments, the performance of our work and provided warranties for the performance of our work to certain of our customers (usually governmental entities). Such guarantees are required by contract for our performance during the installation and operational period of projects throughout Israel and the rest of the world. The performance guarantees typically expire soon after certain milestones are met and warranty guarantees typically expire at the end of the warranty period. The maximum potential amount of future payments we could be required to make under our guarantees at both December 31, 2009 and June 30, 2010 was \$4.6 million. We have not recorded any liability for such amounts as we expect that our performance will be acceptable and to date, no performance bank guarantees have been exercised against us except with respect to our dispute relating to an airport project in Eastern Europe.

SHARE OWNERSHIP

The following table sets forth certain information regarding the beneficial ownership of our outstanding ordinary shares as of the date of this prospectus, by (i) each person who we know beneficially owns 5% or more of our outstanding ordinary shares; (ii) each of our directors and executive officers individually; and (iii) all of our directors and executive officers as a group.

Name	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Outstanding Ordinary Shares(2)	
Nathan Kirsh (3)	2,516,267	24.2	%
Clough Capital Partners L.P.(4)	704,042	6.8	%
Grace & White, Inc. (5)	607,526	5.8	%
Diker Management LLC (6)	604,495	5.8	%
Prescot Group Capital Management LLC. (7)	544,427	5.2	%
Jacob Perry (8)(9)	134,833	1.3	%
Eitan Livneh (10)	128,402	1.2	%
Hagai Katz	24,500	*	
Asaf Even-Ezra (11)	148,926	1.4	%
Yehonatan Ben-Hamozeg	42,500	*	
Ilan Ovadia	34,000	-	
Jacob Even-Ezra (12)	515,945	5.0	%
Shaul Kobrinsky	-	-	
Zeev Livne	-	-	
Jacob Nuss	-	-	
Barry Stiefel	5,000	*	
Liza Zinger	-	-	
All directors and executive officers as a group (13 persons)	3,550,373	34.1	%

* Less than 1%

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 10,396,548 ordinary shares issued and outstanding as of December 20, 2010.

(3) Based upon a Schedule 13D/A filed with the Securities and Exchange Commission on January 16, 2009 and other information available to the company. All of the ordinary shares are held of record by Ki Corporation Limited, or Ki Corporation, a company organized in New Jersey. The Eureka Foundation holds 100% of Ki Corporation. The Eureka Foundation is a Liechtenstein trust controlled by Mr. Kirsh, who also serves as its trustee. Mr. Kirsh may be deemed to have beneficial ownership of the ordinary shares held of record by Mira Mag and Ki Corporation.

(4) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the Securities and Exchange Commission on June 17, 2010. The Schedule 13D indicates that the shares include shares beneficially owned by investment companies, pooled investment vehicles and other accounts for which Clough Capital Partners L.P. serves as investment adviser. Such shares may be deemed beneficially owner by (a) Clough Capital Partners L.P., (b) Clough Capital Partners LLC, the general partner of Clough Capital Partners L.P., and (c) Messrs. Charles Clough, James Canty and Eric Brock, the managing members of Clough Capital Partners LLC. Each such reporting person disclaims beneficial ownership of such shares except to the extent of its respective pecuniary interest therein.

- (5) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the Securities and Exchange Commission on February 1, 2010. The Schedule 13G/A indicates that Grace & White, Inc. is a registered investment adviser.
- (6) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the Securities and Exchange Commission on June 21, 2010. The Schedule 13D indicates that as the sole general partner of certain Diker partnerships with respect to stock directly owned by certain Diker funds, or the Diker Funds, Diker GP, LLC, has the power to vote and dispose of the shares owned by the Diker Funds and, accordingly, may be deemed the beneficial owner of such shares. Diker Management, LLC serves as the investment manager of the Diker Funds. Accordingly, Diker Management may be deemed the beneficial owner of shares held by the Diker Funds. Charles M. Diker and Mark N. Diker are the managing members of each of Diker GP, LLC and Diker Management LLC, and in that capacity direct their operations. Therefore, Charles M. Diker and Mark N. Diker may be deemed the beneficial owners of shares beneficially owned by Diker GP, LLC and Diker Management LLC.
- (7) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the Securities and Exchange Commission on June 14, 2010. The Schedule 13D indicates that Prescott Group Aggressive Small Cap, L.P. and Prescott Group Aggressive Small Cap II, L.P., referred to together as the Small Cap Funds, are the general partners of Prescott Group Aggressive Small Cap Master Fund, G.P., or Prescott Master Fund. Prescott Group Capital Management, L.L.C., or Prescott Capital, serves as the general partner of the Small Cap Funds and may direct the Small Cap Funds, the general partners of Prescott Master Fund, to direct the vote and disposition of the ordinary shares held by the Master Fund. Mr. Frohlich, as the principal of Prescott Capital, may direct the vote and disposition of the ordinary shares held by Prescott Master Fund.
- (8) Includes 100,000 ordinary shares issuable upon the exercise of currently exercisable options granted by our company, having an exercise price of \$7.59 per share that expire in August 2013.
- (9) Includes 33,000 ordinary shares issuable upon the exercise of currently exercisable options granted to Mr. Perry by Ki Corporation. Ki Corporation granted Mr. Perry the right to purchase 100,000 shares upon the same terms and conditions that apply to the exercise of the options granted to him under his employment agreement. Mr. Perry has the right to purchase the shares in three equal annual installments commencing on August 20, 2010 at a price of \$7.59 per share. The right to purchase each installment expires after three years.
- (10) Includes 83,336 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$4.35 per share that expire in August 2014, 20,833 ordinary shares issuable upon the exercise of currently options, having an exercise price of \$4.35 per share that expire in November 2014 and 20,833 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$44.35 per share that expire in February 2015.
- (11) Includes 9,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$8.56 per

share that expire in December 2010 and 24,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$3.53 per share that expire in April 2015. Asaf Even-Ezra is Jacob Even-Ezra's son.

(12)Includes 77,975 ordinary shares held by a trustee. Jacob Even-Ezra is the father of Asaf Even-Ezra.

THE RIGHTS OFFERING

Terms of the Offer

We are distributing at no charge to the holders of our ordinary shares on [], subscription rights to purchase up to an aggregate of [] of our ordinary shares. We expect the total subscription price for the rights offered in the rights offering to be \$15 million, assuming full exercise of all the subscription rights. See below for additional information regarding subscription by DTC and TASE Clearing House participants.

Each shareholder is being issued one right for every [] ordinary share[s] owned on the record date. Each right carries with it a basic subscription right and an over-subscription right. No fractional rights will be issued in the rights offering.

Each right entitles the holder to purchase, at the subscription price of [], [] ordinary share[s]. We refer to this as the basic subscription right.

Holders who fully exercise their basic subscription rights will be entitled to subscribe for additional rights that remain unsubscribed as a result of any unexercised basic subscription rights. We refer to this as the over-subscription right. Over-subscription rights will be allocated pro rata among rights holders who over-subscribed, based on the number of over-subscription rights to which they subscribed. Rights may only be exercised for whole numbers of ordinary shares; no fractional ordinary shares will be issued in the rights offering. Instead, any fractional shares will be rounded down to the nearest whole share. You must exercise your rights with respect to the basic subscription right and the over-subscription right at the same time.

You may be subject to certain regulatory requirements if, as a result of the exercise of your subscription rights, you reach certain holding thresholds of beneficial ownership of our ordinary shares. For example, if your exercise of subscription rights results in you beneficially owning more than 5% of our ordinary shares, you may be required to file a Schedule 13D or Schedule 13G with the U.S. Securities and Exchange Commission. In addition, if your exercise of subscription rights results in your holding 25% or more of our ordinary shares, such exercise must be made by means of a special tender offer in accordance with the Israeli Companies Law.

The rights are exercisable during an 18-trading day period, beginning after 5:00 p.m., New York City time (midnight, Israel time) on [] and ending on [] at 5:00 p.m., New York City time (midnight, Israel time), the expiration date of the rights offering. If you are a beneficial owner of our ordinary shares and hold them through a broker, dealer, bank or other nominee (including a member of DTC or the TASE Clearing House), rather than in your own name, and you wish to exercise your subscription rights, you should contact your nominee to exercise your subscription rights sufficiently in advance of the applicable expiration date of the rights offering in order to ensure timely delivery of a subscription rights certificate reflecting your exercise. Your nominee will instruct you as to the proper time and form of payment of the subscription price.

The rights will be evidenced by subscription rights certificates which will be mailed to shareholders. The subscription rights will not be listed for trading on any stock exchange or market.

For purposes of determining the number of rights a holder may acquire in the rights offering, holders whose ordinary shares are held of record by Cede & Co. or the Hevra Le-Rishumim of Bank Leumi Le-Israel Ltd. will be deemed to be the holders of the rights that are issued to Cede & Co. or Hevra Le-Rishumim of Bank Leumi Le-Israel Ltd., respectively.

There is no minimum subscription amount.

Allocation and Exercise of Over-Subscription Rights

In order to properly exercise an over-subscription right, a rights holder must: (i) exercise its basic subscription right in full, (ii) indicate on its subscription rights certificate that it submits with respect to the exercise of the rights issued to it how many additional ordinary shares it is willing to acquire pursuant to its over-subscription right and (iii) concurrently deliver the subscription payment related to its over-subscription right at the time it makes payment for its basic subscription right.

If there are sufficient remaining rights, all over-subscription requests will be honored in full. If requests for rights pursuant to the over-subscription right exceed the remaining rights available, the available remaining rights will be allocated pro rata among rights holders who over-subscribe based on the number of over-subscription rights to which they subscribe. The percentage of remaining rights each over-subscribing rights holder may acquire will be rounded down to result in delivery of whole ordinary shares. The allocation process will assure that the total number of remaining rights available for over-subscriptions is distributed on a pro rata basis. The formula to be used in allocating the available over-subscription rights is as follows:

$$\frac{\begin{array}{l} \text{[Number of} \\ \text{Over-Subscription} \\ \text{Rights} \\ \text{Subscribed for by an} \\ \text{Exercising Rights} \\ \text{Holder]} \end{array}}{\begin{array}{l} \text{[Total Number of} \\ \text{Over-Subscription} \\ \text{Rights} \\ \text{Subscribed for by All} \\ \text{Exercising Rights} \\ \text{Holders]} \end{array}} \times \begin{array}{l} \text{Total Rights Available} \\ \text{for Rights Holders} \\ \text{Exercising Their} \\ \text{Over-Subscription} \\ \text{Right} \end{array}$$

Rights payments for basic subscriptions and over-subscriptions will be deposited upon receipt by the U.S. subscription agent or us and held in a segregated account with the U.S. subscription agent pending a final determination of the number of ordinary shares to be issued pursuant to the over-subscription right. If the pro rated amount of rights allocated to you in connection with your over-subscription right is less than your over-subscription request, then the excess funds held by the U.S. subscription agent or us on your behalf will be returned to you promptly without interest or deduction. We will deliver certificates representing your ordinary shares or credit your account at your nominee holder with ordinary shares that you purchased pursuant to your over-subscription right as soon as practicable after the rights offering has expired and all proration calculations and reductions contemplated by the terms of the rights offering have been effected.

Brokers, dealers, banks and other nominee holders of rights will be required to certify to the U.S. subscription agent or the TASE Clearing House, as applicable, before any over-subscription right may be exercised with respect to any particular beneficial owner, as to the aggregate number of rights exercised pursuant to the basic subscription right and the number of ordinary shares subscribed for pursuant to the over-subscription right by such beneficial owner.

We will not offer or sell in connection with the rights offering any ordinary shares that are not subscribed for pursuant to the basic subscription right or the over-subscription right.

Over-subscription Commitment

Mr. Nathan Kirsh, our principal shareholder and a director, has undertaken to exercise, directly or through entities affiliated with him, his basic subscription right in full and his over-subscription right in full. As of the date of this prospectus, Mr. Kish beneficially owns 24.2% of our outstanding shares.

Expiration of the Rights Offering and Extensions

You may exercise your subscription rights at any time before 5:00 p.m., New York City time (midnight, Israel time) on [], the expiration date of the rights offering, unless extended. Our board of directors may extend the expiration date for exercising your subscription rights for up to an additional 30 trading days in their sole discretion. If we extend the expiration date, you will have at least ten trading days during which to exercise your rights. Any extension of the rights offering will be followed as promptly as practicable by an announcement, and in no event later than 9:00 a.m., New York City time, on the next business day following the previously scheduled expiration date.

If you are a beneficial owner of our ordinary shares and hold them through a broker, dealer, bank or other nominee (including a member of DTC or the TASE Clearing House), rather than in your own name, and you wish to exercise your subscription rights, you should contact your nominee to exercise your subscription rights sufficiently in advance of the expiration date of the rights offering in order to ensure timely delivery of a subscription rights certificate reflecting your exercise. Your nominee will instruct you as to the proper time and form of payment of the subscription price.

We may choose to extend the expiration date of the rights in order to give investors more time to exercise their subscription rights in the rights offering. We may extend the expiration date of the rights offering by giving oral or written notice to the U.S. subscription agent and the TASE Clearing House on or before the scheduled expiration date. If we elect to extend the expiration date, we will issue a press release announcing such extension no later than 9:00 a.m., New York City time, on the next business day after the most recently announced expiration date.

Any rights not exercised at or before that time will have no value and expire without any payment to the holders of those unexercised rights. We will not be obligated to honor your exercise of subscription rights if the U.S. subscription agent or Magal receives the documents relating to your exercise after the rights offering expires, regardless of when you transmitted the documents.

Amendments, Revocation and Termination of the Rights Offering

Amendments. We reserve the right, in our sole discretion, to amend or modify the terms of the rights offering (including the maximum number of ordinary shares we may issue in the rights offering and the subscription price per share). If we amend or modify the terms of the rights offering, then we will issue a press release announcing such amendment or modification, and we will file with the U.S. Securities and Exchange Commission such documents and other information relating to the amendment or modification as is required under the Securities Act of 1933, as amended. If we amend or modify certain terms of the rights offering, then we will extend the expiration date of the rights offering as required by law.

No Revocation. Once you send in your subscription rights certificate and payment, you cannot revoke the exercise of either your basic or over-subscription rights, even if the market price of our ordinary shares is below the \$3.09 per share subscription price, unless we amend the terms of the rights offering (other than extending the expiration date), in which case you may revoke your exercise before the expiration date. You should not exercise your subscription rights unless you are certain that you wish to purchase additional ordinary shares at the proposed subscription price. Any rights not exercised at or before that time will expire worthless without any payment to the holders of those unexercised rights.

Termination; Cancellation. We may cancel or terminate the rights offering at any time prior to the expiration date. Any cancellation or termination of the rights offering will be followed as promptly as practicable by an announcement or termination.

Reasons for the Rights Offering; Determination of the Offering Price

We are making the rights offering to raise funds for general working capital purposes, including to facilitate the implementation of our new business strategy and the repayment of any outstanding amounts under a \$10 million bridge loan provided to us in September 2010 by Ki Corporation Limited, a company owned by Mr. Nathan Kirsh, our principal shareholder and a director, that we obtained to allow us to begin to implement our new strategic plan. Although we believe that the rights offering will strengthen our financial condition, our board of directors is not making any recommendation as to whether you should exercise your subscription rights.

Our board of directors appointed a special committee to oversee the rights offering and make a recommendation to the board of directors with respect to the terms of the rights offering. The special committee is composed of the chairman of our board of directors and our two outside directors within the meaning of Israeli law. The subscription price, the number of shares that must be owned to receive one right and the number of shares to be issued for each right will be recommended by the special committee to our board of directors, which in turn will consider the terms of the rights offering. In determining the various terms of the rights offering, the special committee and our board of directors will consider, among other things, the fairness opinion of Tamir Fishman, the need to offer the shares at a price that would be attractive to investors relative to the then current trading price for our ordinary shares, historical and current trading prices for our ordinary shares, general conditions in the financial services industry, the need for capital and alternatives available to us for raising capital, potential market conditions, the fact that the rights are not transferable but that holders of rights will have an over-subscription right, and the desire to provide an opportunity to our shareholders to participate in the rights offering on a pro rata basis. In conjunction with its review of these factors, the special committee and our board of directors will review our history and prospects, including our past and present earnings, our prospects for future earnings, and the outlook for our industry, our current financial condition and regulatory status and a range of discounts to market value represented by the subscription prices in various prior rights offerings.

We retained Tamir Fishman to render an opinion to our board of directors as to the fairness, from a financial point of view, of the rights offering to our existing shareholders taken as a whole. The opinion will not constitute a recommendation as to whether you should exercise your subscription rights in the rights offering. We have agreed to pay Tamir Fishman a fee of \$50,000 and reimburse it for reasonable out-of-pocket expenses in connection with the fairness opinion. We have further agreed to indemnify Tamir Fishman and certain other parties affiliated or associated with Tamir Fishman against certain claims, liabilities and expenses related to or arising in connection with the rendering by Tamir Fishman of its services as described in this prospectus. The fairness opinion will not determine the fairness of the pricing of the private placement to Mr. Kirsh or the fairness of any premiums or consideration due to us or our shareholders as the result of the increase of Mr. Kirsh's beneficial ownership of our company to more than 25%.

The subscription price does not necessarily bear any relationship to any other established criteria for value. You should not consider the subscription price as an indication of value of our company or our ordinary shares. You should not assume or expect that, after the rights offering, our ordinary shares will trade at or above the subscription price in any given time period. The market price of our ordinary shares may decline during or after the rights offering, and you may not be able to sell the shares of our ordinary shares purchased during the rights offering at a price equal to or greater than the subscription price. You should obtain a current quote for our ordinary shares before exercising your subscription rights and make your own assessment of our business and financial condition, our prospects for the future, and the terms of this rights offering. On December 20, 2010, the last reported sale price of our ordinary shares on The NASDAQ Global Market was \$3.09 per share and on December 20, 2010, the last reported sale price of our ordinary shares on the TASE was NIS 11.29 per share.

Methods of Exercise of Rights for Record Holders

American Stock Transfer & Trust Company will act as the U.S. subscription agent in connection with the rights offering with respect to holders of our ordinary shares that are registered on our shareholder register maintained at American Stock Transfer & Trust Company, the transfer agent of our ordinary shares, including shares registered in the name of Cede & Co for the benefit of brokers, dealers, banks and other nominees (other than the TASE Clearing House). The U.S. subscription agent will receive for its administrative, processing, invoicing and other services a fee estimated to be approximately \$150,000 plus reimbursement for all reasonable out-of-pocket expenses related to the rights offering.

Rights are evidenced by subscription rights certificates that will be mailed to record date shareholders registered on our shareholder register maintained at American Stock Transfer & Trust Company. The rights certificate will be accompanied by a copy of this prospectus, and on the back of the rights certificate will be a rights exercise form.

During the subscription period ending on [], if you are a record owner of our ordinary shares, you may exercise your rights by delivering a signed exercise form on the back of your rights certificate to American Stock Transfer & Trust Co., together with payment in full of the subscription price for all shares subscribed for through the exercise of the subscription right and the over-subscription right, by 5:00 p.m., New York City time (midnight Israel time), on []. Completed subscription

rights certificates of record holders and payment for the exercise of your rights must be sent to the U.S. subscription agent by one of the methods described below.

By Hand:

By Mail or Overnight Courier:

American Stock Transfer & Trust
Company
Operations Center
Attn: Reorganization Department
59 Maiden Lane
New York, New York 10038

American Stock Transfer & Trust
Company
Operations Center
Attn: Reorganization Department
6201 15th Avenue
Brooklyn, New York 11219

Delivery to an address other than the address listed above will not constitute valid delivery and, accordingly, may be rejected by us.

All payments to the U.S. subscription agent must be in U.S. dollars by money order or bank check drawn on a bank or branch located in the United States or Israel and payable to American Stock Transfer & Trust Company, as Rights Agent. Payment also may be made by wire transfer to the account maintained by American Stock Transfer & Trust Company for this rights offering at [], ABA No. [], Account No. [], for benefit of Magal Security Systems Ltd., with reference to the rights holder's name.

If you are a holder of our ordinary shares that is registered on our shareholder register maintained at American Stock Transfer & Trust Company and you reside in Israel, rather than exercising via the U.S. subscription agent, you may, at your option, exercise your subscription rights by delivering your executed subscription rights certificate to our offices at 17 Altalef Street, Industrial Zone, Yehud, Attention: Ilan Ovadia, accompanied by evidence of a wire transfer or a bank check drawn on a bank located in Israel payable to "Magal Security Systems Ltd." Payment to us may be denominated in U.S. dollars or in NIS, at the representative rate of exchange most recently published by the Bank of Israel at the time of payment. Any wire transfer to us should be sent to the following account of Magal Security Systems Ltd.: Bank [], Account No. [], with reference to the rights holder's name. Completed subscription rights certificates and related payments must be received by us prior to 5:00 p.m., New York City time (midnight, Israel time), on or before the applicable expiration date. We may agree to accept other forms of payment requested by you.

The U.S. subscription agent or we, as applicable, will deposit all funds received prior to the final payment date into a segregated account pending pro-ration and distribution of the ordinary shares.

The method of delivery of subscription rights certificates and payment of the subscription price to the U.S. subscription agent or us will be at the election and risk of the participating rights holders, but if sent by mail it is recommended that such certificates and payments be sent by registered mail, properly insured, with return receipt requested, and that a sufficient number of days be allowed to ensure delivery to the U.S. subscription agent or us and clearance of payment prior to 5:00 p.m., New York City time (midnight, Israel time), on [].

Whichever of the methods described above is used, issuance of the ordinary shares is subject to collection of checks and actual payment.

If a participating rights holder who subscribes for shares as part of the subscription right or over-subscription right does not make payment of any amounts due by the expiration date, the U.S. subscription agent or Magal, as applicable, reserves the right to take any or all of the following actions: (i) reallocate the ordinary shares to other participating rights holders in accordance with the over-subscription right; (ii) apply any payment actually received by it from the participating rights holder toward the purchase of the greatest whole number of ordinary shares which could be acquired by such participating rights holder upon exercise of the basic subscription and any over-subscription right; and/or (iii) exercise any and all other rights or remedies to which it may be entitled, including the right to set off against payments actually received by it with respect to such subscribed for ordinary shares.

Exercise of Rights by Beneficial Owners Who Are Not Record Holders

If you are a beneficial owner of our ordinary shares and hold them through a broker, dealer, bank or other nominee (including a member of DTC or the TASE), rather than in your own name, you should expect your broker, dealer or other nominee to notify you of this rights offering and the procedures for exercising or transferring your rights. If you wish to exercise your subscription rights, you should contact your nominee to exercise your subscription rights sufficiently in advance of the expiration date of the rights offering in order to ensure timely delivery of a subscription rights certificate reflecting your exercise. Your nominee will instruct you as to the proper time and form of payment of the subscription price. In that case, the nominee will complete the subscription rights certificate on behalf of the record date shareholder and arrange for proper payment.

Summarized below are the procedures for exercising your rights if you are a beneficial owner whose ordinary shares are held through our Israeli nominee company (Hevra Le-Rishumim of Bank Leumi Le-Israel Ltd.).

Procedures Applicable to Holders of Shares Through our Israeli Nominee Company

The TASE Clearing House will act as the Israeli subscription agent in connection with the rights offering with respect to our ordinary shares that are held through an Israeli brokerage firm that holds the rights through our Israeli nominee company (Hevra Le-Rishumim of Bank Leumi Le-Israel Ltd.), as well as the ordinary shares held in the DTC account of the TASE Clearing House for the benefit of brokers, dealers, banks and other nominees that are TASE Clearing House members.

The TASE Clearing House will credit the accounts of the respective TASE Clearing House members that hold our ordinary shares of record as of [] with one subscription right per [] ordinary share[s] held in such accounts. The TASE Clearing House members will notify their respective beneficial owners as soon as possible to ascertain their intentions and to obtain instructions with respect to the subscription rights. Such beneficial owners who wish to exercise their subscription rights must send their completed subscription rights certificates to their respective brokers, banks or other nominees, and follow the applicable instructions as to payment of the subscription price, at least three TASE trading days prior to the applicable expiration date, or [], unless the expiration date is extended. The TASE Clearing House members must send completed subscription rights certificates for all shares subscribed for through the exercise of the subscription right and the over-subscription right to the TASE Clearing House at least two TASE trading days prior to the applicable expiration date, or [], unless the expiration date is extended. The TASE Clearing House, in turn, must notify us of all exercises of subscription rights by the various TASE Clearing House members prior to the applicable expiration date, or [], unless the expiration date is extended.

The TASE Clearing House will credit the accounts of the respective TASE Clearing House members with the shares issued to them in the rights offering, concurrently with the debit of the subscription price from such accounts, as soon as practicable following the expiration of the rights offering. The payment of the subscription price will be denominated in NIS, at the representative rate of exchange most recently published by the Bank of Israel at the time of payment.

Nominee Holders

If you are a broker, a trustee or a depository for securities that holds our ordinary shares for the account of others as a nominee holder, you should notify the respective beneficial owners of such shares as soon as possible of the issuance of the rights to find out such beneficial owners' intentions. You should obtain instructions from the beneficial owner with respect to the rights, as set forth in the instructions we have provided to you for your distribution to beneficial owners. If the beneficial owner so instructs, you should complete the appropriate subscription certificates. A nominee holder that holds shares for the account(s) of more than one beneficial owner may exercise the number of rights to which all such beneficial owners in the aggregate otherwise would have been entitled if they had been direct record holders of our ordinary shares on the record date, so long as the nominee submits the appropriate subscription certificates and certifications and proper payment to us. If

you are a member of the TASE, you must comply with the rules of the TASE with respect to providing notices to and receiving instructions from your clients.

General

All questions as to the timeliness, validity, form, eligibility (including times of receipt and matters pertaining to beneficial ownership) and the acceptance of subscription forms and the subscription price will be determined by us, which determinations will be final and binding. No alternative, conditional or contingent subscriptions will be accepted.

We reserve the right to reject any exercise if such exercise is not in accordance with the terms of the rights offering or not in proper form or if the acceptance thereof or the issuance of our ordinary shares thereto could be deemed unlawful. We reserve the right to waive any deficiency or irregularity with respect to any subscription rights certificate. Subscriptions will not be deemed to have been received or accepted until all irregularities have been waived or cured within such time as we determine in our sole discretion. We will not be under any duty to give notification of any defect or irregularity in connection with the submission of subscription rights certificates or incur any liability for failure to give such notification.

Rights Not Transferable

The subscription rights may not be sold or transferred except for being transferable by operation of law, and will not be listed on any trading market.

Delivery of Share Certificates

Shareholders whose ordinary shares are held of record by Cede & Co. on their behalf or on behalf of their broker, dealer, bank or other nominee that is a DTC member (other than the TASE Clearing House) will have any ordinary shares that they acquire in the rights offering issued in the name of Cede & Co.

Shareholders whose ordinary shares are held of record by our Israeli nominee company (Hevra Le-Rishumim of Bank Leumi Le-Israel Ltd.) on their behalf or on behalf of their broker, dealer, bank or other nominee that is a TASE Clearing House member will have any ordinary shares that they acquire in the rights offering issued in the name of Cede & Co. for the DTC account of the TASE Clearing House.

With respect to record shareholders, share certificates for ordinary shares will be mailed promptly after the expiration of the rights offering and payment of the subscription price by the individual holder has cleared.

ERISA and Tax Considerations for U.S. Retirement Plans

Under the Employee Retirement Income Security Act of 1974, as amended, or ERISA, fiduciary responsibility requirements may impact the exercise of rights by fiduciaries acting on behalf of U.S. retirement and other employee benefit plans. Moreover, ERISA and the Internal Revenue Code of 1986, as amended, or the Code, contain prohibited transaction rules that may preclude the exercise of rights by retirement and other plans that are subject to Section 4975 of the Code. In addition, retirement plans, including governmental retirement plans, should also be aware that if they borrow in order to finance their exercise of rights, they may become subject to the tax on unrelated business income under Section 511 of the Code. If any portion of an individual retirement account, or an IRA, is used as security for a loan, the portion so used is treated as distributed to the IRA owner for tax purposes. Due to the complexity of these rules and the penalties for noncompliance, retirement plans should consult with their counsel and other advisers regarding the consequences of their exercise of rights under ERISA and the Code.

If You Have Questions

If you have any questions or need further information about the rights offering, or for additional copies of this prospectus or subscription rights certificates, please contact our Information Agent for the rights offering, [], at [], or, if you are located in Israel, you may also contact Ilan Ovadia, our Chief Financial Officer, at +972-3-5391490, during their respective normal business hours.

PLAN OF DISTRIBUTION

Immediately following the effective date of this prospectus, we will distribute, at no cost, the subscription rights certificates and copies of this prospectus to all holders of record of our ordinary shares on []. If you wish to exercise your basic subscription rights and the over-subscription rights and purchase our ordinary shares, you should

complete the subscription rights certificate and return it, with payment of the subscription price, or follow the procedure for subscription by shareholders whose ordinary shares are held by a nominee, as set forth in “The Rights Offering - Methods for Exercising Rights.”

DESCRIPTION OF SHARE CAPITAL

Our authorized share capital consists of NIS 19,748,000 ordinary shares, par value NIS 1.00 each. All our ordinary shares have the same rights, preferences and restrictions, some of which are detailed below. At the general meeting of shareholders, our shareholders may, subject to certain provisions detailed below, create different classes of shares, each class bearing different rights, preferences and restrictions.

The rights attached to the ordinary shares are as follows:

Dividends Rights. Holders of ordinary shares are entitled to participate in the payment of dividends in accordance with the amounts paid-up or credited as paid up on the nominal value of such ordinary shares at the time of payment (without taking into account any premium paid thereon). However, under article 13 of our articles of association no shareholder shall be entitled to receive any dividends until the shareholder has paid all calls then currently due and payable on each ordinary share held by such shareholder.

The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. Declaration of a final dividend requires the approval by ordinary resolution of our shareholders at a general meeting of shareholders. Such resolution may reduce but not increase the dividend amount recommended by the board of directors. Dividends may be paid, in whole or in part, by way of distribution of dividends in kind.

Voting Rights. Holders of ordinary shares are entitled to one vote for each share held of record on all matters submitted to a vote of shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

Generally, resolutions are adopted at the general meeting of shareholders by an ordinary resolution, unless the Israeli Companies Law or our articles of association require an extraordinary resolution. An ordinary resolution, such as a resolution approving the declaration of dividends or the appointment of auditors, requires approval by the holders of a simple majority of the shares represented at the meeting, in person or by proxy, and voting on the matter. An extraordinary resolution requires approval by the holders of at least 75% of the shares represented at the meeting, in person or by proxy, and voting on the matter. The primary resolutions required to be adopted by an extraordinary resolution of the general meeting of shareholders are resolutions to:

- amend the memorandum of association or articles of association;
- change the share capital, for example by increasing or canceling the authorized share capital or modifying the rights attached to shares; and
- approve mergers, consolidations or winding up of our company.

Our articles of association do not contain any provisions regarding a classified board of directors or cumulative voting for the election of directors. Pursuant to our articles of association, our directors (except the external directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next

annual general meeting of shareholders and until their successors have been elected. All the members of our board of directors (except the external directors) may be reelected upon completion of their term of office.

Rights to Share in the Company's Profits. Our shareholders have the right to share in our profits distributed as a dividend or any other permitted distributions.

Liquidation Rights. Article 111 of our articles of association provides that upon any liquidation, dissolution or winding-up of our company, our remaining assets shall be distributed pro-rata to our ordinary shareholders.

Redemption. Under Article 38 of our articles of association, we may issue redeemable stock and redeem the same.

Capital Calls. Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

Modifications of Share Rights

The rights attached to a class of shares may be altered by an extraordinary resolution of the general meeting of shareholders, provided the holders of 75% of the issued shares of that class approve such change by the adoption of an extraordinary resolution at a separate meeting of such class, subject to the terms of such class. The provisions of the articles of association pertaining to general meetings of shareholders also apply to a separate meeting of a class of shareholders. Shares which confer preferential or subordinate rights relating to, among other things, dividends, voting, and payment of capital may be created only by an extraordinary resolution of the general meeting of shareholders.

General Meetings of Shareholders

Under the Israeli Companies Law a company must convene an annual meeting of shareholders at least once every calendar year and within 15 months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as “special general meetings.” In addition, the board must convene a special general meeting upon the demand of two of the directors, 25% of the nominated directors, one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company.

A shareholder present, in person or by proxy, at the commencement of a general meeting of shareholders may not seek the cancellation of any proceedings or resolutions adopted at such general meeting of shareholders on account of any defect in the notice of such meeting relating to the time or the place thereof. Shareholders who are registered in our register of shareholders at the record date may vote at the general meeting of shareholders. The record date is set in the resolution to convene the general meeting of shareholders, provided, however, that such record date must be between 14 to 21 days or, in the event of a vote by ballots, between 28 to 40 days prior the date the general meeting of shareholders is held.

The quorum required for a general meeting of shareholders consists of at least two record shareholders, present in person or by proxy, who hold, in the aggregate, at least one third of the voting power of our outstanding shares. A general meeting of shareholders will be adjourned for lack of a quorum after half an hour from the time appointed for such meeting to the same day in the following week at the same time and place or any other time and place as the board of directors designates in a notice to the shareholders. At such reconvened meeting, if a quorum is not present within half an hour from the time appointed for such meeting, two or more shareholders, present in person or by proxy, will constitute a quorum. The only business that may be considered at an adjourned general meeting of shareholders is the business that might have been lawfully considered at the general meeting of shareholders originally convened and the only resolutions that may be adopted are the resolutions that could have been adopted at the general meeting of shareholders originally convened.

Limitations on the Right to Own Our Securities

Neither our memorandum or articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of our ordinary shares by non-residents, except that the laws of the State of Israel may restrict the ownership of ordinary shares by residents of countries that are in a state of war with Israel.

Provisions Restricting a Change in Control of Our Company

The Israeli Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such boards' confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated merger. Under our articles of association, such merger must be approved by a resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder. For purposes of the shareholders approval, the merger shall not be deemed as granted unless the court determines otherwise, if it is not supported by the majority of the shares represented at the general meeting, other than those shares that are held by the other party to the merger or by any shareholder holding 25% or more of the outstanding share capital of the company or the right to appoint 25% or more of the members of the board of directors.

The Israeli Companies Law also provides that an acquisition of shares of a public company must be made by means of a special tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company and there is no existing 25% or greater shareholder in the company. An acquisition of shares of a public company must also be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or greater shareholder of the company and there is no existing 45% or greater shareholder in the company. These requirements do not apply if the acquisition (i) was made through a private placement that received shareholder approval, (ii) was from a 25% shareholder of the company and resulted in the acquirer becoming a 25% shareholder of the company or (iii) was from a 45% shareholder of the company and resulted in the acquirer becoming a 45% shareholder of the company. The special tender offer must be extended to all shareholders but, the offer may include explicit limitations allowing the offeror not to purchase shares representing more than 5% of the voting power attached to the company's outstanding shares, regardless of how many shares are tendered by shareholders. The special tender offer may be effected only if (i) at least 5% of the voting power attached to the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of the outstanding shares, the acquisition must be made by means of a tender offer for the entire outstanding shares. In such event, if less than 5% of the outstanding shares are not tendered in the tender offer, all the shares of the company will be deemed as tendered and sold. However, if more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire any shares at all. The law provides for appraisal allowing any shareholder to file a motion to the court within three months following the consummation of a full tender offer.

In addition, the purchase of 25% or more of the outstanding share capital of a company or the purchase of substantial assets of a company requires, under certain conditions, the approval of the Restrictive Practices Authority. Furthermore if the target company has received tax incentives of grants from the Office of the Chief Scientist, changes in ownership may require also the approval of the tax authorities or the Office of the Chief Scientist, as applicable.

Disclosure of Shareholders' Ownership

The Israeli Securities Law, 5728-1968 and regulations promulgated thereunder contain various provisions regarding the ownership threshold above which shareholders must disclose their share ownership. However, these provisions do not apply to companies, such as ours, whose shares are publicly traded in Israel as well as outside of Israel. As a result of the listing of our ordinary shares on the TASE, we are required pursuant to the Israeli Securities Law and the regulations promulgated thereunder to deliver to the Israeli Share Registrar, the Israeli Securities Exchange Commission and the TASE, all reports, documents, forms and information received by us from our shareholders regarding their shareholdings, provided that such information was published or required to be published under applicable foreign law.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following summary describes the material U.S. federal income tax consequences of the receipt, ownership, exercise, and expiration of subscription rights distributed to U.S. Holders (as defined below) pursuant to the rights offering. This summary is based on the Internal Revenue Code of 1986, as amended, or the Code, the final, temporary and proposed U.S. Treasury Regulations promulgated thereunder and administrative and judicial interpretations thereof and the U.S./Israel Income Tax Treaty, all as of the date hereof and all of which are subject to change (possibly with retroactive effect) or different interpretations. For purposes of this summary, a “U.S. Holder” will be deemed to refer only to any of the following holders of our ordinary shares:

- an individual who is either a U.S. citizen or a resident of the United States for U.S. federal income tax purposes;
- a corporation or other entity taxable as a corporation for U.S. federal income tax purposes created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate the income of which is subject to U.S. federal income tax regardless of the source of its income; and
 - a trust, if (a) a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (b) the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person.

This summary does not consider all aspects of U.S. federal income taxation that may be relevant to particular U.S. Holders by reason of their particular circumstances, including potential application of the U.S. federal alternative minimum tax, any aspect of state, local or non-U.S. federal tax laws or U.S. federal tax laws other than U.S. federal income tax laws. In addition, this summary is directed only to U.S. Holders who hold our ordinary shares as “capital assets” within the meaning of Section 1221 of the Code and does not address the considerations that may be applicable to particular classes of U.S. Holders, including financial institutions, regulated investment companies, real estate investment trusts, pension funds, insurance companies, broker-dealers, tax-exempt organizations, grantor trusts, partnerships or other pass-through entities and partners or other equity owners in such partnerships or pass-through entities, U.S. Holders whose functional currency is not the U.S. dollar, U.S. Holders who have elected mark-to-market accounting, U.S. Holders who acquired our ordinary shares through the exercise of options or otherwise as compensation, U.S. Holders who hold our ordinary shares as part of a “straddle,” “hedge” or “conversion transaction,” U.S. Holders selling our ordinary shares short, U.S. Holders deemed to have sold our ordinary shares in a “constructive sale,” and U.S. Holders, directly, indirectly or through attribution, of 10% or more (by vote or value) of our outstanding ordinary shares.

Each U.S. Holder should consult with his, her or its own tax advisor as to the particular tax consequences to him, her or it of the receipt, ownership, exercise, sale and expiration of subscription rights, including the effects of applicable tax treaties, state, local, foreign or other tax laws and possible changes in the tax laws.

Issuance of Subscription Rights

A U.S. Holder's receipt of subscription rights pursuant to the rights offering likely will not be taxable under U.S. federal income tax laws. The distribution of the subscription rights would be taxable under U.S. federal income tax laws if it were part of a "disproportionate distribution," that is, if it were to have the effect of the receipt of cash or other property by some holders of our ordinary shares and an increase in the proportionate interest of other holders of our ordinary shares in our assets or earnings and profits. The following discussion of the material U.S. federal income tax consequences of the rights offering assumes that U.S. Holders will not be subject to U.S. federal income tax upon the receipt of subscription rights pursuant to the rights offering.

Tax Basis and Holding Period of Subscription Rights

A U.S. Holder's tax basis in subscription rights received pursuant to the rights offering generally must be determined by allocating such U.S. Holder's tax basis in his, her or its ordinary shares between such ordinary shares and the subscription rights based on their respective fair market values on the date of the rights distribution. If the fair market value of the subscription rights is less than 15% of the fair market value (on the date of distribution) of the ordinary shares with respect to which the rights are distributed, however, the U.S. Holder's tax basis in the subscription rights received pursuant to the rights offering will be zero, unless such U.S. Holder irrevocably elects (in his, her or its U.S. federal income tax return for the tax year in which the subscription rights are received) to allocate a portion of the tax basis of his, her or its ordinary shares to such subscription rights as described in the preceding sentence. Tax basis may not be allocated to subscription rights which expire without having been exercised at the end of the subscription period. The holding period of subscription rights received pursuant to the rights offering will include the holding period of the ordinary shares with respect to which the subscription rights were distributed.

Expiration of Subscription Rights

If a U.S. Holder does not exercise his, her or its subscription rights prior to the end of the subscription period and such U.S. Holder continues to hold the ordinary shares with respect to which the subscription rights were distributed, such U.S. Holder will recognize no gain or loss and his, her or its tax basis in the ordinary shares with respect to which the subscription rights were distributed will be equal to such U.S. Holder's tax basis in such ordinary shares before receipt of the subscription rights. If a U.S. Holder's subscription rights expire without exercise after the U.S. Holder has disposed of the ordinary shares with respect to which the subscription rights were distributed, such U.S. Holder likely would recognize a capital loss which generally would be treated as U.S.-source capital loss for purposes of computing any allowable U.S. foreign tax credit. Such capital loss would be short-term or long-term capital loss, depending on the U.S. Holder's holding period with respect to the subscription rights, determined as described in "– Tax Basis and Holding Period of Subscription Rights" above. Deductions for capital losses are subject to limitations under the Code.

Exercise of Subscription Rights; Tax Basis and Holding Period of Ordinary Shares

A U.S. Holder will not recognize any gain or loss upon the exercise of subscription rights. A U.S. Holder's initial tax basis in each share received upon the exercise of a subscription right will be equal to the sum of the subscription price paid plus the U.S. Holder's tax basis, if any, in such subscription right, determined as described in "–Tax Basis and Holding Period of Subscription Rights" above.

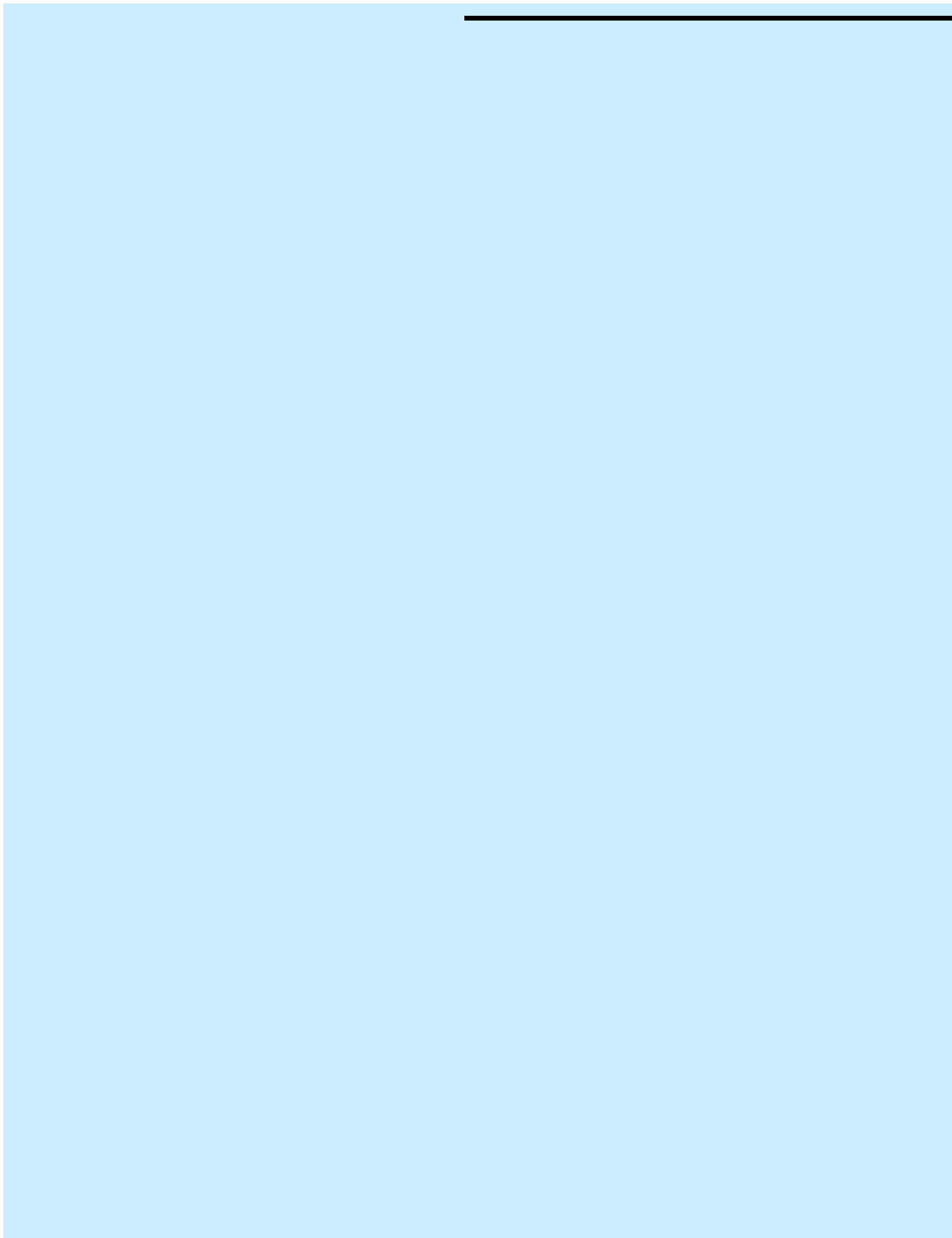
A U.S. Holder's holding period for the ordinary shares acquired upon the exercise of a subscription right will begin on the date of exercise.

If a U.S. Holder exercises a subscription right received in the rights offering after disposing of ordinary shares at a loss, or if a U.S. Holder disposes of ordinary shares at a loss soon after exercising a subscription right, the deductibility of such loss resulting from the sale of the ordinary shares may be limited under the "wash sale" rules in Section 1091 of the Code. U.S. Holders should consult their tax advisors regarding the potential application of these rules.

Acquisition, Ownership and Disposition of Ordinary Shares

For a discussion of the material U.S. federal income tax considerations relating to the acquisition, ownership and disposition of our ordinary shares, including the taxation of any dividends paid with respect to our ordinary shares, the treatment of a U.S. Holder's sale or other disposition of our ordinary shares and the potential application of U.S. information reporting requirements and backup withholding taxes, see "Item 10E. Taxation – United States Federal Income Tax Consequences" in our Annual Report on Form 20-F for the fiscal year ended December 31, 2009, which is incorporated by reference in this prospectus.

U.S. Holders are urged to consult their own tax advisors regarding the U.S. federal income tax consequences of the acquisition, ownership and disposition of our ordinary shares and the potential application of U.S. information reporting requirements and backup withholding taxes.



CERTAIN ISRAELI TAX CONSIDERATIONS

The following summary does not discuss all the aspects of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities will accept the views expressed in the discussion in question. The discussion is not intended, and should not be taken, as legal or professional tax advice and is not exhaustive of all possible tax considerations. Each holder of ordinary shares is urged to consult his, her or its own tax advisor with respect to the particular tax consequences of the rights offering to him, her or it.

The Distribution of the Subscription Rights

We do not believe that the receipt and exercise of your subscription rights will be taxable; however, no tax ruling from the Israeli Income Tax Authority will be sought for the rights offering.

Capital Gains Tax

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of capital assets (or rights to capital assets) located in Israel, including shares of Israeli companies by non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain that is equivalent to the increase of the relevant asset's purchase price which is attributable to the increase in the Israeli consumer price index, or a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Provisions of Israeli tax law may treat a sale of securities listed on a stock exchange differently than the sale of other securities.

Israeli Residents

Generally, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, unless, among others, such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a "Significant Shareholder" at any time during the 12-month period preceding such sale, i.e. such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 25%. Israeli companies are subject to the corporate tax rate on capital gains derived from the sale of listed shares, unless such companies were not subject to the Israeli Income Tax (Inflationary Adjustment) Law, 5745-1985, or the Inflationary Adjustments Law, (or certain regulations) as of August 10, 2005, in which case the applicable tax rate is 25%. However, the foregoing tax rates will not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

Section 94(D) of the Israeli Income Tax Ordinance [New Version], 1961, or the Tax Ordinance, defines "bonus shares" as "including the benefit component in rights issued or in shares originating in such rights." Section 94(A) of the Tax Ordinance provides that at the time of disposition of bonus shares issued to an individual, company or association of individuals, or at the time of sale of shares in respect of which the bonus shares were issued, defined as the Principal Shares, the bonus shares will be deemed to have been purchased on the date the Principal Shares were purchased. In addition, the section provides that the original price (i.e., tax basis) of one bonus share or one Principal Share will be a sum whose proportion to the total original price of all bonus shares and Principal Shares will be the same as the proportion of the par value of one such share to the total par value of all the aforementioned shares. In accordance with Section 94(E) of the Tax Ordinance, the Minister of Finance of Israel may, subject to the approval of the finance committee of the Israeli Parliament, promulgate rules for calculating the amount of the benefit component. Such rules have not been published.

The original price of our shares acquired by individuals prior to January 1, 2003 will generally be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Non-Israeli Residents

Non-Israeli residents are generally exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange outside of Israel, provided however that such shareholders did not acquire their shares prior to an initial public offering, that the gains did not derive from a permanent establishment of such shareholders in Israel, and that such shareholders are not subject to the Inflationary Adjustments Law. However, non-Israeli corporations will not be entitled to such exemption if Israeli residents (i) have a controlling interest of 25% or more in such non-Israeli corporation, or (ii) are the beneficiaries or are entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In certain instances where our shareholders may be liable for Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

In addition, pursuant to the Convention between the Government of the United States of America and the Government of Israel with respect to Taxes on Income, as amended, or the U.S. – Israel Tax Treaty, the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the United States within the meaning of the U.S.- Israel Tax Treaty and who is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty generally will not be subject to Israeli capital gains tax unless such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to particular conditions, or the unless capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the Treaty U.S. Resident would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

EXPENSES ASSOCIATED WITH THE RIGHTS OFFERING

We have agreed to pay substantially all of the expenses incidental to the rights offering, including, without limitation, all registration and filing fees, fees and expenses of our counsel and accountants and transfer agent and subscription agent fees. We estimate that the expenses for which we will be responsible in connection with the rights offering will be approximately \$[]. The following table sets forth the various expenses expected to be incurred by us in connection with the rights offering. All amounts shown are estimates, except the Securities and Exchange Commission registration fee.

SEC registration fee	\$ 1,069.50
Printing, EDGAR and mailing fees	
Legal fees and expenses	
Accounting fees and expenses	
Transfer agent and subscription agent fees	

Miscellaneous expenses	
Total expenses	\$

FOREIGN EXCHANGE CONTROLS AND OTHER LIMITATIONS

Non-residents of Israel who purchase our ordinary shares may freely convert all amounts received in Israeli currency in respect of such ordinary shares, whether as a dividend, liquidation distribution or as proceeds from the sale of the ordinary shares, into freely-repatriable non-Israeli currencies at the rate of exchange prevailing at the time of conversion (provided in each case that the applicable Israeli income tax, if any, is paid or withheld).

Until May 1998, Israel imposed extensive restrictions on transactions in foreign currency. These restrictions were largely lifted in May 1998. Since January 1, 2003, all exchange control restrictions have been eliminated (although there are still reporting requirements for foreign currency transactions). Legislation remains in effect, however, pursuant to which currency controls can be imposed by administrative action at any time.

The State of Israel does not restrict in any way the ownership or voting of our ordinary shares by non-residents of Israel, except with respect to subjects of countries that are in a state of war with Israel.

LEGAL MATTERS

The validity of the securities offered hereby and other legal matters concerning the rights offering relating to Israeli law will be passed upon for us by S. Friedman & Co., Tel-Aviv, Israel. Some legal matters relating to United States law will be passed upon for us by Carter Ledyard & Milburn LLP, New York, New York.

EXPERTS

Our consolidated financial statements as of December 31, 2008 and 2009, and for each of the three years ended December 31, 2009 included in our Annual Report on Form 20-F for the year ended December 31, 2009, have been audited by Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, independent registered public accounting firm, as set forth in their report thereon and incorporated herein. Such consolidated financial statements are incorporated herein by reference in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

MATERIAL CHANGES

Except as otherwise described in our Annual Report on Form 20-F for the fiscal year ended December 31, 2009, in our Reports on Form 6-K filed or submitted under the Exchange Act and incorporated by reference herein and as disclosed in this prospectus, no reportable material changes have occurred since December 31, 2009.

ENFORCEABILITY OF CIVIL LIABILITIES

Service of process upon us and upon our directors and officers and the Israeli experts named in this prospectus, all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, because substantially all of our assets, all of our directors and officers and the Israeli experts named in this prospectus are located outside the United States, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

We have been informed by our legal counsel in Israel, S. Friedman & Co., that there is doubt as to the enforceability of civil liabilities under the Securities Act and the Exchange Act in original actions instituted in Israel. However, subject to specified time limitations, an Israeli court may declare a foreign civil judgment enforceable if it finds that:

- the judgment was rendered by a court which was, according to the laws of the state of the court, competent to render the judgment,
 - the judgment is no longer appealable,
- the obligation imposed by the judgment is enforceable according to the rules relating to the enforceability of judgments in Israel and the substance of the judgment is not contrary to public policy, and
 - the judgment is executory in the state in which it was given.

Even if the above conditions are satisfied, an Israeli court will not enforce a foreign judgment if it was given in a state whose laws do not provide for the enforcement of judgments of Israeli courts (subject to exceptional cases) or if its enforcement is likely to prejudice the sovereignty or security of the State of Israel.

An Israeli court also will not declare a foreign judgment enforceable if:

- the judgment was obtained by fraud,
- there was no due process,

- the judgment was rendered by a court not competent to render it according to the laws of private international law in Israel,
- the judgment is at variance with another judgment that was given in the same matter between the same parties and which is still valid, or
- at the time the action was brought in the foreign court a suit in the same matter and between the same parties was pending before a court or tribunal in Israel.

If a foreign judgment is enforced by an Israeli court, it generally will be payable in Israeli currency. The usual practice in an action to recover an amount in non-Israeli currency is for the Israeli court to render judgment for the equivalent amount in NIS at the rate of exchange on the date of payment, but the judgment debtor also may make payment in non-Israeli currency. Pending collection, the amount of the judgment of an Israeli court stated in NIS ordinarily will be linked to the Israel consumer price index plus interest at the annual rate (set by Israeli law) prevailing at that time. Judgment creditors bear the risk of unfavorable exchange rates.

MAGAL SECURITY SYSTEMS LTD. AND ITS SUBSIDIARIES
INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2010

UNAUDITED

INDEX

	Page
<u>Consolidated Balance Sheets</u>	F - 2
<u>Consolidated Statements of Operations</u>	F - 4
<u>Statements of Changes in Shareholders' Deficiency</u>	F - 5 - F - 6
<u>Consolidated Statements of Cash Flows</u>	F - 7 - F - 8
<u>Notes to Interim Consolidated Financial Statements</u>	F - 9 - F - 17

F - 1

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December
	June 30, 31,
	2010 2009
	Unaudited

ASSETS

CURRENT ASSETS:

Cash and cash equivalents	\$ 4,768	\$ 11,869
Short-term bank deposits	-	1,807
Restricted deposit	2,965	-
Trade receivables (net of allowance for doubtful accounts of \$ 884 as of June 30, 2010 and \$ 911 at December 31, 2009)	12,608	12,328
Unbilled accounts receivable	4,795	5,892
Other accounts receivable and prepaid expenses	4,079	1,573
Deferred income taxes	307	272
Inventories (Note 3)	10,175	10,912
Total current assets	39,697	44,653

LONG-TERM INVESTMENTS AND RECEIVABLES:

Long-term trade receivables	1,565	1,753
Long-term loan	200	200
Long-term deposits	50	40
Severance pay fund	2,105	2,476
Total long-term investments and receivables	3,920	4,469

PROPERTY AND EQUIPMENT, NET 8,747 9,178

OTHER INTANGIBLE ASSETS, NET 279 269

GOODWILL 1,895 2,053

ASSETS ATTRIBUTED TO DISCONTINUED OPERATIONS

	-	28
Total assets	\$ 54,538	\$ 60,650

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

F - 2

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	June 30, 2010	December 31, 2009
	Unaudited	

LIABILITIES AND SHAREHOLDERS'
EQUITY

CURRENT LIABILITIES:

Short-term bank credit	\$ 7,534	\$ 8,234
Current maturities of long-term bank credit	661	1,824
Trade payables	2,490	4,018
Customer advances	5,686	2,330
Other accounts payable and accrued expenses	6,425	7,780

Total current liabilities	22,796	24,186
---------------------------	--------	--------

LONG-TERM LIABILITIES:

Long-term bank debt	216	548
Accrued severance pay	3,171	3,562

Total long-term liabilities	3,387	4,110
-----------------------------	-------	-------

LIABILITIES ATTRIBUTED TO
DISCONTINUED OPERATIONS

	-	45
--	---	----

COMMITMENTS AND CONTINGENT
LIABILITIES (Note 5)

SHAREHOLDERS' EQUITY:

Share capital -

Ordinary shares of NIS 1 par value -

Authorized: 19,748,000 shares at June 30, 2010
and December 31, 2009; Issued and
outstanding: 10,396,548 shares at June 30, 2010
and December 31, 2009

	3,225	3,225
Additional paid-in capital	49,292	48,741
Accumulated other comprehensive income	4,561	3,849
Foreign currency translation (Company's stand alone financial statements)	2,605	3,890
Accumulated deficit	(31,375)	(27,450)

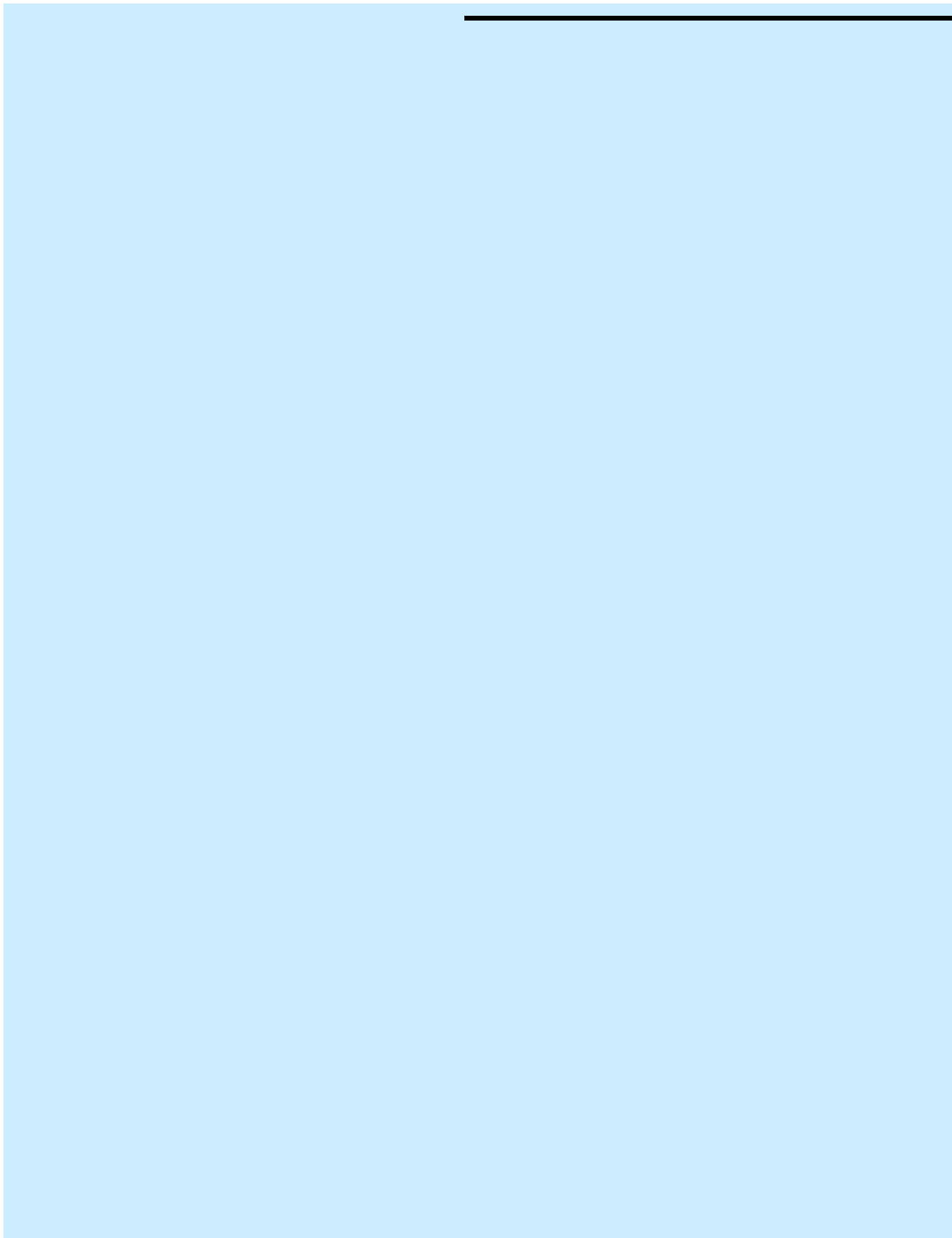
Total Magal shareholders' equity	28,308	32,255
----------------------------------	--------	--------

Non controlling interest	47	54
--------------------------	----	----

Total shareholders' equity	28,355	32,309
----------------------------	--------	--------

Total liabilities and shareholders' equity	\$ 54,538	\$ 60,650
--	-----------	-----------

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



MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands

	Six months ended		Year ended
	June 30,	June 30,	December
	2010	2009	31,
	Unaudited		2009
Revenues	\$21,204	\$21,870	\$ 54,518
Cost of revenues	13,916	13,231	33,331
Gross profit	7,288	8,639	21,187
Operating expenses:			
Research and development	2,155	2,305	4,816
Selling and marketing, net	4,545	4,801	10,864
General and administrative	3,875	3,840	8,372
Total operating expenses	10,575	10,946	24,052
Operating loss	(3,287)	(2,307)	(2,865)
Financial expenses, net	659	226	1,568
Loss before income taxes	(3,946)	(2,533)	(4,433)
Income taxes (tax benefit)	(20)	(344)	864
Loss from continuing operations	(3,926)	(2,189)	(5,297)
Income from discontinued operations, net	-	63	4,216
Net loss	(3,926)	(2,126)	(1,081)
Less: net income (loss) attributable to non-controlling interest	(1)	-	54
Net loss attributable to Magal shareholders	\$(3,925)	\$(2,126)	\$ (1,135)
Basic and diluted loss per share from continuing operations	\$(0.38)	\$(0.21)	\$(0.52)
Basic and diluted earnings per share from discontinued operations	-	0.01	0.41
Basic and diluted loss per share	\$(0.38)	\$(0.20)	\$(0.11)

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

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of shares	Ordinary shares	Additional paid-in capital	Comprehensive income (loss)	Foreign currency translation other	Accumulated Company deficit	Non- controlling interest
Balance as of January 1, 2009	10,396,548	\$ 3,225	\$ 48,043	\$ 2,472	\$ 3,293	\$(26,315)	\$-
Stock-based compensation	-	-	542	-	-	-	-
Stock-based compensation – granted by related party	-	-	156	-	-	-	-
Comprehensive income (loss):							
Net loss	-	-	-	-	-	(1,135)	5
Realized foreign currency translation adjustments from sale of subsidiary	-	-	-	(789)	-	-	-
Foreign currency translation adjustments	-	-	-	2,166	597	-	-
Total comprehensive income							
Balance as of December 31, 2009	10,396,548	3,225	48,741	3,849	3,890	(27,450)	5
Stock-based compensation	-	-	491	-	-	-	-
Stock-based compensation - granted by related party	-	-	60	-	-	-	-
Comprehensive income (loss):							
Net loss	-	-	-	-	-	(3,925)	(1)
Foreign currency translation adjustments	-	-	-	712	(1,285)	-	(6)

Total
comprehensive
loss

Balance as of
June 30, 2010
(unaudited)

10,396,548 \$3,225 \$49,292 \$4,561 \$2,605 \$(31,375) \$4

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

F - 5

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of shares	Ordinary shares	Additional paid-in capital	Accumulated other comprehensive income	Foreign currency translation of the Company	Accumulated deficit	Total comprehensive income
Balance as of January 1, 2009	10,396,548	\$3,225	\$48,043	\$2,472	\$3,293	\$(26,315)	
Stock-based compensation	-	-	180	-	-	-	
Stock-based compensation – granted by related party							
Comprehensive income (loss):							
Net loss	-	-	-	-	-	(2,126)	\$(2,126)
Foreign currency translation adjustments	-	-	-	864	(13)	-	851
Total comprehensive income							\$(1,275)
Balance as of June 30, 2009 (unaudited)	10,396,548	\$3,225	\$48,223	\$3,336	\$3,280	\$(28,441)	

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

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Six months ended		Year ended
	June 30,	2009	December 31, 2009
	Unaudited		
Cash flows from operating activities:			
Net loss	\$(3,926)	\$(2,126)	\$ (1,081)
Adjustments required to reconcile net loss to net cash provided by (used in) operating activities:			
Income from discontinued operations	-	(63)	(4,216)
Depreciation and amortization	505	530	1,204
Loss (gain) on sale of property and equipment	(5)	71	268
Decrease (increase) in accrued interest and exchange differences on marketable securities, short-term and long-term bank deposits and long-term loans	(41)	(27)	2
Write-off of long term loan	-	-	319
Stock based compensation	551	180	698
Decrease (increase) in trade receivables, net	(779)	6,471	3,889
Decrease (increase) in unbilled accounts receivable	1,041	1,945	(582)
Decrease (increase) in other accounts receivable and prepaid expenses	(2,568)	226	1,984
Decrease (increase) in deferred income taxes	(41)	(43)	793
Decrease in inventories	455	436	3,888
Decrease in long-term trade receivables	147	4	95
Decrease in trade payables	(1,470)	(1,050)	(899)
Decrease in other accounts payable and accrued expenses	(1,171)	(1,770)	(1,640)
Increase (decrease) in customer advances	3,478	(406)	551
Accrued severance pay, net	9	43	378
Net cash provided by (used in) continuing operations	(3,815)	4,421	5,651
Net cash provided by (used in) discontinued operations	(17)	(410)	120
Net cash provided by (used in) operating activities	(3,832)	4,011	5,771
Cash flows from investing activities:			
Proceeds from sale of short-term bank deposits	1,800	-	1,316
Escrow deposit	-	-	920
Purchase of long-term deposits	(12)	-	(13)
Proceeds from sale of marketable securities	-	918	918

Proceeds from sale of property and equipment	5	31	64
Purchase of property and equipment	(182)	(928)	(2,025)
Purchase of know-how and patents	(31)	(15)	(27)
Pledged deposit	(2,963)	-	-
Proceeds from sale of subsidiary (b)	-	-	2,850
Net cash provided by (used in) continuing activities	(1,383)	6	4,003
Net cash used in discontinued operations	-	(13)	(15)
Net cash provided by (used in) investing activities	(1,383)	(7)	3,988

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

F - 7

MAGAL SECURITY SYSTEMS LTD.

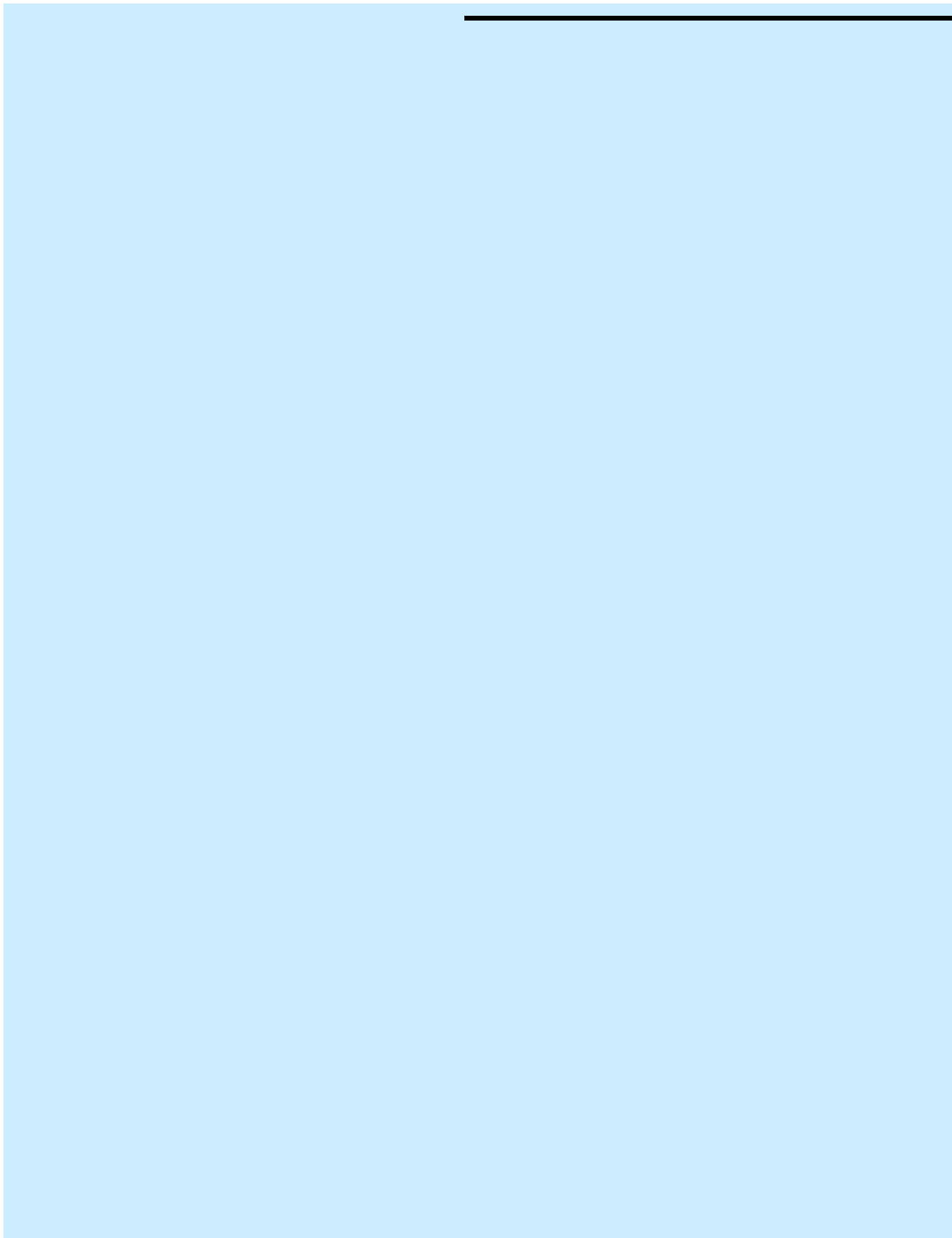
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Six months ended June 30, 2010		Year ended December 31, 2009
	Unaudited		
Cash flows from financing activities:			
Short-term bank credit, net	(517)	152	(14,533)
Proceeds from long-term bank loans	-	-	97
Principal payment of long-term bank loans	(1,485)	(314)	(829)
Net cash used in continuing operations	(2,002)	(162)	(15,265)
Net cash provided by discontinued operations	-	-	771
Net cash used in financing activities	(2,002)	(162)	(14,494)
Effect of exchange rate changes on cash and cash equivalents	116	(528)	(231)
Increase (decrease) in cash and cash equivalents	(7,101)	3,314	(4,966)
Cash and cash equivalents at the beginning of the period	11,869	16,835	16,835
Cash and cash equivalents at the end of the period	\$4,768	\$20,149	\$11,869
Supplemental disclosures of cash flows activities:			
Cash paid during the period for:			
Interest	\$217	\$455	\$881
Income taxes	\$116	\$270	\$431
(b) Proceeds of sale of subsidiary			
Working capital, net			\$(3,227)
Property and equipment			339
Accrued severance pay			(418)
Customer related intangible assets			2,614
Deferred taxes			(715)
Capital gain			4,257
			\$2,850

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



MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

- a. These consolidated financial statements have been prepared in a condensed format as of June 30, 2010 and for the six months then ended ("interim financial statements"). These consolidated financial statements should be read in conjunction with the Company's audited annual consolidated financial statements and accompanying notes as of December 31, 2009 and for the year then ended.
- b. Magal Security Systems Ltd. ("the Company") and its subsidiaries (together - "the Group") are engaged in the development, manufacture, marketing and sale of complex computerized security systems used to automatically detect and deter human intrusion for both civilian and military markets. The Group's systems are used in more than 75 countries around the world.
- c. The Company intends to complete a private placement of 150,000 of the Company's Ordinary shares to Ki Corporation Limited ("Ki Corporation"), a company owned by Mr. Nathan Kirsh, at an initial price per share equal to the closing price of the Company Ordinary shares on the NASDAQ Global Market on the date prior to the private placement. Upon the effective date of the rights offering, the price per share paid by Ki Corporation will be adjusted to the higher of the price per share in the rights offering and the closing price of the Ordinary shares on the NASDAQ Global Market on the date prior to the effective date of the rights offering. The private placement consideration to be received from Ki Corporation Limited will be paid to the Company by means of a partial offset against the outstanding principal amount due Ki Corporation under the bridge loan that it provided to the Company on September 8, 2010.
- d. The Company intends to file a registration statement with the U.S. Securities and Exchange Commission with respect to a rights offering to be made to holders of the Company's ordinary shares that are traded on the NASDAQ Global Market and the Tel Aviv Stock Exchange for a total amount of \$ 15,000. Shareholders who fully exercise their basic subscription rights will be entitled to subscribe for additional rights that remain unsubscribed as a result of any unexercised basic subscription rights. In addition, Mr. Nathan Kirsh, the Company's controlling shareholder and a director, has undertaken to exercise, directly or through entities owned by him, his basic subscription rights in full and his over-subscription rights in full, up to the total rights offering amount of \$ 15,000. The subscription rights will be denominated in dollars while the Company's functional currency is the NIS. Accordingly, on ASC 815-40 the subscription rights will be classified as a liability and marked to market at each reporting date with changes in the fair value of the liability recorded as finance expense or income in the Company's financial statements.
- e. On September 8, 2010, Ki Corporation, provided the Company with a \$ 10,000 bridge loan. If not repaid within six months, the bridge loan will accrue interest at the rate of LIBOR + 4% per year, calculated from the funding date. The term of the loan ends on January 10, 2012,

after which the Company will retain an option to extend the loan for a further 60 days. The interest will be paid together with, and in the same manner as, the principal, at the end of the term of the loan. The Company has undertaken to repay the bridge loan within five business days after the successful completion of the rights offering.

F - 9

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, marketable securities, short-term and long-term bank deposits, trade receivables, unbilled accounts receivable, long-term trade receivables and long-term loans.

Of the Company's cash and cash equivalents and short-term and long-term bank deposits at June 30, 2010, \$ 1,826 is invested in major Israeli and U.S. banks; \$ 1,675 is invested in RBC Royal Bank and approximately \$ 1,267 in other banks, mainly with Deutsche Bank and BBVA Bancomer. Cash and cash equivalents in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally, these deposits may be redeemed upon demand and therefore, bear low risk.

The short-term and long-term trade receivables of the Company, as well as the unbilled accounts receivable, are primarily derived from sales to large and solid organizations and governmental authorities located mainly in Israel, the United States, Canada, Mexico, and Europe. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection and in accordance with an aging policy. As of June 30, 2010, the Company's allowance for doubtful accounts amounted to \$ 884. During the six months ended June 30, 2009, no expenses related to doubtful accounts were recorded. During the six months ended June 30, 2010, we recorded \$348 of expenses related to doubtful accounts. In certain circumstances, the Group may require letters of credit, other collateral or additional guarantees. A loan granted to a third party is secured by a personal guarantee of the beneficial owner of the third party; however, management anticipates difficulties in the full repayment of the loan (see Note 12h in the December 31, 2009 financial statements).

The Company has no significant off-balance sheet concentration of credit risks, such as foreign exchange contracts or foreign hedging arrangements, except for derivative instruments (see Note 2w in the December 31, 2009 financial statements).

F - 10

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE INVENTORIES

3:-

	June 30, 2010 Unaudited	December 31, 2009
Raw materials	\$ 4,110	\$ 3,301
Work in progress	2,190	2,661
Finished products	3,875	4,950
	\$ 10,175	\$ 10,912

During 2009, and for the six months ended June 30, 2009 and 2010, the Company recorded inventory write-offs from continued operations in the amounts of \$ 1,391, \$ 262 and \$ 140, respectively. Such write-offs were included in cost of revenues.

NOTE 4:- SHORT-TERM BANK CREDIT

a. Credit lines:

	June 30 2010 Unaudited	December 31, 2009
Short-term bank credit	\$ 7,534	\$ 8,234
Long-term bank credit	877	2,372
Performance guarantees	4,572	4,572
	12,983	15,178
Unutilized credit lines approximate	3,357	12,069
Total authorized credit lines approximate	\$ 16,340	\$ 27,247

b. The Company's Canadian subsidiary has undertaken to maintain general covenants and the following financial ratios and terms in respect of its outstanding credit lines: a quick ratio of not less than 1.25; a ratio of total liabilities to tangible net worth of not greater than 0.75; and tangible net worth of at least \$ 9,000. As of June 30, 2010, the Company's subsidiary was in compliance with the ratios and terms.

F - 11

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5: COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalty commitments to the Office of the Chief Scientist of Israel's Ministry of Industry, Trade and Labor ("OCS"):

Under the research and development agreements between the Company and the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3%-4.5% of revenues derived from sales of products developed with funds provided by the OCS and ancillary services, up to an amount equal to 100% of the OCS research and development grants received, linked to the U.S. dollars plus interest on the unpaid amount received based on the 12-month LIBOR rate applicable to dollar deposits. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales no payment is required.

Royalties paid to the OCS amounted to \$ 172 for the year ended December 31, 2009, and \$ 11 and \$ 0 for the six months ended June 30, 2009 and 2010, respectively. As of June 30, 2010, the Company had remaining contingent obligations to pay royalties to the OCS in the amount of approximately \$ 1,212.

b. Royalty commitments to a third party:

During 2002, the Company entered into a development agreement for planning, developing and manufacturing a security system with a third party. Under the agreement, the Company agreed to pay the third party royalties based on a defined formula. Under this agreement, the Company also committed to purchase a certain volume of products at a minimum amount of approximately \$ 300 over 2.5 years after the achievement of certain milestones. As of June 30, 2010, royalty commitments under the agreement amounted to \$ 45.

c. In September 2006, the Company signed a non-exclusive agreement with a third party for the rights to use certain intangible assets such as know-how and patents for the production, sale and marketing of a perimeter security system based on fiber-optic lines that is used mainly to protect marine sites. The contract period was for two years and the Company exercised its right to extend the contract for an additional five years in September 2008. The consideration for the license is \$ 548, payable in 24 monthly installments. In addition, the Company agreed to pay royalties based on a defined formula.

In addition, the parties signed an agreement that grants the Company the rights to provide maintenance and support for the systems previously sold by the third party. The Company agreed to pay royalties based on a defined formula. No royalties were paid or accrued as of June 30, 2010.

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- COMMITMENTS AND CONTINGENT LIABILITIES
(Cont.)

d. Guarantees:

As of June 30, 2010, the Group obtained bank performance guarantees and advance payment guarantees and bid bond guarantees from several banks, mainly in Israel, in the aggregate amount of \$ 4,572.

e. Legal proceedings:

In May 2005, the Company entered into an agreement to supply comprehensive security solutions for a sensitive site in Eastern Europe. The Company commenced the project and delivered some of the equipment and other deliverables to the customer in 2005. In April 2006, the customer informed the Company that it was canceling the agreement due to errors in the design documents that the Company submitted. In addition, the customer did not make payments required under the agreement. The Company denied all of the allegations and the case was referred to arbitration.

On June 6, 2007, the Court of Arbitration in the Eastern European country issued its decision in the arbitration and stated that the agreement was void due to legal mistakes made by the customer in the tender process. Based on such decision, the Company decided to initiate a new legal action against the customer seeking compensation for the damages incurred. In March 2010, the Court of Arbitration determined that the customer is liable for certain expenses incurred by the Company in connection with the negotiation and execution of the agreement due to the customer's wrongful behaviour during the negotiations. In addition, the Court of Arbitration determined that the customer is liable for damages caused to the Company due to the customer's unjust enrichment resulting from its failure to pay for certain deliveries made by the Company. The Court of Arbitration's decision is subject to appeal. The scope of damages will be determined in future proceedings.

The Company is subject to legal proceedings arising in the normal course of business. Based on the advice of legal counsel, management believes that these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

f. Charges:

In January 2010, the Company approved a new credit arrangement and created in favor of the banks a first degree fixed charge over its unissued share capital and its goodwill and a first priority floating charge over its factory, business, and all of its assets and rights.

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- COMMITMENTS AND CONTINGENT LIABILITIES
(Cont.)

g. In October 2006, the Company signed an agreement with a third party who consults, markets and implements projects in the security field. According to the agreement, the parties agreed to cooperate in the development of the business of the third party during the first 12 months ("the agreement period").

The Company granted the third party a loan of \$ 600. The Company also agreed to provide the third party with additional monthly amounts to fund its activities during the agreement period, which will not exceed \$ 23 per month. The loan and the monthly amounts bear an annual interest rate of 5% and are to be repaid in October 2011.

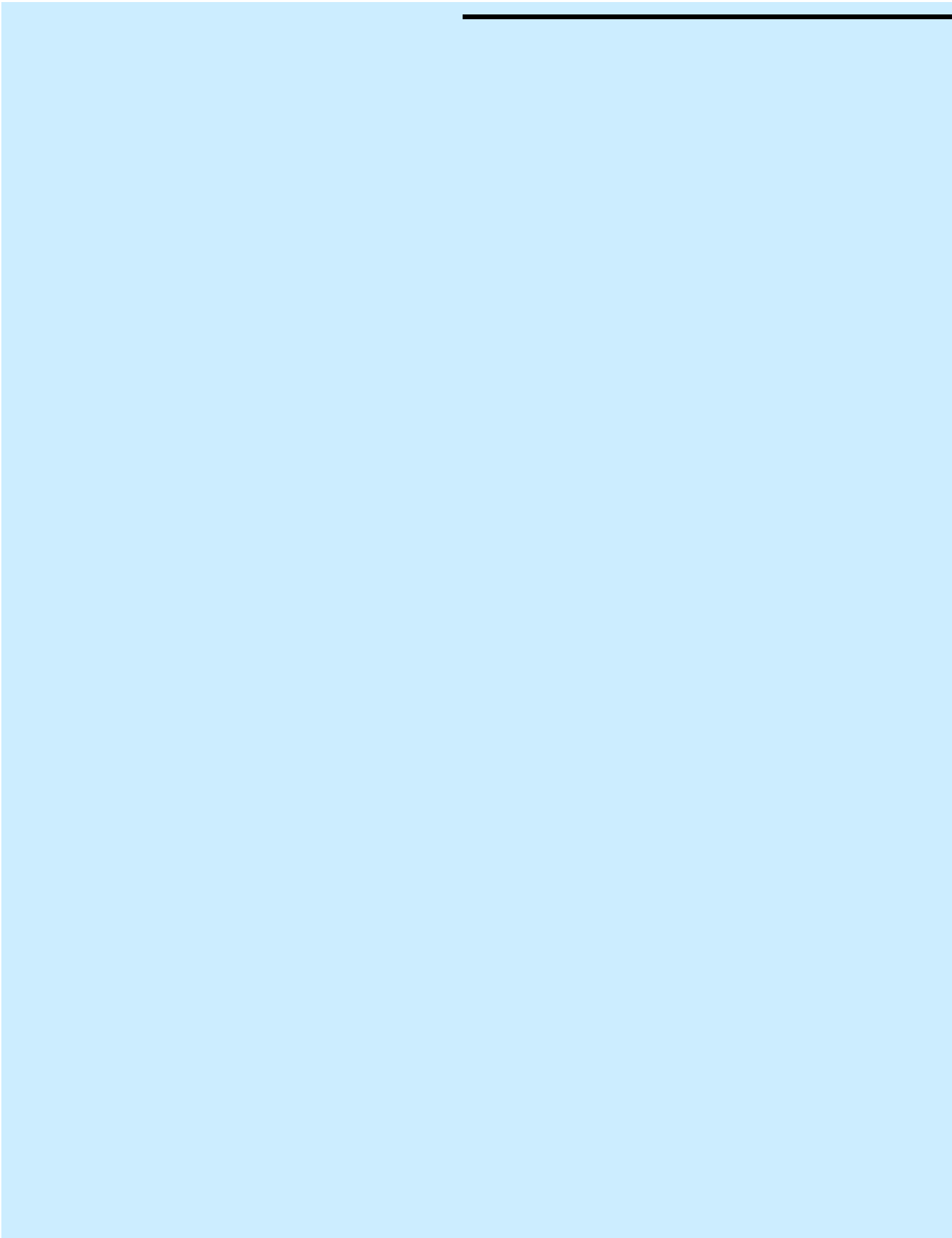
The Company evaluates the anticipated repayment of the loan annually. Due to anticipated difficulties in the implementation of the projects and based on ASC 310-10-35-3, "Loan Impairment" (formerly FAS 114, "Accounting by Creditors for Impairment of a Loan, an Amendment of FASB Statement No. 5 and 15"), management estimated that as at December 31, 2009, only \$ 200 of the loan will probably be repaid, and therefore recorded a provision. In the year ended December 31, 2009, the Company recorded a provision in the amount of \$ 319 related to this loan. For the six months ended June 30, 2010 and 2009, the Company did not record any provision.

h. The Company's subsidiary placed a restricted deposit against an advanced payment received by its customer in total amount of \$2,965.

NOTE 6:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

a. On December 31, 2007, the Company's then Chairman retired from his position. Pursuant to his retirement agreement as amended, the retired Chairman undertook not to compete with the Company for a period of three years following his retirement. In consideration, the Company agreed to pay the retired Chairman a one-time payment of \$ 360 payable within three months. In addition, the former Chairman is entitled to receive certain perquisites from the Company for the rest of his life. The liability as of June 30, 2010, and the special post benefit expense related to the retirement agreement amounted to \$ 622.

b. On November 10, 2008, the Company's former President and chief executive officer (hereinafter - the retired CEO) resigned. The retirement agreement entered into with the retired CEO provided for the payment of \$ 1,645, including consideration for a non-competition undertaking as well as severance payments and other retirement related payments in accordance with the retired CEO's retirement agreement and Israeli law.



MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)

c. In May 2008, one of the Company's major shareholders granted to the executive Chairman of the Board of Directions the right to purchase 100,000 shares, subject to the same terms and conditions that apply to the exercise of the options the executive Chairman received from the Company pursuant to his employment agreement. The employment agreement was approved in the Company's annual shareholders meeting on August 20, 2008. Consequently, the executive Chairman has the right to purchase the shares in three equal installments commencing on August 20, 2010 at a price of \$ 7.59 per share. The right to purchase each installment expires after three years. During 2009 and for the six months ended June 30, 2010, the Company recorded \$ 156, and \$ 60, respectively, in deferred stock compensation with respect to this grant.

NOTE 7:- SEGMENT INFORMATION

The Company adopted ASC 280, "Segment Reporting" (formerly SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information"). The Company operates in three major reportable segments, which represent the Company's operating segments as follows:

- a. Perimeter security systems – The Group's line of perimeter security systems consists of the following: Microprocessor-based central control units, taut wire perimeter intrusion detection systems, INNO fences, vibration detection systems, field disturbance sensors, and other.
- b. Security turnkey projects – The Group executes turnkey projects based on the Company's security management system and acts as an integrator.

F - 15

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- SEGMENT INFORMATION (Cont.)

c. The following data present the revenues, expenditures, assets and other operating data of the Company's operating segments:

	Six month ended June 30,				Year ended December 31,				Total
	2010 (unaudited)		2009 (unaudited)		2009				
	Perimeter	Project	Other	Total	Perimeter	Project	Other	Total	
Revenues	\$ 15,394	\$ 5,810	\$ --	\$ -	\$ 21,204	\$ 15,428	\$ 6,442	\$ --	\$ -
Operating income (loss), before financial expenses and taxes on income	\$(1,727)	\$(1,560)	\$ --	\$ -	\$(3,287)	\$(1,179)	\$(1,128)	\$ --	\$ -
Financial expenses, net					659				
Taxes on income (tax benefit)					(20)				
Income from discontinued operations, net					-				
Net loss					\$(3,926)				
Total long-lived assets	\$ 10,034	\$ 887	\$ -	\$ 10,921	\$ 9,877	\$ 963	\$ -	\$ 10,840	\$ 10,584

MAGAL SECURITY SYSTEMS LTD.

AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 8:- SUBSEQUENT EVENTS

In September 2010, the Company signed an agreement to sell the former premises of its U.S. subsidiary in California for \$ 2,175. The Company recorded a capital loss of approximately \$ 65 in respect to this sale.

F - 17

MAGAL SECURITY SYSTEMS LTD.
SUBSCRIPTION RIGHTS TO PURCHASE UP TO 4,854,369 SHARES

PROSPECTUS

You should rely only on the information incorporated by reference or provided in this prospectus. We have not authorized anyone to provide you with different information. We are not making any offer to sell or buy any of the securities in any state where the offer is not permitted. You should not assume that the information in this prospectus is accurate as of any date other than the date that appears below.

[Date of Prospectus]

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 6. Indemnification of Directors and Officers

Exculpation of Office Holders

The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his or her fiduciary duty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care in the event of distributions.

Insurance of Office Holders

Israeli law provides that a company may, if permitted by its articles of association, enter into a contract to insure its office holders for liabilities incurred by the office holder with a respect to an act performed in his or her capacity as an office holder, as a result of: (i) a breach of the office holder's duty of care to the company or another person; (ii) a breach of the office holder's fiduciary duty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that the act would not prejudice the company's interests; and (iii) a financial liability imposed upon the office holder in favor of another person.

Indemnification of Office Holders

Under Israeli law a company may, if permitted by its articles of association, indemnify an office holder for acts performed by the office holder in such capacity for (i) a monetary liability imposed upon the office holder in favor of another person by any court judgment, including a settlement or an arbitration award approved by a court; (ii) reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on him or her in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (iii) reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon the office holder by a court: in an action, suit or proceeding brought against the office holder by or on behalf of the company or another person, or in connection with a criminal action in which the office holder was acquitted, or in connection with a criminal action in which the office holder was convicted of a criminal offense that does not require proof of criminal intent.

Israeli law provides that a company's articles of association may permit the company to (a) indemnify an office holder retroactively, following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified; and (b) undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the

opinion of the company's board of directors, are, at the time of the undertaking, foreseeable due to the company's activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances.

Limitations on Exculpation, Insurance and Indemnification

The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exculpating an office holder from duty to the company shall be valid, where such insurance, indemnification or exculpation relates to any of the following: (i) a breach by the office holder of his fiduciary duty unless, with respect to insurance coverage or indemnification, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company; (ii) a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission done with the intent to unlawfully yield a personal benefit; or (iv) any fine or forfeiture imposed on the office holder.

II-1

Pursuant to the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our audit committee and board of directors and, if the office holder is a director, also by our shareholders.

Our Articles of Association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by Israeli law. We maintain a directors' and officers' liability insurance policy with a per claim and aggregate coverage limit of \$20 million, including legal costs incurred in Israel. In addition, our audit committee, board of directors and shareholders resolved to indemnify our office holders, pursuant to a standard indemnification agreement that provides for indemnification of an office holder in an amount up to \$5 million. To date, we have provided letters of indemnification to certain of our officers and directors.

Item 7. Recent Sales of Unregistered Securities.

During the preceding three years, we have offered and sold the following securities without registration under the Securities Act of 1933, as amended, or the Securities Act. We believe that the issuance of the securities was exempt from registration under the Securities Act in reliance on Regulation S under the Securities Act or pursuant to Section 4(2) of the Securities Act. No underwriter or underwriting discount or commission was involved in the following transaction.

Two days prior to the effective date of this rights offering, we intend to complete a private placement of 150,000 of our ordinary shares to Ki Corporation Limited, a company owned by Mr. Nathan Kirsh, at an initial price per share equal to the closing price of our ordinary shares on the NASDAQ Global Market on the date prior to the private placement. Upon the effective date of the rights offering, the price per share paid by Ki Corporation Limited will be adjusted to the higher of the price per share in the rights offering and the closing price of our ordinary shares on the NASDAQ Global Market on the date prior to the effective date of the rights offering, but in any event not less than the initial purchase price paid in the private placement. The private placement consideration from Ki Corporation Limited will be paid to us by means of a partial offset against the outstanding principal amount and any accrued interest (if any) under the bridge loan that it provided to us on September 8, 2010. The private placement was approved by our shareholders at an extraordinary general meeting held on August 12, 2010 as a private placement that intends to allow Mr. Kirsh and his affiliates to hold more than 25% of outstanding share capital.

Item 8. Exhibits

Exhibit No.	Description of Exhibit
	Memorandum of Association of the Registrant(1)
3.1	
3.2	Articles of Association of the Registrant(2)
3.4	Specimen of Ordinary Share Certificate(3)
4.1	Form of Subscription Rights Certificate to Purchase Rights for Ordinary Shares of Magal Security Systems Ltd.*
4.2	U.S. Subscription Agent Agreement*

- 4.3 Form of Instructions as to Use of Subscription Rights Certificates*
- 4.4 Form of Notice to Shareholders who are Record Holders*
- 4.5 Form of Notice to Shareholders who are Acting as Nominees*
- 4.6 Form of Notice to Clients of Shareholders who are Acting as Nominees*
- 4.7 Form of Beneficial Owner Election Form*
- 4.8 Form of Nominee Holder Certification*
- 4.9 Amended and Restated Term Sheet between the Registrant and Nathan Kirsh, originally entered into on July 20, 2010 and amended on September 6, 2010, and further amended on November 3, 2010
- 5.1 Opinion of S. Friedman & Co., Advocates*
- 23.1 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global
- 23.2 Consent of Consent of Salles, Sáinz - Grant Thornton, S. C. (relating to Senstar Stellar Latin America, S. A. de C.V.)
- 23.3 Consent of S. Friedman & Co., Advocates (contained in Exhibit 5.1)*
- 24.1 Power of Attorney (included in the signature page to the Registration Statement)

*To be filed by amendment.

- (1) Filed as an exhibit to our Registration Statement on Form F-1 (File No. 33-57438), filed with the Securities and Exchange Commission on January 26, 1993, as amended, and incorporated herein by reference.
- (2) Filed as an exhibit to our Registration Statement on Form F-1 (No. 33-57438), filed with the Securities and Exchange Commission on January 26, 1993, as amended, and incorporated herein by reference, as amended by an amendment filed as an exhibit to our Registration Statement on Form S-8 (File No. 333-6246), filed with the Commission on January 7, 1997 and incorporated herein by reference, and as further amended by an amendment filed as an exhibit to our Annual Report on Form 20-F for the fiscal year ended December 31, 2000, filed with the Securities and Exchange Commission on June 29, 2001 and incorporated herein by reference.
- (3) Filed as an exhibit to our Registration Statement on Form 8-A, filed with the Securities and Exchange Commission on March 18, 1993, as amended, and incorporated herein by reference.

Item 8. Undertakings

The undersigned Registrant hereby undertakes as follows:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933 (the "Securities Act");

(ii) To reflect in the prospectus any facts or events arising after the effective date of this Registration Statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in this Registration Statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20 percent change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the Registration Statement or any material change to such information in this Registration Statement.

Provided, however, that paragraphs (i), (ii) and (iii) above do not apply if the registration statement is on Form F-3 and the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed or furnished to the Securities and Exchange Commission by the Registrant pursuant to Section 13 or Section 15(d) of the Exchange Act that are incorporated by reference in this Registration Statement or is contained in a form of prospectus filed pursuant to Rule 424(b) that is part of the Registration Statement.

(2) That, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered that remain unsold at the termination of the offering.

(4) To file a post-effective amendment to the registration statement to include any financial statements required by Item 8.A of Form 20-F at the start of any delayed offering or throughout a continuous offering. Financial statements and information otherwise required by Section 10(a)(3) of the Securities Act need not be furnished, provided that the Registrant includes in the prospectus, by means of a post-effective amendment, financial statements required pursuant to this paragraph and other information necessary to ensure that all other information in the prospectus is at least as current as the date of those financial statements. Notwithstanding the foregoing, with respect to registration statements on Form F-3, a post-effective amendment need not be filed to include financial statements and information required by Section 10(a)(3) of the Act or Rule 3-19 of Regulation S-K if such financial statements and information are contained in periodic reports filed with or furnished to the Commission by the Registrant pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the Form F-3.

(5) Each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(6) That, for the purpose of determining liability of the registrant under the Securities Act to any purchaser in the initial distribution of the securities, the undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

- (i) Any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 424;
- (ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned Registrant or used or referred to by the undersigned registrant;
- (iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned registrant; and
- (iv) Any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

(8) Insofar as indemnification for liabilities arising under the Securities Act, may be permitted to directors, officers and controlling persons of the

Registrant, pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

II-4

SIGNATURES

Pursuant to the requirements of the Securities Act, the Registrant certifies that it has reasonable grounds to believe that it complies with all of the requirements for filing on Form F-1 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in Yehud, Israel, on December 21, 2010.

Magal Security Systems Ltd.

By: /s/ Eitan Livneh
Eitan Livneh
President and Chief
Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, each director and officer whose signature appears below constitutes and appoints, Jacob Perry and Ilan Ovadia, or either of these, his true and lawful attorney-in-fact and agent, with full power of substitution and re-substitution, to sign in any and all capacities any and all amendments or post-effective amendments to this registration statement on Form F-1, and to sign any and all additional registration statements relating to the same offering of securities of the Registration Statement that are filed pursuant to Rule 462(b) of the Securities Act, and to file the same with all exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, granting such attorney-in-fact and agent full power and authority to do all such other acts and execute all such other documents as he may deem necessary or desirable in connection with the foregoing, as fully as the undersigned may or could do in person, hereby ratifying and confirming all that such attorney-in-fact and agent may lawfully do or cause to be done by virtue hereof.

II-5

Pursuant to the requirements of the Securities Act, this registration statement has been signed below by the following persons in the capacities indicated on December 21, 2010.

Signature	Title
<i>/s/ Jacob Perry</i> Jacob Perry	Chairman of the Board of Directors
<i>/s/ Eitan Livneh</i> Eitan Livneh	President and Chief Executive Officer
<i>/s/ Ilan Ovadia</i> Ilan Ovadia	Chief Financial Officer and Principal Accounting Officer
<i>/s/ Jacob Even-Ezra</i> Jacob Even-Ezra	Director
_____ Nathan Kirsh	Director
<i>/s/ Shaul Kobrinsky</i> Shaul Kobrinsky	Director
_____ Zeev Livne	Director
<i>/s/ Jacob Nuss</i> Jacob Nuss	Director
<i>/s/ Liza Singer</i> Liza Singer	Director
<i>/s/ Barry Stiefel</i> Barry Stiefel	Director
Senstar Inc. By: <i>/s/ Brian Freeman</i> Name: Brian Freeman Title: President and Manager	Authorized Representative in the United States