

MAGAL SECURITY SYSTEMS LTD. AND ITS SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2002
IN U.S. DOLLARS

Table of Contents

Management's Discussion and Analysis	6 - 11
Report of Independent Auditors	13
Consolidated Balance Sheets	14 - 15
Consolidated Statements of Income	16
Statements of Changes in Shareholders' Equity	17
Consolidated Statements of Cash Flows	18 - 19
Notes to Consolidated Financial Statements	20 - 47

Management's Discussion and Analysis

General

The Company's financial statements are denominated in US dollars.

Management considers the US dollar to be the primary currency in which the company operates and therefore, uses the US dollar as its functional currency.

During 2001 Magal established a new company, Smart Interactive Systems, Inc. (SIS), in New York, to participate in the new and growing market for real time video monitoring security services targeted at the higher-margin commercial, industrial and VIP residential market. Consequently, results for the period, were negatively impacted by the ramping up of operations of this new venture. However, SIS is performing in line with Magal's management expectations and it is expected to reach breakeven by the end of the year 2003.

Results of Operations

The following five-year summary presents financial highlights as a percentage of company's revenues:

Year Ended December 31,	2002	2001	2000	1999	1998
Revenues	100%	100%	100%	100%	100%
Cost of revenues	56	52	53	53	52
Gross Profit	44	48	47	47	48
R & D expenses, net	7	8	8	8	7
Selling & marketing expenses	20	19	18	18	18
General & Administrative expenses	11	12	12	13	14
Operating income	6	9	9	8	9
Financial income (expenses), net	--	--	(1)	--	(1)
Income before taxes and write-off of investment in affiliate	6	9	8	8	8
Taxes on income	2	1	1	1	1
Write-off of investment in affiliate	--	--	--	1	--
Net income (loss)	4%	8%	7%	6%	7%

Comparison of 2002 to 2001 and 2000

Revenues. The company's revenues were US\$ 43.0 million, US\$ 41.0 million and US\$ 38.6 million in 2002, 2001 and 2000 respectively, an increase of 5% in 2002 as compared to 2001 and an increase of 6% in 2001 as compared to 2000.

Perimeter Systems. Revenues of perimeter systems were US\$ 36.4 million, US\$ 34.9 million and US\$ 33.9 million in 2002, 2001 and 2000 respectively, an increase of 4% in 2002 as compared to 2001 and 3% in 2001 as compared to 2000.

Gross Profit. Gross profit in the year ended December 31, 2002 was US\$ 19.0 million, compared to US\$ 19.5 million and US\$ 18.0 million in 2001, and 2000, respectively. The gross profit margin was 44.3%, 47.6% and 46.8% in 2002, 2001 and 2000, respectively.

Research and Development Expenses. Net research & development expenses were US\$ 3.1 million, US\$ 3.1 million and US\$ 3 million in 2002, 2001 and 2000, respectively. R&D grants and credits in 2002 were US\$ 0.6 million compared to US\$ 0.3 million and US\$ 0.2 million in 2001 and 2000.

Selling, General and Administrative Expenses. SG&A expenses were US\$ 13.6 million, US\$ 12.9 million and US\$ 11.8 million in 2002, 2001 and 2000, respectively, representing 31.6%, 31.4%, and 30.6%, of revenues, respectively.

Operating Income. Operating income for 2002 decreased 35% to US\$ 2.3 million, compared with US\$ 3.6 million in 2001. Excluding the impact of SIS, operating income for the year decreased by 7% to US\$ 3.9 million, compared with US\$ 4.2 million in 2001. In 2001 operating income increased 9% to US\$ 3.6 million compared with US\$ 3.3 million in 2000.

Net Income. Net income for the year 2002 decreased 40% to US\$ 1.9 million compared with US\$ 3.2 million in 2001. Excluding losses generated by SIS, net income for the year decreased by 11% to US\$ 3.4 million, compared to US\$ 3.8 million in 2001. In 2001 net income increased 10% to US\$ 3.2 million compared with US\$ 2.9 million in 2000.

Quarterly Results of Operations

The following table presents unaudited consolidated quarterly financial information for each of the four quarters for the year ended December 31, 2002. This information has been prepared on the same basis as the audited consolidated financial statements.

(US Dollars in thousands, except per share data)					
	Q1	Q2	Q3	Q4	FY
Revenues	9,466	10,653	9,485	13,362	42,966
Cost of sales	5,172	5,738	5,226	7,788	23,924
Gross profit	4,294	4,915	4,259	5,574	19,042
% Gross profit	45.4%	46.1%	44.9%	41.7%	44.3%
Operating Expenses :					
R & D - net	703	723	850	852	3,128
Selling expenses	1,760	2,279	1,984	2,619	8,642
G & A expenses	1,136	976	1,171	1,655	4,938
	3,599	3,978	4,005	5,126	16,708
Operating income	695	937	254	448	2,334
Financial income (expenses), net	100	71	109	(81)	199
Income before taxes	795	1,008	363	367	2,533
Taxes on income	195	298	144	8	645
Net income	600	710	219	359	1,888
no. shares (diluted)	7,628	7,876	7,840	7,763	7,834
EPS (diluted)	0.08	0.09	0.03	0.05	0.24

The company's operating results may be subject to significant fluctuations in future periods. The company's operating results for any particular quarter are not necessarily indicative of any future results. The company's quarterly operating results may be subject to significant fluctuations due to various factors, including the length of the sale cycles, the timing and size, mix of products and general economic conditions.

Liquidity and Capital Resources

Since our inception, and 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 raised a net total of US\$ 9,837,000 from an initial public offering of 1,380,000 ordinary shares. In February 1997, we raised an additional US\$ 9,440,000 from an offering of an additional 2,085,000 ordinary shares. The proceeds from these offerings are our main source of working capital.

We currently have credit lines totaling US\$ 24 million in the aggregate. There are no restrictions as to our use of each of these credit lines. Our borrowings under these credit lines are generally denominated in U.S. dollars. However, we may occasionally have short-term NIS-denominated borrowings.

As of December 31, 2002, we had approximately US\$ 4.0 million available under our credit lines.

Working capital for the year ended December 31, 2002 was US\$ 15,827,000, compared to US\$ 18,391,000 for the year ended December 31, 2001, and a current ratio of 1.9.

Cash and cash equivalents (including bank deposits) amounted to US\$ 14,876,000 at December 31, 2002, compared to US\$ 14,587,000 at December 31, 2001.

We used net cash from operations of US\$ 2,574,000 for the year ended December 31, 2002, compared to US\$ 368,000 for the year 2001 and net cash generated from operations of US\$ 4,552,000 for the year ended December 31, 2000.

Purchase of property and equipment in 2002, 2001 and 2000 were US\$ 1,459,000, US\$ 1,158,000 and US\$ 3,828,000, respectively. Capital expenditures in 2001 and 2002 were principally for acquisition of equipment for SIS. Capital expenditures in 2000 were principally for PPI's acquisition of its new facility in Fremont.

We believe that our current cash and cash equivalents, including bank deposits, and our expected cash flow from operations in 2003 will be sufficient to meet our planned and potential cash requirements in 2003.

Total assets as of December 31, 2002 amounted to US\$ 59.7 million.

Shareholder's equity at year end reached US\$ 35.0 million compared to US\$ 32.7 million at December 31, 2001 representing 59% of total assets and a bank debt-to-equity ratio of 0.43.

Seasonality

The company's operating results are characterized by a seasonal pattern, with a higher volume of sales towards the end of the year. This pattern, which is expected to continue, is mainly due to two factors: first, the company's customers are mainly budget-oriented organizations with lengthy decision processes which tend to mature late in the year; second, due to weather conditions, installations - and therefore revenues - are often postponed from the first quarter to following quarters.

Dividend Information

In 1998, our board of directors resolved to change our dividend payment policy and to recommend to our shareholders the payment of annual dividends on our ordinary shares amounting to between 25% and 33% of our net profits for the previous fiscal year. The board of directors recommended this policy change because we had accumulated sufficient cash and our operations had been generating a positive cash flow.

In each of 1999 and 2000, our board of directors recommended, and our shareholders approved, the payment of a cash dividend to our shareholders of \$0.10 per ordinary share, representing approximately 32% of our net income before writing off the investment in our affiliate in each of 1998 and 1999. In 2001, our board of directors recommended, and our shareholders approved, the payment of a cash dividend to our shareholders of US\$0.13 per ordinary share, representing approximately 33% of our net income in 2000.

In May 2002, our board of directors recommended a stock dividend of 3% of the issued shares.

Impact of Inflation and Devaluation on Results of Operations, Liabilities and Assets

The dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is not offset, or is offset on a lagging basis, by a devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, companies experience increases in the dollar cost of their operations in Israel. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our profitability, as we receive payments in dollars or dollar-linked NIS for most of our sales, while we incur a portion of our expenses in NIS.

In addition, since part of our sales are quoted in NIS, and a portion of our expenses are incurred in NIS, our results may be adversely affected by a change in the rate of inflation in Israel if the amount of our revenues in NIS decreases and is less than the amount of our expenses in NIS (or if such decrease is offset on a lagging basis) or if such change in the rate of inflation is not offset, or is offset on a lagging basis, by a corresponding devaluation of the NIS against the dollar and other foreign currencies.

The following table presents information about the rate of inflation in Israel, the rate of devaluation of the NIS against the dollar, and the rate of inflation in Israel adjusted for the devaluation:

Year Ended December 31,	Israeli inflation rate %	NIS devaluation rate %	Israeli inflation adjusted for devaluation %
1998	8.6	17.6	(9.0)
1999	1.3	(0.1)	1.3
2000	0	(2.7)	2.7
2001	1.4	9.3	(7.9)
2002	6.5	7.3	(12.3)

A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities which are payable in NIS, unless those expenses or payables are linked to the dollar. This devaluation also has the effect of decreasing the dollar value of any asset which consists of NIS or receivables payable in NIS, unless the receivables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of any unlinked NIS assets and the dollar amounts of any unlinked NIS liabilities and expenses.

Because exchange rates between the NIS and the dollar fluctuate continuously, with a historically declining trend in the value of the NIS, exchange rate fluctuations, particularly larger periodic devaluations, may have an impact on our profitability and period-to-period comparisons of our results. During 2002, foreign currency fluctuations did not have a material adverse impact on our results of operations. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

We periodically enter into foreign exchange contracts to offset the risk of currency exchange rate fluctuations in connection with certain sales and purchase transactions. During 2002 we did not enter into any such contracts and as of December 31, 2002, we had no derivative financial instruments.

Report of Independent Auditors

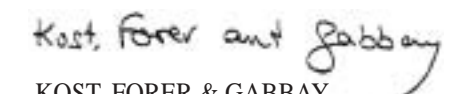
To the Shareholders of
MAGAL SECURITY SYSTEMS LTD.

We have audited the accompanying consolidated balance sheets of Magal Security Systems Ltd. ("the Company") and its subsidiaries as of December 31, 2001 and 2002, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain wholly owned subsidiaries, which statements reflect total revenues of 11.4% of total consolidated revenues for the year ended December 31, 2000. Those statements were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those subsidiaries, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2001 and 2002, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel
February 10, 2003


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