

SAPIENS INTERNATIONAL CORPORATION N.V. AND ITS SUBSIDIARIES

Annual Report 2000

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Letter to Our Shareholders

Dear Shareholders,

In this first letter to you, the shareholders, as the head of the new management team at Sapiens, I would like to briefly review the problems encountered in 2000, but more importantly, I want to outline for you the recovery plan we are implementing for the Company and our business goals for the year ahead.

2000 was a difficult year for Sapiens. Management had announced that 2000 would be a transition year for the Company as Sapiens sought to replace its Y2K line of business with new areas of growth in addition to its traditional solution offerings. This transition was harder than expected, compounded by both global and internal events. The Company suffered from external factors, such as the industry-wide slowdown in business volume and the sharp decline in the euro currency rate. Internally, much of management's attention was focused on the failed merger with Ness Technologies rather than on confronting the acute market issues. To further complicate the problem, Sapiens' cost base grew out of proportion relative to its current revenue generating capabilities, primarily due to heightened delivery requirements in some of our euro conversion projects and the Company's B2B initiative through its eZoneX subsidiary. As a result, the Company recorded a net loss of \$38.2 million for the year compared with net income of \$13.1 million in 1999 on revenues of \$72.7 million compared with \$91.8 million in 1999.

Since assuming managerial responsibilities for Sapiens in December of last year, the new management team has initiated a focused and aggressive recovery program for the Company. We have set for ourselves an aggressive target of restoring Sapiens to profitability by Q4 of 2001.

The recovery plan aims to achieve this goal by leveraging four key assets of the Company:

- our core technologies;
- our key technical staff;
- our operational sales force; and
- our blue-chip customer base.

Our rules-based object technologies, continues to serve as the heart of vibrant software development and reengineering solutions that we uniquely provide to large-scale organizations worldwide. The key to maintaining our leading-edge in this highly competitive technology field remains our professional staff. I am pleased to report that despite our short-term problems, we have succeeded in retaining our highly skilled programmers and technical consultants.



Yitzhak Sharir
President and
Chief Executive Officer

Letter to Our Shareholders

We also have been able to strengthen and expand - not only maintain - our premier customer base and strategic partnerships. The successful launch of our Sapiens eMerge™ solution attracted a number of new customers. In the US, Media Services (a division of Time Warner), New Jersey Manufacturers, and Surplus Line Association of California. In France, we now include customers such as 3M, which is actually a pan-European customer, Groupe Andre, La SMABTP and Air France. In the UK we expanded our client list to include prestigious names such as Barclays, Bank of Ireland, Lloyds TSB, Prudential and Argos.

We also won significant new projects within our installed base of customers. These include projects with insurance companies such as Liverpool Victoria and AXA UK, and supply chain projects with companies such as Fun-Tees (US) and Media Services. Our strategic partnership with IBM, particularly in the U.S.A, expanded in the year 2000. Sapiens achieved the highest level of Certification on IBM's e-Business Application Framework and was also designated a Premier Partner in IBM's PartnerWorld for Developers. This strategic partnership allows Sapiens to broaden the market for its own solutions, gain access to specific types of domain expertise, and adapt our technologies and offerings more broadly.

Looking ahead into 2001, we believe that Sapiens is well-positioned to capitalize on corporate needs in the current business environment. The difficult market conditions facing the technology sector, in parallel to the overall economic slowdown, may create the need for the kinds of solutions that we provide for two important reasons. First, as large companies are forced to cut back on major capital investment, we anticipate a greater need to upgrade and/or migrate legacy systems. Second, as companies cut back on personnel, we expect a greater need to outsource maintenance and other IT functions to specialized external consultants. Sapiens' software solutions and services, offered through four business lines (eMerge application development, Migrations, Outsourcing and IT Services), enable customers in all industries to capitalize on their existing IT assets and staff, while meeting new business demands.

- **eMerge Application Development** is our primary business line. It includes rapid application development and reengineering, comprehensive application integrations, legacy renewal and creative front-end Web exposure. Our eMerge offering also features asset discovery - a global operational platform to assess, plan, carry out and manage all of the enterprise's IT solutions and to assess inter-system and intra-system impacts.
- Sapiens' **migration solutions** assist customers in adapting their IT legacy systems to externally imposed changes, such as the advent of the Internet, or new regulatory or currency requirements (e.g. euro conversion), or internal upheavals such as mergers, acquisitions or new business models. Sapiens' established migration methodologies are used in conjunction with the Company's platform-independent technologies, while our project management experience and asset discovery solution play a major role in the migration of customers' mission-critical systems.

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- In the role of providing **outsourcing services**, Sapiens can play the part of an internal IT team for ongoing IT functions such as application maintenance. Outsourcing projects can be performed either on or off the customers' premises and, again, there is an important role here for Sapiens' asset discovery solution, which contributes to the ongoing maintenance and management of an enterprise's IT environment.
- In performing **specialized IT services**, such as project management and technical assistance, Sapiens works together with the customer for the duration of the entire project, collectively undertaking design, development and deployment tasks, coupled with hands-on-training to achieve a rapid software solution to the customer's business and IT goals.

I am pleased to report that we have successfully completed the initial phase of our recovery plan. More specifically, we are restructuring our organization to reduce costs, improve deliveries and streamline operations. During the last quarter of 2000 and first quarter of 2001, we reduced the number of total personnel by approximately 20% and lowered overhead costs in all areas, including office rental, travel, communications and car leasing expenses. We have closed offices in Brazil and Australia and re-aligned our offices in Germany and Spain, while cutting costs worldwide to significantly improve operational efficiencies. Of course, our existing customers in those territories, in which we closed or re-aligned our offices, will continue to get full support from our global operations. We have also closed the operations of eZoneX Inc.

In addition to the emphasis on cost reduction, we have also introduced tighter managerial controls. We have now successfully instituted monthly managerial reporting systems, as well as pricing and operating margin controls for long-term projects.

A key part of the initial phase of the recovery program was raising additional working capital in order to finance the recovery plan. As previously announced, an investor group, including Yarnfield International Ltd., an affiliate of the Magnum Technologies Fund, and The Formula Group, invested \$15 million in exchange for convertible preferred stock. This capital raising transaction demonstrates a strategic as well as financial commitment by long-term investors who have a deep understanding of our industry. It acted as a strong vote of confidence in our future and a necessary part of our recovery plan. In addition to the funds from the private placement, the Company's principal lenders, Bank Leumi and Bank Hapoalim have extended the Company's credit lines by an additional \$10 million - another vote of confidence, which gives us added financial resources to implement and execute our plan.

Having placed our short-term difficulties in a longer-term perspective, and described our progress in the recovery plan, I would like to introduce myself and our new management team.

Letter to Our Shareholders

I joined Sapiens in November 2000 with experience in leading companies to profitability and growth. I led the growth of Nilit Industries from 1994 through 2000, during which time the company achieved worldwide market recognition and annual revenues grew steadily to reach approximately \$160 million. Prior to joining Nilit, I led a comprehensive turnaround of Orlite Industries from 1990 through 1994. I come from an engineering background where my experience includes managing engineering teams at Israel Aircraft Industries and Israel's Nuclear Research Center.

Joining me as our new CFO is Yuval Hadari, who comes to us with broad experience in the area of finance and administration. Yuval's experience includes positions as VP Finance and CFO of Nilit Ltd. from 1996 to the present and CFO of Scitex Europe S.A. from 1991 through 1995.

Amos Shattner, who has joined us as our EVP Technologies and Operations, has wide-ranging experience in management of information systems, marketing and sales and finance. Amos most recently served as CEO of Varicom Communications, an Israeli start-up in the telecom industry.

Yuval and Amos join Jacob Sivan in his new global role as EVP Marketing and Sales, Haim Zysberg as Chief Technology Officer, and Steve Kronengold, our General Counsel, to form Sapiens' new executive management team. Together with our regional heads -- Gil Arbel, VP for the Americas, Yair Spitzer, VP UK, Saadia Essoudry, VP France, Yechiel Gepner, VP Israel, and Ruvik Barkan, VP Sales and ROW -- the global management team is initiating not only tighter cost controls, but also aggressive sales initiatives as a core element of the recovery program.

In summary, having successfully completed the first phase of our recovery plan and with significant business opportunities on the horizon, the new management team looks forward with confidence and optimism. Sapiens remains a fundamentally sound company that is experiencing short-term difficulties, but has very attractive upside opportunity. Our accumulated assets form a solid foundation for recovery and future growth.

On behalf of the entire management team I want to thank you for your continued commitment and confidence in our ability to restore Sapiens back to growth and profitability. At this time next year, I hope to present a report of a different nature.



Yitzhak Sharir

President and Chief Executive Officer

Management Discussion and Analysis of Financial Condition and Results of Operations

The following management's discussion and analysis of financial condition and results of operations should be read in conjunction with our financial statements and notes thereto. Certain matters discussed below and throughout this annual report are forward-looking statements that are based on our beliefs and assumptions as well as information currently available to us. Such forward-looking statements may be identified by the use of the words "anticipate", "believe", "estimate", "expect", "plan" and similar expressions. Such statements reflect our current views with respect to future events and are subject to certain risks and uncertainties. While we believe such forward-looking statements are based on reasonable assumptions, should one or more of the underlying assumptions prove incorrect, or these risks or uncertainties materialize, our actual results may differ materially from those described herein. Please read the section below entitled "Risk Factors" to review conditions that we believe could cause actual results to differ materially from those contemplated by the forward-looking statements.

RESULTS OF OPERATIONS

Revenues. Total revenues in 2000 decreased 21% to \$72.7 million from \$91.8 million in 1999, and \$71.0 million in 1998. Product revenues decreased 19% in 2000 to \$38.4 million, after increasing 27% in 1999 and 81% in 1998. Consulting and other service revenues decreased 23% to \$34.3 million from \$44.4 million in 1999, and increased 2% from \$33.8 million in 1998.

The major areas of decline in revenues were as follows: France decreased 37.1% to \$16.6 million in 2000 from \$26.4 million in 1999. Germany decreased 41.1% to \$6.3 million in 2000 from \$10.7 million in 1999. In North America revenues decreased 41.7% to \$15.1 million in 2000 from \$25.9 million in 1999. In contrast, Sapiens UK revenues increased by 42.7% to \$17.7 million in 2000 from \$12.4 million in 1999.

Our revenues for the year ended December 31, 2000 were adversely affected by the following significant factors and events:

- Our European operations generated 70% of the Company revenues for the year 2000. These revenues were materially affected by adverse euro dollar exchange rates during the year 2000 as compared with 1999. In dollar terms, the negative impact on our revenues was in the range of six to seven percent.
- We expect that a significant portion of our revenues will continue to be denominated in European currencies, mainly the Euro and the GBP, and some of our revenues will be denominated in the Japanese yen. As a result, movements in the exchange rates between the US dollar and the Euro and/or the US dollar and the Japanese yen could have a material unfavorable impact on our revenues and results of operations.
- Beginning with the second quarter of the year 2000, our entire operation, including significant management attention, was focused on the achievement of a planned merger with Ness Technologies, Inc. The distraction caused by the merger preparations and the cancellation of the merger had a material negative impact on

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our operating results for 2000, particularly in the second half of the year.

- Our operations experienced significant growth resulting from Y2K project revenues during the 1998 and 1999 fiscal years. With the conclusion of Y2K projects in the beginning of the year 2000, the Company experienced a tougher-than-expected transition away from this significant source of revenues.
- In addition, our business, which is focused on large-scale, business critical solutions, was adversely affected by the general slowdown that impacted the entire software industry in the second half of the year 2000.

Gross Profit. Gross profit decreased 55% to \$20.6 million from \$46.1 million in 1999 and \$36.7 million in 1998. Gross margin was 28.3% in 2000 down from 50.2% in 1999 and 51.7% in 1998. Product revenue gross profit decreased 59% in 2000 to \$12.7 million from \$31.0 million in 1999; product gross margin was 33.0% in 2000 compared with 65.4% in 1999.

The decline in gross profit, which occurred mainly during the second half of the year 2000, was due primarily to the following factors:

- We were engaged in a number of large-scale, fixed-price euro migration projects in our effort to transition away from Y2K project revenues. Due to the larger-than-expected demands of these euro migration projects, including technical obstacles in deliveries, and our service-oriented commitment to our customers, we dedicated additional resources and in some instances hired outside consultants in order to meet the project delivery milestones. These unanticipated costs had a material impact on our profit margin during the second half of the year 2000.

Gross profits from consulting and other services decreased 47.7% to \$7.9 million in 2000 from \$15.1 million in 1999. Gross margins from consulting and other services declined in 2000 to 23.0% from 34.0% mainly due to higher fixed cost of consultants, lower utilization and the use of subcontractors and subcontracting companies. We believe that gross margins from consulting and other services should improve in the future. In addition, changes in the relative mix of product revenues and consulting and other services revenues may affect total gross margin in the near future.

Research and Development. Research and development before capitalization of software development costs and royalty-bearing grants increased 35% in 2000 to \$13.4 million from \$9.9 million in 1999, and \$9.1 million in 1998. The increase in research and development gross expenditures resulted from the Company's significant investment in its B2B initiative through its new subsidiary eZoneXchange and other labor-related costs. In addition, research and development costs increased materially due to the need to retain software engineers in highly competitive market conditions together with the consistent efforts to upgrade technology and tools.

Net research and development expenditures rose 82% in 2000 to \$9.1 million from \$5.0 million in 1999, and \$4.1 million in 1998. A portion of our research and development expenditures is funded by the Office of the

Management Discussion and Analysis of Financial Condition and Results of Operations

Chief Scientist ("OCS") in Israel pursuant to programs entitling the Government to receive royalties on sales of products developed as a result of research projects so funded. Due to the late approval of the R&D grant in the year 2000, the Company did not record any R&D funding in 2000 compared with \$2.0 million (20.6% of gross R&D expenditures) in 1999. We expect to receive funding from the OCS during the year 2001. Royalty expense pursuant to the OCS funding programs, included in cost of products, was \$1.3 million and \$1.1 million in 2000 and 1999, respectively.

Capitalized software development costs amounted to \$4.3 million in 2000 compared with \$2.8 million in 1999. Amortization of capitalized software development costs, included in cost of products, was \$3.2 million in 2000 and \$2.8 million in 1999.

We believe that a significant level of investment for research and development is essential for us to maintain our competitive advantage and to achieve our long-term business objectives.

Selling, General and Administrative expenses. Selling, general and administrative expenses increased 67% to \$46.7 million in 2000 from \$27.9 million in 1999 and \$22.9 million in 1998. Expressed as a percent of revenues, selling, general and administrative expenses increased to 64% in 2000 from 30% in 1999. The increase in selling, general and administrative expenses in 2000 was due mainly to the significant expansion of our direct operations both in labor and infrastructure in Europe (mainly Germany, the Netherlands and Spain) and the Pacific (Australia, Japan, Hong Kong and Thailand). The expansion of our infrastructure in these areas did not generate additional revenues in the same period. In addition, the Company engaged in promotional activities related to the launch of the Sapiens eMerge e-business solution offerings, and product-marketing efforts related to our Internet initiative. At the end of the year 2000 the Company implemented significant cost-cutting measures to decrease general and administrative expenses. Such efforts will continue during 2001.

Restructuring Charges. We recorded a restructuring charge in the amount of \$2.6 million, which represents involuntary termination benefits for approximately 200 employees as part of our recovery plan for the year 2001. The restructuring plan is aimed to streamline the Company and improve gross margins by reducing SG&A costs. We will continue to reduce our operating costs, as necessary, with a target of achieving profitability by the fourth quarter of 2001.

In 1999, the Company recorded restructuring charges of \$2,019. The restructuring cost consists of employee termination benefits associated with the involuntary terminations of 40 employees. The involuntary terminations result from the change in the Company's strategy to focus on e-business and Internet-related technologies.

On September 17, 2000, the Company announced that it had agreed to merge with Ness Technologies, Inc. On November 14, 2000, the Company announced that the planned merger would not occur. The Company incurred merger costs of \$1.3 million, consisting mostly of fees for professional services.

Management Discussion and Analysis of Financial Condition and Results of Operations

Taxes on Income. The net tax benefit was \$1.9 million in 2000 compared with net tax benefit of \$1.7 million in 1999, and a net tax expense of \$55 thousand in 1998. The tax benefit in 2000 reflects the reduction of a portion of the valuation allowances recorded by certain of our foreign subsidiaries due mainly to the actual or expected realization of the underlying deferred tax assets. We will continue to evaluate our ability to realize deferred tax assets on a regular basis.

Net Income/Loss. Net loss for 2000 reached \$38.1 million compared with net income of \$13.1 million in 1999 and \$9.7 million in 1998. Preferred stock dividends in 2000 were \$0.1 million compared with \$0.4 million in 1999. We do not anticipate any additional dividend payments in the future due to the full conversion of all outstanding preferred shares which required the payment of dividends.

Liquidity and Capital Resources

The Company incurred significant operating losses and negative cash flow from its operations during the year ended December 31, 2000. While management is implementing a recovery plan designed to restore the Company to profitability by the fourth quarter of 2001, we will continue to incur losses and negative cash flows through most of 2001. You should refer to “Risk Factors - We incurred substantial losses in the year 2000 and there can be no assurance that we will attain and sustain profitable operations” for a discussion of the risks related to our operating losses and negative cash flow. You should also refer to “Risk Factors - The terms of our bank debt contain a number of restrictive covenants which, if breached, could result in acceleration of our obligation to repay our debt” for a discussion of the risks related to our credit facilities.

Cash, cash equivalents and short term investments at the end of 2000 were \$19.9 million compared with \$16.8 million at the end of 1999. Approximately \$2.5 million of our short-term investments were pledged as collateral for certain short-term debt compared with \$2.3 million at the end of 1999.

Net cash used in operations was \$21.1 million in 2000 compared with breakeven net cash used in operations in 1999 and with net cash provided by operations of \$17.6 million in 1998. The decrease in 2000 was due primarily to the net loss partially offset by the increase in payables to suppliers and other liabilities. Net cash used in investing activities was \$3.7 million in 2000, \$4.2 million in 1999 and \$7.3 million in 1998.

Net cash provided by financing activities totaled \$33.4 million in 2000 compared with net cash used in financing activities of \$7.0 million in 1999 and \$0.1 million in 1998. The increase in 2000 was due to a private placement of \$15.0 of common shares of eZoneXchange.com (\$14.6 million net of expenses), an increase in short-term borrowings and the initial payment of \$5.0 million as part of the \$15.0 million private placement of the Company’s Series F Preferred, described below.

Management Discussion and Analysis of Financial Condition and Results of Operations

On December 25, 2000, the Company entered into an agreement with Yarnfield International Limited, an affiliate of the Magnum Technologies Fund, and Formula Systems (1985) Ltd., pursuant to which they agreed to invest \$15 million in the Company in return for convertible preferred shares to be issued by the Company. According to the terms of the private placement, the preferred shares, which have a three-year term of maturity, may be converted into common stock at \$1.50 per common share. The conversion price is subject to adjustment but will not be adjusted to a price below \$1.00 per common share. Other key terms of the transaction include the investors' three-year option to invest an additional \$15 million on the same terms as the current transaction. The investors will also be entitled to nominate two representatives to the Company's Board of Directors, subject to shareholder approval at the annual general meetings of shareholders. The Company's shareholders approved the private placement transaction at a special meeting of shareholders held on February 22, 2001, and the transaction closed on March 6, 2001.

We believe that available working capital and credit lines will be sufficient for the next 12 months to support our operating requirements. The Company may consider other financing alternatives to finance strategic goals and future growth.

Risk Factors

We operate globally in a dynamic and rapidly changing environment that involves numerous risks and uncertainties. The following section lists some, but not all, of those risks and uncertainties that may have a material adverse effect on our business, financial condition or results of operations.

We incurred substantial losses in the year 2000 and there can be no assurance that we will attain and sustain profitable operations.

The Company incurred significant losses from operations in the year 2000 and has adopted a recovery plan intended to achieve profitability. Material components of the turn-around plan include (1) a sharpening of the Company's product and market focus; (2) reduction of expenses and workforce; and (3) restructuring of the Company's operations.

While the Company believes that it has the ability to implement the recovery plan and achieve profitability, the Company's ability to attain and sustain profitable operations in the future will be dependent on many factors, including certain industry-wide factors. While the Company believes it will be able to sustain profitable operations, no assurances can be given that the restructuring and realignment of the Company's management and the shift in the Company's strategic focus will result in sustained profitability.

Continuing adverse conditions in the market for information technology solutions has led to decreased demand for our products and services and could harm our business and results of operations, as well as the price of our shares.

Management Discussion and Analysis of Financial Condition and Results of Operations

Sapiens products and services are generally used by organizations with large information technology budgets and needs. The economic slowdown that has affected the markets in which we operate has had a particularly significant impact on the information technology sector. In response to this difficult economic environment, a number of our customers and potential customers have reduced their information technology budgets, leading to a decline in demand for our products. We believe that these adverse market conditions, and the response of certain of our customers and potential customers to these recent developments, have had a negative impact on our revenues and on the price of our shares. Should these market conditions persist, our business and results of operations could suffer further and the price of our shares could be harmed.

The terms of our bank debt contain a number of restrictive covenants which, if breached, could result in acceleration of our obligation to repay our debt.

Our loan agreements contain a number of conditions and limitations on the way in which we can operate our business, including limitations on our ability to raise debt, sell or acquire assets and pay dividends. Our loan agreements also contain various covenants which require the Company to maintain certain financial ratios related to shareholders equity and operating results that are customary for companies of comparable size. These limitations and covenants may force us to pursue less than optimal business strategies or forego business arrangements which could have been financially advantageous to us or our shareholders.

Our failure to comply with the covenants and restrictions contained in our loan agreements could lead to a default under the terms of these agreements. If a default occurs and we are unable to renegotiate the terms of the debt, the lenders could declare all amounts borrowed and all amounts due to them under the agreements due and payable. If we are unable to repay the debt, the lenders could foreclose on our assets that are subject to liens and sell our assets to satisfy the debt.

Our business involves long-term, fixed-price projects, which involve uncertainties, such as estimated project costs and profit margins.

Our business is characterized by relatively large projects or engagements that can have a significant impact on our total revenue and cost of revenue from quarter to quarter. Because a high percentage of our expenses, particularly employee compensation, is relatively fixed, a variation in the timing of the initiation, progress or completion of projects or engagements, especially at or near the end of any quarter, can cause significant variations in operating results from quarter to quarter.

Our “turn-key” solutions are generally sold as fixed-price projects with delivery requirements spanning more than one year. If our actual cost-to-completion of these projects differs significantly from the estimated cost-to-completion, there could be a material adverse effect on our results of operations and financial position. The sales cycle for our solutions is variable, typically ranging between three months to several months from initial

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contact with the potential client to the signing of a contract. Occasionally, sales require substantially more time. Delays in executing client contracts may affect our revenue and cause our operating results to vary widely. Our “turn-key” solutions are generally priced in excess of \$1 million and are delivered over periods of time ranging from several months to a few years. Payment terms are generally based on periodic payments or on the achievement of milestones. Any delays in payment or in the achievement of milestones may have a material adverse impact on our financial position.

Our quarterly results may be impacted by seasonal trends and other short-term factors.

The operating results of many software and services companies reflect seasonal trends, and we expect to be affected by such trends in the future. Although we have not experienced consistent seasonal fluctuations in operational results to date, we believe that it is likely that we will experience relatively higher revenues in the fourth quarter and relatively lower revenues in the first quarter due mainly to customers’ annual purchasing and budgetary practices. To the extent that our operations in Europe continue to generate a high percentage of our total revenues, we anticipate that we may also experience relatively weaker demand in the third quarter as a result of reduced activities in Europe during the summer months.

Variations in our revenue and operating results could occur as a result of a number of other factors, such as the budgeting and purchasing practices of our customers, the length of the customer product evaluation process, the timing of our customers’ system conversions, the timing and cost of new product introductions and product enhancements, and the timing of any acquisitions and associated costs. Employee hiring and utilization rates may also affect our revenues and results of operations.

We compete against companies with significantly greater resources than our own.

The market for software solutions and related services, and eBusiness solutions in particular, is highly competitive. Our principal competitors generally have significantly greater resources than our own. Price reductions or declines in demand for our solutions and services, whether as a result of competition, technological change, changes in the level of application development, reengineering or maintenance performed internally by our customers or potential customers would have a material adverse effect on our results of operations and financial position. Additional factors that may cause actual results to differ materially from our expectations include industry specific factors; our ability to continuously develop, introduce and deliver commercially viable solutions and technologies, and the market’s rate of acceptance of the solutions we offer; our ability to keep pace with market and technology changes and to compete successfully, and our ability to manage the competitive risks associated with the strategic alliances that we have entered into.

Our international operations involve inherent risks, such as foreign currency fluctuations and compliance with various regulatory and tax regimes.

Management Discussion and Analysis of Financial Condition and Results of Operations

Most of the Company's revenues are derived from international operations that are conducted in local currencies as well as dollars. Changes in the value of such local currencies or the dollar relative to such local currencies will affect the Company's financial position. Gains and losses on translations to dollars of assets and liabilities will contribute to fluctuations in the Company's financial position. The Company may engage in the future in currency-hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on the Company's financial position. However, there can be no assurance that any such hedging transaction, if entered into, will materially reduce the effect of fluctuation in foreign currency exchange rates on such results or on the dollar price at which the Common Shares are publicly traded. In addition, if for any reason exchange or price controls or other restrictions on the conversion of foreign currencies were imposed, the Company's financial position could be adversely affected. Other potential risks that may impact the Company's international business activities include longer accounts receivable payment cycles and the burdens of complying with a wide variety of foreign laws, although such factors have not had a material adverse effect on the Company's financial position to date.

Our business involves business-critical solutions, which expose us to potential liability claims.

Our products focus specifically on organizations' business-critical applications including those related to specialized redevelopment issues such as the adoption of the single European currency. While the terms of our sales contracts typically limit our exposure to potential liability claims, and we carry errors and omissions insurance against such claims, there can be no assurance that such insurance will continue to be available on acceptable terms, if at all, or that such insurance will provide us with adequate protection against any such claims. A significant liability claim against us could have a material adverse effect on our results of operations and financial position.

Although we protect our rights vigorously, there can be no assurance that these measures will be successful.

In accordance with industry practice, the Company relies upon a combination of contractual provisions and intellectual property law to protect its proprietary technology. The Company believes that because of the dynamic nature of the computer and software industries, copyright protection is less significant than factors such as the knowledge and experience of the Company's management and personnel. The Company seeks to protect the source code of its products as trade secret information and as an unpublished copyright work. The Company also relies on security and copy protection features in its proprietary software. The Company distributes its products under software license agreements which grant customers a personal, non-transferable license to use the Company's products and contain terms and conditions prohibiting the unauthorized reproduction or transfer of the Company's products. In addition, the Company attempts to protect trade secrets and other proprietary information through agreements with employees, consultants, and distributors. Although the Company intends to protect its rights vigorously, there can be no assurance that these measures will be successful.

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If we fail to remain technologically competitive, we could lose customers or market share.

The market for the Company's solutions is characterized by rapidly changing business conditions and customer requirements. The introduction of solutions embodying new technology and the emergence of new customer requirements can render existing technology obsolete and unmarketable. The Company's ability to anticipate changes in technology and customer requirements and to successfully develop and introduce new and enhanced solutions on a timely basis will be significant factors in the Company's ability to grow and to remain competitive. Substantial expenditures are required for research and development and new product introduction. There can be no assurance that the Company will have sufficient resources to make such investments. If the Company is unable, for technological or other reasons, to develop solutions on a timely basis in response to the changing demands of its industry, the Company's business and financial results could be materially adversely affected. The Company has in the past experienced limited delays introducing its technology and enhancements, and there can be no assurance that it will not encounter technical or other difficulties that could delay introduction of new technologies or enhancements in the future. There can be no assurance that the Company will be successful in developing and marketing enhancements that incorporate new technology on a timely basis, or that its new solutions will adequately address the changing needs of the marketplace.

Conducting business in Israel entails certain risks that could harm our business.

We have offices and research and development facilities in the State of Israel. Political, economic and military conditions in Israel directly affect our operations. We could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel. The future of the "peace process" is uncertain and has deteriorated due to recent violence between Israelis and Palestinians. In addition, several countries still restrict business with Israel and with companies doing business in Israel. We could be adversely affected by adverse developments in the "peace process" or by restrictive laws or policies directed towards Israel or Israeli businesses.

All male permanent residents of Israel between the ages of 18 and 45 are, unless exempt, obligated to perform reserve duty in the Israeli Defence Forces, presently consisting of approximately 30 days of service annually. Additionally, all such residents are subject to being called to active duty at any time upon the outbreak of hostilities. Many of the Company's officers and employees are currently obligated to perform annual reserve duty. While the Company has operated effectively under these requirements since its organization, no assessment can be made as to the full impact of such requirements on the Company's business or work force and no prediction can be made as to the effect on the Company of any expansion of such obligations. The Company believes that its relations with its employees are good.



Report of Independent Auditors

**To the Shareholders of
SAPIENS INTERNATIONAL CORPORATION N.V.**

We have audited the consolidated balance sheets of Sapiens International Corporation N.V. ("the Company") and its subsidiaries as of December 31, 1999 and 2000, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2000. 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 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 about 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 provide a reasonable basis for our opinion.

In our opinion, the consolidated 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, 1999 and 2000, and the results of their operations and cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel
February 7, 2001, except Note 10c for which the date is
May 1, 2001

KOST FORER & GABBAY

A Member of Ernst & Young International

Consolidated Balance Sheets

U.S. dollars in thousands

December 31,	1999	2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 8,735	\$ 17,038
Marketable securities including amounts pledged of \$2,318 and \$2,548 as of December 31, 1999 and 2000, respectively (Note 3 and Note 11)	8,055	2,872
Trade receivables (net of allowance for doubtful accounts of \$2,511 and \$5,041 as of December 31, 1999 and 2000, respectively) (Note 4)	31,943	31,663
Other receivables and prepaid expenses (Note 5)	<u>7,118</u>	<u>7,713</u>
Total current assets	<u>55,851</u>	<u>59,286</u>
PROPERTY AND EQUIPMENT, NET (Note 6)	<u>5,207</u>	<u>6,707</u>
OTHER ASSETS:		
Capitalized software development costs, net of accumulated amortization of \$13,050 and \$16,226 as of December 31, 1999 and 2000, respectively (Note 7a)	9,312	10,385
Goodwill, net of accumulated amortization of \$2,398 and \$3,504 as of December 31, 1999 and 2000, respectively (Note 7b)	10,056	9,197
Other, net of accumulated amortization of \$1,652 and \$2,141 as of December 31, 1999 and 2000, respectively (Note 7c)	<u>4,679</u>	<u>6,825</u>
Total other assets	<u>24,047</u>	<u>26,407</u>
Total assets	<u>\$ 85,105</u>	<u>\$ 92,400</u>

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

Consolidated Balance Sheets

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

December 31,	1999	2000
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank debt (Note 9a)	\$ 3,590	\$ 16,767
Current maturities of long-term debt (Note 9b)	67	214
Trade payables	3,495	6,112
Deferred revenues	2,392	3,172
Other liabilities and accrued expenses (Note 8)	15,988	25,131
Total current liabilities	25,532	51,396
LONG-TERM LIABILITIES:		
Convertible subordinated notes and other long term liabilities (Note 9b)	8,159	7,433
REDEEMABLE SHARES IN A SUBSIDIARY (Note 1d)	–	14,675
COMMITMENT AND CONTINGENT LIABILITIES (Note 10)		
SHAREHOLDERS' EQUITY:		
Share capital (Note 13):		
Cumulative convertible Preferred shares: Authorized 608,000		
Dutch Guilder 1 par value at December 31, 1999 and 2000,		
1999 - 4,500 issued and outstanding		
2000 - 0 issued and outstanding,	4	–
Common shares: Authorized 40,000,000 Dutch Guilder 1 par value at		
December 31, 1999 and 2000,		
1999 - 21,677,278 issued and 21,464,511 outstanding	8,694	9,364
2000 - 23,214,661 issued and 23,001,894 outstanding		
Additional paid-in capital	69,593	71,945
Deferred stock compensation	–	(175)
Proceeds on account of shares (Note 13a)	–	5,000
Treasury shares	(2,423)	(2,423)
Common shares accrued as dividends	967	–
Accumulated other comprehensive loss	(3,450)	(4,651)
Accumulated deficit	(21,971)	(60,164)
Total shareholders' equity	51,414	18,896
Total liabilities and shareholders' equity	\$ 85,105	\$ 92,400

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

Consolidated Statements Of Operations

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

Year Ended December 31,	1998	1999	2000
Revenues (Note 14b and 14c):			
Products	\$ 37,181	\$ 47,390	\$ 38,403
Consulting and other services	<u>33,799</u>	<u>44,440</u>	<u>34,341</u>
Total revenues	<u>70,980</u>	<u>91,830</u>	<u>72,744</u>
Cost of revenues:			
Products	12,690	16,354	25,737
Consulting and other services	<u>21,611</u>	<u>29,333</u>	<u>26,414</u>
Total cost of revenues	<u>34,301</u>	<u>45,687</u>	<u>52,151</u>
Gross profit	<u>36,679</u>	<u>46,143</u>	<u>20,593</u>
Operating expenses:			
Research and development, net (Note 15a)	4,112	5,021	9,101
Marketing, selling, general and administrative, net	22,921	27,880	46,682
Aborted merger costs (Note 16)	-	-	1,252
Restructuring costs (Note 1c)	<u>-</u>	<u>2,019</u>	<u>2,558</u>
Total operating expenses	<u>27,033</u>	<u>34,920</u>	<u>59,593</u>
Operating income (loss)	9,646	11,223	(39,000)
Financial income (expenses), net	457	412	(632)
Other expenses, net	<u>(328)</u>	<u>(220)</u>	<u>(403)</u>
Income (loss) before taxes on income	9,775	11,415	(40,035)
Taxes on income (benefit) (Note 12)	<u>55</u>	<u>(1,678)</u>	<u>(1,949)</u>
	9,720	13,093	(38,086)
Minority interests in (income) losses of a subsidiary	<u>15</u>	<u>(25)</u>	<u>-</u>
Net income (loss)	<u>\$ 9,735</u>	<u>\$ 13,068</u>	<u>\$ (38,086)</u>
Dividends on Preferred shares (Note 13h)	<u>\$ (645)</u>	<u>\$ (418)</u>	<u>\$ (107)</u>
Net income (loss) to shareholders of Common shares	<u>\$ 9,090</u>	<u>\$ 12,650</u>	<u>\$ (38,193)</u>
Basic net earnings (loss) per share (Note 15b)	<u>\$ 0.48</u>	<u>\$ 0.61</u>	<u>\$ (1.69)</u>
Diluted net earnings (loss) per share (Note 15b)	<u>\$ 0.43</u>	<u>\$ 0.53</u>	<u>\$ (1.69)</u>

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

Statements Of Changes In Shareholders' Equity

U.S. dollars in thousands

	Preferred shares	Common Shares	Additional Paid-in Capital	Treasury Shares	Common Shares Accrued as Dividends	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
Balance as of January 1, 1998	\$ 4	\$ 7,200	\$ 59,878	\$ (2,423)	\$ 335	\$ (1,052)	\$ (43,873)	\$ 20,069
Comprehensive income:								
Net income	-	-	-	-	-	-	9,735	9,735
Other comprehensive loss:								
Unrealized losses on available-for-sale marketable securities, net	-	-	-	-	-	-	-	(51)
Foreign currency translation adjustments	-	-	-	-	-	-	-	(952)
Other comprehensive loss	-	-	-	-	-	(1,003)	-	(1,003)
Total comprehensive income								8,732
Conversion of Preferred shares to Common shares:								
Series "D1"	(*-	39	(39)	-	-	-	-	-
Series "D2"	(*-	71	(71)	-	-	-	-	-
Employee stock options exercised	-	500	1,821	-	-	-	-	2,321
Warrants exercised	-	39	293	-	-	-	-	332
Amortization of compensation expense related to issuance of warrants to service providers	-	-	27	-	-	-	-	27
Common shares issued as dividends on Series D1, and D2 Preferred shares	-	12	86	-	(98)	-	-	-
Common shares accrued as dividends on Preferred shares	-	-	-	-	483	-	(483)	-
Shares issued in connection with prior security issuance	-	24	(24)	-	-	-	-	-
Shares issued in connection with the acquisitions of SAIC and Insuretech	-	111	1,523	-	-	-	-	1,634
Balance as of December 31, 1998	\$ 4	\$ 7,996	\$ 63,494	\$ (2,423)	\$ 720	\$ (2,055)	\$ (34,621)	\$ 33,115

*) Represents an amount lower than \$1.

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

Statements Of Changes In Shareholders' Equity

U.S. dollars in thousands

	Preferred shares	Common Shares	Additional Paid-in Capital	Treasury Shares	Common Shares Accrued as Dividends	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
Balance as of January 1, 1999	\$ 4	\$ 7,996	\$ 63,494	\$ (2,423)	\$ 720	\$ (2,055)	\$ (34,621)	\$ 33,115
Comprehensive income:								
Net income	-	-	-	-	-	-	13,068	<u>13,068</u>
Other comprehensive loss:								
Unrealized losses on available-for-sale marketable securities, net	-	-	-	-	-	-	-	(261)
Foreign currency translation adjustments	-	-	-	-	-	-	-	<u>(1,134)</u>
Other comprehensive loss	-	-	-	-	-	(1,395)	-	<u>(1,395)</u>
Total comprehensive income								<u>11,673</u>
Conversion of Preferred shares to Common shares:								
Series "D1"	(*-	73	(73)	-	-	-	-	-
Employee stock options exercised	-	352	1,996	-	-	-	-	2,348
Warrants exercised	-	109	1,180	-	-	-	-	1,289
Amortization of compensation expense related to issuance of warrants to service providers	-	-	57	-	-	-	-	57
Common shares issued as dividends on Series D1 Preferred shares	-	17	154	-	(171)	-	-	-
Common shares accrued as dividends on Preferred shares	-	-	-	-	418	-	(418)	-
Shares issued in connection with the acquisitions of Syspart and Sapiens Japan	-	147	2,785	-	-	-	-	<u>2,932</u>
Balance as of December 31, 1999	<u>\$ 4</u>	<u>\$ 8,694</u>	<u>\$ 69,593</u>	<u>\$ (2,423)</u>	<u>\$ 967</u>	<u>\$ (3,450)</u>	<u>\$ (21,971)</u>	<u>\$ 51,414</u>

*) Represents an amount lower than \$1.

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

Statements Of Changes In Shareholders' Equity

U.S. dollars in thousands

	Preferred Shares	Common Shares	Additional Paid-in Capital	Deferred Stock Compensation	Proceeds on Account of Shares	Treasury Shares	Common Shares Accrued as Dividends	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
Balance as of January 1, 2000	\$ 4	\$ 8,694	\$ 69,593	\$ –	\$ –	\$ (2,423)	\$ 967	\$ (3,450)	\$ (21,971)	\$ 51,414
Comprehensive loss:										
Net loss	–	–	–	–	–	–	–	–	(38,086)	(38,086)
Other comprehensive loss:										
Unrealized losses on available-for-sale marketable securities, net	–	–	–	–	–	–	–	–	–	(58)
Foreign currency translation adjustments	–	–	–	–	–	–	–	–	–	(1,143)
Other comprehensive loss	–	–	–	–	–	–	–	(1,201)	–	(1,201)
Total comprehensive loss										(39,287)
Conversion of Preferred shares to Common shares:										
Series "D1"	(1)	131	(130)	–	–	–	–	–	–	–
Series "E"	(2)	169	(167)	–	–	–	–	–	–	–
Series "D2"	(1)	104	(103)	–	–	–	–	–	–	–
Employee stock options exercised	–	166	832	–	–	–	–	–	–	998
Warrants exercised	–	2	6	–	–	–	–	–	–	8
Amortization of compensation expense related to issuance of warrants to service providers	–	–	78	–	–	–	–	–	–	78
Deferred stock compensation related to options repriced	–	–	628	(628)	–	–	–	–	–	–
Amortization expense on re-priced options	–	–	–	453	–	–	–	–	–	453
Deferred tax benefit on exercised options	–	–	547	–	–	–	–	–	–	547
Common shares accrued as dividends on Preferred shares	–	–	–	–	–	–	107	–	(107)	–
Common shares issued as dividends on Preferred shares:										
Series "D1"	–	31	326	–	–	–	(357)	–	–	–
Series "E"	–	40	366	–	–	–	(406)	–	–	–
Series "D2"	–	25	286	–	–	–	(311)	–	–	–
Shares issued and payment in respect of acquisitions adjustments of SAIC, Syspart and Sapiens Japan	–	2	(317)	–	–	–	–	–	–	(315)
Proceeds on account of shares	–	–	–	–	5,000	–	–	–	–	5,000
Balance as of December 31, 2000	\$ –	\$ 9,364	\$ 71,945	\$ (175)	\$ 5,000	\$ (2,423)	\$ –	\$ (4,651)	\$ (60,164)	\$ 18,896

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

Consolidated Statements Of Cash Flows

U.S. dollars in thousands

Year Ended December 31,	1998	1999	2000
Cash flows from operating activities:			
Net income (loss)	\$ 9,735	\$ 13,068	\$ (38,086)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	5,364	6,024	6,984
Amortization of deferred gain on sale – leaseback transaction	(223)	(160)	(226)
Increase of value on marketable securities	(452)	(222)	(91)
Gain on disposal of property and equipment	(93)	(11)	(8)
Amortization of compensation expense related to issuance of warrants to service providers	27	57	78
Amortization of compensation expense on re-priced options	–	–	453
Increase in trade receivables	(1,137)	(16,790)	(873)
Decrease (increase) in other receivables and prepaid expenses	209	(2,959)	(251)
Increase in deferred income taxes, net	–	(1,443)	(2,636)
Reduction of income taxes related to employee stock options exercised	–	–	547
Increase (decrease) in trade payables	(686)	50	2,702
Increase (decrease) in deferred revenues	1,560	(835)	942
Increase in other liabilities and accrued expenses	3,306	3,194	9,332
Net cash provided by (used in) operating activities	<u>17,610</u>	<u>(27)</u>	<u>(21,133)</u>
Cash flows from investing activities:			
Purchase of property and equipment	(2,404)	(2,174)	(3,663)
Increase in capitalized software development costs	(3,025)	(2,814)	(4,250)
Purchase of marketable securities	(4,620)	(3,253)	(6,763)
Proceeds from sale of marketable securities	4,322	8,124	12,078
Proceeds from sale of property and equipment	11	103	38
Purchase of other assets	(613)	(1,059)	(321)
Payment for acquisition of IMA (1)	–	–	(275)
Proceeds from acquisition of Sapiens Japan (2)	–	184	–
Payment for acquisition of Syspart (3)	–	(3,360)	(164)
Payment for acquisition of SAIC (4)	(1,002)	–	(401)
Net cash used in investing activities	<u>(7,331)</u>	<u>(4,249)</u>	<u>(3,721)</u>

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

Consolidated Statements Of Cash Flows

U.S. dollars in thousands

Year Ended December 31,	1998	1999	2000
Cash flows from financing activities:			
Proceeds from issuance of redeemable shares in subsidiary	–	–	14,675
Amortization of bond issuance costs	141	142	–
Proceeds from exercise of options and warrants	2,199	3,637	819
Proceeds on account of shares	–	–	5,000
Increase (decrease) in short-term bank debt, net	(1,753)	(1,973)	13,204
Payment of Senior Subordinated Notes	–	(8,743)	–
Principal payment of long-term liabilities	(930)	(48)	(255)
Payments received on long-term notes receivable	224	–	–
Net cash provided by (used in) financing activities	<u>(119)</u>	<u>(6,985)</u>	<u>33,443</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(276)</u>	<u>(226)</u>	<u>(286)</u>
Increase (decrease) in cash and cash equivalents	9,884	(11,487)	8,303
Cash and cash equivalents at the beginning of year	<u>10,338</u>	<u>20,222</u>	<u>8,735</u>
Cash and cash equivalents at the end of year	<u>\$ 20,222</u>	<u>\$ 8,735</u>	<u>\$ 17,038</u>
(1) Estimated net fair value of the assets acquired and liabilities assumed of IMA at the acquisition date (see Note 1b) was as follows:			
Working capital (excluding cash and cash equivalents)			\$ 90
Property and equipment			76
Goodwill			<u>109</u>
			<u>\$ 275</u>
(2) Estimated net fair value of the assets acquired and liabilities assumed of Sapiens Japan at the acquisition date (see Note 1b) was as follows:			
Working capital deficiency (excluding cash and cash equivalents)		\$ (74)	
Property and equipment		73	
Long-term liabilities		(1,177)	
Goodwill		<u>1,762</u>	
		584	
Less – amounts financed by the issuance of shares (see Note 13f)		<u>(768)</u>	
		<u>\$ (184)</u>	

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

Consolidated Statements Of Cash Flows

U.S. dollars in thousands

Year Ended December 31,	1998	1999	2000
(3) Estimated net fair value of the assets acquired and liabilities assumed of Syspart at the acquisition date (see Note 1b) was as follows:			
Working capital deficiency (excluding cash and cash equivalents)		\$ (1,249)	
Property and equipment		99	
Goodwill		<u>6,674</u>	
		5,524	
Less amounts financed by the issuance of shares (see Note 13g)		<u>(2,164)</u>	
		<u>\$ 3,360</u>	
(4) Estimated net fair value of the assets acquired and liabilities assumed of SAIC at the acquisition date (see Note 1b) was as follows:			
Working capital deficiency (excluding cash and cash equivalents)	\$ (215)		
Property and equipment	10		
Goodwill	<u>2,491</u>		\$ <u>583</u>
	2,286		583
Less amounts financed by the issuance of shares (see Note 13e)	<u>(1,284)</u>		<u>(182)</u>
	<u>\$ 1,002</u>		<u>\$ 401</u>
Supplemental cash flow activities:			
Cash paid during the year for:			
Interest	<u>\$ 1,055</u>	<u>\$ 750</u>	<u>\$ 1,305</u>
Income taxes	<u>\$ 407</u>	<u>\$ 261</u>	<u>\$ 337</u>
Non-cash transactions:			
Common shares accrued as dividends on Preferred shares	<u>\$ 483</u>	<u>\$ 418</u>	<u>\$ 107</u>
Common shares issued as dividends on Preferred shares	<u>\$ 98</u>	<u>\$ 171</u>	<u>\$ 1,074</u>

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

Notes to Consolidated Financial Statements

NOTE 1: BUSINESS AND ORGANIZATION

a. General:

Sapiens International Corporation N.V. (the Company), which operates through its worldwide subsidiaries, is a provider of enterprise-wide solutions for the rapid development of scaleable mission-critical software applications. These solutions consist primarily of rapid application development ("RAD"), integration of legacy systems into new applications and technologies, mapping and management of enterprise IT assets, and reengineering services that integrate the Company's rule-based object technology, efficient RAD methodology, and extensive consulting expertise.

The Company delivers strategic, end-to-end, customized e-business solutions to its customers, enabling them to capitalize on their assets in the transition to e-business. The Company provides both cross-industry solutions as well as those for specific vertical markets. The Company delivers e-business solutions by analysis of customers' requirements, Web/application development, technical implementation, integration, project management, and long-term support services. The Company also provides a specialized solution for the migration of European IT systems to the Euro currency.

As to major customers see Note 14c.

b. Acquisition of companies:

- (1) In January 2000, the Company acquired all of the outstanding shares of Internet Marketing Associates, Inc. (hereinafter - "IMA"), a Canadian corporation for \$322,000 paid in cash. The operations of IMA are included in the consolidated statements from January 1, 2000. The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated to the fair value of the assets acquired and liabilities assumed of IMA and resulted in recording of goodwill of approximately \$109,000, which is being amortized over 3.5 years.

Pro forma information in accordance with APB 16 has not been provided as the net income and net earnings per share of IMA for 1999 and 2000 were not material in relation to total consolidated net income and net earnings per share.

- (2) In May 1999, the Company acquired an additional 70.1% of the outstanding shares of Sapiens Japan Co., a Japanese corporation (hereinafter - "Sapiens Japan"). The Company previously owned 19.9% of the outstanding shares of Sapiens Japan Co. The total consideration was approximately \$1.5 million of which 48% was paid in cash and 52% in Sapiens' Common shares. The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated to the fair value of the assets acquired and liabilities assumed of Sapiens Japan and resulted in the recording of goodwill of approximately \$1.8 million, which is being amortized over 10 years. The operations of Sapiens Japan are included in the consolidated statements from the acquisition date. On June 25, 2000 the Company issued 18,244 additional Common shares due to a share price adjustment clause in the share purchase agreement.

Notes to Consolidated Financial Statements

Pro forma information in accordance with APB 16 has not been provided as the net income and net earnings per share of Sapiens Japan for 1998 and 1999 were not material in relation to total consolidated net income and net earnings per share.

- (3) In May 1999, the Company acquired all of the outstanding shares of Syspart (Deutschland) GmbH, a German corporation (hereinafter - "Syspart"). The total consideration was approximately \$6 million (including \$354,000 of costs related to the acquisition) of which 64% was paid in cash and 36% in Sapiens' Common shares. The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated to the fair value of the assets acquired and liabilities assumed of Syspart and resulted in the recording of goodwill of approximately \$6.7 million, which is being amortized over 10 years. The operations of Syspart are included in the consolidated statements from the acquisition date. On June 12, 2000 the Company paid in cash additional consideration in the amount of \$164,000, due to a share price adjustment clause in the share purchase agreement.

Pro forma information in accordance with APB 16 has not been provided as the net income and net earnings per share of Syspart for 1998 and 1999 were not material in relation to total consolidated net income and net earnings per share.

- (4) In July 1998, the Company acquired all of the shares of Societe Auxilliaire d'informatique et de Communication, a French corporation (hereinafter - SAIC). The total consideration was approximately \$2 million (including \$205,000 of costs related to the acquisition) of which 51% was paid in cash and 49% in Sapiens' Common shares (including 60,000 shares of Common stock set aside in escrow as a contingent payment). The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated to the fair value of the assets acquired and liabilities assumed of SAIC and resulted in recording of goodwill of approximately \$2.5 million, which is being amortized over 10 years. The operations of SAIC are included in the consolidated statements from the acquisition date. The acquisition agreement called for payment of an additional amount contingent upon the actual performance of SAIC. Such payment was recorded as additional goodwill, during the fourth quarter of 2000, when actual performance of SAIC was evaluated. The additional consideration was approximately \$0.6 million of which \$0.4 million was paid in cash and \$0.2 million in Sapiens' Common shares. Of the 60,000 shares of Common stock set aside in escrow, 46,000 were released to the sellers and 14,000 were cancelled. The additional amount was recorded as additional goodwill and is being amortized over the remaining expected life of the original goodwill.

Pro-forma information in accordance with APB 16 has not been provided as the net income and net earnings per share of SAIC for 1998 were not material in relation to total consolidated net income and net earnings per share.

c. Restructuring costs

In 2000, the Company recorded restructuring charges of approximately \$2.6 million which was accrued as a short-term liability as of December 31, 2000. The restructuring costs consist of employee termination

Notes to Consolidated Financial Statements

benefits associated with involuntary terminations of approximately 200 employees, accounted for in accordance with EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)" (EITF 94-3). The terminations resulted from the Company's strategy to reduce costs and restore profitability.

In 1999, the Company recorded restructuring charges of approximately \$2 million of which \$990,000 was paid in 1999 and \$1 million was accrued as a short-term liability as of December 31, 1999 and paid in the year 2000. The restructuring costs consist of employee termination benefits associated with the involuntary termination of 40 employees, accounted for in accordance with EITF 94-3. The employee terminations resulted from the change in the Company's strategy to focus on e-business and Internet-related technologies.

d. Investment in eZoneXchange:

In April 2000, the Company completed a private placement of 600,000 shares of Common stock ("Shares") of its subsidiary, eZoneXchange.com, Inc. ("eZoneXchange"), for \$15 million. The investor also received a warrant to purchase an additional 2.25% of the Common stock of eZoneXchange at the same private placement share price of \$25 per share. As part of the transaction, the Company entered into a Put and Call Option agreement pursuant to which the investors were granted the right (exercisable in whole or in part) to cause the Company during the put option exercise period (May 4, 2004 through May 3, 2005) to repurchase the investors' shares of eZoneXchange for the principal amount of the investors' investment plus 5% annual interest accrued thereon from May 4, 2000. The Put and Call agreement provides that 50% of the consideration for the investors shares will be paid in cash and 50% in Sapiens' Common stock to be valued according to the average closing market price of Sapiens' Common stock over the 14 day trading period preceding the date of issuance of the Put consideration. The agreement also included a call option which grants the Company the option to purchase the shares at a price of \$30 million in the first two years after the investment date, \$37.5 million in the third year, and \$45 million in the fourth year. The purchase price will be multiplied by the percentage of shares purchased. The exercise period will last until the earlier of the fourth anniversary of the investment, an acquisition of, or an IPO of eZoneXchange. The amount of \$15 million was accounted for as a liability under redeemable shares in a subsidiary, net of expenses. See Note 17b.

Notes to Consolidated Financial Statements

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A majority of the revenues of the Company and certain of its subsidiaries is generated in U.S. dollars ("dollar"). In addition, a substantial portion of the Company's costs is incurred in dollars. Company's management believes that the dollar is the primary currency of the economic environment in which the Company and these subsidiaries operate. Thus, the functional and reporting currency of the Company and certain of its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are re-measured into U.S. dollars in accordance with Statement No. 52 of the Financial Accounting Standard Board ("FASB"), "Foreign Currency Translation". All transaction gains and losses of the re-measurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

The financial statements of foreign subsidiaries whose functional currency is not the U.S. dollar, have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statements of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as accumulated other comprehensive income (loss), in shareholders' equity.

Foreign currency translation differences included in the financial income (loss) amounted to approximately \$32,000, \$(302,000) and \$(210,000) for the years ended December 31, 1998, 1999 and 2000, respectively.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Intercompany balances and transactions have been eliminated.

d. Cash equivalents:

Cash equivalents consist of interest-bearing demand deposits, money market funds and highly liquid debt instruments originally purchased with a maturity of three months or less.

Notes to Consolidated Financial Statements

e. Marketable securities:

Management determines the proper classification of investments in marketable debt and equity securities at the time of purchase and reevaluates such designations as of each balance sheet date. All securities were covered by SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and were designated as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in a separate component of shareholders' equity, accumulated other comprehensive income. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the consolidated statement of operations

f. Property and equipment, net:

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets:

Equipment and furniture	4 - 15 years
Computer equipment and software	3 - 6 years
Motor vehicles	3 - 7 years
Leasehold improvements	(over the shorter of the term of the lease or the estimated useful life of the asset)

The Company and its subsidiaries periodically assess the recoverability of the carrying amount of property and equipment and provide for any possible impairment loss based upon the difference between the carrying amount and fair value of such assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". As of December 31, 2000, no impairment losses have been identified.

g. Capitalized software development costs:

Research and development costs incurred in the process of developing new products or product improvements, are charged to expense as incurred, net of participation by the Office of the Chief Scientist in the Israeli Ministry of Industry and Trade ("the OCS").

Statement of Financial Accounting Standards (SFAS) No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a detailed program design.

Capitalized software costs are amortized by the greater of the amount computed using: (i) the ratio that current gross revenues from sales of the software bear to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the software product (three to five years). The Company assesses the recoverability of this intangible asset on

Notes to Consolidated Financial Statements

a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its most recent analyses, management believes that no material impairment of capitalized software development costs exists as of December 31, 2000.

h. Other assets:

Other assets are stated at cost less accumulated amortization. Amortization is computed using the straight-line method as follows:

Prepaid royalties	15 years
Distribution rights	7 years
Acquired technology	5-8 years
Goodwill	3.5-10 years

The Company evaluates the realization of goodwill and other intangible assets annually and the appropriateness of the amortization period based on the estimated future undiscounted cash flows derived from the asset. Any impairment loss is recognized in the statement of operations. Based on its most recent analyses, management believes that no impairment of other assets exists as of December 31, 2000.

i. Revenue recognition:

Product revenues include fixed-price contracts (which include the sale of software technology and services) and software license sales.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101 (SAB 101) "Revenue Recognition in Financial Statements", as amended in June 2000, which summarizes the Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company adopted SAB 101 during the fourth quarter of 2000. The adoption did not have a significant effect on the Company's consolidated results of operations or financial position.

Revenues from fixed-price contracts are recognized based on SOP 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts", using contract accounting on a percentage of completion method based on the relationship of actual costs incurred to total costs estimated to be incurred over the duration of the contract. 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. As of December 31, 2000 no such estimated losses were identified.

Revenues earned under software licensing agreements with end-users are recognized when all criteria outlined in Statement of Position (SOP) 97-2 "Software Revenue Recognition" (as amended) are met. Revenue from license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable.

Notes to Consolidated Financial Statements

The Company and its subsidiaries generally do not grant rights of return. Where software arrangements involve multiple elements, revenue is allocated to each element based on vendor specific objective evidence ("VSOE") of the relative fair values of each element in the arrangement, in accordance with the "residual method" prescribed by SOP 98-9 "Modification of SOP 97-2, Software Revenue Recognition With Respect to Certain Transactions". The Company's VSOE used to allocate the sales price to consulting, training and maintenance is based on the price charged when these elements are sold separately. License revenues are recorded based on the residual method. Under the residual method, revenue is recognized for the delivered elements when (1) there is VSOE of the fair values of all the undelivered elements other than those accounted for using long-term contract accounting, and (2) all revenue recognition criteria of SOP 97-2, as amended, are satisfied.

Consulting and other service revenue includes training and post-contract maintenance service. Revenues from consulting, maintenance and training services are recognized ratably over the contractual period or as services are performed.

Deferred revenue includes amounts received from customers for which revenue has not been recognized.

j. Advertising expenses:

Advertising expenses are charged to expenses as incurred.

k. Government grants:

Royalty-bearing grants from the Government of Israel for funding of research and development projects are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred, and are recorded as a reduction of research and development costs.

Non-royalty bearing grants from the Government of Israel for funding of marketing activities are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred, and are recorded as a reduction of marketing expenses. The Company received marketing grants in the amounts of \$360,000, \$120,000 and \$0 for the years ended December 31, 1998, 1999 and 2000, respectively.

l. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax based on 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. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

Notes to Consolidated Financial Statements

m. 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 and trade receivables.

The Company's cash and cash equivalents are invested in deposits with major international financial institutions. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The Company's trade receivables are derived from sales to large and solid organizations located mainly in Europe and North America. The Company performs ongoing credit evaluations of its customers and has established an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers and other information. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

The Company's marketable securities include investments in debentures of U.S. and non-U.S. Corporations. Management believe that those Corporations are financially sound, the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities.

The Company has no significant off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

n. Financial instruments:

The estimated fair value of financial instruments has been determined by the Company using available market information and valuation methodologies. Considerable judgment is required in estimating fair values. Accordingly, the estimates may not be indicative of the amounts the Company could realize in a current market exchange. The carrying amounts of cash and cash equivalents, trade receivables, short-term bank credit and trade payables approximate fair values due to the short-term maturity of such instruments.

The carrying amounts of the Company's long-term borrowings arrangements approximate their fair value. Fair values were estimated using discounted cash flow analyses, based on prevailing market borrowing rates.

o. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share is computed based on the weighted average number of Common shares outstanding during each year including contingent shares. Diluted earnings per share is computed based on the weighted average number of Common shares outstanding during each year, plus dilutive potential Common shares considered outstanding during the year, in accordance with SFAS No. 128, "Earnings Per Share".

In 2000, all convertible Preferred shares, outstanding stock options, and warrants have been excluded from the calculation of the diluted net loss per Common share because all such securities were anti-dilutive for

Notes to Consolidated Financial Statements

the period presented. The total weighted average number of shares related to the outstanding convertible Preferred shares, options and warrants excluded from the calculations of diluted net loss per share was 93,506 and 2,195,043 for the years ended December 31, 1999 and 2000, respectively.

p. Stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25") and Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN 44") in accounting for its employee stock option plans. Under APB 25, when the exercise price of the Company's share options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized. The pro forma disclosures required by SFAS No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123"), are provided in Note 13.

The Company applies SFAS 123 and EITF 96-18 "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" with respect to warrants and options issued to non-employees. SFAS 123 requires use of an option valuation model to measure the fair value of the options at the grant date.

q. Employee rights upon retirement:

The Company has various defined contribution plans for employees of its subsidiaries around the world. Most of the plans are those required according to the laws of the country in which the subsidiary operates. Contributions made under the plans are invested with financial institutions. Benefits under the plans are based on contributions from employees and the Company and earnings on insurance contracts or other investment instruments in which the contributions are invested.

Expense for contributions made to these plans was \$786,000, \$921,000, and \$1,408,000 for 1998, 1999 and 2000, respectively.

r. Impact of recently issued accounting standards:

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, which is required to be adopted in years beginning after June 15, 2000. Because of the Company's minimal use of derivatives, management does not anticipate that the adoption of the new Statement will have a significant effect on earnings or the financial position of the Company.

Notes to Consolidated Financial Statements

NOTE 3: MARKETABLE SECURITIES

At December 31, 1999 and 2000, the Company's short-term investments in marketable securities was classified as available-for-sale securities and was carried at fair value. Gross realized gains on sales of these securities included in earnings in 1998, 1999 and 2000 totaled \$328,000, \$222,000 and \$212,000, respectively. Gross realized losses on sales of these securities in 1998, 1999 and 2000 totaled \$63,000, \$0 and \$49,000, respectively.

The aggregate fair value, gross unrealized holding gains, gross unrealized holding losses and amortized cost for securities at fair value by major security type at December 31, 1999 and 2000, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	U.S. dollars in thousands			
December 31, 1999:				
U.S. treasury securities	\$ 24	\$ 6	\$ -	\$ 30
Non-U.S. corporate debt securities	<u>7,898</u>	<u>204</u>	<u>(77)</u>	<u>8,025</u>
	<u>\$ 7,922</u>	<u>\$ 210</u>	<u>\$ (77)</u>	<u>\$ 8,055</u>
December 31, 2000:				
Non-U.S. corporate debt securities	<u>\$ 2,799</u>	<u>\$ 94</u>	<u>\$ (21)</u>	<u>\$ 2,872</u>
	<u>\$ 2,799</u>	<u>\$ 94</u>	<u>\$ (21)</u>	<u>\$ 2,872</u>

The scheduled maturities of available-for-sale marketable securities as of December 31, 1999 and 2000 are as follows:

	1999		2000	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	U.S. dollars in thousands			
Due within one year	\$ 2,873	\$ 3,046	\$ 269	\$ 339
Due after one year through five years	<u>5,049</u>	<u>5,009</u>	<u>2,530</u>	<u>2,533</u>
	<u>\$ 7,922</u>	<u>\$ 8,055</u>	<u>\$ 2,799</u>	<u>\$ 2,872</u>

As for pledges see Note 11.

Notes to Consolidated Financial Statements

NOTE 4: TRADE RECEIVABLES

The Company's trade receivables are composed of accounts receivable in the amounts of \$19.3 million and \$17.7 million as of December 31, 1999 and 2000, respectively and unbilled receivables in the amounts of \$12.6 million and \$14.0 million as of December 31, 1999 and 2000, respectively.

NOTE 5: OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31,	
	1999	2000
	U.S. dollars in thousands	
Sales and other taxes receivable	\$ 2,913	\$ 3,437
Prepaid expenses	1,747	1,670
Deferred income taxes	957	1,240
Other	<u>1,501</u>	<u>1,366</u>
	<u>\$ 7,118</u>	<u>\$ 7,713</u>

NOTE 6: PROPERTY AND EQUIPMENT, NET

	Cost		Accumulated Depreciation	
	December 31,		December 31,	
	1999	2000	1999	2000
	U.S. dollars in thousands			
Equipment and furniture	\$ 2,267	\$ 2,970	\$ 1,158	\$ 1,363
Computer equipment and software	9,115	11,642	6,078	7,944
Motor vehicles	209	128	130	95
Leasehold improvements	<u>1,566</u>	<u>2,082</u>	<u>584</u>	<u>713</u>
	<u>\$ 13,157</u>	<u>\$ 16,822</u>	<u>\$ 7,950</u>	<u>\$ 10,115</u>

Depreciation expense totaled \$1,670,000, \$1,839,000 and \$2,213,000 for the years ended December 31, 1998, 1999 and 2000, respectively.

As for pledges see Note 11.

Notes to Consolidated Financial Statements

NOTE 7: OTHER ASSETS

- a. Amortization expense for capitalized software development costs for 1998, 1999 and 2000 was \$3,059,000, \$2,842,000 and \$3,176,000, respectively. Amortization expense is included in cost of products.
- b. Goodwill amortization amounted to \$210,000, \$863,000 and \$1,106,000 for the years 1998, 1999 and 2000, respectively.
- c. Other assets, net of amortization, are comprised of the following:

	Cost		Accumulated Amortization	
	December 31,		December 31,	
	1999	2000	1999	2000
	U.S. dollars in thousands			
Prepaid royalties	\$ 2,083	\$ 2,083	\$ 966	\$ 1,099
Technology and usage rights	640	669	212	298
Other intangible assets	1,259	1,425	366	560
Distribution rights	753	840	108	184
Long-term deferred income taxes	<u>1,596</u>	<u>3,949</u>	<u>—</u>	<u>—</u>
	<u>\$ 6,331</u>	<u>\$ 8,966</u>	<u>\$ 1,652</u>	<u>\$ 2,141</u>

Amortization of other assets charged to expense was \$382,000, \$622,000 and \$489,000 for the years 1998, 1999 and 2000, respectively.

NOTE 8: OTHER LIABILITIES AND ACCRUED EXPENSES

	December 31,	
	1999	2000
	U.S. dollars in thousands	
Employee and related payroll accruals	\$ 5,331	\$ 7,046
Sales and other taxes payable	5,508	4,208
Accrued restructuring costs (Note 1c)	1,029	2,558
Accrued expenses	<u>4,120</u>	<u>11,319</u>
	<u>\$ 15,988</u>	<u>\$ 25,131</u>

Notes to Consolidated Financial Statements

NOTE 9: DEBT**a. Short-term debt:**

A portion of the Company's short-term loans requires that the Company pledges cash or short-term investments as collateral for its borrowings (Note 11).

The Company has available unsecured revolving credit line facilities for borrowings of up to a total of \$16 million as of December 31, 2000. Under the terms of these credit line agreements, the Company is not required to pledge assets, but is required to maintain certain financial ratios. Borrowings under these agreements bear interest at rates ranging between the London Interbank Offered Rate plus 0.75% to plus 1% and on New Israeli Shekel ("NIS") borrowings, at the prime rate of interest in Israel less 0.5% to plus 2%. The Company had an unused credit facility in the amount of approximately \$5 million as of December 31, 2000.

	Linkage	Weighted Average Interest Rate December 31,		December 31,	
		1999	2000	1999	2000
		%	%	U.S. dollars in thousands	
Credit lines	New Israeli Shekel *	–	9.073	\$ –	\$ 11,175
Short-term loans	US Dollar**	6.16	7.454	<u>3,590</u>	<u>5,592</u>
				<u>\$ 3,590</u>	<u>\$ 16,767</u>

* Including non-material amounts linked to the French Franc.

** Including non-material amounts linked to the Japanese Yen.

Notes to Consolidated Financial Statements

b. Convertible subordinated notes and other long-term liabilities:

	Linkage	Rate of Interest %	Maturity	December 31,	
				1999	2000
				U.S. dollars in thousands	
Convertible subordinated notes ("Old Notes" - conversion price \$ 32 per Common share)	US Dollar	5	September 2003	\$ 6,930	\$ 6,930
Capital lease obligations (Note 10b)	French Franc	5	August 2005	268	217
Other long-term debts	Japanese Yen***	2.475-5	October 2003	799	497
				7,997	7,644
Less - current maturities				(67)	(214)
				7,930	7,430
Deferred gain on sale lease back				229	3
				<u>\$ 8,159</u>	<u>\$ 7,433</u>

*** Including non-material amounts linked to the French Franc.

Long-term debt maturities after December 31, 2000 are as follows (U.S. dollars in thousands):

2001	\$ 214
2002	216
2003	7,126
2004	52
Thereafter	36
	<u>\$ 7,644</u>

Interest expense was \$ 1.0 million, \$ 0.9 million and \$ 1.0 million for the years 1998, 1999 and 2000, respectively.

Notes to Consolidated Financial Statements

NOTE 10: COMMITMENTS AND CONTINGENT LIABILITIES

- a. The Company partially finances its research and development expenditures under programs sponsored by the Office of the Chief Scientist ("OCS") of Israel for the support of research and development activities conducted in Israel.

In exchange for participation in the programs by the OCS, the Company agreed to pay 3%-5% of total net sales of software developed within the framework of these programs. The royalties will be paid up to a maximum amount equivalent to 100%-150% of the grant provided by the OCS, linked to the dollar. Repayment of such grants is not required in the event that there are no sales of products developed within the framework of such funded programs.

Royalties paid or accrued amounted to \$810,000, \$1,068,000 and \$1,257,000 in 1998, 1999 and 2000, respectively.

As of December 31, 2000, the Company had a contingent liability to pay royalties of approximately \$ 11.4 million.

- b. The Company and its subsidiaries lease various office equipment, office space, and motor vehicles through operating and capital leases. Future minimum lease payments for the next five years and thereafter are as follows:

	Operating Leases	Capital Leases
	U.S. dollars in thousands	
2001	\$ 4,843	\$ 61
2002	3,146	61
2003	2,351	61
2004	1,994	61
2005 and thereafter	<u>1,997</u>	<u>41</u>
Total future minimum lease payments	<u>\$ 14,331</u>	285
Less - amount representing interest		<u>(68)</u>
Principal payments remaining on capital lease obligations		<u>\$ 217</u>

Rent expense for the years ended December 31, 1998, 1999 and 2000 was \$1,358,000, \$1,776,000 and \$2,892,000, respectively.

Notes to Consolidated Financial Statements

- c. In 2000, the Company filed a lawsuit against GIE AGF Systems D'Information (hereinafter - "AGF SI"), a customer, regarding an unpaid balance related to a year two thousand project performed during 1998 and 1999. The Company's claim was related to a dispute about the implementation of contracts signed between the parties regarding the above project. While the Company, with the advice of counsel, believed that the court would rule in its favor and the amounts recorded would be collected, on February 14, 2001 the French court ruled that AGF SI must pay the Company the sum of approximately \$3 million. In accordance with SFAS No. 5 "Accounting for Contingencies", as a result of the ruling the Company recorded a \$2.4 million charge to marketing, selling, general and administrative expenses in the fourth quarter.

NOTE 11: SECURITY INTERESTS AND PLEDGES

The Company has pledged \$2.5 million of its marketable securities as collateral for certain short-term debt.

All of the Company's leased assets are pledged to the finance companies that provided the lease financing.

The Company also pledged bank guarantees in the amount of \$0.5 million as security for the building that was sold and leased back in 1995.

NOTE 12: INCOME TAXES

- a. Net operating losses carryforward:

At December 31, 2000, the Company had net operating loss carryforwards for U.S. federal income tax purposes of approximately \$7,840,000, which are available to offset future federal taxable income and expire in years 2008 to 2020 and tax credits of \$774,000, which generally expire in 2002 to 2010. Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitations may result in the expiration of net operating losses before utilization.

In addition, the Company had net operating loss carryforwards relating to non-U.S. subsidiaries totaling approximately \$46,599,000, which are available to offset future taxable income. Generally, a majority of such amounts has no expiration date. However, in some cases, amounts expire in the years 2001 to 2003.

Notes to Consolidated Financial Statements

U.S. dollars in thousands, except per share data

b. Israeli income tax:

Sapiens Technologies Ltd. (hereinafter - "Technologies"), a subsidiary incorporated in Israel has been granted an "Approved Enterprise" status for five investment programs approved in 1984, 1991, 1993, 1995 and 1998, by the Israeli Government under the Law for Encouragement of Capital Investments, 1959 ("the Law").

Undistributed Israeli income derived from the "Approved Enterprise" programs entitle Technologies to a tax exemption for a period of two to four years and to a reduced tax rate of up to eight years (depending on the level of foreign-investment in Technologies). These tax benefits are subject to a limitation of the earlier of twelve years from commencement of operations, or fourteen years from receipt of approval. Technologies completed the implementation of its investment programs. Technologies used all the tax benefits under the 1984 plan and is entitled to additional benefits under the 1991 plan which commenced in 1992 and will expire in 2002. Under the 1993 plan, the benefit period commenced in 1998 and will expire in 2006. Under the 1995 plan, the benefit period commenced in 1998 and will expire in 2008. The benefits have not yet commenced for the 1998 plan.

The law also grants entitlement to claim accelerated depreciation on machinery and equipment used by the "Approved Enterprise", during the first five years.

The tax-exempt profits that will be earned by Technologies' "Approved Enterprises" can be distributed to shareholders, without imposing tax liability on Technologies only upon the complete liquidation of Technologies. If these retained tax-exempt profits are distributed in a manner other than in the complete liquidation of Technologies it would be taxed at the corporate tax rate applicable to such profits as if Technologies had not elected the alternative system of benefits (depending on the level of foreign-investment in Technologies) for an "Approved Enterprise".

Income from sources other than the "Approved Enterprise" during the benefit period, will be subject to tax at the regular corporate tax rate of 36%.

Technologies has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income tax have been provided on income attributable to the Company's "Approved Enterprise".

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the above law, regulations published thereunder and the instruments of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest.

Results of the Company's Israeli subsidiaries for tax purposes are measured and reflected in real terms in accordance with the changes in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are presented in U.S. dollars. The difference between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate causes a difference between taxable income or loss and the income or

Notes to Consolidated Financial Statements

loss reflected in the financial statements. In accordance with paragraph 9(f) of SFAS 109, the Israeli subsidiaries have not provided deferred income taxes on this difference between the reporting currency and the tax bases of assets and liabilities.

The Israeli subsidiaries are "industrial" companies under the Law for the Encouragement of Industry (Taxation), 1969 and as such are entitled to certain tax benefits, including accelerated rate of depreciation and deduction of public offering expenses. The Israeli subsidiaries have not utilized this tax benefit.

c. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company and its subsidiaries' deferred tax liabilities and assets are as follows:

	December 31, 1999		December 31, 2000	
	Current	Non-current	Current	Non-current
U.S. dollars in thousands				
Deferred tax assets:				
Net operating losses carryforward	\$ -	\$ 8,686	\$ -	\$ 16,586
Tax credits carryforward	-	774	-	774
Other temporary differences	<u>957</u>	<u>2,334</u>	<u>1,240</u>	<u>406</u>
Gross deferred tax assets	957	11,794	1,240	17,766
Less - valuation allowance	<u>-</u>	<u>(10,198)</u>	<u>-</u>	<u>(13,817)</u>
Net deferred tax asset	<u>\$ 957</u>	<u>\$ 1,596</u>	<u>\$ 1,240</u>	<u>\$ 3,949</u>

As of December 31, 2000 the Company and its subsidiaries have increased the valuation allowance by approximately \$3.6 million in respect of deferred tax assets resulting from tax loss carryforwards and other temporary differences. Management currently believes that it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized in the foreseeable future.

Provisions for income tax expense are comprised of the following:

	Year Ended December 31,		
	1998	1999	2000
U.S. dollars in thousands			
Current (foreign)	\$ 381	\$ 549	\$ 383
Deferred (foreign)	<u>(326)</u>	<u>(2,227)</u>	<u>(2,332)</u>
	<u>\$ 55</u>	<u>\$ (1,678)</u>	<u>\$ (1,949)</u>

Notes to Consolidated Financial Statements

The Company's entire provision for taxes on income relates to operations in jurisdictions other than the Netherlands Antilles. The effective income tax rate varies from period to period because each jurisdiction in which the Company operates has its own system of taxation (not only with respect to the nominal rate, but also with respect to the allowance of deductions, credits and other benefits). In addition, the provision for income taxes for the fiscal years ended December 31, 1998, 1999 and 2000, does not include the recognition of a majority of the deferred tax assets relating to the net operating losses of the Company's subsidiaries worldwide. The main reconciling item between the statutory tax rate of the Company and the effective tax rate is the non-recognition of tax benefits from accumulated net operating losses carryforward among the various subsidiaries worldwide due to the uncertainty of the realization of such tax benefits.

NOTE 13: SHAREHOLDERS' EQUITY

- a. In December 2000, the Company signed a memorandum of understanding for a \$15 million investment, which remained subject to shareholder approval by the end of February 2001. On December 25, the Company received a \$5 million nonrefundable deposit, for which it will issue 5 million Common shares if the agreement is not approved by shareholders, or Series F Preferred shares if it is approved. The Series F Preferred shares are convertible into Common shares of the Company at any time at a ratio of \$1.50 per share of Common stock. The conversion ratio will be adjusted, to 110% of the average closing sale price of the Company's Common shares in the 10 trading days following August 15, 2001 and March 1, 2002. The conversion ratio shall not be adjusted to less than \$1.00 nor more than \$1.50 per share of Common stock. At maturity, 3 years from the date of investment, the Company will redeem all of the outstanding Series F Preferred shares through payment of cash or delivery of Common shares. If Common shares are issued, the redemption price will be the average closing sale price of the Company's Common share during the 30 trading days preceding maturity.

The Company recorded the \$5 million cash received as proceeds on account of shares within the shareholders' equity.

The investors are entitled, for a period of 3 years, to invest an additional \$15 million in identical securities then held by the investors pursuant to this transaction.

In addition, the investors have the right to two "demand registrations" of an under written public offering of Common shares with unlimited piggyback rights.

- b. Common shares confer upon their holders voting rights, the right to receive cash dividends and the right to share in excess assets upon liquidation of the Company.
- c. During the first quarter of 2000, all of the remaining Series D1, and E Preferred shares, 1,500 and 1,700, were converted to Common shares at the respective conversion prices and, as a result, 291,971 and 377,778 Common shares were issued.

Notes to Consolidated Financial Statements

As of December 31, 2000, the remaining 1,300 Series D2 Preferred shares had been converted to Common shares at the conversion price and, as a result, 253,041 Common shares were issued.

In 2000, 571,519 warrants to purchase Common shares were issued as part of the conversion of Preferred shares.

- d. In February 1998, the Company issued 50,000 Common shares in connection with the purchase of 80% of InsureTech Alternatives Inc.
- e. In July 1998, the Company issued 171,300 Common shares (including 60,000 in escrow) in connection with the purchase of SAIC. In 2000, after the valuation of SAIC's performance specified in the share purchase agreement, 46,000 Common shares were released from escrow to the sellers and 14,000 were canceled. (see Note 1b).
- f. In August 1999, the Company issued 78,000 Common shares in connection with the purchase of additional 70.1% of Sapiens Japan (see Note 1b). In June 2000, an additional 18,244 shares were issued in accordance with the price adjustment provision in the share purchase agreement.
- g. In August 1999, the Company issued 216,400 Common shares in connection with the Purchase of Syspart (see Note 1b).
- h. Dividends on Preferred shares:

In 1998, the Company accrued dividends to be paid in the form of Common shares on its series D1, D2 and E Preferred stock in the amount of \$ 483,000 of which \$ 61,000 was paid by the issuance of 14,310 Common shares. Additionally, the Company issued 9,539 Common shares of \$37,000 as dividends, which were accrued in 1997.

Included in the amount of dividends on Preferred shares in 1997 and 1998 is the amortization of the discount to the market price on the conversion of convertible shares at the date of the grant given to Series D1, D2 and E Preferred shareholders in the amount of \$162,000 and \$1,038,000, respectively. This amount represents 15% of the market value of the share at the date of the grant of the convertible securities, multiplied by the number of convertible securities issued. This amount is a charge for Earnings Per Share calculations only.

In 1999, the Company accrued dividends to be paid in the form of Common shares on its series D1, D2 and E Preferred stock, in the amount of \$418,000, of which, \$57,000 was paid by the issuance of 11,199 Common shares. Additionally, the Company issued 10,527 Common shares in respect of \$54,000 in dividends, which were accrued in 1997 and 11,679 Common shares in respect of \$60,000 in dividends which were accrued in 1998.

Notes to Consolidated Financial Statements

In 2000, the Company accrued dividends to be paid out in the form of Common shares on its Series D1, D2 and E Preferred stock, in the amount of \$ 107,000. In the course of conversion of all of the Company's Preferred stock (see Note 13c), all of the remaining accumulated dividends, \$1,074,000, were paid by the issuance of 220,249 Common shares.

i. Stock option plan:

Stock options granted under the Company's 1992 Stock Option and Incentive Plan ("the Plan") to employees and service providers are exercisable at the fair market value of the Company's Common shares on the date of grant and, subject to termination of employment, expire ten years from the date of grant and are generally exercisable in four equal annual installments commencing one year from the date of grant. In January 1997 and October 1998, the Company increased the number of shares available for grant by 1.1 million shares and approved grants of such shares, on each of those dates, respectively.

In January 2000 and November 2000, the Company increased the number of shares available for grants by 2,000,000 and 4,000,000 respectively, and approved grants of such shares. In December 2000, 772,800 previously granted options with exercise prices from \$2.25 to \$13.875 were repriced to \$0 resulting in total compensation expense of \$628,000 of which \$453,000 was recognized in 2000 for the portion already vested and \$175,000 was deferred to be recognized over the remaining vesting period ending in 2004. As of December 31, 2000, approximately 123,300 Common shares of the Company are still available for future grant. Any options which are forfeited or canceled before expiration become available for future grant under the Plan.

In December, 2000 the Company granted 2,548,000 Time Accelerated Restricted Stock Award options (hereinafter - "TARSAP's") to employees. The TARSAP's include an acceleration feature, based on the Company's performance in the years 2001 and 2002. No compensation expense was recorded, since the fair value was equal to the exercise price at the date of grant.

In 2000, 373,250 employee options to purchase Common shares were exercised, and the Company received proceeds of approximately \$1.0 million.

Notes to Consolidated Financial Statements

A summary of stock option activities in 1998, 1999 and 2000 is as follows:

	Year Ended December 31,					
	1998		1999		2000	
	Amount	Weighted Average Exercise Price	Amount	Weighted Average Exercise Price	Amount	Weighted Average Exercise Price
Outstanding at January 1	3,405,600	\$ 2.27	3,860,950	\$ 3.92	4,342,775	\$ 5.50
Granted	1,547,500	\$ 6.29	1,409,150	\$ 8.83	5,435,750	\$ 3.10
Exercised	(992,950)	\$ 2.32	(701,000)	\$ 3.46	(373,250)	\$ 2.67
Cancelled and forfeited	(99,200)	\$ 2.29	(226,325)	\$ 5.53	(452,197)	\$ 9.89
Outstanding at December 31, Exercisable options at December 31,	<u>3,860,950</u>	<u>\$ 3.92</u>	<u>4,342,775</u>	<u>\$ 5.50</u>	<u>8,953,078*</u>	<u>\$ 3.66</u>
	<u>2,695,000</u>	<u>\$ 2.49</u>	<u>1,778,275</u>	<u>\$ 2.85</u>	<u>2,124,166</u>	<u>\$ 3.31</u>

* Including 772,800 options repriced to zero.

The options outstanding as of December 31, 2000, have been classified by range of exercise price, as follows:

Exercise Price	Options Outstanding as of December 31, 2000	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Options Exercisable as of December 31, 2000	Weighted Average Exercise Price
\$ 0	772,800	6.86	\$ -	557,100	\$ -
\$ 0.813	3,832,000	9.99	\$ 0.81	-	\$ -
\$ 2.25-3.375	1,130,525	5.52	\$ 2.49	982,500	\$ 2.40
\$ 3.875-5.875	755,750	9.56	\$ 5.76	-	\$ -
\$ 6.5-9.5	2,024,203	8.29	\$ 8.18	584,566	\$ 8.00
\$ 12.25-13.875	<u>437,800</u>	9.06	<u>\$ 13.57</u>	-	\$ -
	<u>8,953,078</u>		<u>\$ 3.66</u>	<u>2,124,166</u>	<u>\$ 3.31</u>

Under SFAS No. 123, pro forma information regarding net income (loss) and net earnings (losses) per share is required as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for 1998, 1999 and 2000: risk-free interest rates of 5%, 6%, and 6.5% respectively, dividend yields of 0% for each year, volatility factors of

Notes to Consolidated Financial Statements

the expected market price of the Company's Common shares of 0.465, 0.702 and 0.867, respectively and a weighted-average expected life of the options of 10, 6 and 6 years, respectively.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from traded options, and because changes in the subjective assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable measure of the fair value of its employee stock options.

The weighted-average fair value of the options at their grant dates in 1998, 1999 and 2000 was \$2.02, \$2.78 and \$1.43, respectively.

Pro forma information under SFAS 123:

	Year Ended December 31,		
	1998	1999	2000
	U.S. dollars in thousands		
Net income (loss) to shareholders' of Common shares as reported	<u>\$ 9,090</u>	<u>\$ 12,650</u>	<u>\$ (38,193)</u>
Pro forma net income (loss) to shareholders' of Common shares	<u>\$ 6,713</u>	<u>\$ 6,457</u>	<u>\$ (28,467)</u>
Pro forma basic net earnings (loss) per share	<u>\$ 0.35</u>	<u>\$ 0.30</u>	<u>\$ (1.26)</u>
Pro forma diluted net earnings (loss) per share	<u>\$ 0.30</u>	<u>\$ 0.26</u>	<u>\$ (1.26)</u>

j. Warrants:

In 1997, the Company issued 787,000 warrants to the placement agents in connection with the private placements at exercise prices ranging from \$2.00 to \$3.50. As of December 31, 2000, 3,100 warrants had been exercised.

In 1998 and 1999, the Company granted warrants to service providers at an exercise price ranging from \$2 to \$9 per share (the market value of the share at the grant date). As required by SFAS No. 123, these warrants were measured at fair value (according to the Black-Scholes option pricing model) and in accordance with EITF 96-18 with the following weighted-average assumptions for 1998 and 1999: risk-free interest rates of 5% and 6% respectively, dividend yields of 0% for each year, volatility factors of the expected market price of the Company's Common shares of 0.465 and 0.702, respectively and a weighted-average expected life of the warrants of 10 and 6 years, respectively.

As of December 31 2000, 28,100 warrants originally granted in 1996 were exercised at \$2 per share.

Notes to Consolidated Financial Statements

c. Major customer:

In 1998, revenues from one customer represented approximately 28% of the Company's total revenues. In 2000, revenues from a different customer represented 11% of the Company's total revenues.

NOTE 15: SELECTED STATEMENTS OF OPERATIONS DATA

a. Research and development costs:

	Year Ended December 31,		
	1998	1999	2000
	U.S. dollars in thousands		
Total costs	\$ 9,054	\$ 9,872	\$ 13,351
Less - capitalized software development costs	(3,025)	(2,814)	(4,250)
Less - royalty-bearing grants	(1,917)	(2,037)	-
Research and development costs, net	<u>\$ 4,112</u>	<u>\$ 5,021</u>	<u>\$ 9,101</u>

b. Earnings per share data:

The following table sets forth the computation of basic and diluted earnings per share.

	Year ended December 31,		
	1998	1999	2000
	U.S. dollars in thousands		
1) Numerator			
Net income to shareholders of Common shares	\$ 9,090	\$ 12,650	\$(38,193)
Effect of dilutive securities:			
Preferred share dividends	-	366	-
Numerator for diluted earnings per share - income available to shareholders of Common shares	<u>\$ 9,090</u>	<u>\$ 13,016</u>	<u>\$ 38,193</u>

The effect of the inclusion of the convertible Preferred shares dividends in 1998 and 2000 would be antidilutive.

Notes to Consolidated Financial Statements

2) Denominator

	Year Ended December 31,		
	1998	1999	2000
	Number of shares in thousands		
Weighted average number of shares	18,870	20,732	22,542
Common shares to be issued as dividends	<u>96</u>	<u>81</u>	<u>17</u>
Denominator for basic earnings per share	<u>18,966</u>	<u>20,813</u>	<u>22,559</u>
Effect of dilutive securities:			
Employee stock options	1,860	2,016	-
Warrants issued to third parties	561	665	-
Convertible Preferred shares	<u>-</u>	<u>1,064</u>	<u>-</u>
Dilutive potential Common shares	<u>2,421</u>	<u>3,745</u>	<u>-</u>
Denominator for diluted earnings per share - adjusted weighted average shares, assumed conversions and exercise of options and/or warrants	<u>21,387</u>	<u>24,558</u>	<u>22,559</u>

The effect of the inclusion of the convertible Preferred shares in 1998 would be antidilutive. Because of the loss in 2000, all potential dilutive securities are anti-dilutive.

NOTE 16: ABORTED MERGER COSTS

During the year 2000, efforts were made to merge the Company in a transaction that was to be accounted for as a pooling of interest. The merger efforts were aborted and the costs incurred in relation to these efforts amounted to \$1,252,000. This amount is comprised almost entirely of professional and legal fees.

NOTE 17: SUBSEQUENT EVENTS (UNAUDITED)

- a. In December 2000, the Company signed a memorandum of understanding with Yarnfield International Limited, an affiliate of Magnum Technologies Fund, and Formula Systems Ltd. for a \$15 million investment in exchange for Series F Preferred shares, and received a nonrefundable amount of \$5 million. In February 2001, the Company's shareholders approved the transaction and the Company issued to the investors an aggregate of 10,000 Series F Preferred shares par value 1,500 Dutch guilder per share, each of which may

Notes to Consolidated Financial Statements

be converted into 1,000 Common shares, subject to adjustment, at a cash price of \$1,500 per series F share, reflecting an aggregate consideration for the Series F convertible Preferred shares of \$15 million. Ron Zuckerman, Chairman of the Board of the Company, is an advisor to Magnum. See Note 13a.

- b. On February 13, 2001, the Company and the investors in eZoneXchange agreed to amend the terms of the Put and Call Option Agreement that the Company entered into in connection with the investors' purchase of 600,000 shares of eZoneXchange for \$15 million in April 2000. According to the terms of the amendment, the investors put 173,100 shares of eZoneXchange to the Company in return for \$4.5 million.

In addition, if the market price of the Company Common stock reaches \$2 per share, the investors will have the right to put an additional 192,333 shares of its eZoneXchange stock in return for the Sapiens Common stock at a price of \$2.75 per share.

The remaining portion of the investment in eZoneXchange (approximately one-third or \$5 million) will continue to be subject to the original terms of the Put and Call Option Agreement.

eZoneXchange shall also grant the investors warrants that will allow them to retain 25% of eZoneXchange's issued and outstanding share capital, in the event of an additional round of financing in eZoneXchange.

During February 2001, the Company decided to close the New York and Chicago offices of its B2B subsidiary eZoneXchange.com, Inc. and reduce its operating costs, while allowing the possibility of an investment by outside parties in the future.

- c. In April 2001 the Company entered into agreements with Bank Leumi Le-Israel B.M. and Bank Hapoalim Ltd. (collectively the "Banks") to extend the Company's credit facilities by an additional \$10 million. In connection with such extension, the Company has undertaken not to pledge any of its assets or the assets of its subsidiaries without the approval of the Banks. The Company and various of its subsidiaries also granted floating charges to the Banks and issued cross guaranties in support of the credit facilities.
- d. On April 4, 2001, the Company entered into a share purchase and loan agreement with Red Coral Holdings, Inc. ("Red Coral"), which may be deemed to be beneficially owned by the Company's President and Chief Executive Officer. According to the terms of the agreement, Red Coral purchased 1,500,000 Common Shares of the Company for a purchase price of \$975,000. As part of the agreement, the Company granted to Red Coral a loan in the amount of \$975,000 for the purpose of acquiring the Common Shares. The term of the loan is six years with accrued interest at a rate of 0.5% over LIBOR. To secure payment of the loan, Red Coral granted the Company a lien and security interest on all of the Common Shares. To secure fulfillment of the terms of the agreement, the Common Shares are being held in escrow by the General Counsel of the Company.

Corporate Directory

Corporate Officers and Principal Executives

Yitzhak Sharir

President and Chief Executive Officer

Yuval Hadari

Chief Financial Officer

Amos Shattner

Executive Vice President, Technology and Operations

Yaacov Sivan

Executive Vice President, Sales and Marketing

Haim Zysberg

Chief Technology Officer

Steve Kronengold

Executive Vice President, Secretary and General Counsel

Gil Arbel

Executive Vice President, Americas

Yair Spitzer

Vice President, UK

Saadia Essoudry

Vice President, France and Belgium

Helmut Hilgers

Vice President, Germany

Yechiel Gepner

Vice President, Israel

Ruvik Barkan

Vice President, Sales and ROW

Manabu Okada

Vice President, Japan

Board of Directors

Ron Zuckerman, Chairman

Michel Berty

Kenneth J. Bialkin

Danny Goldstein

L. Robert Libutti

Tsvi Misinai

Shlomo (Shai) Sole

Holland Intertrust (ANTILLES)
N.V.

Sapiens International Corporation N.V.

Landhuis Joonchi

Kaya Richard J. Beaujon

Curacao, Netherlands Antilles

Web site: www.sapiens.com

Executive Offices

Yitzhak Rabin Science Park

P.O. Box 4011

76120 Rehovot

Israel

Tel: 972 8 938 2777

Fax: 972 8 938 2730

AMERICAS

Sapiens Americas

2000 CentreGreen Way, Suite 240

Cary, NC 27513

USA

Tel: 1 919 405 1500

Fax: 1 919 405 1700

EUROPE

FRANCE

Sapiens France

Tours les Mercuriales

Tour du Levant

40, Rue Jean Jaures

Bagnolet, Cedex 93170

Tel: 33 1 4972 4848

Fax: 33 1 4972 4849

GERMANY

Sapiens Deutschland GmbH

In der Au 25

D-61440 Oberursel (Taunus)

Tel: 49 61 71 62 720

Fax: 49 61 71 62 72 95

ISRAEL

Sapiens Israel Software Systems

P.O. Box 4011

Rehovot 76120

Tel: 972 8 938 2888

Fax: 972 8 938 2855

THE NETHERLANDS

Sapiens Nederland N.V.

Holland Office Center IV,

Kruisweg 813a, 2132 NG

Hoofddorp

Tel: 31 23 558 46 00

Fax: 31 23 555 34 67

SPAIN

Sapiens Informatica Espana

Gran Vía, 86

Edificio España, Grupo II

Planta 18 Pta. 8

28014 Madrid

Tel: 34 686 48 61 93

UNITED KINGDOM

Sapiens UK Limited

Harman House

Uxbridge, Middlesex UB8 1QQ

Tel: 44 1895 464 000

Fax: 44 1895 463 098

ASIA PACIFIC

JAPAN

Sapiens Japan

Queen's tower C 11F

2-3-5 Minatomirai, Nishi-ku

Yokohama 220-6211

Tel: 81 45 682 4777

Fax: 81 45 682 4780

Independent Auditors

Kost Forer & Gabbay

A Member of Ernst & Young

International

3 Aminadav Street

Tel Aviv 61575

Israel

Transfer Agent

American Stock Transfer & Trust
Company

59 Maiden Lane

New York, NY 10038

Tel: 1 718 921 8200

Investor Relations

Ms. Judith Kleinman, Director,

Taylor Rafferty Associates

e-mail: jdk@taylor-rafferty.com

Annual Meeting

The annual general meeting of stockholders is scheduled to take place at 10:00 a.m. on Monday, August 27, 2001 at Sapiens International Corporation N.V., Curacao, Netherlands Antilles.

emerge into the future>>



www.sapiens.com

email: info@sapiens.com