MAGIC SOFTWARE ENTERPRISES LTD
Form 20-F
April 30, 2019

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 20-F

OR

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from _____to _____

OR

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

Date of event requiring this shell company report

Commission file number: 0-19415

MAGIC SOFTWARE ENTERPRISES LTD.

(Exact name of Registrant as specified in its charter

and translation of Registrant's name into English)

Israel

(Jurisdiction of incorporation or organization)

5 Haplada Street, Or Yehuda 6021805, Israel

(Address of principal executive offices)

Amit Birk; +972 (3) 538 9322; abirk@magicsoftware.com

5 Haplada Street, Or Yehuda 6021805, Israel

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 0.1 Par Value	**NASDAQ Global Select Market**

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

48,861,038 Ordinary Shares, par value NIS 0. 1 per share

(as of December 31, 2018)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer: Accelerated filer: Non-accelerated filer: Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 13(a) of the Exchange Act.

† The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP | International Financial Reporting Standards as issued by the International Accounting Standards Board | Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

This annual report on Form 20-F is incorporated by reference into the registrant's Registration Statements on Form S-8, File Nos. 333-113552, 333-132221 and 333-149553.

INTRODUCTION

We are a global provider of: (i) proprietary application development and business process integration platforms; (ii) selected packaged vertical software solutions; as well as (iii) a vendor of software services and IT outsourcing software services. Our software technology is used by customers to develop, deploy and integrate on-premise, mobile and cloud-based business applications quickly and cost effectively. In addition, our technology enables enterprises to accelerate the process of delivering business solutions that meet current and future needs and allow customers to dramatically improve their business performance and return on investment. With respect to software services and IT outsourcing services, we offer a vast portfolio of professional services in the areas of infrastructure design and delivery, application development, technology consulting planning and implementation services, support services, cloud computing for deployment of highly available and massively-scalable applications and API's and supplemental outsourcing services. In addition, we offer a variety of proprietary comprehensive packaged software solutions through certain of our subsidiaries for (i) revenue management and monetization solutions in mobile, wireline, broadband and mobile virtual network operator/enabler, or MVNO/E ("Leap"); (ii) enterprise management systems for both hubs and traditional air cargo ground handling operations from physical handling and cargo documentation through customs, seamless electronic data interchange, or EDI communications, dangerous goods, special handling, track and trace, security to billing ("Hermes"); (iii) enterprise human capital management, or HCM, solutions, to facilitate the collection, analysis and interpretation of quality data about people, their jobs and their performance, to enhance HCM decision making ("HR Pulse"); (iv) comprehensive systems for managing broadcast channels in the area of TV broadcast management through cloud-based on-demand service or on-premise solutions; and (vi) enterprise-wide and fully integrated medical platform ("Clicks"), specializing in the design and management of patient-file oriented software solutions for managed care and large-scale health care providers. This platform allows providers to securely access an individual's electronic health record at the point of care, and it organizes and proactively delivers information with potentially real time feedback to meet the specific needs of physicians, nurses, laboratory technicians, pharmacists, front- and back-office professionals and consumers.

Based on our technological capabilities, our software solutions enable customers to respond to rapidly-evolving market needs and regulatory changes, while improving the efficiency of their core operations. We have approximately 2,000 employees and operate through a network of over 3,000 independent software vendors, or ISVs, who we refer to as Magic Software Providers, or MSPs, and hundreds of system integrators, distributors, resellers, and consulting and OEM partners. Thousands of enterprises in approximately 50 countries use our products and services.

Our application development and business process integration platforms consist of:

Magic xpa – a proprietary application platform for developing and deploying business applications.

AppBuilder – a proprietary application platform for building, deploying, and maintaining high-end, mainframe-grade business applications.

Magic xpi – a proprietary platform for application integration.

Magic xpc – hybrid integration platform as a service (iPaaS).

These software solutions enable our customers to improve their business performance and return on investment by supporting cost-effective and rapid delivery integration of business applications, systems and databases. Using our products, enterprises and MSPs can achieve fast time-to-market by rapidly building integrated solutions and deploy them in multiple environments while leveraging existing IT resources. In addition, our software solutions are scalable and platform-agnostic, enabling our customers to build software applications by specifying their business logic requirements in a high-level language rather than in computer code, and to benefit from seamless platform upgrades and cross-platform functionality without the need to re-write their applications. Our platforms also support the development of mobile applications that can be deployed on a variety of smartphones and tablets, and in a cloud environment. In addition, we continuously evolve our platforms to include the latest technologies to meet the demands of our customers and the markets in which they operate.

We sell our platforms globally through a broad channel network, including our own direct sales representatives and offices, independent country distributors, MSPs that use our technology to develop and sell solutions to their customers, and system integrators. We also offer software maintenance, support, training and consulting services to supplement with our products, thus aiding in the successful implementation of Magic xpa, AppBuilder, Magic xpi and Magic xpc projects, and assuring successful operation of the platforms once installed.

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Our vertical packaged software solutions include:

Clicks – a proprietary comprehensive core software solution for medical record information management system, used in the design and management of patient-files for managed care and large-scale healthcare providers. The platform is connected to each provider's clinical, administrative and financial data base system, residing at the provider's central computer, and allows immediate analysis of complex data with potentially real-time feedback to meet the specific needs of physicians, nurses, laboratory technicians, pharmacists, front- and back-office professionals and consumers.

Leap™ – a proprietary comprehensive core software solution for Business Support Systems, or BSS, including convergent charging, billing, customer management, policy control, mobile money and payment software solutions for the telecommunications, content, Machine to Machine/Internet of Things or M2M/IoT, payment and other industries.

Hermes Solution – Hermes Air Cargo Management System is a proprietary, state-of-the-art, packaged software solution for managing air cargo ground handling. Our Hermes Solution covers all aspects of cargo handling, from physical handling and cargo documentation through customs, seamless EDI communications, dangerous goods and special handling, tracking and tracing, security and billing. Customers benefit through faster processing and more accurate billing, reporting and ultimately enhanced revenue. the system also features the Hermes Business Intelligence (HBI) solution, adding unprecedented data analysis capabilities and management-decision support tools. The Hermes Solution is delivered on a licensed or fully hosted basis.

HR Pulse – A customizable single-tenant SaaS tool that helps organizations to monitor employee performance, progress and potential through a menu of templates that can create new HCM solutions, complement existing processes, and/or integrate with legacy HR systems already in use by organizations.

MBS Solution – a proprietary comprehensive core system for TV broadcast management for use in managing broadcast channels.

In addition, we provide a broad range of advanced software professional services and IT outsourcing services in the areas of infrastructure design and delivery, end-to-end application development, technology planning and implementation services, as well as outsourcing services to a wide variety of companies, including Fortune 1000 companies. The technical personnel we provide generally supplement in-house capabilities of our customers. We have extensive and proven experience with virtually all types of telecom infrastructure technologies in wireless and wire-line as well as in the areas of infrastructure design and delivery, application development, project management, technology planning and implementation services.

We have substantial experience in end-to-end development of high-end software solutions, beginning with collection and analysis of system requirements, continuing with architecture specifications and setup, to software

implementation, component integration and testing. From concept to implementation, from application of the ideas of startups requiring the early development of an application or a device, to somewhat larger, more established enterprises, vendors or system houses who need our team of experts to take full responsibility for the development of their systems and products. With our ability to draw on our pool of resources, comprised of hundreds of highly trained, skilled, educated and flexible engineers, we adhere to timelines and budget and work in full transparency with our customers every step of the way to create a tailor-made and cost-effective solution to answer all of our customers' unique needs.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with United States generally accepted accounting principles, or U.S. GAAP.

We have obtained trademark registrations for Magic® in the United States, Canada, Israel, the Netherlands (Benelux), Switzerland, Thailand and the United Kingdom. All other trademarks and trade names appearing in this annual report are owned by their respective holders.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any previous filling with the Securities and Exchange Commission, or the SEC, you may read the document itself for a complete recitation of its terms.

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Definitions

In this annual report, unless the context otherwise requires:

References to “Magic,” the “Company,” the “Registrant,” “our company,” “us,” “we” and “our” refer to Magic Software Enter Ltd. and its consolidated subsidiaries;

References to “our shares,” “Ordinary Shares” and similar expressions refer to Magic’s Ordinary Shares, par value NIS 0. 1 per share;

References to “dollars”, “U.S. dollars”, “U.S. $” and “$” are to United States Dollars;

References to “Euro” or “€” are to the Euro, the official currency of the Eurozone in the European Union;

References to “shekels” and “NIS” are to New Israeli Shekels, the Israeli currency;

References to the “Articles” are to our Amended Articles of Association, as currently in effect;

References to the “Securities Act” are to the Securities Act of 1933, as amended;

References to the “Exchange Act” are to the Securities Exchange Act of 1934, as amended;

References to “NASDAQ” are to the NASDAQ Stock Market;

References to the “TASE” are to the Tel Aviv Stock Exchange; and

References to the “SEC” are to the United States Securities and Exchange Commission.

Cautionary Note Regarding Forward-Looking Statements

Certain matters discussed in this annual report are forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Exchange Act and the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, 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," "may," "will," "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 expressed or implied by the forward-looking statements. Please read the risks discussed in Item 3 – "Key Information" under the caption "Risk Factors" and cautionary statements appearing elsewhere in this annual report in order to review conditions that we believe could cause actual results to differ materially from those contemplated by the forward-looking statements. We undertake no obligation to release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. Whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report might not occur.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following table summarizes certain selected consolidated financial data for the periods and as of the dates indicated. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. “Operating and Financial Review and Prospects” and our consolidated financial statements and notes thereto included elsewhere in this annual report.

We derived the following consolidated statement of income data for the years ended December 31, 2016, 2017 and 2018 and the consolidated balance sheet data as of December 31, 2017 and 2018 from our audited consolidated financial statements included elsewhere in this annual report. The selected consolidated statement of income data for the year ended December 31, 2014 and 2015 and the consolidated balance sheet data as of December 31, 2014, 2015 and 2016 are derived from our audited consolidated financial statements not included in this annual report. Our historical consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP, and presented in U.S. dollars.

Statement of Income Data:

	Year ended December 31,				
	2014	2015	2016	2017	2018

	(**U.S. dollars in thousands, except per share data**)				
Revenues:					
Software	$25,351	$21,598	$19,626	$21,644	$25,454
Maintenance and technical support	22,780	22,908	25,885	30,386	30,951
Consulting services	116,173	131,524	156,135	206,110	227,970
Total revenues	164,304	176,030	201,646	$258,140	$284,375
Cost of revenues:					
Software	7,646	7,836	8,674	9,564	9,960
Maintenance and technical support	2,921	2,466	2,952	3,888	4,120
Consulting services	89,160	102,919	121,756	161,709	181,477
Total cost of revenues	99,727	113,221	133,382	175,161	195,557
Gross profit	64,577	62,809	68,264	82,979	88,818
Operating costs and expenses:					
Research and development, net	4,750	4,888	5,839	6,942	5,696
Selling and marketing	24,580	23,062	23,776	27,244	27,197
General and administrative	14,521	13,425	17,562	22,837	24,227
Operating income	20,726	21,434	21,087	25,956	31,698
Financial income (expense), net	(1,786)	(685)	(430)	(1,711)	(149)
Other income (expense), net	(67)	8	-	-	-
Income before taxes on income	18,873	20,757	20,657	24,245	31,847
Taxes on income	(2,307)	(3,681)	(3,949)	(6,331)	(7,071)
Net income	$25,351	$17,076	$16,708	$17,914	$24,776
Change in redeemable non-controlling interests	425	639	2,258	1,536	3,383
Net income attributable to non-controlling interests	621	239	281	936	1,510
Net income attributable to Magic's Shareholders	15,520	16,198	14,169	15,442	19,883
Basic earnings per share [(1)]	$0.36	$0.37	$0.27	$0.35	$0.39
Diluted earnings per share	$0.36	$0.36	$0.27	$0.35	$0.39
Shares used to compute basic earnings per share [(2) (3)]	44,172	44,248	44,347	44,436	46,665
Shares used to compute diluted earnings per share	43,305	44,452	44,516	44,597	46,797
Dividends	8,681	7,788	7,761	9,554	13,348
Cash dividend declared per ordinary share[(1)]	$0.22	$0.18	$0.18	$0.22	$0.29

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Balance Sheet Data:

	December 31,				
	2014	2015	2016	2017	2018
	(U.S. dollars in thousands)				
Working capital	$103,049	$106,945	$113,668	$122,403	$158,301
Cash, cash equivalents, short term deposits and marketable securities	84,430	76,684	87,822	90,946	113,920
Total assets	224,184	239,846	316,399	342,539	362,326
Total equity	187,724	193,106	196,641	213,563	248,369

(1) From September 10, 2012 through September 3, 2013 we declared and paid accumulated cash dividend distributions of $0.31 per share ($11,448 in the aggregate). On February 18, 2014, we declared a dividend distribution of $0.12 per share ($ 4,468 in the aggregate) which was paid on March 14, 2014. On August 19, 2014 we declared a dividend distribution of $0.095 per share ($4,195 in the aggregate) which was paid on September 4, 2014. On February 5, 2015, we declared a dividend distribution of $0.081 per share ($3,582 in the aggregate) which was paid on March 11, 2015. On August 12, 2015, we declared a dividend distribution of $0.095 per share ($ 4,204 in the aggregate) which was paid on September 10, 2015. On February 21, 2016, we declared a dividend distribution of $0.09 per share ($3,991 in the aggregate) which was paid on March 17, 2016. On August 14, 2016, we declared a dividend distribution of $0.085 per share ($3,770 in the aggregate) which was paid on September 22, 2016. On February 22, 2017, we declared a dividend distribution of $0.085 per share ($3,774 in the aggregate) which was paid on April 5, 2017. On August 13, 2017, we declared a dividend distribution of $0.13 per share ($5,779 in the aggregate) which was paid on September 13, 2017. On February 28, 2018, we declared a dividend distribution of $0.13 per share ($5,784 in the aggregate) which was paid on March 26, 2018. On August 8, 2018, we declared a dividend distribution of $0.155 per share ($7,600 in the aggregate) which was paid on September 5, 2018. Subsequent to the balance sheet date, on March 4, 2019, we declared a dividend distribution of $0.15 per share ($7,300 in the aggregate) which was paid on March 25, 2019.

(2) On March 5, 2014, we completed a follow-on public offering of 6,900,000 of our Ordinary Shares including 900,000 Ordinary Shares sold pursuant to the underwriters' full exercise of their over-allotment option at a price to the public of $8.50 per share pursuant to an underwriting agreement with Barclays Capital Inc. and William Blair & Company, L.L.C, as representative of certain underwriters.

(3) On July 12, 2018, we completed a private placement of 3,150,559 of our Ordinary Shares to several leading Israeli institutional investors and 1,117,734 Ordinary Shares to our principal shareholder, Formula Systems (1985) Ltd., under the same terms based on a price of $8.20 per share.

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Dividend Policy

Our Board of Directors' dividend policy was amended on August 9, 2017 to distribute dividends of up to 75% of our annual distributable profits each year (previously 50% of our annual distributable profits), subject to any applicable law. We have paid dividends since 2012. Our Board of Directors may in its discretion and at any time, whether as a result of a one-time decision or a change in policy, change the rate of dividend distributions or decide not to distribute a dividend.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. Our business, prospects, financial condition and results of operations could be adversely affected due to any of the following risks. In that case, the value of our ordinary shares could decline, and you could lose all or part of your investment.

Risks Related to Our Business and Our Industry

We are dependent on a limited number of core product families and services and a decrease in revenues from these products and services would adversely affect our business, results of operations and financial condition; our future success will be largely dependent on the acceptance of future releases of our core product families and service offerings and if we are unsuccessful with these efforts, our business, results of operations and financial condition will be adversely affected.

We derive a significant portion of our revenues from sales of application and integration platforms and vertical software solutions and from related professional services, software maintenance and technical support as well as from other IT professional services, which include IT consulting and outsourcing services. Our future growth depends heavily on our ability to effectively develop and sell new products developed by us or acquired from third parties as well as add new features to existing products and new software service offerings. A decrease in revenues from our principal products and services would adversely affect our business, results of operations and financial condition.

Our future success depends in part on the continued acceptance of our application platforms and integration products primarily under our Magic xpa, Magic xpi, AppBuilder and Magic xpc brands and our vertical packaged software solutions, primarily Clicks, Leap™, the Hermes solution and HR Pulse. The continued acceptance of these platforms and software solutions will be dependent in part on the continued acceptance and growth of the cloud market, including rich internet applications, or RIAs, mobile and software as a service, or SaaS, for which certain of them are particularly useful and advantageous. We will need to continue to enhance our products to meet evolving requirements and if new versions of such products are not accepted, our business, results of operations and financial condition may be adversely affected.

Rapid technological changes may adversely affect the market acceptance of our products and services, and our business, results of operations and financial condition could be adversely affected.

We compete in a market that is characterized by rapid technological changes. Other companies are also seeking to offer software solutions, enterprise mobility solutions, internet-related solutions, such as cloud computing, and complementary services to generate growth. These companies may develop technological or business model innovations or offer services in the markets that we seek to address that are, or are perceived to be, equivalent or superior to our products and services. In addition, our customers' business models may change in ways that we do not anticipate and these changes could reduce or eliminate our customers' needs for our products and services. Our operating results depend on our ability to adapt to market changes and develop and introduce new products and services into existing and emerging markets.

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The introduction of new technologies and devices could render existing products and services obsolete and unmarketable and could exert price pressures on our products and services. Our future success will depend upon our ability to address the increasingly sophisticated needs of our customers by:

Supporting existing and emerging hardware, software, databases and networking platforms; and

Developing and introducing new and enhanced software development technology and applications that keeps pace with such technological developments, emerging new product markets and changing customer requirements.

In addition, if release dates of any future products or enhancements are delayed or if they fail to achieve market acceptance when released, our business, financial condition and results of operations could be adversely affected.

Adapting to evolving technologies can require substantial financial investments, distract management and adversely affect the demand for our existing products and services.

Adapting to evolving technologies may require us to invest a significant amount of resources, time and attention into the development, integration, support and marketing of those technologies. The acceptance and growth of cloud computing and enterprise mobility are examples of rapidly changing technologies, which we have adapted into our products, packaged software solution and software service offerings. This required us to make a substantial financial investment to develop and implement cloud computing and enterprise mobility into our software solution models and has required significant attention from our management to refine our business strategies to include the delivery of these solutions. As the market continues to adopt these new technologies, we expect to continue to make substantial investments in our software solutions, system integrations and professional services related to these changing technologies. Even if we succeed in adapting to a new technology by developing attractive products and services and successfully bringing them to market, there is no assurance that the new product or service will have a positive impact on our financial performance and could even result in lower revenue, lower margins and higher costs and therefore could negatively impact our financial performance.

If our customers terminate contracted projects or choose not to retain us for additional projects, our revenues and profitability may be negatively affected.

Our IT professional services customers typically retain us on a non-exclusive basis. Many of our customer contracts, including those that are on a fixed price and timeframe basis, can be terminated by the customer with or without cause upon 90 days' notice or less, and generally without termination-related penalties. Additionally, our contracts with customers are typically limited to discrete projects without any commitment to a specific volume of business or future

work and may involve multiple stages. Furthermore, the increased breadth of our service offerings may result in larger and more complex projects for our customers that require us to devote resources to more thoroughly understand their operations. Despite these efforts, our customers may choose not to retain us for additional stages or may cancel or delay planned or existing engagements due to any number of factors, including:

a customer's financial difficulties;

a change in a customer's strategic priorities;

a customer's demand for price reductions; and

a decision by a customer to utilize its in-house IT capacity or work with our competitors.

These potential terminations, cancellations or delays in planned or existing engagements could make it difficult for us to use our personnel efficiently and may negatively affect our revenues and profitability.

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We enter from time to time into fixed-price contracts that could subject us to losses in the event we fail to properly estimate our costs.

We enter from time to time into number of firm fixed-price contracts. If our initial cost estimates are incorrect, it may cause losses on these contracts. Because many of these contracts involve new technologies and applications, unforeseen events, such as technological difficulties and other cost overruns, can result in the contract pricing becoming less favorable or even unprofitable to us and have an adverse impact on our financial results.

If we fail to meet our customers' performance expectations, our reputation may be harmed, causing us to lose customers or exposing us to legal liability.

Our ability to attract and retain customers depends to a large extent on our relationships with our customers and our reputation for high quality solutions, professional services and integrity. As a result, if a customer is not satisfied with our services or solutions, including those of subcontractors we engage, our reputation may be damaged. Our failure to meet these goals or a customer's expectations may result in a less profitable or an unprofitable engagement. Moreover, if we fail to meet our customers' expectations, we may lose customers and be subject to legal liability, particularly if such failure adversely affects our customers' businesses.

In addition, a portion of our projects may be considered critical to the operations of our customers' businesses. Our exposure to legal liability may be increased in the case of contracts in which we become more involved in our customers' operations. While we typically strive to include provisions designed to limit our exposure to legal claims relating to our services and the solutions we develop, these provisions may not adequately protect us or may not be enforceable in all cases. The general liability insurance coverage that we maintain, including coverage for errors and omissions, is subject to important exclusions and limitations. We cannot be certain that this coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. A successful assertion of one or more large claims against us that exceeds our available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could adversely affect our profitability.

If our technical support or professional services are not satisfactory to our customers, they may not renew their maintenance and support agreements or buy future products, which could adversely affect our future results of operations.

Our business relies on our customers' satisfaction with the technical support and professional services we provide to support our products. If we fail to provide technical support services that are responsive, satisfy our customers'

expectations and resolve issues that they encounter with our products and services, then they may elect not to purchase or renew annual maintenance and support contracts and they may choose not to purchase additional products and services from us. Accordingly, our failure to provide satisfactory technical support or professional services could lead our customers not to renew their agreements with us or renew on terms less favorable to us, and therefore have a material and adverse effect on our business and results of operations.

We face intense competition in the markets in which we operate. This competition could adversely affect our business, results of operations and financial condition.

We compete with other companies in the areas of application platforms, business integration and business process management, or BPM, tools, and in the applications, mobile solutions, vertical solutions and professional services markets in which we operate. The growth of the cloud computing market has increased the competition in these areas. We expect that such competition will continue to increase in the future with respect to our technology, applications and professional services that we currently offer and applications, and with respect to our services that we and other vendors are developing. Increased competition, direct and indirect, could adversely affect our business, financial condition and results of operations.

As we also compete with other companies in the technical IT consulting and outsourcing services industry, this industry is highly competitive and fragmented and has low entry barriers. We compete for potential customers with providers of outsourcing services, systems integrators, computer systems consultants, other providers of technical IT consulting services and, to a lesser extent, temporary personnel agencies. We expect competition to increase, and we may not be able to remain competitive.

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Some of our existing and potential competitors are larger companies, have substantially greater resources than us, including financial, technological, marketing, skilled human resources and distribution capabilities, and enjoy greater market recognition than us. We may not be able to differentiate our products and services from those of our competitors, offer our products as part of integrated systems or solutions to the same extent as our competitors, or successfully develop or introduce new products that are more cost-effective, or offer better performance than our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

Unfavorable national and global economic conditions could adversely affect our business, operating results and financial condition.

During periods of slowing economic activity, our customers may reduce their demand for our products, technology and professional services, which would reduce our sales, and our business, operating results and financial condition may be adversely affected. The global and domestic economies continue to face a number of economic challenges, including threatened sovereign defaults, credit downgrades, restricted credit for businesses and consumers and potentially falling demand for a variety of products and services. These developments, or the perception that any of them could occur, could result in longer sales cycles, slower adoption of new technologies and increased price competition for our products and services. We could also be exposed to credit risk and payment delinquencies on our accounts receivable, which are not covered by collateral.

We are exposed to economic and market conditions that impact the communications industry.

We provide packaged software and software services to service providers in the telecom industry, and our business may therefore be highly dependent upon conditions in that industry. Developments in the telecom industry, such as the impact of global economic conditions, industry consolidation, emergence of new competitors, commoditization of voice, video and data services and changes in the regulatory environment, at times have had, and could continue to have, a material adverse effect on our existing or potential customers. In the past, these conditions reduced the high growth rates that the communications industry had previously experienced and caused the market value, financial results and prospects and capital spending levels of many telecom companies to decline or degrade. Industry consolidation involving our customers may place us at risk of losing business to the incumbent provider to one of the parties to the consolidation or to new competitors. During previous economic downturns, the telecom industry experienced significant financial pressures that caused many in the industry to cut expenses and limit investment in capital intensive projects and, in some cases, led to restructurings and bankruptcies. Continuing uncertainty as to economic recovery in recent years may have adverse consequences for our customers and our business.

Downturns in the business climate for telecom companies have previously resulted in slower customer buying decisions and price pressures that adversely affected our ability to generate revenue. Adverse market conditions may have a negative impact on our business by decreasing our new customer engagements and the size of initial spending

commitments under those engagements, as well as decreasing the level of discretionary spending by existing customers. In addition, a slowdown in buying decisions may extend our sales cycle period and may limit our ability to forecast our flow of new contracts. If such adverse business conditions arise in the future, our business may be harmed.

As some of our revenues are derived from the Israeli government sector, a reduction of government spending in Israel on IT services may reduce our revenues and profitability; and any delay in the annual budget approval process may negatively impact our cash flows.

We perform work for a wide range of Israeli governmental agencies and related subcontractors. Any reduction in total Israeli government spending for political or economic reasons may reduce our revenues and profitability. In addition, the government of Israel has experienced significant delays in the approval of its annual budget in recent years. Such delays in the future could negatively affect our cash flows by delaying the receipt of payments from the government of Israel for services performed.

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We may encounter difficulties in realizing the potential financial or strategic benefits of recent business acquisitions. We expect to make additional acquisitions in the future that could disrupt our operations and harm our operating results.

A significant part of our business strategy is to pursue acquisitions and other initiatives based on strategy centered on three key factors: growing our customer base, expanding geographically and adding complementary solutions to our portfolio— all while we seek to ensure our continued high quality of services and product delivery. In the past five years we made numerous acquisitions, including: (i) in 2013, Dario Solutions IT Ltd., a provider of software integration and software solutions for large and mid-range customers in Israel and Microsoft Gold Level Partner; (ii) in 2013, Valinor Ltd., a Microsoft Certified Partner and a Oracle Gold Level Partner that specializes in project and product consultation, and the installation and implementation of databases; (iii) in 2013, the enterprise division of AllStates Technical Services, LLC, a U.S.-based full-service provider of consulting and outsourcing solutions for IT, engineering and telecom personnel; (iv) in 2014, Datamind, a system integrator of user-driven Business Intelligence ("BI") solutions (mainly QlikView and Qlik Sense) that enable customers to make better, faster and more informed business decisions, wherever they are; (v) in 2014, Formula Telecom Solutions Ltd., an Israeli based global proprietary software vendor that specializes in the development, sale, service and support of business support systems, including convergent charging, billing, customer management, policy control and payment software solutions for the telecommunications, content, Machine to Machine/Internet of Things, or M2M/IoT, payment and other industries; (vi) in 2015, Comblack IT Ltd, an Israeli-based company specializing in software professional services and outsource services for mainframes and complex large-scale environments; (vii) in 2015, Infinigy Solutions LLC, a U.S.-based services company focused on expanding the development and implementation of technical solutions which delivers design-driven turnkey solutions, combining Architecture and Engineering, or A&E design project management and general contracting competencies, across the wireless communications industry; (viii) in 2016, Roshtov Software Industries Ltd, an Israeli-based software company that is a local Israeli market leader in patient medical record information systems; (ix) in 2016, Shavit Software (2009) Ltd., an Israeli-based company specializing in software professional and outsource services; and (x) in late December 2017, Futurewave Systems, Inc., a U.S.-based full-service provider of consulting and outsourcing solutions for IT personnel.

Mergers and acquisitions of companies are inherently risky and subject to many factors outside of our control and no assurance can be given that our future acquisitions will be successful and will not adversely affect our business, operating results, or financial condition. In the future, we may seek to acquire or make strategic investments in complementary businesses, technologies, services or products, or enter into strategic partnerships or alliances with third parties in order to expand our business. Failure to manage and successfully integrate such acquisitions could materially harm our business and operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products technologies and professional services to a failure to do so. Even when an acquired company has previously developed and marketed products, there can be no assurance that new product enhancements will be made in a timely manner or that pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products. If we acquire other businesses, we may face difficulties, including:

Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired businesses or enterprises;

Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;

Integrating financial forecasting and controls, procedures and reporting cycles;

Potential difficulties in completing projects associated with in-process research and development;

Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;

Insufficient revenue to offset increased expenses associated with acquisitions; and

The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

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The increasing amount of intangible assets and goodwill recorded on our balance sheet may lead to significant impairment charges in the future.

The amount of goodwill and identifiable intangible assets on our consolidated balance sheet has increased significantly from $86.5 million as of December 31, 2013 to approximately $136.5 million as of December 31, 2018 because of our acquisitions, and may increase further following future acquisitions. We regularly review our long-lived assets, including identifiable intangible assets and goodwill, for impairment. Goodwill and indefinite life intangible assets are subject to impairment review at least annually. Other long-lived assets are reviewed when there is an indication that impairment may have occurred. Impairment testing under U.S. GAAP, subject to downturns in our operating results and financial condition, may lead to impairment charges in the future. Any significant impairment charges could have a material adverse effect on our results of operations.

If we fail to manage our growth, our business could be disrupted and our profitability will likely decline.

We have experienced rapid growth during recent years, through both acquisitions and organically. The number of our employees over the last five years increased from 1,300 as of December 31, 2013 to approximately 2,226 as of December 31, 2018 and may increase further as we aim to enhance our businesses. This increase may significantly strain our management and other operational and financial resources. In particular, continued headcount growth increases the integration challenges involved in:

Recruiting, training and retaining skilled technical, marketing and management personnel;

Maintaining high quality standards;

Preserving our corporate culture, values and entrepreneurial environment;

Developing and improving our internal administrative infrastructure, particularly our financial, operational, communications and other internal controls; and

Maintaining high levels of customer satisfaction.

The rapid execution necessary to exploit the market for our business model requires an effective planning and management process. Our systems, procedures or controls may not be adequate to support the growth in our operations, and our management may not be able to achieve the rapid execution necessary to exploit the market for

our business model. Our future operating results will also depend on our ability to expand our development, sales and marketing organizations. If we are unable to manage growth effectively, our profitability will likely decline.

If we fail to attract and retain highly skilled IT professionals, we may not have the necessary resources to properly staff projects and competition for such professionals may adversely affect our business, results of operations and financial condition.

Our success depends largely on the contributions of our employees and our ability to attract and retain qualified personnel, including technology, consulting, engineering, marketing and management professionals and upon our ability to attract and retain qualified computer professionals to serve as temporary IT personnel. Competition for the limited number of qualified professionals with a working knowledge of certain sophisticated computer languages is intense. We compete for technical personnel with other providers of technical IT consulting and outsourcing services, systems integrators, providers of outsourcing services, computer systems consultants, customers and, to a lesser extent, temporary personnel agencies, and competition may be amplified by evolving restrictions on immigration, travel, or availability of visas for skilled technology workers. A shortage of, and significant competition for software professionals with the skills and experience necessary to perform the required services, may require us to forego projects for lack of resources and may adversely affect our business, results of operations and financial condition. In addition, our ability to maintain and renew existing engagements and obtain new business for our contract IT professional services operations depends, in large part, on our ability to hire and retain technical personnel with the IT skills that keep pace with continuing changes in software evolution, industry standards and technologies, and customer preferences. Demand for qualified professionals conversant with certain technologies may exceed supply as new and additional skills are required to keep pace with evolving computer technology or as competition for technical personnel increases. Increasing demand for qualified personnel could also result in increased expenses to hire and retain qualified technical personnel and could adversely affect our profit margins

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We have a history of quarterly fluctuations in our results of operations and expect these fluctuations to continue.

We have experienced, and in the future may continue to experience, significant fluctuations in our quarterly results of operations. Factors that may contribute to fluctuations in our quarterly results of operations include:

The size and timing of orders;

The high level of competition that we encounter;

The timing of our products introductions or enhancements or those of our competitors or of providers of complementary products;

Market acceptance of our new products, applications and services;

The purchasing patterns and budget cycles of our customers and end-users;

The mix of product sales;

Exchange rate fluctuations;

General economic conditions; and

The integration of newly acquired businesses.

Our customers ordinarily require the delivery of our products promptly after we accept their orders. With the exception of contracts for services and packaged software solution projects, which normally would extend between nine to eighteen months, we usually do not have a backlog of orders for our products. Consequently, revenues from our products in any quarter depend on orders received and products provided by us and accepted by the customers in that quarter. A deferral in the placement and acceptance of any large order from one quarter to another or from one year to another could adversely affect our results of operations for the respective quarter or year. Our customers sometimes require an acceptance test for services and packaged software solutions projects we provide and as a result, we may have a significant backlog of orders arising from those services and projects. Our revenues from services depend on orders received and services provided by us and accepted by our customers in that quarter. If sales in any quarter or year do not increase correspondingly or if we do not reduce our expenses in response to level or declining

revenues in a timely fashion, our financial results for that period may be adversely affected. For these reasons, quarter-to-quarter comparisons of our results of operations are not necessarily meaningful and you should not rely on the results of our operations in any particular quarter as an indication of future performance.

The majority of revenues of two of our principal IT professional services subsidiaries and of our 2016 acquired Roshtov subsidiary are dependent upon a small number of key customers. Therefore, a significant decrease in revenues from such customers could adversely affect our business, results of operations and financial condition.

We depend on repeat product and professional services revenues from existing customers. Our five largest customers accounted for, in the aggregate, 27% of our revenues in each of the years ended December 31, 2017 and 2018, respectively. If these existing customers decide not to continue utilizing our professional services, not to renew their existing engagements, or not to continue using our products, or decide to significantly decrease their total spend with us, it may adversely affect our business, results of operations and financial condition. Under their master services agreements, all five customers may terminate their agreements with us upon only a 30-day notice without any penalty.

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We derive a significant portion of our revenues from independent distributors who are under no obligation to purchase our products and the loss of such independent distributors could adversely affect our business, results of operations and financial condition.

We sell our products and packaged software solutions through our own direct sales representatives and offices, as well as through third parties that in the case of our development platforms (Magic xpa and AppBuilder) use our technology to develop and sell solutions to their customers (ISVs) and through system integrators. The ISVs then sell the applications they develop on the Magic xpa or AppBuilder application platforms to end-users. In some regions, especially in Asia and Asia-Pacific, Central and Eastern Europe, Spain, Italy, South America, Africa and a few countries in the Mediterranean area, we also sell our products and packaged software solutions through a broad distribution and sales network, including independent regional distributers. We are dependent upon the acceptance of our products by our ISVs and independent distributors and their active marketing and sales efforts. Typically, our arrangements with our independent distributors do not require them to purchase specified amounts of products or prevent them from selling competitive products. Our ISVs may stop using our technology to develop and sell solutions to end-users. Similarly, our independent distributors may not continue, or may not give a high priority to, marketing and supporting our products. Our results of operations could be adversely affected by a decline in the number of ISVs utilizing our technology and by changes in the financial condition, business, marketing strategies, local and global economic conditions, or results of our independent distributors. If any of our distribution relationships are terminated, we may not be successful in replacing them on a timely basis, or at all. In addition, we will need to develop new sales channels for new products, and we may not succeed in doing so. Any changes in our distribution and sales channels, or our inability to establish effective distribution and sales channels for new markets, could adversely impact our ability to sell our products and result in a loss of revenues and profits.

Changes in the ratio of our revenues generated from different revenue elements may adversely affect our gross profit margins.

We derive our revenues from the sale of software licenses, related professional services, maintenance and technical support as well as from other IT professional services. In recent years the decline in our gross margin was affected by the change in proportion of our revenues generated from the sale of each of those elements of our revenues. Our revenues from the sale of our software licenses, related professional services, maintenance and technical support have higher gross margins than our revenues from IT professional and outsourcing services. Our software licenses revenues also include the sale of third party software licenses, which have a lower gross margin than sales of our proprietary software products. Any increase in the portion of third party software license sales out of total license sales will decrease our gross profit margin. If the relative proportion of our revenues from the sale of IT professional services continues to increase as a percentage of our total revenues, our gross profit margins may continue to decline in the future.

Our success depends in part upon the senior members of our management and research and development teams, and our inability to attract and retain them or attract suitable replacements could have a negative effect on our

ability to operate our business.

We are dependent on the senior members of our management and research and development teams. We do not maintain key man life insurance for any of the senior members of our management and research and development teams. Competition for senior management in our industry is intense, and we may not be able to retain our senior management personnel or attract and retain new senior management personnel in the future. The loss of one or more members of our senior management and research and development teams could have a negative effect on our ability to attract and retain customers, execute our business strategy and otherwise operate our business, which could reduce our revenues, increase our expenses and reduce our profitability.

We may encounter difficulties with our international operations and sales that could adversely affect our business, results of operations and financial condition.

While our principal executive offices are located in Israel, 71%, 64% and 63% of our sales in the years ended December 31, 2016, 2017 and 2018, respectively, were generated in other regions and countries including, but not limited to the Americas, Europe, Japan, Asia-Pacific, India, and Africa. Our success in becoming a stronger competitor in the sale of development application platforms, integration solutions, packaged software solutions and professional services is dependent upon our ability to increase our sales in all our markets. Our efforts to increase our penetration into these markets are subject to risks inherent to such markets, including the high cost of doing business in such locations. Our efforts may be costly and they may not result in profits, which could adversely affect our business, results of operations and financial condition.

Our current international operation and our plans to further expand our international operations subjects us to many risks inherent to international business activities, including:

Limitations and disruptions resulting from the imposition of government controls;

Compliance with a wide variety of foreign regulatory standards;

Compliance with the U.S. Foreign Corrupt Practices Act of 1977, as amended, or FCPA, particularly in emerging market countries;

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Import and export license requirements, tariffs, taxes and other trade barriers;

Political, social and economic instability abroad, terrorist attacks and security concerns in general. For example, our operations in India may be adversely affected by future political and other events in the region;

Trade restrictions;

Changes in tariffs;

Increased exposure to fluctuations in foreign currency exchange rates;

Complexity in our tax planning, and increased exposure to changes in tax regulations in various jurisdictions in which we operate, which could adversely affect our operating results and limit our ability to conduct effective tax planning;

Increased financial accounting and reporting requirements and complexities;

Weaker protection of intellectual property rights in some countries;

Greater difficulty in safeguarding intellectual property;

Increased management, travel, infrastructure and legal compliance costs associated with having multiple international operations;

Longer payment cycles and difficulties in enforcing contracts and collecting accounts receivable;

The need to localize our products and licensing programs for international customers;

As we continue to expand our business globally, our success will depend, largely, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Any of these risks could harm our international operations and reduce our international sales, adversely affecting our business, results of operations, financial condition and growth prospects.

Currency exchange rate fluctuations in the markets in which we conduct business could adversely affect our business, results of operations and financial condition.

Our financial statements are stated in U.S. dollars, our functional currency. However, in the years ended December 31, 2016, 2017 and 2018, approximately 50%, 52% and 52% of our revenues, respectively, were derived from sales outside the United States, particularly, Israel, Europe, Japan and Asia-Pacific, the United Kingdom and Africa. We also maintain substantial non-U.S. dollar balances of assets, including cash and accounts receivable, and liabilities, including accounts payable and debts to banks and financial institutions. Similarly, a significant portion of our expenses, primarily salaries, related personnel expenses, subcontractors expenses and the leases of our offices and related administrative expenses, were incurred outside the United States. Therefore, fluctuations in the value of the currencies in which we do business relative to the U.S. dollar, primarily NIS, euros and Japanese yen, may adversely affect our business, results of operations and financial condition, by decreasing the U.S. dollar value of assets held in other currencies and increasing the U.S. dollar amount of liabilities payable in other currencies, or by decreasing the U.S. dollar value of our revenues in other currencies and increasing the U.S. dollar amount of our expenses in other currencies. Even if we use derivatives or engage in any currency-hedging transactions intended to reduce the effect of fluctuations of foreign currency exchange rates on our financial position and results of operations, there can be no assurance that any such hedging transactions will materially reduce the effect of fluctuation in foreign currency exchange rates on such results. In addition, if for any reason exchange or price controls or other restrictions on the conversion of foreign currencies were imposed, our financial position and results of operations could be adversely affected.

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Breaches of network or information technology security, natural disasters or terrorist attacks could have an adverse effect on our business.

Cyber-attacks or other breaches of network or IT security, natural disasters, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. We may be subject to attempts to breach the security of our networks and IT infrastructure through cyber-attack, malware, computer viruses and other means of unauthorized access. While we maintain insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. Our inability to operate our facilities because of such events, even for a limited period, may result in significant expenses or loss of market share to other competitors for our application platforms as well as in the process and business integration technologies and IT services market. In addition, a failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. To date, we have not been subject to cyber-attacks or other cyber incidents, which, individually or in the aggregate, resulted in a material impact to our operations or financial condition.

Maintaining the security of our products, computers and networks is a critical issue for our customers and us. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate computer and network security measures. In addition, hackers also develop and deploy viruses, worms and other malicious software programs, some of which may be specifically designed to attack our products, systems, computers or networks. Additionally, outside parties may attempt to fraudulently induce our employees or users of our products to disclose sensitive information in order to gain access to our data or our customers' data. These potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees or our customers, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability or fines for us, damage our brand and reputation or otherwise harm our business. These risks are persistent and likely will increase as we continue to grow our cloud offerings and services and store and process increasingly large amounts of our customers' confidential information and data. We also may acquire companies, products, services and technologies and inherit such risks when we integrate these acquisitions within our company. Further, as regulatory focus on privacy issues continues to increase and become more complex, these potential risks to our business will intensify. Changes in laws or regulations associated with the enhanced protection of certain types of sensitive data could greatly increase our cost of providing our products and services

Regulation of the internet and telecommunications, privacy and data security may adversely affect sales of our products and result in increased compliance costs.

As internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies and industry groups becomes more likely. For example, we believe increased regulation is likely with respect to the solicitation,

collection, processing or use of personal, financial and consumer information as regulatory authorities around the world are considering a number of legislative and regulatory proposals concerning data protection, privacy and data security. In addition, the interpretation and application of consumer and data protection laws and industry standards in the United States, Europe and elsewhere are often uncertain and in flux.

In particular, our European activities are subject to the new European Union General Data Protection Regulation, or GDPR, which create additional compliance requirements for us. GDPR broadens the scope of personal privacy laws to protect the rights of European Union citizens and requires organizations to report on data breaches within 72 hours and be bound by more stringent rules for obtaining the consent of individuals on how their data can be used. GDPR took effect on May 25, 2018 and non-compliance may expose entities such as our company to significant fines or other regulatory claims. While we have invested in, and intend to continue to invest in, reasonably necessary resources to comply with these new standards, to the extent that we fail to adequately comply, that failure could have an adverse effect on our business, financial conditions, results of operations and cash flows.

Furthermore, the application of existing laws to cloud-based solutions is particularly uncertain and cloud-based solutions may be subject to further regulation, the impact of which cannot be fully understood at this time. Moreover, these laws may be interpreted and applied in a manner that is inconsistent with our data and privacy practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data and privacy practices, which could have an adverse effect on our business and results of operations. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business. In addition, any new regulation, or interpretation of existing regulation, imposing greater fees or taxes on internet-based services, or restricting information exchange over the Web, could result in a decline in the use and adversely affect sales of our products and our results of operations.

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Our products have a lengthy sales cycle that could adversely affect our revenues.

The typical sales cycle for our solutions is lengthy and unpredictable, requires pre-purchase evaluation by a significant number of persons in our customers' organizations, and often involves a significant operational decision by our customers as they typically use our technologies to develop and deploy as well as to integrate applications that are critical to their businesses. Our sales efforts involve educating our customers and industry analysts and consultants about the use and benefits of our solutions, including the technical capabilities of our solutions and the efficiencies achievable by organizations deploying our solutions. As a result, the licensing and implementation of our technologies generally involves a significant commitment of attention and resources by prospective customers. Because of the long approval process that typically accompanies strategic initiatives or capital expenditures by companies, our sales process is often delayed, with little or no control over any delays encountered by us. Our sales cycle, which generally ranges from three to eighteen months, can be further extended for sales made through third party distributors. We spend substantial time, effort and money in our sales efforts without any assurance that such efforts will produce any sales.

Our proprietary platforms and vertical software solutions may contain defects that may be costly to correct, delay their market acceptance and expose us to difficulties in the collection of receivables and to litigation.

Despite our regular quality assurance testing, as well as testing performed by our partners and end-users who participate in our beta-testing programs, undetected errors or "bugs" may be found in our software products or in applications developed with our technology. This risk is exacerbated by the fact that a significant percentage of the applications developed with our technology were and are likely to continue to be developed by our ISVs, system integrators and enterprises over which we exercise no supervision or control. If defects are discovered, we may not be able to successfully correct them in a timely manner or at all. Defects and failures in our products could result in a loss of, or delay in, market acceptance of our products, as well as difficulties in the collection of receivables and litigation, and could damage our reputation.

Our standard license agreement with our customers contains provisions designed to limit our exposure to potential product liability claims that may not be effective or enforceable under the laws of some jurisdictions. In addition, the professional liability insurance that we maintain may not be sufficient against potential claims. Accordingly, we could fail to realize revenues and suffer damage to our reputation as a result of, or in defense of, a substantial claim.

Third parties have in the past, and may in the future, claim that we infringe upon their intellectual property rights and such claims could harm our business.

The software industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patents and other intellectual property rights. In particular, leading companies in the software industry own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims against us. From time to time, third parties, including certain of these leading companies, may assert patent, copyright, trademark or other intellectual property claims against us, our customers and partners, and those from whom we license technology and intellectual property.

Although we believe that our products and services do not infringe upon the intellectual property rights of third parties, we cannot assure you that third parties will not assert infringement or misappropriation claims against us with respect to current or future products or services, or that any such assertions will not require us to enter into royalty arrangements or result in costly litigation, or result in us being unable to use certain intellectual property. We cannot assure you that we are not infringing or otherwise violating any third party intellectual property rights. Infringement assertions from third parties may involve patent holding companies or other patent owners who have no relevant product revenues, and therefore our own issued and pending patents may provide little or no deterrence to these patent owners in bringing intellectual property rights claims against us.

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Any intellectual property infringement or misappropriation claim or assertion against us, our customers or partners, and those from whom we license technology and intellectual property could have a material adverse effect on our business, financial condition, reputation and competitive position regardless of the validity or outcome. If we are forced to defend against any infringement or misappropriation claims, whether they are with or without merit, are settled out of court, or are determined in our favor, we may be required to expend significant time and financial resources on the defense of such claims. Furthermore, an adverse outcome of a dispute may require us to pay damages, potentially including treble damages and attorneys' fees, if we are found to have willfully infringed on a party's intellectual property; cease making, licensing or using our products or services that are alleged to infringe or misappropriate the intellectual property of others; expend additional development resources to redesign our products or services; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or works; and to indemnify our partners, customers, and other third parties. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. Any of these events could seriously harm our business, results of operations and financial condition. In addition, any lawsuits regarding intellectual property rights, regardless of their success, could be expensive to resolve and divert the time and attention of our management and technical personnel.

Our proprietary technology and packaged software solutions are difficult to protect and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

Our success and ability to compete depend in large part upon our ability to protect our proprietary technology. In accordance with industry practice, since we have no registered patents on our software solution technologies, we rely on a combination of trade secret and copyright laws and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. We believe that due to the dynamic nature of the computer and software industries, copyright protection is less significant than factors such as the knowledge and experience of our management and personnel, the frequency of product enhancements and the timeliness and quality of our support services. Therefore, we distribute our products under software license agreements that grant customers a personal, non-transferable license to use our products and contain terms and conditions prohibiting the unauthorized reproduction or transfer of our products and our policy is to require employees and consultants to execute confidentiality and non-compete agreements upon the commencement of their relationships with us. These measures may not be adequate to protect our technology from third-party infringement, and our competitors might independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection for intellectual property rights than that provided under U.S. or Israeli laws.

Our customers and we rely on technology and intellectual property of third parties, the loss of which could limit the functionality of our products and disrupt our business.

We use technology and intellectual property licensed from unaffiliated third parties in certain of our products, and we may license additional third-party technology and intellectual property in the future. Any errors or defects in this

third-party technology and intellectual property could result in errors that could harm our brand and business. In addition, licensed technology and intellectual property may not continue to be available on commercially reasonable terms, or at all. The loss of the right to license and distribute this third party technology could limit the functionality of our products and might require us to redesign our products.

Further, although we believe that there are currently adequate replacements for the third-party technology and intellectual property we presently use and distribute, the loss of our right to use any of this technology and intellectual property could result in delays in producing or delivering affected products until equivalent technology or intellectual property is identified, licensed or otherwise procured, and integrated. Our business would be disrupted if any technology and intellectual property we license from others or functional equivalents of this software were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required either to attempt to redesign our products to function with technology and intellectual property available from other parties or to develop these components ourselves, which would result in increased costs and could result in delays in product sales and the release of new product offerings. Alternatively, we might be forced to limit the features available in affected products. Any of these results could harm our business and impact our results of operations.

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Some of our services and technologies may use "open source" software, which may restrict how we use or distribute our services or require that we release the source code of certain products subject to those licenses.

Some of our services and technologies may incorporate software licensed under so-called "open source" licenses, including, but not limited to, the GNU General Public License and the GNU Lesser General Public License. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on origin of the software. Additionally, open source licenses typically require that source code subject to the license be made available to the public and that any modifications or derivative works to open source software continue to be licensed under open source licenses. These open source licenses typically mandate that proprietary software, when combined in specific ways with open source software, become subject to the open source license. If we combine our proprietary software with open source software, we could be required to release the source code of our proprietary software.

We take steps to ensure that our proprietary software is not combined with, and does not incorporate, open source software in ways that would require our proprietary software to be subject to an open source license. However, few courts have interpreted open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to some uncertainty. Additionally, we rely on multiple software programmers to design our proprietary technologies, and although we take steps to prevent our programmers from including open source software in the technologies and software code that they design, write and modify, we do not exercise complete control over the development efforts of our programmers and we cannot be certain that our programmers have not incorporated open source software into our proprietary products and technologies or that they will not do so in the future. In the event that portions of our proprietary technology are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code, re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce or eliminate the value of our services and technologies and materially and adversely affect our business, results of operations and prospects.

We could be required to provide the source code of our products to our customers.

Some of our customers have the right to require the source code of our products to be deposited into a source code escrow. Under certain circumstances, our source code could be released to our customers. The conditions triggering the release of our source code vary by customer. A release of our source code would give our customers access to our trade secrets and other proprietary and confidential information that could harm our business, results of operations and financial condition. A few of our customers have the right to use the source code of some of our products based on the license agreements signed with such clients (mostly with respect to older versions of our solutions), although such use is limited for specific matters and cases, these clients are exposed to some of our trade secrets and other proprietary and confidential information which could harm us.

Any unauthorized, and potentially improper, actions of our personnel could adversely affect our business, operating results and financial condition.

The recognition of our revenue depends on, among other things, the terms negotiated in our contracts with our customers. Our personnel may act outside of their authority and negotiate additional terms without our knowledge. We have implemented policies to help prevent and discourage such conduct, but there can be no assurance that such policies will be followed. For instance, in the event that our sales personnel negotiate terms that do not appear in the contract and of which we are unaware, whether such additional terms are written or verbal, we could be prevented from recognizing revenue in accordance with our plans. Furthermore, depending on when we learn of unauthorized actions and the size of the transactions involved, we may have to restate revenue for a previously reported period, which would seriously harm our business, operating results and financial condition.

Under applicable employment laws, we may not be able to enforce covenants not to compete and therefore may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.

We generally enter into non-competition agreements with our employees. These agreements prohibit our employees from competing directly with us or working for our competitors or clients for a limited period after they cease working for us. We may be unable to enforce these agreements under the laws of the jurisdictions in which our employees work and it may be difficult for us to restrict our competitors from benefiting from the expertise that our former employees or consultants developed while working for us. For example, Israeli courts have required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer that have been recognized by the courts, such as the secrecy of a company's confidential commercial information or the protection of its intellectual property. If we cannot demonstrate that such interests will be harmed, we may be unable to prevent our competitors from benefiting from the expertise of our former employees or consultants and our ability to remain competitive may be diminished.

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Our business may be materially affected by changes to fiscal and tax policies. Potentially negative or unexpected tax consequences of these policies, or the uncertainty surrounding their potential effects, could adversely affect our results of operations and share price.

As a multinational corporation, we are subject to income taxes, withholding taxes and indirect taxes in numerous jurisdictions worldwide. Significant judgment and management attention and resources are required in evaluating our tax positions and our worldwide provision for taxes. In the ordinary course of business, there are many activities and transactions for which the ultimate tax determination is uncertain. In addition, our tax obligations and effective tax rates could be adversely affected by changes in the relevant tax, accounting, and other laws, regulations, principles and interpretations. This may include recognizing tax losses or lower than anticipated earnings in jurisdictions where we have lower statutory rates and higher than anticipated earnings in jurisdictions where we have higher statutory rates, changes in foreign currency exchange rates, or changes in the valuation of our deferred tax assets and liabilities.

We may be audited in various jurisdictions, and such jurisdictions may assess additional taxes against us. If we experience unfavorable results from one or more such tax audits, there could be an adverse effect on our tax rate and therefore on our net income. Although we believe our tax estimates are reasonable, the final determination of any tax audits or litigation could be materially different from our historical tax provisions and accruals, which could have a material adverse effect on our operating results or cash flows in the period or periods for which a determination is made. Additionally, we are subject to transfer pricing rules and regulations, including those relating to the flow of funds between us and our affiliates, which are designed to ensure that appropriate levels of income are reported in each jurisdiction in which we operate.

The recently enacted U.S. Tax Cuts and Jobs Act of 2017, or the Tax Act, enacted in December 2017, introduced significant changes to the U.S. Internal Revenue Code. The primary impact of the Tax Act on us was a reduction of our effective tax rate in the US. The final impact of the Tax Act may differ from the tax expense we incurred, due to, among other things, possible changes in the interpretations and assumptions made by us as a result of additional information, additional guidance that will be issued by the U.S. Department of Treasury, the IRS or other standard-setting bodies. There may be additional tax effects of the Tax Act that may impact our future financial statements upon finalization of law, regulations, and additional guidance and will be accounted for when such guidance is issued.

Certain of our credit facility agreements with banks and other financial institutions are subject to a number of restrictive covenants that, if breached, could result in acceleration of our obligation to repay our debt.

In the context of our engagements with banks and other financial institutions for receiving various credit facilities, we have undertaken to maintain a number of conditions and limitations on the manner in which we can operate our business, including a negative pledge and limitations on our ability to distribute dividends. These credit facilities

agreements also contain various financial covenants that require us to maintain certain financial ratios related to shareholders' equity, total rate of financial liabilities and minimum outstanding balance of total cash and short-term investments. These limitations and covenants may force us to pursue less than optimal business strategies or forego business arrangements that could have been financially advantageous to us and, by extension, to our shareholders. A breach of the restrictive covenants could result in the acceleration of our obligations to repay our debt. See Note 12 to our consolidated financial statements for additional information on liabilities to banks and other financial institutions.

If we are unable to maintain effective internal control over financial reporting in accordance with Sections 302 and 404(a) of the Sarbanes-Oxley Act of 2002, the reliability of our financial statements may be questioned and our share price may suffer.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and on our executives and directors. To comply with this statute, we are required to document and test our internal control over financial reporting, and our independent registered public accounting firm must issue an attestation report on our internal control procedures, and our management is required to assess and issue a report concerning our internal control over financial reporting. Our efforts to comply with these requirements have resulted in increased general and administrative expenses and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. We may identify material weaknesses or significant deficiencies in our assessments of our internal controls over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities, and could adversely affect our operating results, investor confidence in our reported financial information and the market price of our Ordinary Shares.

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Risks Related to Our Ordinary Shares

Our Ordinary Shares are traded on more than one market and this may result in price variations.

Our Ordinary Shares are traded primarily on the NASDAQ Global Select Market and on the TASE. Trading of our Ordinary Shares on these markets is made in different currencies (U.S. dollars on the NASDAQ Global Select Market and NIS on the TASE) and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Consequently, the trading prices of our Ordinary Shares on these two markets may differ. Any decrease in the trading price of our Ordinary Shares on one of these markets could cause a decrease in the trading price of our Ordinary Shares on the other market.

The trading volume of our shares has been low in the past and may be low in the future, which reduces liquidity for our shareholders, and may furthermore cause the share price to be volatile, all of which may lead to losses by investors.

There has historically been limited trading volume in our Ordinary Shares, both on the NASDAQ Global Select Market and the TASE, which results in reduced liquidity for our shareholders. As a further result of the limited volume, our Ordinary Shares have experienced significant market price volatility in the past and may experience significant market price and volume fluctuations in the future, in response to factors such as announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results and general conditions in the industry in which we compete.

In the past, securities class action litigations have often been brought against registrants following periods of volatility in the market price of their securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management’s attention and resources.

We are a foreign private issuer under the rules and regulations of the SEC and are therefore exempt from a number of rules under the Exchange Act and are permitted to file less information with the SEC than a domestic U.S. reporting company, which reduces the level and amount of disclosure that you receive.

As a foreign private issuer under the Exchange Act, we are exempt from certain rules under the Exchange Act, including the proxy rules, which impose certain disclosure and procedural requirements for proxy solicitations. Moreover, we are not required to file periodic reports and financial statements with the SEC as frequently or as

promptly as domestic U.S. companies with securities registered under the Exchange Act; and are not required to comply with Regulation FD, which imposes certain restrictions on the selective disclosure of material information. In addition, our officers, directors and principal shareholders are exempt from the reporting and "short-swing" profit recovery provisions of Section 16 of the Exchange Act and the rules under the Exchange Act with respect to their purchases and sales of our Ordinary Shares. Accordingly, you receive less information about our company than you would receive about a domestic U.S. company, and are afforded less protection under the U.S. federal securities laws than you would be afforded in holding securities of a domestic U.S. company.

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Stock Market Rules. Among other things, as a foreign private issuer we may also follow home country practice with regard to, the composition of the board of directors, director nomination procedure, compensation of officers and quorum at shareholders' meetings. In addition, we may follow our home country law, instead of the NASDAQ Stock Market Rules, which require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules. In addition, as foreign private issuer, we are not required to file quarterly reviewed financial statements. A foreign private issuer that elects to follow a home country practice instead of such requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the SEC each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement.

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Our controlling shareholder, Formula Systems (1985) Ltd., beneficially owns approximately 45.21% of our outstanding Ordinary Shares and therefore has a controlling influence over matters requiring shareholder approval, which could delay or prevent a change of control that may benefit our public shareholders.

Formula Systems (1985) Ltd., or Formula Systems (symbol: FORTY), an Israeli company whose shares trade on the NASDAQ Global Select Market and the TASE, directly owned 22,080,468 or 45.21%, of our outstanding Ordinary Shares as of December 31, 2018. Asseco Poland S.A., or Asseco, a Polish company listed on Warsaw Stock Exchange, owns 26.29% of the outstanding shares of Formula Systems. Guy Bernstein, our Chief Executive Officer who is also the Chief Executive Officer of Formula Systems, owns 13.437% of the outstanding shares of Formula Systems. In addition, on October 4, 2017 Asseco entered into a shareholders agreement with Mr. Bernstein, under which agreement Asseco has been granted an irrecoverable proxy to vote an additional 1,971,973 Ordinary Shares of Formula, thereby effectively giving Asseco beneficial ownership (voting power) over an aggregate of 39.66% of Formula's outstanding ordinary share. Therefore, based on the foregoing beneficial ownership by each of Formula and Asseco, each of Formula and Asseco may be deemed to directly or indirectly (as appropriate) control us.

Although transactions between us and our controlling shareholders are subject to special approvals under Israeli law, Formula and Asseco may exercise their controlling influence over our operations and business strategy and use their sufficient voting power to control the outcome of various matters requiring shareholder approval. These matters may include:

The composition of our board of directors, which has the authority to direct our business and to appoint and remove our officers;

Approving or rejecting a merger, consolidation or other business combination;

Raising future capital; and

Amending our Articles, which govern the rights attached to our Ordinary Shares.

This concentration of ownership of our Ordinary Shares could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our Ordinary Shares that might otherwise give one the opportunity to realize a premium over the then-prevailing market price of our Ordinary Shares. This concentration of ownership may also adversely affect our share price.

Our U.S. shareholders may suffer adverse tax consequences if we are classified as a passive foreign investment company or as a "controlled foreign corporation."

Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of the average quarterly value of our assets (which may be measured in part by the market value of our Ordinary Shares, which is subject to change) are held for the production of, or produce, passive income, we would be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes under the Code. Based on our gross income and gross assets, and the nature of our business, we believe that we were not classified as a PFIC for the taxable year ended December 31, 2018. Because PFIC status is determined annually based on our income, assets and activities for the entire taxable year, it is not possible to determine whether we will be characterized as a PFIC for the taxable year ending December 31, 2019, or for any subsequent year, until we finalize our financial statements for that year. Furthermore, because the value of our gross assets is likely to be determined in large part by reference to our market capitalization, a decline in the value of our Ordinary Shares may result in our becoming a PFIC. Accordingly, there can be no assurance that we will not be considered a PFIC for any taxable year. Our characterization as a PFIC could result in material adverse tax consequences for you if you are a U.S. investor, including having gains realized on the sale of our Ordinary Shares treated as ordinary income, rather than a capital gain, the loss of the preferential rate applicable to dividends received on our Ordinary Shares by individuals who are U.S. holders, and having interest charges apply to distributions by us and the proceeds of share sales. Certain elections exist that may alleviate some of the adverse consequences of PFIC status and would result in an alternative treatment (such as mark-to-market treatment) of our Ordinary Shares. Prospective U.S. investors should consult their own tax advisers regarding the potential application of the PFIC rules to them. Prospective U.S. investors should refer to "Item 10.E. Taxation—U.S. Federal Income Tax Considerations" for discussion of additional U.S. income tax considerations applicable to them based on our treatment as a PFIC.

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Certain U.S. holders of our Ordinary Shares may suffer adverse tax consequences if we or any of our non-U.S. subsidiaries are characterized as a "controlled foreign corporation", or a CFC, under Section 957(a) of the Code. Certain changes to the CFC constructive ownership rules under Section 958(b) of the Code introduced by the TCJA may cause one or more of our non-U.S. subsidiaries to be treated as CFCs, may also impact our CFC status, and may affect holders of our Ordinary Shares that are United States shareholders. Generally, for U.S. shareholders that own 10% or more of the combined vote or combined value of our Ordinary Shares, this may result in negative U.S. federal income tax consequences and these shareholders may be subject to certain reporting requirements with the U.S. Internal Revenue Service. Any such 10% U.S. shareholder should consult its own tax advisors regarding the U.S. tax consequences of acquiring, owning, or disposing our Ordinary Shares and the impact of the TCJA, especially the changes to the rules relating to CFCs.

Risks Related to Our Location in Israel

Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.

We are organized under the laws of the State of Israel, and our principal executive offices and manufacturing and research and development facilities are located in Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could adversely affect our business, financial condition and results of operations.

Conflicts in North Africa and the Middle East, including in Egypt and Syria that border Israel, have resulted in continued political uncertainty and violence in the region. Efforts to improve Israel's relationship with the Palestinian Authority have failed to result in a permanent solution, and there have been numerous periods of hostility in recent years. In addition, relations between Israel and Iran continue to be seriously strained, especially with regard to Iran's nuclear program. Such instability may affect the economy, could negatively affect business conditions and, therefore, could adversely affect our operations. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect our business, financial condition and results of operations in the future.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

Our results of operations may be adversely affected by the obligation of our personnel to perform military service.

Many of our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

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We currently have the ability to benefit from certain government tax benefits, which may be cancelled or reduced in the future.

We are currently eligible to receive certain tax benefits under programs of the Government of Israel. In order to maintain our eligibility for these tax benefits, we must continue to meet specific requirements. If we fail to comply with these requirements in the future, such tax benefits may be cancelled.

Service and enforcement of legal process on us and our directors and officers may be difficult to obtain.

We are organized in Israel and some of our directors and executive officers reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, most of our assets and the assets of some of our executive officers are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

Provisions of Israeli law may delay, prevent or make difficult an acquisition of us, which could prevent a change of control and therefore depress the price of our shares.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or complicating a merger with, or other acquisition of, us. This could cause our Ordinary Shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are organized under Israeli law. The rights and responsibilities of holders of our Ordinary Shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in

some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes at the general meeting with respect to, among other things, amendments to a company's articles of association, compensation policy, increases in a company's authorized share capital, mergers and actions and transactions involving interests of officers, directors or other interested parties which require the shareholders' general meeting's approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that he or she possesses the power to determine the outcome of a vote at a meeting of our shareholders, or who has, by virtue of the company's articles of association, the power to appoint or prevent the appointment of an office holder in the company, or any other power with respect to the company, has a duty of fairness toward the company. The Israeli Companies Law does not establish criteria for determining whether or not a shareholder has acted in good faith.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Corporate details

Our legal and commercial name is Magic Software Enterprises Ltd., and we were organized and registered in Israel on February 10, 1983 and began operations in 1986. We are a public limited liability company and operate under the provisions of the state of Israel. Our Ordinary Shares have been listed on the NASDAQ Stock Market (symbol: MGIC) since our initial public offering in the United States on August 16, 1991. On January 3, 2011, our shares were transferred to the NASDAQ Global Select Market. Since November 16, 2000, our Ordinary Shares have also traded on the Tel Aviv Stock Exchange, or the TASE, and since December 15, 2011, our shares have been included in the TASE's TA-125 Index.

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Capital Expenditures and Divestitures since January 1, 2014

On March 5, 2014, we completed a follow-on public offering of 6,900,000 of our Ordinary Shares including 900,000 shares sold pursuant to the underwriters' exercise of their over-allotment option, at a price to the public of $8.50 per share.

In October 2014, we acquired 100% of Formula Telecom Solutions Ltd., or FTS, an Israeli based software vendor, for a total consideration of $5.8 million. FTS specializes in the development, sale, service and support of business support systems, or BSS, including convergent charging, billing, customer management, policy control and payment software solutions for the telecommunications, content, Machine to Machine/Internet of Things or M2M/IoT, payment and other industries. FTS has a track record of proven experience and successful implementation of many projects in Western and Eastern Europe, Asia and Africa.

In April 2015, we acquired a 70% interest in Comblack IT Ltd., for a total consideration of $1.8 million, with an option to increase our interest to 100%. Comblack IT Ltd. is an Israeli-based company that specializes in software professional and outsourcing management services for mainframes and complex large-scale environments.

In June 2015 we acquired a 70% interest in Infinigy Solutions LLC, a U.S.-based services company focused on expanding the development and implementation of technical solutions throughout the telecommunications industry with offices over the U.S., providing nationwide coverage and support for wireless engineering, deployment services, surveying, environmental service and project management, for a total consideration of $6.5 million.

In June 2016, we acquired a 60% equity interest, with the option to acquire the remaining 40% of the equity in the future, in Roshtov Software Industries Ltd., or Roshtov, an Israeli company. Roshtov is the developer of the Clicks development platform, which is used in the design and management of patient-file oriented software solutions for managed care and large-scale healthcare providers. The aggregate purchase price for the 60% interest was approximately $20.6 million and we have the option to acquire the remaining 40% of the equity in Roshtov in the future based on the same valuation.

In October 2016, we acquired a 100% equity interest in Shavit Software (2009) Ltd., or Shavit, an Israeli company, for a total consideration of $6.8 million, of which $4,699,000 was paid upon closing, $2,137,000 (measured based on present value) was allocated to deferred payment and contingent payment and paid in 2017 and 2018. Shavit specializes in software professional and outsource management services.

In late December 2017, we acquired a 100% equity interest in Futurewave Systems, Inc., a U.S.-based full-service provider of consulting and outsourcing solutions for IT personnel, for a total consideration of $3.0 million.

On July 12, 2018, we issued 4,268,293 ordinary shares at a price of $8.20 per share for a total of $34.6 million net of issuance expenses. The shares were issued to Israeli institutional investors and to our controlling shareholder, Formula Systems (1985) Ltd.

Our fixed assets capital expenditures for the years ended December 31, 2016, 2017 and 2018 were approximately $0.8 million, $1.4 million and $0.9 million, respectively. These expenditures were principally for network equipment and computer hardware, as well as for vehicles, furniture, office equipment and leasehold improvements.

B. Business Overview

We are a global provider of: (i) proprietary application development and business process integration platforms, (ii) selected packaged vertical software solutions, as well as (iii) a vendor of software services and IT outsourcing software services. We report our results on the basis of two reportable business segments: software solutions (which include proprietary and non-proprietary software technology, maintenance and support and complementary services) and IT professional services.

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Our software solutions are used by customers to develop, deploy and integrate on-premise, mobile and cloud-based business applications quickly and cost effectively. In addition, our technology enables enterprises to accelerate the process of delivering business solutions that meet current and future needs and allow customers to dramatically improve their business performance and return on investment. We also provide selected verticals with a complete software solution.

In the aggregate, we employ approximately 2,226 persons and operate through a network of over 3,000 independent software vendors, who we refer to as Magic Software Providers, or MSP's, and hundreds of system integrators, distributors, resellers, and consulting and OEM partners. Thousands of enterprises in approximately 50 countries use our products and services.

Our software technology platforms

Throughout our history, we have traditionally maintained two major lines of products, one is our application development platform, which today is known as Magic xpa Application Platform, an evolution of our original metadata-based development platform; and the second is our application integration platform, Magic xpi Integration Platform, originally introduced in 2003 under the name iBOLT. In December 2011, we acquired the AppBuilder development platform of BluePhoenix Solutions Ltd., a leading provider of value-driven legacy IT modernization solutions. AppBuilder is a comprehensive application development infrastructure used by many Fortune 1000 enterprises around the world. This enterprise application development environment is a powerful, model-driven tool that enables development teams to build, deploy, and maintain large-scale, custom-built business applications.

Our software technology platforms consist of:

- Magic xpa Application Platform - a proprietary application platform for developing and deploying business applications.

- AppBuilder Application Platform - a proprietary application platform for building, deploying, and maintaining high-end, mainframe-grade business applications.

    - Magic xpi Integration Platform - a proprietary platform for application integration

    - Magic xpc Integration Platform - hybrid integration platform as a service (iPaaS).

Our vertical software packages

- **Clicks™** – offered by our Roshtov subsidiary, is a proprietary comprehensive core software solution for medical record information management systems, used in the design and management of patient-file for managed care and large-scale healthcare providers. The platform is connected to each provider clinical, administrative and financial data base system, residing at the provider's central computer, and allows immediate analysis of complex data with potentially real-time feedback to meet the specific needs of physicians, nurses, laboratory technicians, pharmacists, front- and back-office professionals and consumers.

- **Leap™** – offered by our FTS subsidiary, is a proprietary comprehensive core software solution for BSS, including convergent charging, billing, customer management, policy control, mobile money and payment software solutions for the telecommunications, content, Machine to Machine/Internet of Things or M2M/IoT, payment and other industries.

- **Hermes Solution** – offered by our Hermes Logistics Technologies Ltd. subsidiary, the Hermes Air Cargo Management System is a proprietary, state-of-the-art, packaged software solution for managing air cargo ground handling. Our Hermes Solution covers all aspects of cargo handling, from physical handling and cargo documentation through customs, seamless EDI communications, dangerous goods and special handling, tracking and tracing, security and billing. Customers benefit through faster processing and more accurate billing, reporting and ultimately enhanced revenue. The Hermes Solution is delivered on a licensed or fully hosted basis. Hermes recently supplemented its offering with the Hermes Business Intelligence (HBI) solution, adding unprecedented data analysis capabilities and management-decision support tools.

- **HR Pulse –** Offered by our Pilat NAI, Inc. and Pilat Europe Ltd. subsidiaries, Pulse (now in its 10th release) is a proprietary tool for the creation of customizable HCM solutions quickly and affordably. It has been used by Pilat to create products, such as Pilat Frist and Pilat Professional, that provide "out of the box" SaaS solutions for organizations that implement Continuous Performance and/or Talent Management.

- **MBS Solution** – offered by our Complete Business Solutions Ltd. subsidiary, is a proprietary comprehensive core system for managing TV broadcast channels.

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Our professional software and IT services

Our software professional services offerings include a vast portfolio of professional services in the areas of infrastructure design and delivery, application development, technology consulting planning and implementation services, support services, DevOps (Development & Operations), Mobile, Big Data and Analytical BI, M/F, cloud computing for deployment of highly available and massively-scalable applications and APIs and supplemental IT outsourcing services to a wide variety of companies, including Fortune 1000 companies. The technical personnel we provide generally supplement in-house capabilities of our customers. We have extensive and proven experience with virtually all types of telecom infrastructure technologies in wireless and wire-line as well as in the areas of infrastructure design and delivery, application development, project management, technology planning and implementation services.

We have substantial experience in end-to-end development of high-end software solutions, beginning with collection and analysis of system requirements, continuing with architecture specifications and setup, to software implementation, component integration and testing. From concept to implementation, from application of the ideas of startups requiring the early development of an application or a device, to somewhat larger, more established enterprises, vendors or system houses who need our team of experts to take full responsibility for the development of their systems and products. With our ability to draw on our pool of resources, comprised of hundreds of highly trained, skilled, educated and flexible engineers, we adhere to timelines and budget and work in full transparency with our customers every step of the way to create a tailor-made and cost-effective solution to answer all of our customers' unique needs.

Our IT services subsidiaries consist of:

Coretech Consulting Group LLC

Fusion Solutions LLC

Xsell Resources Inc.

AllStates Consulting Services LLC

Futurewave Systems, Inc.

CommIT Group

Comblack Ltd

Infinigy Solutions LLC Group

Shavit Software Ltd.

Partnerships and Alliances:

We continue to build on our existing strategic partnerships that include Oracle, JD Edwards, SAP, Salesforce.com, Microsoft, IBM and SugarCRM to enhance our mobile, integration and cloud offerings.

In September 2013, we initiated a technology partnership with GigaSpaces Technologies, a pioneer provider of In-Memory Computing technology for deployment, management and scaling of mission-critical applications. By combining our technologies, we assist our customers in becoming cloud-ready and enjoying the benefits of high performance, scalability and availability that can be achieved with in-memory computing technology, all with a seamless migration effort and virtually no learning curve. Since the announcement, we have implemented IMDG architecture in our Magic xpi Integration Platform.

In October 2013, we partnered with Sugar CRM, a growing cloud and on-premise CRM ecosystem, and Sage, a popular provider of ERP and other business systems to small and medium business, enabling us to provide pre-built connectors for quick and reliable integration with these applications.

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In July 2015, we were recognized as “Salesforce Ecosystem Champion of the Year for France” for the Magic xpi Integration Platform with its pre-built and certified Salesforce adapter. In giving this award, Salesforce said their “growth is possible through the commitment to exceptional solutions and customer satisfaction provided by Salesforce partners like Magic Software.”

Also in July 2015, our Valinor subsidiary was recognized as the 2015 Microsoft Country Partner of the Year for Israel. The Microsoft Country Partner of the Year Awards honor partners at the country level that have demonstrated business excellence in delivering Microsoft solutions to multiple customers over the past year. This award recognizes Valinor as succeeding in effective engagement with its local Microsoft office while showcasing innovation and business impact, driving customer satisfaction, and winning new customers.

In 2016, we received the SugarCRM’s global ISV Partner Award for best engagement and teaming with fellow partners across the SugarCRM partner ecosystem.

In March 2017, we became a certified technology partner in the Technology Alliance Program for ServiceMax, a GE Digital company, the leader in cloud-based field service management solutions. As a result of this partnership, we launched a prebuilt, certified ServiceMax connector for our Magic xpi integration platform. This dedicated connector enables real-time business process integration between ServiceMax and other enterprise software, such as ERP systems, enabling ServiceMax customers to streamline field service processes, eliminate duplicate data entry, and increase productivity.

In March 2018, following an extension of our partnership with Salesforce, we included new features in our Magic xpi 4.7 to make the integration between Salesforce and other systems even easier. By collaborating with Salesforce, we are significantly expanding our partners’ network and maximizing our service offering to customers around the world, enabling them to better serve their customers via all channels by connecting to back-office ERP and finance applications, and streamlining business processes across numerous applications.

We are an Oracle Platinum Partner holding an Oracle Validated Integration status, a SAP Channel Gold Partner holding SAP Certified Integration status, an IBM Server Proven, and a SYSPRO business partner, among others. We appear on the Salesforce AppExchange and are a featured partner on SugarCRM’s Sugar Exchange, marketplaces for apps provided by partners. We continue to update and strengthen our relationships with these major IT partners by attending partner events and by updating and certifying our Magic xpi connectors for each specific ecosystem.

Industry Overview

In recent years, the number of available enterprise applications has grown significantly which has led information system complexity within many organizations to a level that has obstructed business progress and evolution, reduced business agility and led to significantly higher costs. We believe this complexity will continue to increase in the future. Although it is not unusual for organizations to operate multiple applications, systems and platforms that were created utilizing disparate programming languages, the complexity of these environments typically reduces an organization's operating flexibility, hinders decision-making processes and leads to costly inefficiencies and redundancies. When organizations seek to swiftly change, update and upgrade IT assets to support new business processes or to cope with changes in business and regulatory environments, they often find that the introduction and integration of new or upgraded business applications is more complex than expected, requires significant implementation resources, takes a long time to implement and is costly. The proliferation of smartphones and mobile platforms necessitates device-independent and future-proof business solutions for fast, simple, and cost-effective mobile deployment. In addition, new cloud computing technologies present enterprises with an opportunity to realize greater agility and meaningful cost savings to businesses, creating a growing need for further changes to enterprises' IT applications and systems.

Based on Gartner, Inc., or Gartner, a leading research and advisory firm providing information technology related insight, despite uncertainty fueled by recession rumors, Brexit, and trade wars and tariffs, the likely scenario for IT spending in 2019 is growth, with the global enterprise information technology market growing by 3.9% in 2018 and expected growth for 2019 and 2020 of 3.2% (to $3.76 trillion) and 2.8%, respectively (Gartner, Worldwide IT Spending Forecast, Q4.18 Update, January 2019). The market consists of five primary components, including communication services, IT services, devices, enterprise software and data center systems. The IT services segment represented $983 billion (26.9%) of the overall IT spending in 2018, and 27.3% of the total expected market opportunity in 2019. The enterprise software segment represented $397 billion (10.9%) of the overall IT spending in 2018, and 11.4% of the total expected market opportunity in 2019. Gartner also reports that ongoing spending to support digitalization initiatives in areas such as bimodal IT and customer experience underlies strength in application markets (Gartner Forecast Alerts: IT Spending, Worldwide, Q418 Update).

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The pace of digital transformation is also accelerating at companies all around the world. Customers are increasingly demanding an all-digital experience from the companies they do business with. They seek instant gratification through real-time updates or instant customer service without having to talk to or wait for other human beings. Employees are also pushing for a more digital experience in their workplaces. The confluence of these internal and external forces is causing companies of all sizes to put digital transformation goals at the top of the agenda. It is becoming clearer that companies will need to embrace and prioritize the creation of a digital operating environment to gain a competitive edge and be able to recruit and maintain a talented employee base. The confluence of these internal and external forces is causing companies of all sizes to put digital transformation goals at the top of the agenda. It is becoming clearer that companies will need to embrace and prioritize the creation of a digital operating environment to gain a competitive edge and be able to recruit and maintain a talented employee base.

Although the market for low-code development platforms is not new by any means, it has certainly started to gain more traction over the past couple of years and is expected to continue its strong growth as the gap between the important role of software at large enterprises and the lack of software skills in the market continues to widen. Forrester expects the market to increase to $21.2 billion by 2022, up from $3.8 billion in 2017, a CAGR of 41%. Some of the highest-growth years for the market are expected to be between 2019 and 2021, where growth is expected to be over 50%.

Manual coding and application development is a complex and time-consuming process with an end result that is not guaranteed. The process requires constant iteration as bugs are discovered and new features are integrated. In addition, the communication gap and general disconnect between developers and end-users are critical shortcomings of manual coding that results in business applications that are less than ideally designed. Many of these problems can be addressed by low-code and no-code development platforms. The enterprise application development software market consists of several application development sub-segments and includes large dominant players such as IBM, Microsoft, Oracle, Salesforce.com, HP, CA Technologies and Compuware as well as a large number of highly specialized vendors, with focused capabilities for specific vertical markets. Huge backlogs of enterprise app development work and growing demand for apps coupled with shortage and expense of skilled programmers, is increasingly leading enterprises to turn to low-code/no-code application development platforms that democratize the development process and give business users the ability to develop applications themselves with minimal or no assistance from IT. Through the adoption of business applications, these business users are increasingly looking for ways to automate manual workflows and become more efficient and effective by reallocating their time to solving more complex business problems. Even IT resources and developers are using low-code development tools to increase their development speed and reduce backlog. a growing market for low-code/no-code development platforms.

The IT services segment of the market is comprised of a broad array of specific segments such as infrastructure design and delivery, application development, technology consulting planning and implementation services, support services and supplemental outsourcing services. In addition, IT professional services include quality assurance, product engineering services and process consulting. The IT services segment is also undergoing a profound transition, with some key trends that have accelerated recently. Growing demand for mobile and cloud-based applications as well as Big Data solutions also entails more complex IT development and integration projects which management and implementation require a higher level of expertise, In addition, the typical software-based projects of IT consulting

have been gradually shifting towards software and technology-driven solutions that can be embedded into clients' systems, providing ongoing engagement services. This transition has been accentuated by an underlying change in IT services sourcing processes: the need for a faster go-to-market process as well as constrained resources in IT departments is resulting in greater influence by specific business units on the purchasing decision as opposed to the traditional sourcing process. The traditional outsourcing business model of capacity on demand is also transitioning towards a model of capability on demand. Information technology service buyers are increasingly looking at outcome-driven managed services with a tighter integration between software, service and infrastructure.

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We have identified the following trends that are relevant to the markets we operate in:

Increasingly complex business integration: In recent years, enterprises operate multiple applications and platforms, using various programming languages, resulting in complex enterprise information systems. Such systems and the ability to swiftly change, update, and upgrade them to support new business processes are crucial to the enterprise's ability to cope with changes in the business, economic and regulatory environment. However, the introduction and integration of new business applications is complex, requires significant time and human resources and entails significant and often unpredicted costs. Therefore, enterprises are in need of solutions that will facilitate the rapid and seamless deployment of business applications.

Reusing IT assets/enterprise applications: In an increasingly dynamic technology, business and economic environment, organizations face mounting pressure to continue to leverage their large IT investments in enterprise applications, such as ERP and CRM, while increasing their ability to change business processes and support new ones. Tools to support lightweight yet rapid, iterative and modular development methodologies, reusable architectures and application life-cycle management are primary drivers for spending on application development worldwide.

Enterprise mobility: With the proliferation of smartphones and mobile platforms that support enterprise mobility, enterprise users now expect instant access to real-time information, a rich user experience, seamless integration with various enterprise systems and support to multiple mobile devices. As such, enterprises need to be able to develop device-independent and robust business solutions for fast and cost-effective mobile deployment.

Cloud, Platform-as-a-Service and Software-as-a-Service: Cloud, Platform-as-a-Service (PaaS) and Software-as-a-Service (SaaS) are each becoming a well-established phenomenon in some areas of enterprise IT. Cloud-hosted applications continue to grow as alternatives to internally managed systems as they deliver greater agility and meaningful cost savings to businesses. In addition, fast time-to-deployment, low cost-of-entry, and adoption of pay-as-you-go models drive growing adoption of SaaS applications. In turn, SaaS applications enable the rapid construction, deployment and management of some custom-built applications accessed as a service in the cloud. With more SaaS deployments, the need for integration tools that bridge the cloud apps with on-premise application increases.

Big Data: The amount of digital information that is being generated by enterprises each year, across a number of diverse data sources and formats, is growing rapidly. Enterprises are required to retain, process and analyze data to attain meaningful insights and gain competitive advantages, and therefore require versatile and flexible tools in order to quickly and reliably process these increasingly large amounts of data.

IT Consulting: The typical software-based projects of IT consulting have been gradually shifting towards software and technology-driven solutions that can be embedded into clients' systems, providing ongoing engagement services.

Sourcing processes: The need for a faster go-to-market process as well as constrained resources in IT departments is resulting in greater influence by specific business units on the purchasing decision as opposed to the traditional sourcing process. The traditional outsourcing business model of capacity on demand is also transitioning towards a model of capability on demand. Information technology service buyers are increasingly looking at outcome-driven managed services with a tighter integration between software, service and infrastructure.

Mobility & IT skills shortage: Growth in mobility skills demand is outpacing organizations' ability to keep up, resulting in mobile strategists facing a skills shortage across the entire mobility ecosystem, with mobile application development skills in greatest demand. Poor availability of skilled staff is driving mobile strategists to outsource many functions across the mobility ecosystem, including application development and testing services. The increasing mobility skills gap will force mobile strategists to use a multifaceted application development and delivery approach.

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Magic's Software Solutions

Our software solutions enable enterprises to accelerate the planning, development, deployment and integration of on-premise, mobile and cloud business applications that can be rapidly customized to meet current and future needs. Our software solutions and complementary professional services empower customers to dramatically improve their business performance and return on investment by enabling the cost-effective and rapid delivery, integration and mobilization of business applications, systems and databases. Our technology and solutions are especially in demand when time-to-market considerations are critical, budgets are tight, and integration is required with multiple platforms or applications, databases or existing systems and business processes, as well as for RIA and SaaS applications. Our technology also provides the option to deploy our software capabilities in the cloud, hosted in a web services cloud computing environment. We believe these capabilities provide organizations with a faster deployment path and lower total cost of ownership. Our technology also allows developers to stage multiple applications before going live in production.

Development communities are facing high complexity, cost and extended pay-back periods in order to deliver cloud, RIAs, mobile and SaaS applications. Magic xpa, AppBuilder, Magic xpi and Magic xpc provide MSPs with the ability to rapidly build integrated applications in a more productive manner, deploy them in multiple modes and architectures as needed, lower IT maintenance costs and speed time-to-market. Our solutions are comprehensive and industry proven. These technologies can be applied to the entire software development market, from the implementation of micro-vertical solutions, through tactical application modernization and process automation solutions, to enterprise spanning service-oriented architecture, or SOA, migrations and composite applications initiatives. Unlike most competing platforms, we offer a coherent and unified toolset based on the same proven metadata driven and rules-based declarative technology. Our low-code, metadata platforms consist of pre-compiled and pre-written technical and administrative functions, which are essentially ready-made business application coding that enables developers to bypass the intensive technical code-writing stage of application development and integration, concentrate on building the correct logic for their apps and move quickly and efficiently to deployment. Through the use of metadata-driven platforms such as Magic xpa, AppBuilder, Magic xpi and Magic xpc, software vendors and enterprise customers can experience unprecedented cost savings through fast and easy implementation and reduced project risk.

Our software technology solutions include application platforms for developing and deploying specialized and high-end large-scale business applications and integration platforms that allow the integration and interoperability of diverse solutions, applications and systems in a quick and efficient manner. These solutions enable our customers to improve their business performance and return on investment by supporting the affordable and rapid delivery and integration of business applications, systems and databases. Using our software solutions, enterprises and ISVs can accelerate time-to-market by rapidly building integrated solutions, deploying them in multiple environments while leveraging existing IT resources. In addition, our solutions are scalable and platform-agnostic, enabling our customers to build solutions by specifying their business logic requirements in a commonly used language rather than in computer code, and to benefit from seamless platform upgrades and cross-platform functionality without the need to re-write applications. Our technology also enables future-proof protection and supports current market trends such as the development of mobile applications that can be deployed on a variety of smartphones and tablets, and cloud

environments. In addition, we also offer a variety of vertical-targeted products that are focused on the needs and requirements of specific growing markets. Certain of these products were developed utilizing our application development platform.

We sell our solutions globally through our own direct sales representatives and offices and through a broad sales distribution network, including independent country distributors, independent service vendors that use our technology to develop and sell solutions to their customers, and system integrators. We also offer software maintenance, support, training, and consulting services in connection with our products, thus aiding the successful implementation of projects and assuring successful operation of the platforms once installed. We sell our integration solutions to customers using specific popular software applications, such as SAP, Salesforce.com, IBM i (AS/400), Oracle JD Edwards, Microsoft SharePoint, Microsoft Dynamics, SugarCRM and other eco-systems. As such, we enjoy a well-diversified client base across geographies and industries including oil & gas companies, telecommunications groups, financial institutions, healthcare providers, industrial companies, public institutions and international agencies.

The underlying principles and purpose of our technology are to provide:

Simplicity – the use of code-free/low code development tools instead of hard coding and multiple programming languages;

Business focus – the use of pre-compiled business logic and components eliminates repetitive, low level technical and coding tasks;

Comprehensiveness – the use of a comprehensive development and deployment platform offers a full end-to-end development, deployment and integration capability;

Automation of mundane tasks – to accelerate development and maintenance and reduce risk; and

Interoperability – to support business logic across multiple hardware and software platforms, operating systems and geographies.

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We offer two complementary application platforms that address the wide spectrum of composite applications, Magic xpa and AppBuilder. Our Magic xpi integration platform and Magic xpc iPaaS solution delivers fast and simple integration and orchestration of business processes and applications. We gained 104 new Magic xpa and xpi end customers in 2018. We also have an increasing number of customers that use both our Magic xpa and Magic xpi platforms to develop and deploy mobile apps quickly and easily.

Magic xpa Application Platform

Magic xpa Application Platform, our metadata driven application platform, provides a simple, low code and cost-effective development and deployment environment that lets organizations and MSPs quickly create user-friendly, enterprise-grade, multi-channel mobile and desktop business app that employ the latest advanced functionalities and technologies. The Magic xpa Application Platform, formerly named uniPaaS, was first released in 2008 and is an evolution of our original eDeveloper product, a graphical, rules-based and event-driven framework that offered a pre-compiled engine for database business tasks and a wide variety of generic runtime services and functions which was released in 2001.

We have continually enhanced our Magic xpa application platform to respond to major market trends such as the growing demand for cloud-based offerings including Rich Internet Applications (RIA), mobile applications and SaaS. Accordingly, we have added new functionalities and extensions to our application platform, with the objective of enabling the development of RIA, SaaS, mobile and cloud-enabled applications. SaaS is a business and technical model for delivering software applications, similar to a phone or cable TV model, in which the software applications are installed and hosted in dedicated data centers and users subscribe to these centers and use the applications over an internet connection. This model requires the ability to deliver RIA. Magic xpa is a comprehensive RIA platform. It uses a single development paradigm that handles all ends of the application development and deployment process including client and server partitioning and the inter-communicating layers.

Magic xpa offers customers the power to choose how they deploy their applications, whether full client or web; on-premise or on-demand; in the cloud or behind the corporate firewall; software or mobile or SaaS; global or local. Our Magic xpa Application Platform complies with event driven and service oriented architectural principles. By offering technology transparency, this product allows customers to focus on their business requirements rather than technological means. The Magic xpa single development paradigm significantly reduces the time and costs associated with the development and deployment of cloud-based applications, including RIAs, mobile and SaaS. In addition, application owners can leverage their initial investment when moving from full client mode to cloud mode, and modify these choices as the situation requires. Enterprises can use cloud-based Magic xpa applications in a SaaS model and still maintain their databases in the privacy of their own data centers. It also supports most hardware and operating system environments such as Windows, Unix, Linux and AS/400, as well as multiple databases and is interoperable with .NET and Java technologies.

Magic xpa can be applied to the full range of software development, from the implementation of micro-vertical solutions, through tactical application modernization and process automation solutions, to enterprise spanning SOA migrations and composite applications initiatives. Unlike most competing platforms, we offer a coherent and unified toolset based on the same proven metadata driven and rules based declarative technology, resulting in increased cost savings through fast and easy implementation and reduced project risk.

On October 15, 2013, we announced the availability of new offline capabilities for Magic xpa and the launch of our Enterprise Mobility Solution that provides businesses with a holistic solution to address their critical enterprise mobility requirements. Our Enterprise Mobility Solution combines our enhanced application and integration platforms, and new mobile-oriented professional services. Our Enterprise Mobility Solution provides everything businesses need to deliver successful enterprise-grade business apps including: (i) secure and reliable access to real-time enterprise data; (ii) seamless natural user experiences enabled by native apps that can take full advantage of embedded device capabilities and third-party add-ons; (iii) fast time-to-market; (iv) full security at data, user, device and application levels; and (v), comprehensive management capabilities. We also offer professional services for every stage in the mobile app lifecycle. We believe that by offering a comprehensive solution, we can increase the attractiveness and competitiveness of our Enterprise Mobility Solution to enterprises looking to deploy mobile applications.

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In July 2014, we released Magic xpa Application Platform 2.5 with new features and enhancements to allow for fast and easy enterprise mobility application creation and improved user experience along with the brand-new Magic Mobile Accelerator Framework, which includes a set of pre-built, reusable and customizable components for a wide variety of popular mobile application features, including user interface and display, navigation, graphs and charting, location services, synchronization, and device and application auditing. Designed to work together under the same framework, accelerator components enable Magic developers to create attractive, functional mobile applications, faster and with less effort than before.

In May 2015, we released Magic xpa 3.0, an improved version of our application platform including high performance In-Memory Data Grid architecture, an enhanced Visual Studio-based development environment, powerful new mobile development capabilities and support for Big Data and Fast Data by enabling users to stream application data to an in-memory space.

In March 2016, we released Magic xpa version 3.1 of our Magic xpa Application Platform, incorporating feedback from the field to bring our customers additional value in terms of simplifying app modernization, accelerating enterprise mobile app development and maximizing end user adoption. This release included end user customization capabilities, an enhanced UI, and a new Upgrade Manager.

In November 2016, we released Magic xpa version 3.2. The Magic xpa 3.2 release included new Windows 10 mobile client and iOS 10 support for expanded mobile options; UX and productivity improvements; a Web Services Gateway providing support for n-tiered application architecture; a new Compare and Merge Tool; improvements to the Upgrade Manager utility and additional backward compatibility features.

In February 2018, we released Magic xpa 3.3 with a more seamless and easier integration with Java, similar to the already existing integration with ..NET, making the Magic xpa platform even more robust. Along with that, we provided a new WS provider mechanism, built on Apache Axis2, enhancing our current WCF based capabilities.

In August 2018, we released Magic xpa 4.0 with its new Angular-based Web application framework that provides developers and Angular developers with the power to develop device-agnostic and feature-packed Web applications. Magic xpa 4.0 decouples the business logic from the presentation of the apps providing developers with the flexibility to use the Angular open-source platform with industry-standard state-of-the-art technologies, including HTML5, CSS, and JavaScript for designer-quality screens, while benefiting from the productivity, security, and scalability capabilities provided by our low-code development platform.

In addition, we further modernized our Integrated Development Environment (IDE) by moving toward a full-fledged Visual Studio-based studio, offering our users an even more intuitive and user-friendly experience.

Our 2019 roadmap includes the release of a 64-bit edition of Magic xpa, featuring a full 64-bit runtime engine for Windows and Linux.

During 2018, Magic xpa was listed in Gartner's Market Guide for Application Platforms report. In addition, Magic xpa was listed in the Forrester Wave™ for Mobile Low-Code Development Platforms.

AppBuilder Application Platform

AppBuilder, a platform we acquired in December 2011, is a proprietary development environment used for managing, maintaining and reusing complicated applications needed by large businesses. It provides the infrastructure for enterprises worldwide, across several industries, with applications running millions of transactions daily on legacy systems. Enterprises using AppBuilder can build, deploy and maintain large-scale custom-built business applications for years without being dependent on any particular technology. The AppBuilder deployment environments include IBM mainframe, Unix, Linux and Windows. AppBuilder is intended to increase productivity and agility in the creation and deployment of enterprise class computing.

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AppBuilder follows the 4GL development paradigm to help enterprises focus on the business needs and definition and overlook technical hurdles. AppBuilder developers define the business roles and prior to deployment the code is generated from the development environment to the required run time environment. Several large MSPs have utilized AppBuilder to build state of the art applications that are deployed through many large customers.

AppBuilder implements a model driven architecture approach to application development. It provides the ability to design an application at the business modeling level and generate forward to an application. AppBuilder has a platform-independent, business-rules language that enables generation to multiple platforms. It is possible to generate the client part of an application as Java and the server part as COBOL. As businesses change, the server part can be generated as Java without changing the application logic. Only a simple configuration option needs to be changed.

AppBuilder contains everything a development environment needs to create any type of simple or complex business application with platform-independent functionality, including:

System administration security controls for scope and permissions;

Migration, testing, and deployment functions;

Architecture-independent development;

An integrated toolset for designing, developing, and deploying applications;

Object-based components managed from host, server, or client repositories;

Support for Java/J2EE, COBOL, C#, and C programming languages;

An efficient, cross-platform code generation facility;

Ready-to-use business logic and libraries;

A remote prepare facility for mainframe development;

Multiple language user interface support; and

DBCS support.

In April 2016, AppBuilder launched a next-generation HTML5 development tool. AppBuilderHTML5 enables AppBuilder enterprise customers to easily turn their large-scale client/server business applications into fully functional browser-based apps.

During 2016, AppBuilder launched the next generation of its group repository tool, the Versioned Group Repository (VGRE). AppBuilder VGRE is aimed at mid-size development projects, runs on Microsoft Windows Server platform and enables AppBuilder enterprise customers to parallel support for multiple application releases, called branches, and access to the full history of individual objects. This includes comparisons as well as version manipulation features like merge. VGRE is an extension to the existing repository portfolio with full backward compatibility including well known features like impact analysis, security, upload/download, migrations, rebuilds, remote preparation and others.

Magic xpi Integration Platform

Our Magic xpi integration platform (an evolution of our original and formerly branded iBOLT platform, launched in 2003) is a graphical, wizard-based code-free solution delivering fast and simple integration and orchestration of business processes and applications. Magic xpi allows businesses to more easily view, access, and leverage their mission-critical information, delivering true enterprise application integration, or EAI, business process management, or BPM, and SOA infrastructure. Increasing the usability and life span of existing legacy and other IT systems, Magic xpi allows fast EAI, development and customization of diverse applications, systems and databases, assuring rapid return on invested capital and time-to-market, increased profitability and customer satisfaction.

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Magic xpi allows the integration and interoperability of diverse solutions, including legacy applications, in a quick and efficient manner. In January 2010, we released Magic xpi 3.2 and since then we have continued to develop the Magic xpi channel. We entered into agreements with additional system integrators, consultancies and service providers, who acquired Magic xpi skills and offer Magic xpi licenses and related services to their customers. We also offer special editions of Magic xpi with optimized and certified connectors for specific enterprise application vendor ecosystems, such as SAP, Oracle JD Edwards, Microsoft SharePoint and Salesforce.com. These special editions contain specific features and pricing tailored for these market sectors.

On October 31, 2013, we announced major enhancements with the release of our Magic xpi version 4.0 Integration Platform, which included the adoption of an In-Memory Data Grid, or IMDG, architecture and new off-the-shelf certified adapters optimized for Sugar CRM, Sage ERP and SYSPRO applications. With core enterprise systems in place, organizations of all sizes are looking to business process integration and automation to increase operational efficiency, competitiveness and innovation. Our new IMDG-based architecture offers: (i) cost-effective elastic scalability, (ii) built-in clustering and failover capabilities (the capability to switch to a redundant or standby computer server, system, hardware component or network upon a failure) that support enterprise needs for business continuity, and (iii) faster processing and increased transaction loads spurred by new mobile, cloud and big data use cases. Our expanded library of off-the-shelf adapters, which includes native adapters for Oracle JD Edwards Enterprise One, JD Edwards World, SAP, IBM Lotus Notes, Microsoft Dynamics, Microsoft SharePoint and Salesforce, along with over 60 built-in technology adapters, facilitates use in a broad range of integration scenarios, meeting the needs of a wide range of potential customers and increasing return on investment.

In December 2014, we released version 4.1 of our Magic xpi Integration Platform, incorporating feedback from the field to bring our customers additional value in terms of redundancy, reliability, stability, performance, and monitoring. For example, users are now able to define an alternate host for the server to work with if the main host is unavailable or if the startup procedure on the main host fails. We also added a new mechanism to rebalance the Space partitions so that the primary partition and its backup will not run on the same machine when they are deployed on a clustered environment.

In addition, we released/updated the following connectors:

Dynamics CRM 2013

Dynamics CRM 2015

Dynamics AX connector

SugarCRM upgrade to API V10

Google calendar – API upgrade

In 2015, Magic xpi was awarded the Integrate 2015 award for Top Innovator for Integration Middleware.

In June 2016, we released version 4.5 of our Magic xpi Integration Platform, designed to make digital transformation and IoT projects easier. Magic xpi 4.5 included a fresh Microsoft® Visual Studio®-based UI with enhanced productivity features, expanded out-of-the-box connectivity including an MQTT adapter, and a Connector Builder that lets users quickly build their own full-featured reusable connectors. Magic xpi 4.5 had expanded connectivity capabilities and robust in-memory computing architecture to help the execution of business-critical digital transformation and IOT projects.

In March 2017, we released Magic xpi version 4.6 with enhancements including a New ServiceMax connector for quick and easy connectivity with ServiceMax, a New OData client connector for easy connectivity to ecosystems exposing services via this open standardized protocol, a SAP Business One connector verified for SAP Business One HANA and support for additional services and new and improved functionalities to our existing MS Dynamics CRM connector.

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In August 2017, our Magic xpi integration platform was recognized by the analyst firm Ovum as a well-positioned integration platform that is a good option for small-and medium-size enterprises. In addition, Magic xpi was listed in 2017 in 10 Gartner reports including three Market Guides for Application Integration Platforms, HIP-Enabling Technologies and IoT Integration.

In March 2018, we released Magic xpi version 4.7 with a new OData Provider connector, Active Directory Federation Services (ADFS) support for the SharePoint Online (MOSS) connector, ability to write new connectors based on Magic xpa Application Platform's runtime technology and multiple features to improve programming productivity, such as visual indicators of data flow status and an enhanced monitor to provide an even more accurate bird's eye view of all running projects.

In October 2018, we announced that Magic xpi Integration Platform 4 achieved SAP-certified integration with SAP S/4HANA, enabling our customers to optimize business processes through automation across leading ERP, CRM, finance, and other enterprise systems using a single platform.

In February 2019, we released Magic xpi version 4.9 with a new REST client connector, ODATA connector enhancements, inherent UPSERT support in the data mapper, and built-in cloud support.

Magic xpc Integration Platform

In November 2017, we announced the expansion of our integration offering with the launch of Magic xpc, a hybrid integration platform as a service (IPaaS), which enable customers to accelerate digital transformation on the cloud, on-premises or on both.

Magic xpc is powered by its out-of-the-box integration connectors for mainstream business applications, databases, protocols and tools for building custom integrations. Magic's iPaaS platform was built using node.JS and docker technology. Magic xpc users can monitor their integration flows and create and manage alerts from a single interface. Built on top of open-source components with no cloud vendor lock-in, Magic xpc is available on both public and private cloud platforms including, Amazon Web Services, Azure, and Google Cloud.

Vertical software solutions

Clicks™

Our Roshtov subsidiary has approximately three decades of proven experience based on its proprietary comprehensive core software solution for medical record information management systems, using in the design and management of patient-file for managed care and large-scale healthcare providers. The platform, which can be tailor-made to the specific needs of the healthcare provider, is connected to the clinical, administrative and financial data base system, residing at the provider's central computer, and allows immediate analysis of complex data with potentially real-time feedback to meet the specific needs of physicians, nurses, laboratory technicians, pharmacists, front- and back-office professionals and consumers.

All of our clients that buy or subscribe to our Clicks software solution also enter into software support agreements with us for maintenance and support of their medical record management systems. In addition to immediate software support in the event of problems, these agreements allow clients to access new releases covered by support agreements. In addition, each client has 12-hour access, six days a week (6 hours on Friday) to the applicable call-center support teams.

We employ a team of 30 research and development specialists that together with our clients create a future where the health care system works to improve the well-being of individuals and communities. Roshtov's proven ability to innovate has led to what we believe to be an industry leading architectures and a breadth and depth of solutions and services.

There are four healthcare service providers in Israel, of which, Maccabi Healthcare Services and Clalit, which are the two largest healthcare providers in Israel accounting for 77% of the Israeli market, have been our customers since the early 1990's.

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Leap™

Our FTS subsidiary has over 20 years of BSS experience, based on dozens of projects delivered to customers worldwide. We implement revenue management and monetization solutions in mobile, wireline, broadband, MVNO/E, payments, e-commerce, M2M / Internet of Things, mobile money, cable, cloud and content markets under the brand name of Leap™. Our Leap™ solutions lower the total cost of ownership (TCO) for telecom, content and payment service providers.

FTS works with telecommunications, content and payment service providers globally to help them manage complex transactions and relationships with greater flexibility and independence. Analyzing transactions from a business standpoint, FTS offers end-to-end and add-on telecom billing, charging, policy control and payments solutions to customers worldwide, and services both growing and major providers.

FTS targets mid to lower level tier service providers, supporting their BSS needs with end-to-end, turnkey billing and other BSS projects. In addition, FTS offers upper-tiers of service providers with BSS and monetization solutions for specific needs, including policy control and charging solutions, M2M billing, billing for content services, MVNE/MVNO billing, mobile money software solutions, payment and mobile financial services solutions and others.

Our Leap™ offering is comprised of:

Leap™ BCCF (Business Control and Charging Function) – a proprietary packaged software solution which serves as the underlying foundation of our Leap™ products and solutions. Leap BCCF enables service providers to handle the aspects of event processing, from defining the system's business logic, through importing events and formatting, to charging and executing business rules. With Leap BCCF, new services are deployed on the fly, and strategic business rules are formulated more easily, ensuring real-time responses to both service and customer-related events and providing a baseline for policy control.

Leap™ Billing 6.3 – a convergent charging, billing and customer care solution that realizes substantial reductions in OPEX and CAPEX while increasing customer satisfaction and retention. Leap Billing software's flexibility and ease of use enables the service providers' billing platform to work more at the speed of marketing by offering new marketing plans or services in a rapid time-to-market.

Leap™ Policy Control **-** Leap Policy Control is an integrated charging and policy control solution (a full PCC solution based on PCRF & online/offline charging). Compliant with the 3GPP's Diameter policy control standard, Leap Policy Control provides traffic and subscriber management strategies. Leap Policy Control gives operators the power to monitor usage in real time and, using fully configurable business rules, define how they manage network resources, applications, and subscribers – in real time – while generating revenue from personalized mobile applications, content and services. Leap Policy Control can be implemented as a stand-alone solution or as part of a larger BSS project implementation.

FTS Express™ **-** FTS express™ is an all-in-one software appliance for online charging, billing, AAA, balance management, customer care, policy control and interconnect, designed for entry-level operations of MVNOs, LTE, VoIP, ISP, broadband, IPTV and more.

The following is a sample of the monetization solutions offered by FTS:

End-to-end, turnkey billing and customer care solutions;

Convergent, online charging and billing;

Policy control and charging;

MVNO/E billing;

Billing for content;

Interconnect billing;

M2M / IoT billing;

Broadband and multi-play billing;

Mobile money solutions;

E-commerce and M-commerce solutions;

Payments and mobile payments solutions;

Smart revenue sharing and partner management solutions and

Billing service bureau

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FTS's solutions are delivered via cloud, on-premises or in a fully managed-services mode and are backed by our Israel and Bulgaria-based experienced professional services support team.

In 2016, industry analyst firm Frost & Sullivan's Stratecast practice named FTS as a key monetization innovation enabler for communication service providers. This is because FTS Leap™ solutions enable the monetization of complex value chains, supporting the revenue management needs of content providers, telematics, IoT, and financial service providers, among others.

During 2017, FTS was evaluated by Gartner in its Magic Quadrant for Integrated Revenue and Customer Management for CSPs. FTS has improved its position based on both of the Magic Quadrant axes, Completeness of Vision and Ability to Execute, according to Gartner's evaluation of FTS' IRCM products, including FTS Billing, FTS Policy Control and FTS express.

HR Pulse

Now in its 10th release, HR Pulse is a proprietary platform that creates and customizes software applications for HCM, with the goal to combine technology with effective processes, to facilitate the collection, analysis and interpretation of quality data about people, their jobs and their performance, to enhance HCM decision making, resulting in increased organizational efficiency and effectiveness. HR Pulse addresses four distinct functional areas with the ability to also work as one consolidated system:

Performance and goal management:

Development management;

Talent management and succession planning; and

Compensation and merit review.

Our offering includes customizable "out of the box" HCM SaaS Solutions, such as Pilat Frist and Pilat Professional, that provides a menu of templates that can be used to affordably and expeditiously create customized HCM solutions for companies. The HR Pulse platform promotes the building and implementation of solutions that address broader business challenges as well. Such offerings include 360-degree feedback, employee surveys, leadership and

management development, coaching and job evaluation.

Hermes

Hermes has been developing and evolving cargo management systems for the air cargo industry since 2002. Hermes Air Cargo Management System is a proprietary, state-of-the-art, packaged software solution for managing air cargo ground handling. Our Hermes Solution covers all aspects of cargo handling, from physical handling and cargo documentation through customs, seamless EDI communications, dangerous goods and special handling, tracking and tracing, security and billing. Over the last 10 years Hermes systems have been implemented in over 70 terminals on five continents, providing efficient and accurate handling of more than 5 million tons of freight annually. Customers benefit through faster processing and more accurate billing, reporting and ultimately enhanced revenue. Customers include independent ground handlers, airlines with a cargo arm, hubs belonging to an individual airline or those catering to a number of airlines transiting cargo to additional destinations. The Hermes Solution is delivered on a licensed or fully hosted basis. In 2016, Hermes supplemented its offering with the Hermes Business Intelligence (HBI) solution, adding unprecedented data analysis capabilities and management-decision support tools.

Our Value Proposition

Hermes systems are built with the specific needs of air cargo handlers and airlines in mind and are amongst the most versatile and sophisticated around. Hermes Solutions are focused on maximizing customer profits by streamlining ground handling processes and employing built-in best practices to reduce handling errors. Hermes team of cargo experts carry out a full business analysis, listen to our customers' requirements, suggest additional functionality and work with them to deliver an air cargo management solution that is streamlined around their processes and customized to their needs. Hermes works with everyone from smaller cargo handlers to large airlines all over the world and counts Menzies Aviation, WFS (FRA), Luxair, Etihad Airport Services and Frankfurt Cargo Services among their customers.

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Strategy

Our goal is to continue our profitable and cash generative growth within our software solutions and professional services markets. We plan to achieve this goal by focusing on the following principles:

Expand sales to existing customers. We intend to capitalize on the opportunity to more effectively cross-sell solutions and services across our existing customer base. In addition to selling complementary software solutions to customers that already use our development application solutions or packaged software solutions, we believe our strong customer, MSP and partner relationships and execution track record position us to successfully grow our revenues by delivering complementary development and integration tools from our product offering to our existing IT services customers and by delivering IT services to our existing application development customer base.

Capitalize on opportunities created by new technological trends. We believe that emerging industry trends such as mobile applications, cloud applications, SaaS and big data will require our enterprise customers and partners to continue and upgrade existing systems and to integrate their current infrastructure with new mobile and cloud applications or with new big data management solutions. We intend to market the capabilities of our software solutions and professional services offerings to customers that are currently impacted or will potentially be impacted by the increased complexity resulting from these trends. For instance, we intend to promote Magic xpa through Rich Internet Applications (RIAs).

Grow our customer base through new offerings. We plan to grow our business by attracting new ISV enterprise customers with new technology offerings and new professional services through our already established expertise in the areas of mobile technologies and projects, cloud applications, SaaS and Big Data solutions, and integration solutions. Due to our track record in these industry segments, we believe we are well positioned to develop and offer new application development and integration solutions that will enable us to attract new customers. In addition, we believe our familiarity with these verticals will allow us to differentiate our IT services offering and grow our market share in this vertical as well.

Provide new solutions to new ecosystems. We expect the same industry trends of mobile, cloud, SaaS and big data to lead to the creation of additional enterprise applications ecosystems. We intend to continue to develop new solutions that will allow us to form new partnerships, which in turn will grow our revenues. We also intend to focus on recruiting OEM partners that will incorporate our Magic xpi integration technology into their product offerings.

Acquire complementary businesses. As part of our growth strategy, we will continue to seek and evaluate opportunities to grow through acquisitions of companies and operations with complementary software solutions, technologies and related intellectual property, packaged software solutions, augmenting integration and services capabilities, additional distribution channels or market share. We have a strict acquisition policy pursuant to which we only pursue acquisitions in cases we identify as having a clear business opportunity and a clear path to revenue growth. In addition, we only pursue acquisitions which we believe entail low integration and operational risk as a

result of our internal familiarity with the target or the industry in which it operates, through our network of MSPs, system integrators, distributors, resellers, and consulting and OEM partners. We intend to balance any investments in such acquisitions with investments in our existing business and our policy of returning value to shareholders in the form of dividends.

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Product Development

We place considerable emphasis on research and development in order to improve and expand the functionality of our technologies and to develop new applications. We believe that our future success depends upon our ability to maintain our technological leadership, to enhance our existing products and to introduce new commercially viable products addressing the needs of our customers on a timely basis. We also intend to support emerging technologies as they are introduced in the same way we have supported new technologies in the past. We will continue to devote a significant portion of our resources to research and development. We believe that internal development of our technology is the most effective means of achieving our strategic objective of providing an extensive, integrated and feature-rich development technology. For significant version release see “Magic’s Software Solutions” discussed above.

Product Related Services

Professional Services. We offer fee-based consulting services in connection with installation assurance, application audits and performance enhancement, application migration and application prototyping and design. Consulting services are aimed at generating both additional revenues and ensuring successful implementation of Magic xpa, Appbuilder, Magic xpi and Magic xpc projects through knowledge transfer. As part of management efforts to focus on license sales, our goal is to provide such activities as a complementary service to our customers and partners. We believe that the availability of effective consulting services is an important factor in achieving widespread market acceptance.

Services are offered as separately purchased add-on packages or as part of an overall software development and deployment technology framework. Over the last several years, we have built upon our established global presence to form business alliances with our MSPs that use our technology to develop solutions for their customers, and distributors to deliver successful solutions in focused market sectors.

Maintenance. We offer our customers annual maintenance contracts providing for unspecified upgrades and new versions and enhancements for our products on a when-and-if-available basis for an annual fee.

Customer Support. We believe that a high level of customer support is important to the successful marketing and sale of our products. Our in-house technical support group provides training and post-sale support. We believe that effective technical support during product evaluation as well as after the sale has substantially contributed to product acceptance and customer satisfaction and will continue to do so in the future.

We offer online support systems for our MSPs and end users, providing them with the ability to instantaneously enter, confirm and track support requests through the Internet. These systems support MSPs and end-users worldwide. As part of this online support, we offer Support Knowledge Base tools providing the full range of technical notes and other documentation including technical papers, product information, and answers to most common customer queries and known issues that have already been reported.

Training. We conduct formal and organized training on our development tools and packaged software solutions. We develop courses, pertaining to our principal products and provide trainer and student guidebooks. Course materials are available both in traditional, classroom courses and as web-based training modules, which can be downloaded and studied at the student's own pace and location. The courses and course materials are designed to accelerate the learning process, using an intensive technical curriculum in an atmosphere conducive to productive training.

IT Services

Background

Our IT services offerings consist of a variety of professional services that can be grouped into integration and other IT services. Our integration services include:

Infrastructure analysis, design and delivery - management of complex, tailor-made projects and telecom infrastructure projects in wireless and wire-line as well as IT consulting services, mainly for the defense and public sectors.

Technology consulting and implementation services - planning and execution of end-to-end, large-scale, complex solutions in networking, cyber security, command & control and high performance transaction systems.

Application development - We specialize in end-to-end projects that feature an array of technologies, from development and implementation of concepts for startups to overall responsibility for the development of systems for large enterprises. Our development services include development of on-premise, mobile and cloud applications as well as Embedded and real time software development.

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With more than 1,700 experts and hundreds of projects gone live in a variety of advanced technologies in the U.S., Europe and Israel, we have developed significant expertise and accumulated vast experience in integration projects. Such projects are typically more complex and require a high level of industry knowledge and highly skilled professionals. Our integration expertise, as well as our global reach allows us to deliver comprehensive, value added services to our customers. Our IT services customers include major global telecoms, OEMs and engineering, furnish and installation service companies.

Strategic Consulting and Outsourcing Services

We provide a broad range of IT consulting services in the areas of infrastructure design and delivery, application development, technology planning and implementation services, cloud computing, as well as supplemental outsourcing services. Our wholly-owned subsidiaries, Fusion Solutions LLC, Xsell Resources Inc., Allstates Consulting Services LLC, Futurewave Systems, Inc., the Comm-IT Group, Infinigy Solutions LLC., Comblack Ltd. and Shavit Software (2009) Ltd. provide advanced IT consulting and outsourcing services to a wide variety of companies including Fortune 1000 companies. Our technical personnel generally supplement the in-house capabilities of our customers. Our approach is to make available a broad range of technical personnel to meet the requirements of our customers rather than focusing on specific specialized areas. We have extensive knowledge of and have worked with virtually all types of wireless and wireline telecom infrastructure technologies as well as in the areas of infrastructure design and delivery, application development, project management, technology planning and implementation services. Our consulting partners come from a wide range of industries, including finance, insurance, government, health care, logistics, manufacturing, media, retail and telecommunications. With an experienced team of recruiters in the telecom and IT areas and with a substantial and a growing database of telecom talent, we can rapidly respond to a wide range of requirements with well qualified candidates. Our customer list includes major global telecoms, OEMs and engineering, furnish and installation service companies. We have built long-term relationships with our customers by providing expert telecom talent. We provide individual consultants for contract and contract-to-hire assignments as well as candidates for full time placement. In addition, we configure teams of technical consultants for assigned projects at our customers' sites.

Customers, End-Users and Markets

We market and sell our products and services in more than 50 countries worldwide. The following tables present our revenues by revenue type and geographical market for the periods indicated:

	Year ended December 31,		
	2016	2017	2018
	(**in thousands**)		
Software sales	$19,626	$21,644	$25,454

Maintenance and technical support	25,885	30,386	30,951
Consulting services	156,135	206,110	227,970
Total revenues	$201,646	$258,140	$284,375

	Year ended December 31,		
	2016	2017	2018
	(**in thousands**)		
Israel	$58,079	$91,917	$103,850
Europe	23,642	26,635	28,257
United States.	100,470	123,113	137,066
Japan	11,226	9,253	9,797
Other	8,229	7,222	5,405
Total revenues	$201,646	$258,140	$284,375

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Our Magic xpa, Magic xpi, Magic xpc and AppBuilder technologies are used by a wide variety of developers, integrators and solution providers, that can generally be divided into two sectors (i) those performing in-house development (corporate IT departments), and (ii) MSPs, including large system integrators and smaller independent developers, and VARs that use our technology to develop or provide solutions to their customers. MSPs who are packaged software publishers use our technology to write standard packaged software products that are sold to multiple customers, typically within a vertical industry sector or a horizontal business function.

Among the thousands of customers running their business systems with our technology are the following

ABB Group

Able B.V.

ADD

Adidas Canada

Adecco Nederland

Agricultural Bank of China

Allstate Life Insurance

ATLAS Grupo Financiero Seguros y Fianzas

Auchan

AutoScout24

Bank Leumi

BNP Paribas

Boston Medical Center

CBIA

Çelebi Ground Handling Inc.

Centric

Fukushima Bank

Gakken

GE Capital

GGD Amsterdam

Grange Company

Groupe Flo

Grupo Inversionistas en Autotransportes Mexicanos

Guardian Life Insurance

Hebrew University of Jerusalem

Hitachi Systems

IDF

ING Commercial Finance BV

ISS

Japan Chamber of Commerce

Korea Development Bank (KDB)

Lekkerland Nederland BV

Lloyds Bank

Petzl

PGG Wrightson

PTT

QboCel Mexico

Rosenbauer

Segafredo France

Sennheiser

Sony DADC

Staff Development Management Systems (SDMS Ltd)

SECOM Trust Systems

Sodiaal

Stallergenes

State of Washington Courts

Sterling Crane

Sun Life Insurance

Synbra Holding BV

Telenet Belgium

Christie Digital

Club Med

Coca Cola

Crane & Co.

Datenlotsen

Eco-Emballages

Electra

Export-Import Bank of Thailand

Ekro

Euroclear

Farm Mutual Reinsurance Plan

Finanz Informatik

Fiskars

Franken Brunnen

Fujitsu Marketing

Fujitsu-Ten

L'Occitane

Loxam

MatrixCare

Mahindra & Mahindra

Moose Toys

Morgan Advanced Materials

Mundipharma

Nagarjuna Fertilizers & Chemicals Ltd.

Nespresso

NextiraOne

NHS Trust

Nihon UNISYS

Nintendo

Orangina Schweppes

Pacific Steel & Recycling

Parrot

TelOne Zimbabwe

The Himalaya Drug Company

TOA

TOTO

UPS

Valeo services

Veolia Waters

Viparis

Vishay Intertechnology

Vodafone Iceland

Volvo Brazil

WellMark

Worldwide Flight Services (WFS)

ZF Lemforder

Sales, Marketing and Distribution

We market, sell and support our products through our own global offices and marketing department, as well as through a broad global channel-network of MSPs, system integrators, value-added distributors and resellers, and OEM and consulting partners. Our sales force is based in our regional offices in the United States, Japan, Germany, United Kingdom, Netherlands, France, Hungary, South Africa, India and Israel, and through regional distributors elsewhere. Our sales network is present in about 50 countries worldwide.

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Direct Sales. For Magic xpa and AppBuilder, our direct sales force pursues software solution providers and enterprise accounts. Our sales personnel carry out strategic sales with a direct approach to decision makers, managing a constantly monitored consultative type of sales cycle. Magic xpi and Magic xpc are mostly sold through indirect channels and through our ecosystem business relationships, but we have some direct customers with integration needs.

As of December 31, 2018, we employed approximately 140 sales personnel including, a team of sales engineers who provide pre-sale technical support, presentations and demonstrations in order to support our sales force.

Indirect Sales. We maintain an indirect sales channel, through our ecosystem business relationships, as well as through system integrators, value added distributors and resellers, OEM partners, as well as consultancies and service providers. We maintain an indirect sales channel for Magic xpa through MSPs and system integrators, who use our application and integration platforms to develop and deploy different applications for sale to their end-user customers.

Distributors. In general, we distribute our products through regional non-exclusive distributors in those countries where we do not have a sales office. A regional distributor is typically a software marketing organization with the capability to add value with consulting, training and support. Distributors that are also MSPs are generally responsible for the implementation of both our application platform and business and process integration suite and localization into their native languages. The distributors also translate our marketing literature and technical documentation. Distributors must undergo our program of sales and technical training. Marketing, sales, training, consulting, product and customer support are provided by the local distributor. We are available for backup support for the distributor and for end-users. In coordination with the local subsidiaries and distributors, we also provide sales support for large and multinational accounts. We have 44 distributors in Europe, Latin America and Asia, many of whom are also MSPs.

VARs. In general, we resell our products through VARs that extend their capabilities with our offerings. These include SAP VARs.

Global Marketing Activities. We carry out a wide range of marketing activities aimed at generating awareness of our solutions offerings. Among our activities, we focus on online marketing, including a content-rich website available in eight foreign languages, social networks communication, search engine optimization, on-line advertising, lead generation campaigns, public relations, case studies, blogs, industry analyst relations, attendance at conferences and trade shows and lead generation campaigns around key professional white papers and webinars. We conduct distributor and user conferences to update our worldwide affiliates and user base on our new product offerings, marketing and promotional activities, pricing, best practices, technical information and other information.

In light of the increased impact of cloud and enterprise mobility technologies on the IT landscape, in 2011 we commenced a strategic marketing repositioning initiative that led to a complete rebranding of certain of our products' look, feel and naming (to emphasize that our products belong to the same technology stack), messaging, as well as a refined definition of our market positioning, value proposition and corporate values. In June 2012, we launched the new branding after we completed the strategic repositioning and designed a fresh and dynamic new logo, a new corporate tagline as well as fully re-written web site in English and seven other languages. To expand our community of developers and reach out to new audiences around the world, we run an ongoing introductory campaign, which offers Magic xpa Single User Edition as a freely downloadable product. Magic xpa Single User Edition is an ideal gateway for new developers who want to join Magic Software's global community and take advantage of new opportunities as their businesses grow. Thousands of developers around the world have downloaded, learned and used Magic xpa Single User Edition, and we are confident that this campaign will increase their understanding, awareness and adoption of our application platform.

We use the Salesforce.com CRM platform and the Marketo marketing automation tool globally to connect all our lead generation campaigns with our sales pipeline management. We have aligned all our local offices to work according to the same global sales and marketing processes. We have also used our own Magic xpi Integration Platform to automate processes between our Salesforce and SAP systems to increase efficiency.

Competition

The markets for our Enterprise Mobility Solution, and Magic xpa and Magic xpi platforms are characterized by rapidly changing technology, evolving industry standards, frequent new product introductions, mergers and acquisitions, and rapidly changing customer requirements. These markets are therefore highly competitive, and we expect competition to continue to intensify. The growth of the SaaS and mobile markets increases the competition in these areas. We constantly follow and analyze the market trends and our competitors in order to effectively compete in these markets and avoid losing market share to our direct competitors and other players.

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With Magic xpa, we compete in the application platform, SOA architecture and enterprise mobility markets. Among our current competitors are Kony, IBM, Microsoft, Adobe, Oracle, SAP Sybase, OutSystems and Pegasystems. With Magic xpi, we compete in the integration platform market. Among our current competitors are IBM, Informatica, TIBCO, MuleSoft, Jitterbit, Talend and Software AG.

More and more enterprises prefer to integrate their applications using integration platform as a service (iPaaS) technology and for this purpose we launched our new Magic xpc, a hybrid iPaaS solution.

There are several similar products in the market utilizing the model driven architecture, or MDA, approach utilized by AppBuilder. The market for this type of platform is highly competitive. Companies such as CA and IBM have tools that compete directly with AppBuilder. Furthermore, new development paradigms have become very popular in IT software development and developers today have many alternatives.

The telecom BSS domain in which we operate through our FTS subsidiary is a highly competitive market in which we compete based on product quality, service quality, timeliness in delivery and pricing. Within the global billing, charging and policy control market, FTS principally competes against global IT providers and the in-house IT departments of telecommunications operators. Among the competitors focused on this market are Amdocs, Ericsson, Comverse, NetCracker Technology, CSG Systems, Redknee Solutions and Oracle Communications.

There are also a number of smaller or regional telecom BSS competitors who compete on a regional or domestic market level. These tend to be smaller players, and may include companies such as Comarch, Mind CTI, Tecnotree, Cerillion, Openet and Elitcore, among others.

Additional competitors may enter each of our markets at any time. Moreover, our customers may choose to develop internally the functionality and capabilities our current product line offers them and therefore they may also compete with us.

Our goal is to maintain our technological advantages, time to market and worldwide sales and distribution network. We believe that the principal competitive factors affecting the market for our products include developer productivity, rapid results, product functionality, performance, reliability, scalability, portability, interoperability, ease-of-use, demonstrable economic benefits for developers and users relative to cost, quality of customer support and documentation, ease of installation, vendor reputation and experience, financial stability as well as intuitive and out-of-the-box solutions to extend the capabilities of ERP, CRM and other application vendors for enterprise integration.

Intellectual Property

In accordance with industry practice, since we have no registered patents on our software solution technologies, we rely upon a combination of copyright, trademark, trade secret laws and contractual restrictions to protect our rights in our software products. Our policy has been to pursue copyright protection for our software and related documentation and trademark registration of our product names. In addition, our key employees and independent contractors and distributors are required to sign non-disclosure and secrecy agreements.

We provide our products to customers under a non-exclusive, non-transferable license. Usually, we have not required end-users of our products to sign license agreements. Generally, a “shrink wrap” license agreement is included in the product packaging, which explains that by opening the package seal, the user is agreeing to the terms contained therein. It is uncertain whether license agreements of this type are legally enforceable in all of the countries in which the software is marketed.

We do not believe that patent laws are a significant source of protection for our products since the software industry is characterized by rapid technological changes, the policing of unauthorized use of software is a difficult task and software piracy is expected to continue to be a persistent problem for the packaged software industry. As there can be no assurance that the above-mentioned means of legal protection will be effective against piracy of our products, and since policing unauthorized use of software is difficult, software piracy can be expected to be a persistent potential problem.

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We believe that because of the rapid pace of technological change in the software industry, the legal protections for our products are less significant factors in our success than the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of our support services.

Our trademark rights include rights associated with our use of our trademarks and rights obtained by registration of our trademarks. We have obtained trademark registrations in South Africa, Canada, China, Israel, the Netherlands (Benelux), Switzerland, Thailand, Japan, the United Kingdom and the United States. The initial terms of the registration of our trademarks range from 10 to 20 years and are renewable thereafter. Our use and registration of our trademarks do not ensure that we have superior rights to others that may have registered or used identical or related marks on related goods or services. We have registered a copyright for our software in the United States and Japan. In addition, we have registered copyrights for some of our manuals in the United States and have acquired an International Standard Book Number (ISBN) for some of our manuals. Our copyrights expire 70 years from date of first publication.

C. Organizational structure

The following table sets forth the legal name, location and country or state of incorporation and percentage ownership of our subsidiaries as of December 31, 2018:

Subsidiary Name	Country of Incorporation	Ownership Percentage	
Magic Software Japan K.K	Japan	100	%
Magic Software Enterprises Inc.	Delaware	100	%
Magic Software Enterprises (UK) Ltd.	United Kingdom	100	%
Hermes Logistics Technologies Limited	United Kingdom	100	%
Magic Software Enterprises Spain Ltd	Spain	100	%
Coretech Consulting Group, Inc.	Pennsylvania	100	%
Coretech Consulting Group LLC	Delaware	100	%
Fusion Solutions LLC.	Delaware	100	%
Fusion Technical Solutions LLC.	Delaware	49	%
Xsell Resources Inc.	Pennsylvania	100	%
Magic Software Enterprises (Israel) Ltd	Israel	100	%
Magic Software Enterprises Netherlands B.V.	Netherlands	100	%
Magic Software Enterprises France	France	100	%
Magic Beheer B.V	Netherlands	100	%
Magic Benelux B.V	Netherlands	100	%
Magic Software Enterprises GMBH	Germany	100	%
Magic Software Enterprises India Pvt. Ltd	India	100	%
Onyx Magyarorszag Szsoftverhaz	Hungary	100	%
Magix Integration (Proprietary) Ltd	South Africa	100	%

AppBuilder Solutions Ltd	United Kingdom	100	%
Complete Business Solutions Ltd	Israel	100	%
Datamind Technologies Ltd	Israel	80	%
CommIT Technology Solutions Ltd	Israel	77.8	%
CommIT Software Ltd (shares held by Comm-IT Technology Solutions Ltd.)	Israel	100	%
CommIT Embedded Ltd (shares held by Comm-IT Technology Solutions Ltd.)	Israel	75	%
Valinor Ltd. (shares held by Comm-IT Technology Solutions Ltd.)	Israel	100	%
Dario Solutions IT Ltd (shares held by Comm-IT Technology Solutions Ltd.)	Israel	100	%
Quickode Ltd (shares held by Comm-IT Technology Solutions Ltd.)	Israel	100	%
Twingo Ltd (shares held by Comm-IT Technology Solutions Ltd.)	Israel	60	%
Pilat Europe Ltd.	United Kingdom	100	%
Pilat (North America), Inc.	New Jersey	100	%
Roshtov Software Industries Ltd	Israel	60	%
BridgeQuest Labs, Inc.	North Carolina	100	%
BridgeQuest, Inc.	North Carolina	100	%
Allstates Consulting Services LLC	Delaware	100	%
F.T.S. - Formula Telecom Solutions Ltd.	Israel	100	%
FTS Bulgaria Ltd. (FTS Global Ltd.)	Bulgaria	100	%
Comblack IT Ltd.	Israel	70	%
Yes-IT Ltd. (shares held by Comblack IT Ltd)	Israel	100	%
Shavit Software (2009) Ltd. (shares held by Comblack Ltd)	Israel	100	%
Infinigy (UK) Holdings Limited	United Kingdom	100	%
Infinigy (US) Holding Inc.	Georgia	100	%
Infinigy Solutions LLC.	Georgia	70	%
Infinigy Engineering LLP (shares held by Infinigy Solutions LLC.)	Georgia	99.9	%
Skysoft Solutions Ltd.	Israel	75	%
Futurewave Systems, Inc.	Georgia	100	%

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D. Property, plants and equipment

Our headquarters and principal administrative, finance, sales, marketing and research and development office is located in a 23,841 square foot office facility that we lease in Or Yehuda, Israel, a suburb of Tel Aviv. We paid $0.4 million in annual rent for the Or Yehuda facilities under a lease agreement expiring in June 2019.

Our subsidiaries lease office space in Laguna Hills, California; King of Prussia, Pennsylvania; Dallas, Texas; Houston, Texas; New Jersey; Atlanta, Georgia; Paris, France; Munich, Germany; Pune, India; Bangalore, India; Tokyo, Japan; Budapest, Hungary; Houten, the Netherlands; Johannesburg, South Africa; Bracknell, the United Kingdom; Saint Petersburg, Russia and various locations in Israel. The aggregate annual cost for such facilities was $2.4 million in the year ended December 31, 2018.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating results

The following discussion of our results of operations should be read together with our consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.

Background

We were organized under the laws of Israel on February 10, 1983 and began operations in 1986. Our Ordinary Shares have been listed on the NASDAQ Stock Market (symbol: MGIC) since our initial public offering in the United States on August 16, 1991. On January 3, 2011, our shares were transferred to the NASDAQ Global Select Market. Since November 16, 2000, our Ordinary Shares have also traded on the Tel Aviv Stock Exchange, or the TASE, and since December 15, 2011, our shares have been included in the TASE's TA-125 Index.

Overview

We develop market, sell and support application platforms, business and process integration and selected vertical comprehensive software solutions packages. We have 36 active wholly-owned subsidiaries in the United States, Israel Europe, Asia and South Africa. Of such subsidiaries, 20 are engaged in developing, marketing and supporting vertical applications, as well as in selling and supporting our products, and 16 subsidiaries specialize in providing broad range of IT consulting and outsourcing services in the areas of infrastructure design and delivery, application development, technology planning and implementation services, as well as supplemental outsourcing services.

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As an IT technology innovator, we have many years of experience in assisting software companies and enterprises worldwide to produce and integrate their business applications. Our application platforms, Magic xpa and AppBuilder, are used by thousands of enterprises and MSPs to develop solutions for their users and customers in approximately 50 countries. We also provide maintenance and technical support as well as professional services to our enterprise customers and to MSPs. In addition, we sell our Magic xpi and magic xpc technologies for business integration to enterprises using specific popular software applications, such as SAP, Salesforce.com, IBM i (AS/400) or Oracle JD Edwards and other business applications. We refer to these vendor-centered market sectors as ecosystems.

Vision and Focus Areas

Our vision of how the industry will evolve is being driven by the change in enterprise mobility, cloud computing and Big Data. We believe that our technology and vast services will allow us to expand our offerings into the cloud and mobile enterprise markets with speed, scale and flexibility. We intend to remain focused on both the technology and business architectures that will enable our customers to take advantage of the cost efficiencies and competitive advantages conveyed by these technologies. We intend to continue to prudently take advantage of opportunities to capture market transitions and to put our assets to use in existing and new markets as the recovery continues. We believe that our strategy and our ability to innovate and execute may enable us to improve our competitive position in difficult business conditions and may continue to provide us with long-term growth opportunities.

Key Factors Affecting our Business

Our operations and the operating metrics discussed below have been, and will likely continue to be affected by certain key factors as well as certain historical events and actions. The key factors affecting our business and results of operations include among others, dependence on a limited number of core product families, selected vertical software solutions and services, competition, ability to realize benefits from business acquisitions, dependence on a key customer for a significant percentage of our revenues and changes in the mix of revenues generated by different revenue elements affect our gross margins and profitability. For further discussion of the factors affecting our results of operations, see “Risk Factors.”

Dependence on a limited number of core product families and services

We derive a significant portion of our revenues from sales of application and integration platforms primarily under our Magic xpa, Magic xpi, Magic xpc and AppBuilder brands and from related professional services, software maintenance and technical support as well as from packaged software solutions in several business verticals (mainly human recourses, cargo handling, patient medical records and billing), and from other IT professional services, which

include IT consulting and outsourcing services. Our future growth depends heavily on our ability to effectively develop and sell new products developed by us or acquired from third parties as well as add new features to existing products. A decrease in revenues from our principal products and services would adversely affect our business, results of operations and financial condition.

Competition

We compete with other companies in the areas of application platforms, business integration and business process management, and in the applications and services markets in which we operate. The growth of the SaaS and Enterprise Mobility market has increased the competition in these areas. We expect that such competition will continue to increase in the future, both with respect to our technology, applications and services which we currently offer and applications and services which we and other vendors are developing. Increased competition, direct and indirect, could adversely affect our business, financial condition and results of operations.

We also compete with other companies in the technical IT consulting and outsourcing services industry. This industry is highly competitive and fragmented and has low entry barriers. We, through five of our subsidiaries in the United States and five of our subsidiaries in Israel, compete for potential customers with providers of outsourcing services, systems integrators, computer systems consultants, other providers of technical IT consulting services and, to a lesser extent, temporary personnel agencies. We expect competition to increase, and we may not be able to remain competitive.

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Some of our existing and potential competitors are larger companies, have substantially greater resources than us, including financial, technological, marketing, skilled human resources and distribution capabilities, and enjoy greater market recognition than us. We may not be able to differentiate our products and services from those of our competitors, offer our products as part of integrated systems or solutions to the same extent as our competitors, or successfully develop or introduce new products that are more cost-effective, or offer better performance than our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

Dependence on key customers

We depend on repeat product and professional services revenues from a certain base of existing customers. Our five largest customers accounted for in the aggregate 27% of our revenues in each of the years ended December 31, 2017 and 2018, respectively. One of these five customers accounts for 84% of the revenues of a subsidiary. If these existing customers decide not to continue utilizing our professional services, not to renew their existing engagements, not to continue using our products, or decide to significantly decrease their total expenditures with us, it may adversely affect our business, results of operations and financial condition. Under their master services agreements, all five customers may terminate their agreements with us upon only a 30-days' notice and without any penalty.

Revenue Mix

We derive our revenues from the sale of proprietary and third party software licenses, related professional services, maintenance and technical support as well as from other IT professional services. In recent years the decline in our gross margin was primarily affected by the change in proportion of our revenues generated from the sale of each of those elements of our revenues. Our revenues from the sale of our proprietary software licenses, related professional services, maintenance and technical support have higher gross margins than our revenues from third party software licenses and IT professional and outsourcing services. Any increase in the portion of third party software license sales out of total license sales will decrease our gross profit margin. If the relative proportion of our revenues from the sale of IT professional services continues to increase as a percentage of our total revenues, our gross profit margins may continue to decline in the future.

We may encounter difficulties in realizing the potential financial or strategic benefits of recent and future business acquisitions.

A significant part of our business strategy is to pursue acquisitions and other initiatives based on strategy centered on three key factors: growing our customer base, expanding geographically and adding complementary solutions to our portfolio— all while we seek to ensure our continued high quality of services and product delivery. As such, in recent

years we made numerous of acquisitions. Mergers and acquisitions of companies are inherently risky and subject to many factors outside of our control and no assurance can be given that our future acquisitions will be successful and will not adversely affect our business, operating results, or financial condition. In the future, we may seek to acquire or make strategic investments in complementary businesses, technologies, services or products, or enter into strategic partnerships or alliances with third parties in the future in order to expand our business. Failure to manage and successfully integrate acquisitions could materially harm our business and operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products and technologies to a failure to do so. Even when an acquired company has previously developed and marketed products, there can be no assurance that new product enhancements will be made in a timely manner or that pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products.

If we acquire another business, we may face difficulties, including: Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired businesses or enterprises;

Diversion of management’s attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;

Potential difficulties in completing projects associated with in-process research and development;

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Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;

Insufficient revenue to offset increased expenses associated with acquisitions; and

The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

Impact of Currency Fluctuations and of Inflation

Our financial statements are stated in U.S. dollars, our functional currency. However, a substantial portion of our revenues and costs are incurred in other currencies, particularly NIS, Euros, Japanese yen, and the British pound. We also maintain substantial non-U.S. dollar balances of assets, including cash, accounts receivable, and liabilities, including accounts payable and debts to banks and financial institutions. Therefore, fluctuations in the value of the currencies in which we do business relative to the U.S. dollar may adversely affect our business, results of operations and financial condition. The depreciation of such other currencies in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our liabilities which are payable in those other currencies (unless such costs or payables are linked to the U.S. dollar). Such depreciation also has the effect of decreasing the U.S. dollar value of any asset that is denominated in such other currencies or receivables payable in such other currencies (unless such receivables are linked to the U.S. dollar). In addition, the U.S. dollar value of revenues and expenses denominated in such other currencies would decrease. Conversely, the appreciation of any currency in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked assets and the U.S. dollar amounts of any unlinked liabilities and increasing the U.S. dollar value of revenues and expenses denominated in other currencies.

In addition, while we incur a portion of our costs in NIS, the U.S. dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is (or is not) offset, or is offset on a lagging basis, by a devaluation of the NIS in relation to the U.S. dollar.

Because exchange rates between the NIS, euro, Japanese Yen and the British pound and the U.S. dollar fluctuate continuously, exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. We cannot assure you that in the future our results of operations may not be adversely affected by currency fluctuations.

The following table sets forth for the periods indicated, (depreciation) or appreciation of the U.S. dollar against the most important currencies for our business and the Israeli consumer price index:

	Year Ended December 31,				
	2014	2015	2016	2017	2018
New Israeli Shekel	(12)%	(0.3)%	(1.5)%	(9.8)%	8.1 %
Euro	(11.5)%	(10.4)%	3.5 %	(12.2)%	4.6 %
Japanese Yen	(14.9)%	(0.8)%	(2.8)%	(3.8)%	(2.4)%
British Pound	(5.5)%	(4.9)%	20.6%	(9)%	5.6 %
Israeli Consumer Price Index	(0.2)%	(1.0)%	(0.2)%	0.4 %	0.8 %

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Segments

We report our results on the basis of two reportable business segments: software services (which include proprietary and non-proprietary software technology and complementary services) and IT professional services. Set forth below is segment information for the years ended December 31, 2016, 2017 and 2018.

	Software services	IT professional services	Unallocated expense	Total
	(U.S. dollars in thousands)			
2016				
Total revenues	$70,834	$ 130,812	$ -	$201,646
Expenses	58,549	118,663	3,347	180,559
Operating income (loss)	$12,285	$ 12,149	$ (3,347)	$21,087
Depreciation, amortization and stock based compensation expenses	7,531	3,769	460	11,760
Capitalized software development costs	(4,224)	-	-	(4,224)
EBITDA	$15,592	$ 15,918	$ (2,887)	$28,623
2017				
Total revenues	$77,100	$ 181,040	$ -	$258,140
Expenses	63,649	164,558	3,977	232,184
Operating income (loss)	$13,451	$ 16,482	$ (3,977)	$25,956
Depreciation, amortization and stock based compensation expenses	9,242	4,100	347	13,689
Capitalized software development costs	(3,771)	-	-	(3,771)
EBITDA	$18,922	$ 20,582	$ (3,630)	$35,874
2018				
Total revenues	$81,332	$ 203,043	$ -	$284,375
Expenses	63,902	183,985	4,790	252,677
Operating income (loss)	$17,430	$ 19,058	$ (4,790)	$31,698
Depreciation, amortization and stock based compensation expenses	8,727	3,611	,420	12,758
Capitalized software development costs	(3,666)	-	-	(3,666)
EBITDA	$22,491	$ 22,669	$ (4,370)	$40,790

Explanation of Key Income Statement Items

Revenues. Revenues are derived from sales of software licenses (proprietary and non-proprietary), related professional services, maintenance and technical support and other IT professional services, which include, cloud

computing and IT consulting and outsourcing services. Revenues may continue to be affected by factors including market uncertainty, which can result in cautious spending in our global markets; changes in the geopolitical environment; sales cycles; fluctuation of exchange rates; changes in the mix of direct sales and indirect sales and variations in sales channels.

Cost of Revenues. Cost of revenues for software sales consist primarily of software production costs, royalties and licenses payable to third parties, as well as amortization of capitalized and acquired software costs. Cost of revenues for maintenance and technical support and professional services consists primarily of personnel expenses, subcontracting and other related costs. Cost of revenues for software sales is affected by changes in the mix of products sold; price competition; sales discounts; fluctuation of exchange rates; and increases in labor costs. Service gross margin may be impacted by various factors such as the change in mix between technical support services and advanced IT professional services, the timing of technical support service contract initiations and renewals and the timing of our strategic investments in headcount and resources to support this business.

Research and Development Expenses, Net. Research and development costs consist primarily of personnel expenses of employees engaged in on-going research and development activities, subcontracting, development tools and other related expenses. The capitalization of software development costs is applied as reductions to gross research and development costs to calculate net research and development expenses.

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The following table sets forth the gross research and development costs, capitalized software development costs, and the net research and development expenses for the periods indicated:

	Year ended December 31,		
	2016	2017	2018
	(U.S. dollars in thousands)		
Gross research and development costs	$10,063	$10,713	$9,363
Less capitalized software development costs	(4,224)	(3,771)	(3,667)
Research and development expenses, net	$5,839	$6,942	$5,696

Selling and Marketing Expenses. Selling and marketing expenses consist primarily of salaries and related expenses for sales and marketing personnel, sales commissions, third party royalties, marketing programs and campaigns, website related expenses, public relations, on-line advertising, industry analyst relations, promotional materials, travel expenses and conferences and trade shows exhibit expenses, as well as amortization of acquired customer relationships recorded as a result of business combinations.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related expenses for executive, accounting, human resources and administrative personnel, professional fees, legal expenses, provisions for doubtful accounts, and other general and administrative corporate expenses.

Financial income (expenses), net. Net financial income (expenses) consists primarily of interest earned on cash equivalents deposits and marketable securities, bank fees and interest paid on loans received, interest expenses related to liabilities in connection with acquisitions and foreign currency translation adjustments.

Results of Operations

The following table presents selected consolidated statement of operations data for the periods indicated as a percentage of total revenues:

	Year ended December 31,		
	2016	2017	2018
Revenues:			
Software	9.7 %	8.4 %	9.0 %
Maintenance and technical support	12.8	11.8	10.8

Consulting services	77.5	79.8	80.2
Total revenues	100.0%	100.0%	100.0%
Cost of revenues:			
Software	4.3	3.7	3.5
Maintenance and technical support	1.5	1.5	1.4
Consulting services	60.3	62.6	63.9
Total cost of revenues	66.1	67.8	68.8
Gross profit	33.9	32.2	31.2
Operating costs and expenses:			
Research and development, net	2.9	2.7	2.0
Selling and marketing,	11.8	10.6	9.6
General and administrative	8.7	8.8	8.5
Total operating expenses, net	23.4	22.1	20.1
Operating income	10.5	10.1	11.1
Financial income (expenses), net	(0.2)	(0.7)	0.1
Income before taxes on income	10.3	9.4	11.2
Tax on income	2.0	2.5	2.5
Net income attributable to redeemable non-controlling interests	(0.2)	(0.6)	(0.5)
Net income attributable to non-controlling interests	(2.4)	(0.6)	(1.2)
Net income attributable to Magic’s shareholders	5.9	6.0	7.7

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Year Ended December 31, 2018 Compared With Year Ended December 31, 2017

Revenues. Revenues in 2018 increased by 10% from $258.1 million in 2017 to $284.4 million in 2018.

Revenues from the software services business segment increased by 5%, from $77.1 million in 2017 to $81.3 million in 2018.

Revenues from the IT professional services business segment increased by 13% from $180.0 million in 2017 to $203.0 million in 2018, primarily attributable to: (i) the inclusion of Futurewave Systems Inc. (consolidated as of December 2017), and (ii) increased demand for the professional services offerings in Israel by Comblack IT Ltd, and in the U.S. by our U.S. subsidiaries.

Revenues from sales of proprietary technology software licenses increased by 16% from $14.7 million in 2017 to $17.0 million in 2018. The increase in sales of licenses was attributable mainly to an increase in demand for both our Magic xpa and Magic xpi solutions.

Revenues from sales of proprietary packaged and third party software solutions increased by 23% from $6.9 million in 2017 to $8.5 million in 2018, primarily attributable to a significant increase in third party software solutions ordered by Israeli customers.

Revenues from maintenance and technical support increased by 2% from $30.4 million in 2017 to $31.0 million in 2018.

Revenues from IT consulting services increased by 11% from $206.1 million in 2017 to $228.0 million in 2018. The increase was primarily attributable to: (i) the inclusion of Futurewave Systems Inc. (consolidated as of December 2017), and (ii) increased demand for the professional services offerings in Israel by Comblack IT Ltd, and in the U.S. by our U.S. subsidiaries.

The following table summarizes our revenues by geographical market for the years ended December 31, 2017 and 2018:

	Year ended December 31,	
	2017	2018
	(U.S. dollars in thousands)	
United States	$123,113	$137,066
Israel	91,917	103,850
Europe	26,635	28,257
Japan	9,253	9,797
Other	7,222	5,405
Total revenues	$258,140	$284,375

Cost of Revenues. Cost of revenues increased by 12% from $175.2 million in 2017 to $195.6 million in 2018.

Cost of revenues for software increased by 4% from $9.6 million in 2017 to $10.0 million in 2018.

Cost of revenues for maintenance and technical support increased by 5% from $3.9 million in 2017 to $4.1 million in 2018.

Cost of revenues for IT consulting services increased by 12% from $161.7 million in 2017 to $181.5 million in 2018. The increase in cost of revenues for IT consulting services is consistent with the increase in revenues from the same segment. Cost of revenues for the years ended December 31, 2017 and 2018 include $7,000 and $2,000, respectively, of stock-based compensation recorded under ASC 718.

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Gross Margin. Gross margin in 2018 was 31% compared to gross margin of 32% in 2017. The decrease in gross margin was primarily attributable to an increase in sales of IT professional services carrying a lower gross margin, partially offset by the increase in sales of software and maintenance and technical support carrying a higher gross margin.

Research and Development Expenses, Net. Gross research and development costs decreased by 13% from $10.7 million in 2017 to $9.4 million in 2018. Net research and development costs decreased by 18% from $6.9 million in 2017 to $5.7 million in 2018. In 2018, we capitalized $3.7 million of software development costs compared to $3.8 million in 2017. Net research and development costs as a percentage of revenues was 2.0% in 2018 compared to 2.7% in 2017. Gross (net) research and development costs as a percentage of revenues of our software services business segment was approximately 12% (7%) in 2018 compared to approximately 14% (9%) in 2017. The decrease in our absolute gross and net research and development costs in 2018 is primarily attributable to the cost reduction program which was implemented in Israel, offset by an increase in our offshore activities which further contributed to our cost efficiency. Research and development costs for the years ended December 31, 2017 and 2018 include $8,000 and $4,000, respectively, of stock-based compensation recorded under ASC 718.

Selling and Marketing Expenses. Selling and marketing expenses of $27.2 million remained constant in 2017 and 2018. Selling and marketing expenses as a percentage of revenues decreased from 10.6% in 2017 to 9.6% in 2018. The decrease in selling and marketing expenses as a percentage of revenues is primarily due to the increase of our revenues in 2018. Selling and marketing expenses for the years ended December 31, 2017 and 2018 include $0 and $4,000, respectively, of stock-based compensation recorded under ASC 718.

General and Administrative Expenses. General and administrative expenses increased by 6% from $22.8 million in 2017 to $24.2 million in 2018. General and administrative expenses as a percentage of revenues decreased from 8.8% in 2017 to 8.5% in 2018. The increase in general and administrative expenses is primarily attributable to: (i) an increase in legal expenses in 2018 compared to 2017; and (ii) a decrease in income recorded due to contingent liabilities as part of a business combination that did not meet its conditions from $0.8 million recorded in 2017 to $0.2 million recorded in 2018. General and administrative expenses for the years ended December 31, 2017 and 2018 include $63,000 and $184,000, respectively, of stock-based compensation recorded under ASC 718.

Financial Expenses, Net. We recorded net financial expenses of $1.7 million in 2017 and net financial income of $0.1 million in 2018. The change in net financial expenses (income) between 2017 and 2018 was primarily attributable to the devaluation of the NIS in relation to the U.S. dollar on our NIS-denominated debt to financial institution.

Taxes on Income. We recorded taxes on income of $6.3 million in 2017 compared to $7.1 million in 2018. The increase in taxes on income is primarily attributable to an increase in tax uncertainties amounting to $1.0 million.

Net Income Attributable to Our Shareholders. Our net income increased from $15.4 million in 2017 to $19.9 million in 2018, primarily attributable to (i) an increase in gross profit of $5.8 million and (ii) a decrease in financial expenses, net, of $1.9 million, which was offset by (i) an increase in net income attributable to redeemable non-controlling interests of $1.8 million, (ii) an increase in taxes on income of $0.7 million, and (iii) an increase in net income attributable to non-controlling interests of $0.6 million.

Year Ended December 31, 2017 Compared With Year Ended December 31, 2016

Revenues. Revenues in 2017 increased by 28% from $201.6 million in 2016 to $258.1 million in 2017.

Revenues from the software services business segment increased by 9%, from $70.8 million in 2016 to $77.1 million in 2017, primarily attributable to the inclusion of Roshtov Software Industries Ltd. for the full year (consolidated during the second half of 2016), accounting for 68% of the growth.

Revenues from the IT professional services business segment increased by 38% from $130.8 million in 2016 to $180.0 million in 2017, primarily attributable to: (i) increased demand for the professional services offerings in Israel by Comblack IT Ltd, and in the U.S. by all of our U.S. subsidiaries; and (ii) the inclusion of Shavit Software (2009) Ltd. (consolidated as of November 2016), Twingo Ltd., (consolidated as of August 2016) and Quickcode Ltd., (consolidated as of February 2016) for the full year.

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Revenues from sales of proprietary technology software licenses increased by 16% from $12.7 million in 2016 to $14.7 million in 2017. The increase in sales of licenses was attributable to anticipated software renewal lifecycle among some of our AppBuilder's larger enterprise customers and increased demand for the Magic xpi Integration Platform growing by 51% compared to 2016. This growth was offset by a decrease in our vertical packaged software solution Leap™ revenues following a successful completion of a large project and by a 6% decline in our Magic xpa license sales.

Revenues from sales of proprietary packaged and third party software solutions amounting to $6.9 million remained constant in 2016 and 2017.

Revenues from maintenance and technical support increased by 17% from $25.9 million in 2016 to $30.4 million in 2017. The increase in maintenance and technical support was primarily attributable to the inclusion of Roshtov Software Industries Ltd. for the full year (consolidated during the second half of 2016).

Revenues from IT consulting services increased by 32% from $156.1 million in 2016 to $206.1 million in 2017. The increase was primarily attributable to: (i) increased demand for the professional services offerings of in Israel by Comblack IT Ltd, and in the U.S. from all our U.S. subsidiaries; and (ii) the inclusion of Shavit Software (2009) Ltd. (consolidated as of November 2016), Twingo Ltd., (consolidated as of August 2016) and Quickcode Ltd., (consolidated as of February 2016) for the full year.

The following table summarizes our revenues by geographical market for the years ended December 31, 2016 and 2017:

	Year ended December 31,	
	2016	2017
	(U.S. dollars in thousands)	
United States	$100,470	$123,113
Israel	58,079	91,917
Europe	23,642	26,635
Japan	11,226	9,253
Other	8,229	7,222
Total revenues	$201,646	$258,140

Cost of Revenues. Cost of revenues increased by 31% from $133.4 million in 2016 to $175.2 million in 2017.

Cost of revenues for software increased from $8.7 million in 2016 to $9.6 million in 2017. The increase in cost of revenues for licenses was attributable to: (i) the increase in amortization costs of acquired software, Clicks (acquired during the second half of 2016); and (ii) the increase in amortization of capitalized software development costs related to our Magic xpa and Magic xpi application development and integration platforms.

Cost of revenues for maintenance and technical support increased by 32% from $3.0 million in 2016 to $3.9 million in 2017, primarily due to the inclusion of Roshtov Software Industries Ltd. for the full year (consolidated during the second half of 2016).

Cost of revenues for IT consulting services increased by 33% from $121.8 million in 2016 to $161.7 million in 2017. The increase in cost of revenues for IT consulting services was primarily attributable to the inclusion of Shavit Software (2009) Ltd. (consolidated as of November 2016), Twingo Ltd., (consolidated as of August 2016) and Quickcode Ltd., (consolidated as of February 2016) for the full year, with the remaining increase being consistent with the increase in revenues from IT consulting services. Cost of revenues for the years ended December 31, 2016 and 2017 include $15,000 and $7,000, respectively, of stock-based compensation recorded under ASC 718.

Gross Margin. Gross margin in 2017 was 32% compared to gross margin of 34% in 2016. The decrease in gross margin was primarily attributable to: (i) an increase in sales of IT professional services carrying a lower gross margin compared to the increase in sales of software and Maintenance and technical support despite its higher gross margin; and (ii) an increase in amortization of capitalized software development costs (related to Magic xpa and Magic xpi application development and integration platforms) and acquired technology (related to Roshtov Software Industries Ltd) amounting to $5.4 million in 2017 compared to $4.5 million in 2016.

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Research and Development Expenses, Net. Gross research and development costs increased by 6% from $10.1 million in 2016 to $10.7 million in 2017. Net research and development costs increased by 19% from $5.8 million in 2016 to $6.9 million in 2017. In 2017, we capitalized $3.8 million of software development costs compared to $4.2 million in 2016. Net research and development costs as a percentage of revenues was 2.7% in 2017 compared to 2.9% in 2016. Gross (net) research and development costs as a percentage of revenues of our software services business segment was approximately 14% (9%) in 2017 compared to approximately 14% (8.2%) in 2016. The increase in our absolute gross research and development costs in 2017 is primarily attributable to the inclusion of Roshtov Software Industries Ltd. for the full year (consolidated during the second half of 2016). Research and development costs for the years ended December 31, 2016 and 2017 include $17,000 and $8,000, respectively, of stock-based compensation recorded under ASC 718.

Selling and Marketing Expenses. Selling and marketing expenses increased by 15% from $23.8 million in 2016 to $27.2 million in 2017. Selling and marketing expenses as a percentage of revenues decreased from 11.8% in 2016 to 10.6% in 2017. The increase in selling and marketing costs was primarily attributable to (i) an increase in amortization expenses of acquired customer relationships recorded as a result of business combinations in 2017 amounting to $6.5 million compared to $5.3 million in 2016, and (ii) acquisitions completed during 2016 and consolidated for the entire year for the first time in 2017 amounting to $1.4 million, and (iii) increase in our sales and marketing investments in our software technology platforms amounting to $0.8 million. The decrease in selling and marketing expenses as a percentage of revenues is primarily due to the change in the mix of our revenues resulting in an increase in revenues from professional services, despite the absolute increase in selling and marketing expenses as detailed above. Selling and marketing expenses for the years ended December 31, 2016 and 2017 include $71,000 and $0, respectively, of stock-based compensation recorded under ASC 718.

General and Administrative Expenses. General and administrative expenses increased by 30% from $17.6 million in 2016 to $22.8 million in 2017. General and administrative expenses as a percentage of revenues increased from 8.7% in 2016 to 8.8% in 2017. The increase in general and administrative expenses is primarily attributable to: (i) acquisitions completed during 2016 and consolidated for the entire year for the first time in 2017 amounting to $1.9 million; (ii) an increase in headcount of general and administrative employees from 122 in 2016 to 139 in 2017; and (iii) an increase in provision for doubtful accounts from $0.4 million recorded in 2016 to $1.2 million recorded in 2017. General and administrative expenses for the years ended December 31, 2016 and 2017 include $49,000 and $63,000, respectively, of stock-based compensation recorded under ASC 718.

Financial Expenses, Net. We recorded net financial expenses of $0.4 million in 2016 and $1.7 million in 2017. The increase in net financial expenses between 2016 and 2017 was primarily attributable to an increase in interest expenses on debt to banks and financial institutions of $1.6 million, offset by a valuation of contingent liabilities in acquired subsidiaries in 2016 amounting to $0.2 million.

Taxes on Income. We recorded taxes on income of $3.9 million in 2016 compared to $6.3 million in 2017. The increase in taxes on income is primarily attributable to: (i) acquisitions completed during 2016 and consolidated for

the entire year for the first time in 2017 amounting to $1.4 million: (ii) a decrease in deferred tax assets relate to net operating losses amounting to $1.2 million and (iii) an increase in current taxes recorded by our subsidiaries in Israel and the U.S. in line with the increase in our operating income. These increase were offset by the positive impact of the decrease in our deferred tax liabilities recorded following the reduction in the U.S. federal income tax rate to 21% (instead of 35%) effective from January 1, 2018, amounting to $0.4 million.

Net Income Attributable to Our Shareholders. Our net income increased from $14.2 million in 2016 to $15.4 million in 2017, primarily attributable to (i) an increase in gross profit of $14.7 million and (ii) a decrease in net income attributable to redeemable non-controlling interests of $3.0 million, which was offset by (i) an increase in operating expenses of $9.8 million, (ii) an increase in taxes on income of $2.4 million, (iii) an increase in net income attributable to non-controlling interests of $0.7 million, and (iv) an increase in financial expenses of $1.3 million.

B. Liquidity and capital resources

To date, we have financed our operations through income generated by operations, proceeds from our public offerings in 1991 (approximately $8.5 million), 1996 (approximately $5.0 million), 2000 (approximately $79.6 million) and 2014 (approximately $54.7 million), private equity investments in 1998 (approximately $12.2 million), 2010 (approximately $20.3 million) and 2018 (approximately $34.6 million), loans and research and development and marketing grants primarily from the Government of Israel. In addition, we have also financed our operations through short-term loans, long-term loans and borrowings under available credit facilities.

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In November 2016, we obtained a NIS 120 million loan linked to the New Israel Shekel from an Israeli financial institution. We intended to use the proceeds from this loan for our general corporate purposes, which may include the funding of our working capital needs and the funding of potential acquisitions. The principal amount of the loan is payable in seven equal annual payments with the final payment due on November 2, 2023 and bears a fixed interest rate of 2.60% per annum, payable in two semi-annually payments. The loan, which may be prepaid under certain circumstances (in any event for not less than NIS 5.0 million and thereon for amounts which are a multiple of NIS 5.0 million), is subject to various financial covenants which mainly consist of the following:

a. Our equity will not be lower than $100 million (one hundred million U.S. Dollars) at all times.

b. Our cash and cash equivalent and marketable securities available for sales will not be less than $10 million (ten million U.S. Dollars).

c. The ratio of our total financial debts to total assets will not exceed 50%.

d. The ratio of our total financial debts less cash, short-term deposits and short-term marketable securities to the annual EBITDA will not exceed 3.25 to 1.

e. Cross default, including following an immediate repayment initiated in relation to other financial indebtedness in an amount that exceeds $5 million;

f. Suspension of trading of the debentures on the TASE over a period of 60 days, or the delisting of the debentures from the TASE;

g. If there is a change in control without consent of the lender (a change of control is deemed to occur if Formula ceases to be the controlling shareholder of our company, whether directly or indirectly. Formula will be considered a controlling shareholder for so long as it continues to hold at least 30% of the means of control of our company (within the meaning of the Israeli Securities Law) and there is no other person or entity holding a higher percentage. To the extent that Formula holds such controlling interest jointly with others, it will be deemed to remain our controlling shareholder if it maintains the highest percentage ownership among such other shareholders);

h. The existence and continuation of a bankruptcy event involving our company, or the liquidation of our company or writing off of our assets;

i. There has been a material adverse change in the business of our company compared to the position of our company shortly before the issuance of the loan and there is a material concern that we will not be able to pay our obligations under the loan agreement on time;

j. Failure to comply with the negative pledge covenant.

To date, we are in full compliance with the financial covenants of the loan.

On July 12, 2018, we issued 4,268,293 ordinary shares at a price of $8.20 per share for a total of $34.6 million net of issuance expenses. The shares were issued to Israeli institutional investors and to our controlling shareholder, Formula Systems (1985) Ltd.

As of December 31, 2018, we had approximately $113.9 million in cash and cash equivalents and available-for-sale marketable securities, with net working capital of approximately $158.3 million and long term debts to banks and others of approximately $19.4 million compared to approximately $90.9 million in cash and cash equivalents and available-for-sale marketable securities, with working capital of approximately $122.4 million and long term debts to banks and others of approximately $27.8 million, as of December 31, 2017.

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As of December 31, 2017 and 2018, our long-term and short-term debt amounted to $37.6 million and $28.0 million, respectively and our redeemable non-controlling interests as of December 31, 2017 and 2018 amounted to $25.8 million and $27.2 million, respectively.

Based on our current operating forecast, we believe that our cash and cash equivalents (including available-for-sale marketable securities and existing working capital, will be sufficient to meet our cash requirements for working capital and capital expenditures for at least the next 12 months. We assume that our cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, accounts receivable collections, payments of loans and the timing and amount of tax and other payments.

We believe the overall credit quality of our portfolio is strong, with our cash equivalents and fixed income portfolio invested in securities with a weighted-average credit rating exceeding A. Our fixed income and publicly traded equity securities are classified as Level 2 investments, as measured under ASC 820, “Fair Value Measurements and Disclosures,” as these vendors either provide a quoted market price in an active market or use observable inputs.

Cash Flows

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

	Year ended December 31,		
	2016	2017	2018
	(**U.S. dollars in thousands**)		
Net income from operations	$16,708	$17,914	$24,776
Adjustments to reconcile net income to net cash provided by operating activities:	11,247	7,594	(726)
Net cash provided by operating activities	27,955	25,508	24,050
Net cash used in investing activities	(34,203)	(7,316)	(19,554)
Net cash provided by (used in) financing activities	20,411	(19,414)	8,426
Effect of exchange rate changes on cash and cash equivalents	(1,037)	1,985	(1,872)
Increase (decrease) in cash and cash equivalents from operations	13,126	762	11,050

Net cash provided by operating activities was $24.1 million for the year ended December 31, 2018, compared to $25.5 million and $28.0 million for the years ended December 31, 2017 and 2016, respectively.

Net cash provided by operations in 2018 consists primarily of $24.8 million of net income adjusted for non-cash activities, including $12.6 million of depreciation and amortization expenses, $0.2 million of stock compensation expenses, a $2.2 million increase in trade payables, a $0.2 million of amortization of marketable securities premium, a $1.8 million increase in accrued expenses and other accounts payable, a $0.4 million decrease in deferred revenues, and a $2.1 million decrease in value of loans which are denominated in NIS as a result of the devaluation of the NIS in relation to the U.S. dollar, offset by a $0.1 million change in deferred taxes, net, a $4.4 million increase in in other long term and short term accounts receivable and prepaid expenses, and a $11.4 million increase in trade receivables, net.

Net cash provided by operations in 2017 consists primarily of $17.9 million of net income adjusted for non-cash activities, including $13.6 million of depreciation and amortization expenses, a $0.1 million of stock compensation expenses, a $3.6 million increase in trade payables, a $0.2 million of amortization of marketable securities premium, a $4.4 million increase in accrued expenses and other accounts payable, a $1.2 million increase in deferred revenues, and a $3.2 million increase in value of loans which are denominated in NIS as a result of the appreciation of the NIS in relation to the U.S. dollar, offset by a $1.1 million change in deferred taxes, net, a $1.8 million increase in in other long term and short term accounts receivable and prepaid expenses, and a $15.8 million increase in trade receivables, net.

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Net cash provided by operations in 2016 consists primarily of $16.7 million of net income adjusted for non-cash activities, including $11.6 million of depreciation and amortization expenses, a $0.2 million of stock compensation expenses, a $1.4 million increase in trade payables, and a $0.3 million of amortization of marketable securities premium, and a $1.6 million increase in accrued expenses and other accounts payable offset by a $1.0 million change in deferred income taxes, net, a $0.2 million decrease in deferred revenues, and a $2.6 million increase in trade receivables, net.

Net cash used in investing activities was approximately $19.6 million for the year ended December 31, 2018, compared to net cash used in investing activities of approximately $7.3 million for the year ended December 31, 2017 and net cash used in investing activities of approximately $34.2 million for the year ended December 31, 2016.

Net cash used in investing activities in 2018 is primarily attributable to $16.9 million investment in marketable securities and short-term bank deposits, $0.9 investment in long-term bank deposits, $1.2 million used in business combinations, $0.9 million used to purchase property and equipment and $3.7 million of capitalized software development costs, offset by $4 million provided by proceeds from maturity of marketable securities.

Net cash used in investing activities in 2017 is primarily attributable to $5.8 million investment in marketable securities, $1.8 million paid in connection with business combinations, $1.4 million used primarily to purchase network equipment and computer hardware, as well as for furniture, office equipment and leasehold improvements, and $3.8 million of capitalized software development costs, offset by, $1.2 million repayment of short-term loan by a related-party, and $4.2 million provided by proceeds from maturity of marketable securities.

Net cash used in investing activities in 2016 is primarily attributable to $9.4 million investment in marketable securities, $29.7 million paid in connection with business combinations, $0.8 million used primarily to purchase network equipment and computer hardware, as well as for furniture, office equipment and leasehold improvements, $4.2 million of capitalized software development costs, and $1.2 million short-term loan to a related-party, offset by, $8.5 million provided by short-term bank deposits, and $2.6 million provided by proceeds from maturity of marketable securities.

Net cash provided by financing activities was approximately $8.4 million for the year ended December 31, 2018, primarily attributable to the issuance of $34.6 million of ordinary shares and $0.3 million received from the exercise of employee options, which were offset by $3.1 million used in business combinations, dividend distributions of $13.5 million, dividends paid to redeemable non-controlling interests of $2.7 million, decrease in short-term credit of $0.4 million and repayment of long-term loans of $6.6 million.

Net cash used in financing activities was approximately $19.4 million for the year ended December 31, 2017, primarily attributable to dividend distributions of $9.4 million, dividend paid to non-controlling and redeemable non-controlling interests of $5.9 million, $5.1 million used in business combinations and repayment of long-term loans of $8.2 million, offset by a $8.5 million long-term loan received and $0.6 million received from the exercise of employee options.

Net cash provided by financing activities was approximately $20.4 million for the year ended December 31, 2016, primarily attributable to a long-term loan received from a financial institution in an amount of $31.4 million, $1.8 million used in business combinations and an increase in short-term credit of $0.9 million, offset by dividend distributions of $7.8 million, dividend paid to non-controlling and redeemable non-controlling interests of $2.0 million and purchase of non-controlling interest of $0.4 million.

Dividends

We have paid dividends since September 2012 consistent with our Board of Directors' dividend policy. On August 2017, our Board of Directors amended our dividend distribution policy, whereas, each year we distribute a dividend of up to 75% of our annual distributable profits (previously 50%), subject to applicable law. Our Board of Directors may at its discretion and at any time, change, whether as a result of a one-time decision or a change in policy, the rate of dividend distributions or decide not to distribute a dividend. Since 2012 until December 31, 2018 we declared in the aggregate cash dividends of approximately $1.376 per share ($58.6 million in the aggregate). On March 3, 2019, we declared a cash dividend in the amount of $0.15 per share ($7.3 million in the aggregate) that was paid on March 27, 2019.

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For information about our dividend policy and distributions, see Item 8A. “Financial Information - Consolidated Statements and Other Financial Information.”

General

Our consolidated financial statements appearing in this annual report have been prepared in U.S. dollars and in accordance with U.S. GAAP.

Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in currencies other than the U.S. dollar are converted into dollars in accordance with the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 830 “Foreign Currency Matters.” The majority of our sales are made outside of Israel and a substantial part of them is in dollars. In addition, a substantial portion of our costs is incurred in dollars. Since the dollar is the primary currency of the economic environment in which we and certain of our subsidiaries operate, the dollar is our functional and reporting currency and accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars using the foreign exchange rate in effect at each balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. For certain foreign subsidiaries whose functional currency is other than the U.S. dollar, all balance sheet accounts have been translated using the exchange rates in effect at each balance sheet date. Operational accounts have been translated using the average exchange rate prevailing during each year. The resulting translation adjustments are reported as a component of accumulated other comprehensive income (loss) in equity.

Critical Accounting Policies and Estimations

We have identified the policies below as critical to the understanding of our financial statements. The preparation of our consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in certain circumstances that affect the amounts reported in the accompanying financial statements and the related footnotes. Actual results may differ from these estimates. To facilitate the understanding of our business activities, certain of our accounting policies that we believe are the most important to the portrayal of our financial condition and results of operations and that require management’s subjective judgments are described below. We base our judgments on our experience and various assumptions that we believe are reasonable.

Revenue Recognition

Effective as of January 1, 2018, we implement the provisions of Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers ("ASC 606"). See Note 19 to our financial statements included in this annual report for further disclosures required under ASC 606.

Revenues are recognized when control of the promised goods or services are transferred to the customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services.

We determine revenue recognition through the following steps:

identification of the contract with a customer;

identification of the performance obligations in the contract;

determination of the transaction price;

allocation of the transaction price to the performance obligations in the contract; and

recognition of revenue when, or as, we satisfy a performance obligation.

Most of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct.

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We derive our revenues from licensing the rights to use our software (proprietary and non-proprietary), provision of related professional services, maintenance and technical support as well as from other software and IT professional services (either fixed price or based on time and materials). We sell our products primarily through direct sales force and indirectly through distributors and value added resellers.

Under ASC 606, an entity recognizes revenue when or as it satisfies a performance obligation by transferring software license or software services to the customer, either at a point in time or over time. We recognize our revenues from software sales at a point in time upon delivery of a software license. The software license is considered a distinct performance obligation, as the customer can benefit from the software on its own. We recognize revenue over time on significant customization contracts that are covered by contract accounting standards using cost inputs to measure progress toward completion of its performance obligations, which is similar to the method prior to the adoption of ASC 606. 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 for the entire contract. During the years ended December 31, 2016, 2017 and 2018, no material estimated losses were identified.

Our revenues from maintenance and support are derived from annual maintenance contracts providing for unspecified upgrades for new versions and enhancements on a when-and-if-available basis for an annual fee. The right for an unspecified upgrade for new versions and enhancements on a when-and-if-available basis do not specify the features, functionality and release date of future product enhancements for the customer to know what will be made available and the general timeframe in which it will be delivered. We consider the maintenance performance obligation as a distinct performance obligation that is satisfied over time and recognized on a straight-line basis over the contractual period.

Revenue from professional services both related to software and IT professional services businesses consists of either fixed price or Time and Materials (T&M), and are considered performance obligations that are satisfied over time, and revenues are recognized as the services are provided.

The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software license are estimated using the residual approach, due to the lack of selling software licenses on a standalone basis, or the fact Company sells the license to different customers for a broad range of amounts. Standalone selling prices of services are determined by considering several external and internal factors including, but not limited to, transactions where the specific performance obligation is sold separately.

We generally do not grant a right of return to our customers. When a right of return exists, we defer revenue until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria are met. Deferred revenues include unearned amounts received under maintenance and support (mainly) and amounts received from customers for which revenues have not yet been recognized.

Revenue from third-party sales is recorded at a gross or net amount according to certain indicators. The application of these indicators for gross and net reporting of revenue depends on the relative facts and circumstances of each sale and requires significant judgment.

We pay commissions to sales and marketing and certain management personnel based on their attainment of certain predetermined sales or profit goals. Sales commissions are considered incremental costs of obtaining a contract with a customer and are deferred and amortized. We capitalize and amortize incremental costs of obtaining a contract, such as certain sales commission costs, on a systematic basis that is consistent with the transfer to the customer of the performance obligations to which the asset relates. We generally expense sales commissions as they are incurred when the amortization period would have been less than one year. Amortization expenses related to these costs are included in sales and marketing expenses in the accompanying condensed interim consolidated statements of operations.

We do not assess whether a contract has a significant financing component if the expectation at contract inception is such that the period between payment by the customer and the transfer of the promised goods or services to the customer will be one year or less.

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Research and development costs

Research and development costs incurred in the process of software development before establishment of technological feasibility are charged to expenses as incurred. Costs incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in ASC 985-20, “Costs of Software to be Sold, Leased or Marketed.”

We establish technological feasibility upon completion of a detailed program design or working model.

Research and development costs incurred in the process of developing product enhancements are generally charged to expenses as incurred.

ASC 985-20-35 requires that a product be amortized when the product is available for general release to customers. We consider a product to be available for general release to customers when we complete the internal validation of the product that is necessary to establish that the product meets its design specifications including functions, features, and technical performance requirements. Internal validation includes the completion of coding, documentation and testing that ensure bugs are reduced to a minimum. The internal validation of the product takes place a few weeks before the product is made available to the market. In certain instances, we enter into a short pre-release stage, during which the product is made available to a selected number of customers as a beta program for their own review and familiarization. Subsequently, the release is made generally available to customers from our download area. Once a product is considered available for general release to customers, the capitalization of costs ceases and amortization of such costs to “cost of sales” begins.

Capitalized software costs are amortized on a product by product basis by the straight-line method over the estimated useful life of the software product (approximately 5 years, due to their high rates of acceptance, the continued reliance on these products by existing customers, and the demand for such products from prospective customers, all of which validate our expectations) which provides greater amortization expense compared to the revenue-curve method.

We assess the recoverability of these intangible assets on a regular basis by assessing the net realizable value of these intangible assets based on the estimated future gross revenues from each product reduced by the estimated future costs of completing and disposing of it, including the estimated costs of performing maintenance and customer support over its remaining economical useful life using internally generated projections of future revenues generated by the products, cost of completion of products and cost of delivery to customers over its remaining economical useful life. During the years ended December 31, 2016, 2017 and 2018, no such unrecoverable amounts were identified.

Research and development costs incurred in the process of developing product enhancements are generally charged to expenses as incurred.

Business Combinations

We account for business combinations under ASC 805 “Business Combinations,” which requires that we allocate the purchase price of acquired businesses to assets acquired, liabilities assumed, non-controlling interest and redeemable non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. We expense any excess of the fair value of net assets acquired over purchase price and any subsequent changes in estimated contingencies as they are incurred. In addition, changes in valuation allowance related to acquired deferred tax assets and in acquired income tax position are to be recognized in earnings. We engage third-party appraisal firms to assist management in determining the fair values of certain assets acquired and liabilities assumed. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets.

We make estimates of fair value based upon assumptions and judgments a marketplace participant would consider and which we believe to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired businesses and relevant market and industry data and are, inherently, uncertain. Critical estimates made in valuing certain of the intangible assets include, among other things, the following: (i) future expected cash flows from license sales, maintenance agreements, customer contracts and acquired developed technologies and patents; (ii) expected costs to develop the in-process research and development into commercially viable products and estimated cash flows from the projects when completed; (iii) the acquired company’s brand and market position as well as assumptions about the period of time the acquired brand will continue to be used in the combined company’s product portfolio; and (iv) discount rates. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results. Changes to these estimates, relating to circumstances that existed at the acquisition date, are recorded as an adjustment to goodwill during the purchase price allocation period (generally within one year of the acquisition date) and as operating expenses, if otherwise.

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In connection with purchase price allocations, we estimate the fair value of the support obligations assumed in connection with acquisitions. The estimated fair value of the support obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin. The sum of the costs and operating profit approximates, in theory, the amount that we would be required to pay a third party to assume the support obligation. See Note 3 to our consolidated financial statements for additional information on accounting for our recent acquisitions.

Goodwill

As a result of our acquisitions, our goodwill represents the excess of the consideration paid or transferred plus the fair value of contingent consideration and any non-controlling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired.

ASC 350 allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the qualitative assessment does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the two-step impairment test is performed. Alternatively, ASC 350 permits an entity to bypass the qualitative assessment for any reporting unit and proceed directly to performing the first step of the goodwill impairment test.

The provisions of ASC 350 require that the quantitative two-step impairment test will be performed on goodwill at the level of the reporting units. In the first step, or “Step one”, we compare the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and we are not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then we must perform the second step, or “Step two”, of the impairment test in order to determine the implied fair value of goodwill. To determine the fair value used in Step one, we use discounted cash flows. If and when we are required to perform a Step two analysis, determining the fair value of its net assets and its off-balance sheet intangibles, then we would be required to make judgments that involve the use of significant estimates and assumptions.

We determine the fair value of each reporting unit by using the income approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit’s fair value. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. We consider historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for its goodwill.

We performed annual impairment tests during the fourth quarter in each of the years ended December 31, 2016, 2017 and 2018 and did not identify any impairment losses.

Impairment of long-lived assets and intangible assets subject to amortization

We review our long-lived assets for impairment in accordance with ASC 360, “Property, Plant and Equipment,” or ASC 360, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets.

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As required by ASC 820, “Fair Value Measurements and disclosures” we apply assumptions, judgments and estimates that marketplace participants would consider in determining the fair value of long-lived assets (or asset groups).

Intangible assets with finite lives are comprised of distribution rights, acquired technology, customer relationships, backlog and non-compete agreements and are amortized over their economic useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. Distribution rights, acquired technology and non-compete agreements were amortized on a straight line basis and customer relationships and backlog were amortized on an accelerated method basis over a period between 1 and 15 years based on the customer relationships identified.

During the years ended December 31, 2016, 2017 and 2018, no impairment indicators were identified.

Marketable Securities

We account for all our investments in marketable securities in accordance with ASC 320 “Investments – Debt and Equity Securities,” or ASC 320. Our marketable securities consist mainly of debt securities which are designated as available-for-sale and are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders’ equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in financial income, net, together with accretion (amortization) of discount (premium), and interest or dividends. Other debt securities are held as trading securities and are measured at fair value through profit or loss.

We recognize an impairment charge when a decline in the fair value of an investment that falls below its cost basis is determined to be other-than-temporary.

Declines in fair value of available-for-sale equity securities that are considered other-than-temporary, based on criteria described in SAB Topic 5M, “Other Than Temporary Impairment of Certain Investments in Equity Securities,” are charged to earnings (based on the entire difference between fair value and amortized cost). Factors considered in making such a determination include the duration and severity of the impairment, the financial condition and near-term prospects of the issuer, and the intent and ability of the company to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value.

For declines in value of debt securities we apply an amendment to ASC 320. Under the amended impairment model, an other-than-temporary impairment loss is deemed to exist and recognized in earnings if management intends to sell or if it is more likely than not that it will be required to sell, a debt security, before recovery of its amortized cost basis. If the criteria mentioned above, does not exist, we evaluate the collectability of the security in order to determine if the security is other than temporary impaired.

For debt securities that are deemed other-than-temporary impaired, the amount of impairment recognized in the statement of operations is limited to the amount related to "credit losses" (the difference between the amortized cost of the security and the present value of the cash flows expected to be collected), while impairment related to other factors is recognized in other comprehensive income.

We did not record any impairment in the value of marketable securities during the years ended December 31, 2016, 2017 and 2018.

Stock-based Compensation

We account for stock-based compensation in accordance with ASC 718 "Compensation – Stock Compensation," or ASC 718. ASC 718 requires registrants to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in our consolidated statement of income. We recognize compensation expenses for the value of our awards, which have graded vesting based on the accelerated method over the requisite service period of each of the awards, net of estimated forfeitures. To measure and recognize compensation expense for share-based awards we use the Binomial option-pricing model. The Binomial model for option pricing requires a number of assumptions, of which the most significant are the suboptimal exercise factor and expected stock price volatility. The suboptimal exercise factor is estimated based on employees' historical option exercise behavior.

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The suboptimal exercise factor is the ratio by which the stock price must increase over the exercise price before employees are expected to exercise their stock options. Expected volatility is based upon actual historical stock price movements and was calculated as of the grant dates for different periods, since the Binomial model can be used for different expected volatilities for different periods. Expected volatility is based upon actual historical stock price movements and is calculated as of the grant dates for different periods, since the Binomial model can be used for different expected volatilities for different periods. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term to the contractual term of the options. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. Estimated forfeitures are based on actual historical pre-vesting forfeitures. Since dividend payment is applied to reduce the exercise price of our options, the effect of the dividend protection is reflected by using an expected dividend assumption of zero. For awards with performance conditions, compensation cost is recognized over the requisite service period if it is ‘probable’ that the performance conditions will be satisfied, as defined in ASC 450-20-20, “Loss Contingencies.”

Contingencies

From time to time, we are subject to legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to intellectual property, contracts, employment and other matters. We accrue a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. These accruals are reviewed and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions, including profit from intercompany sales not yet realized outside the Group, have been eliminated upon consolidation.

Changes in the parent’s ownership interest in a subsidiary with no change of control are treated as equity transactions, with any difference between the amount of consideration paid and the change in the carrying amount of the non-controlling interest, recognized in equity.

Non-controlling interests of subsidiaries represent the non-controlling share of the total comprehensive income (loss) of the subsidiaries and fair value of the net assets upon the acquisition of the subsidiaries. The non-controlling interests are presented in equity separately from the equity attributable to the equity holders of the Company. Redeemable non-controlling interests are classified as mezzanine equity, separate from permanent equity, on the consolidated balance sheets and measured at each reporting period at the higher of their redemption amount or the non-controlling interest book value, in accordance with the requirements of ASC 810 “Consolidation” and ASC 480-10-S99-3A, “Distinguishing Liabilities from Equity”.

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Fair Value Measurements

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

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

Level 2 - Significant other observable inputs based on market data obtained from sources independent of the reporting entity;

Level 3 - Unobservable inputs which are supported by little or no market activity (for example cash flow modeling inputs based on assumptions).

Assets and liabilities measured at fair value on a recurring basis are comprised of marketable securities, foreign currency forward contracts and contingent consideration of acquisitions (See Note 5 to the consolidated financial statements).

The carrying amounts reported in the balance sheet for cash and cash equivalents, short term bank deposits, trade receivables, other accounts receivable, short-term bank credit, trade payables and other accounts payable approximate their fair values due to the short-term maturities of such instruments.

Accounting for Income Tax

We account for income taxes in accordance with ASC 740, “Income Taxes,” or ASC 740. ASC 740 prescribes the use of the “asset and liability” method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance, if

necessary, to reduce deferred tax assets to their estimated realizable value. Deferred tax assets and liabilities are classified as non-current.

Taxes that would apply in the event of disposal of investments in subsidiaries have not been taken into account in computing deferred taxes, as it is our intention to hold these investments, rather than realize them. We do not expect our non-Israeli subsidiaries to distribute taxable dividends in the foreseeable future, as their earnings are needed to fund their growth while we expect to have sufficient resources in the Israeli companies to fund our cash needs in Israel.

Our non-Israeli subsidiaries are taxed according to the tax laws in their respective domiciles of residence. If earnings are distributed to Israel in the form of dividends or otherwise, the Company may be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and foreign withholding tax rates.

Neither Israeli income taxes, foreign withholding taxes nor deferred income taxes were provided in relation to undistributed earnings of the non-Israeli subsidiaries. This is because we intend to permanently reinvest undistributed earnings in the foreign subsidiaries in which those earnings arose. If these earnings were distributed in the form of dividends or otherwise, we would be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and non-Israeli withholding taxes.

The amount of cash and cash equivalents that are currently held outside of Israel that would be subject to income taxes if distributed as dividends is $12.9 million. However, a determination of the amount of the unrecognized deferred tax liability for temporary difference related to those undistributed earnings of foreign subsidiaries is not practicable due to the complexity of the structure of our group of subsidiaries for tax purposes and the difficulty of projecting the amount of future tax liability.

We utilize a two-step approach in recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. Under the first step we evaluate a tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, based on technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement with the tax authorities. We have accrued interest and penalties related to unrecognized tax benefits in our provisions for income taxes. The total amount of gross unrecognized tax benefits (tax on income) for the years ended December 31, 2016, 2017 and 2018 were ($159,000), ($300,000) and ($1,050,000), respectively.

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Recently Issued Accounting Standards

For a description of recently issued and recently adopted accounting standards, see Note 2 to our consolidated financial statements appearing elsewhere in this annual report.

C. Research and Development

Our research and development and support personnel work closely with our customers, our prospective customers and relevant market analysts to determine our requirements and to design enhancements and new releases to meet market needs. We periodically release enhancements and upgrades to our core products. In the years ended December 31, 2018, 2017 and 2016, we invested $9.4 million, $10.7 million and $10.1 million in research and development, respectively. Research and development activities take place in our facilities in Israel, India, Russia and Japan**.**

As of December 31, 2018, we employed 198 employees in research and development activities, of which 78 persons were located in Israel, 94 persons in India, 21 persons in Russia, 5 persons in Japan (when measured on a full time basis). Our product development team includes technical writers who prepare user documentation for our products. In addition, we have also entered into arrangements with subcontractors for the preparation of product user documentation and certain product development work.

For additional information regarding product development see Item 4. “Information on the Company - Business Overview - Product Development.”

D. Trend Information

For information see discussion in Item 4. “Information on the Company-Business Overview-Industry Background and Trends” and Item 5. “Operating and Financial Review and Prospects - Results of Operations.”

E. Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our minimum contractual obligations as of December 31, 2018 and the effect we expect them to have on our liquidity and cash flow in future periods.

	Payments due by period			
Contractual Obligations	**Total**	**less than 1 year**	**1-3 years**	**3-5 years**
Operating lease obligations	$6,235,000	$2,224,000	$3,305,000	$706,000
Liabilities due to acquisition activities	1,004,000	910,000	94,000	-
Severance payments, net*	3,934,000	-	-	-
Uncertainties in income taxes (ASC 740) **	2,175,000	-	-	-
Short and Long term debt	28.049,000	8,661,000	10,241,000	9,147,000
Total contractual obligations	$41,397,000	$11,795,000	$13,640,000	$9,853,000

* Severance payments relate to accrued severance obligations and notice obligations mainly to our Israeli employees as required under Israeli labor law or personal employment agreements. We are legally required to pay severance upon certain circumstances, primarily upon termination of employment by our company, retirement or death of the respective employee. Our liability for all of our Israeli employees is fully provided for by monthly deposits with insurance policies and by an accrual.

** Payment of uncertain tax benefits would result from settlements with taxing authorities. Due to the difficulty in determining the timing of settlements, this information is not included in the above table. We do not expect to make any significant payments for these uncertain tax positions within the next 12 months.

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ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

Set forth below are the name, age, principal position and a biographical description of each of our directors and executive officers:

Name	Age	Position
Guy Bernstein	51	Chief Executive Officer and Director
Sagi Schliesser [(1)]	47	External Director
Ron Ettlinger [(1)]	52	External Director
Naamit Salomon	54	Director
Avi Zakay[(1)]	40	Director
Asaf Berenstin	41	Chief Financial Officer
Udi Ertel	59	President, Software Solutions division
Amit Birk	48	Vice President, Mergers and Acquisitions, General Counsel and Corporate Secretary
Arik Kilman	66	Chairman, Software Solutions division
Yakov Tsaroya	49	Chief Executive Officer of Coretech Consulting Services and Fusion Solutions
Uzi Yaari	45	Chief Executive Officer of Complete Business Solutions
Arik Faingold	42	President, Integration Solutions division
Yuval Baruch	52	Chief Executive Officer of Hermes Logistics
Hanan Shahaf	67	Chief Executive Officer of Roshtov Software Industries Ltd

(1) Member of our Audit and Compensation Committees

Messrs. Guy Bernstein, Avi Zakay and Ms. Naamit Salomon were re-elected as directors at our 2018 annual general meeting of shareholders to serve as directors until our 2019 annual general meeting of shareholders.

Messrs. Sagi Schliesser and Ron Ettlinger are serving as external directors pursuant to the provisions of the Israeli Companies Law for their second three-year terms.

Mr. Guy Bernstein and Mr. Asaf Berenstin are first cousins. Mr. Arik Faingold is the brother of Mr. Idan Faingold who is an executive officer of the Comm-IT Group and the two brothers are the owners of the 13.6% minority interest in that company. Other than such relationships, there are no family relationships among our directors and senior executives.

Guy Bernstein has served as our chief executive officer since April 2010 and has served as a director of our company since January 2007 and served as the chairman of our board of directors from April 2008 to April 2010. Mr. Bernstein has served as the chief executive officer of Formula Systems, our parent company, since January 2008. From December 2006 to November 2010, Mr. Bernstein served as a director and the chief executive officer of Emblaze Ltd. or Emblaze, our former controlling shareholder. Mr. Bernstein also serves as the chairman of the board of directors of Sapiens International Corporation N.V., or Sapiens, and is the chairman of the board of directors of Matrix IT Ltd., both of which are subsidiaries of Formula Systems. From April 2004 to December 2006, Mr. Bernstein served as the chief financial officer of Emblaze and he has served as a director of Emblaze since April 2004. Prior to that and from 1999, Mr. Bernstein served as our chief financial and operations officer. Prior to joining our company, Mr. Bernstein was senior manager at Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, from 1994 to 1997. Mr. Bernstein holds a B.A. degree in accounting and economics from Tel Aviv University and is a certified public accountant (CPA) in Israel.

Sagi Schliesser has served as an external director of our company since November 2015 and is a member of our audit committee. Mr. Schliesser has been the co-founder and chief executive officer of TabTale, a creator of innovative games, interactive books and educational apps since 2010. Prior to founding TabTale, Mr. Schliesser was the CTO of Sapiens International Corporation (NASDAQ and TASE: SPNS), managing Sapiens Technologies. Previously Mr. Schliesser served for seven years as VP of R&D and CTO of IDIT Technologies Ltd., a global provider of insurance software solutions. Before that Mr. Schliesser was one of the founders of WWCOM, a B2B enablement software startup. Mr. Schliesser holds a B.Sc. degree with honors in Computer Science and Psychology from Tel Aviv University, as well as a Master’s degree in Computer Science from the Interdisciplinary Center in Herzliya and an M.B.A. degree with honors in Business Psychology from Hamaslool Ha’akademi Shel Hamichlala Leminhal.

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Ron Ettlinger has served as a director of our company since December 2014 and is a member of our audit committee. Mr. Ettlinger is the founder and has been the chief executive officer of "Nippon Europe Israel Ltd.," a leading provider of car multimedia advanced systems, since October 2000. Prior to that, Mr. Ettlinger was the owner and general manager of Universal Ltd., a car service. Mr. Ettlinger is the founder and since July 2014 has served as chief executive officer of Nippon Lights Ltd., a leading provider of LED lights and panels. Mr. Ettlinger holds a B.A. degree in Business, with a major in finance and marketing from Tel-Aviv College of Management.

Naamit Salomon has served as director of our company since March 2003. Since January 2010, Ms. Salomon has served as a partner in an investment company. Ms. Salomon also serves as a director of Sapiens, which is part of the Formula group. Ms. Salomon served as the chief financial officer of Formula Systems from August 1997 until December 2009. From 1990 through August 1997, Ms. Salomon served as the controller of two large privately held companies in the Formula group. Ms. Salomon holds a B.A. degree in Economics and Business administration from Ben Gurion University and an LL.M. degree from Bar-Ilan University.

Avi Zakay has served as director of our company since February 2018. Mr. Zakay has been the sales manager of the Volkswagen dealership and showroom in Rishon Letzion (Champion Motors) since 2014. In 2013, he served as the sales manager of the showroom of Mitsubishi Motors in Netanya, and from 2007 to 2013, he served as a sales manager of BMW and Mercedes-Benz in Tel Aviv. Mr. Zakay holds a B.A. degree in Business Administration and studied for an M.B.A. degree, both from Michlala Le-minhal College in Tel-Aviv.

Asaf Berenstin has served as our chief financial officer since April 2010. In November 2011, Mr. Berenstin was appointed as Chief Financial Officer of our parent company Formula Systems (1985) Ltd. in addition to his position as chief financial officer of our company. Prior to that and from August 2008, Mr. Berenstin served as our corporate controller. Mr. Berenstin also serves as a director of Michpal Micro Computers (1983) Ltd., a director at TSG IT Advanced Systems Ltd., and is a director at InSync staffing, all of them are subsidiaries of Formula Systems. Prior to joining our company and from July 2007, Mr. Berenstin served as a controller at Gilat Satellite Networks Ltd. (NASDAQ: GILT). From October 2003 to July 2008, Mr. Berenstin was a certified public accountant at Kesselman & Kesselman, a member of PriceWaterhouseCoopers. Mr. Berenstin holds a B.A. degree in Accounting and Economics and an M.B.A. degree, both from Tel Aviv University, and is a certified public accountant (CPA) in Israel.

Udi Ertel has served as president of Software Solutions division since 2013. Prior to that and from January 2011, Mr. Ertel served as vice president, sales and distribution, responsible for our sales and business activities in South Africa, Hungary and was responsible for distribution in the Asia Pacific region, East Europe and the Mediterranean basin. Mr. Ertel joined our company in 2004, initially serving as the chief executive officer of our Israeli subsidiary, Magic Software Enterprises (Israel) Ltd., and from January 2009 as our vice president, global services and operations. Before joining our company, Mr. Ertel served for nine years as the chief executive officer of Complot (83) Ltd. Mr. Ertel holds a B.Sc. degree in Computer Science and Mathematics and completed his studies towards an M.B.A. degree (without thesis), both from Tel Aviv University in Israel.

Amit Birk has served as our vice president, mergers and acquisitions, general counsel and corporate secretary since May 1999. From 1997 to 1998, Mr. Birk was an associate at Avital Dromi & Co., a leading law firm in Tel Aviv, Israel. Since November 2007, Mr. Birk serves as an external director of BGI Investment (1961) Ltd., an Israeli public company. Mr. Birk holds an LL.B. degree from the University of Sheffield, an M.B.A. degree from Bar-Ilan University and a Practical Engineer degree from ORT College. Mr. Birk is also a certified mediator.

Arik Kilman has served as chairman of our Software Solutions division since January 2017 and president of AppBuilder Software Solutions division since January 2012, following our acquisition of AppBuilder Solutions Ltd. at which time he was named Chief Executive Officer of AppBuilder. Prior to joining our company, Mr. Kilman served as Chief Executive Officer of BluePhoenix Solutions Ltd., the former parent of AppBuilder from May 2003 to January 2009 and from April 2010 to December 2011. Mr. Kilman holds a B.A. degree in Economics and Computer Science from New York City College of Technology.

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Yakov Tsaroya has served as chief executive officer of our subsidiary, CoreTech Consulting Group LLC, since 2006. Mr. Tsaroya has also served as Chief Executive Officer of Fusion Solution LLC and Xsell Resources Inc. since our acquisition of these companies in 2010. Mr. Tsaroya holds a B.A. degree in Accounting and Finance from the College of Administration in Israel and is a certified public accountant (CPA) in Israel.

Uzi Yaari joined Complete Business Solutions as CEO in 2015 after spending seven years as CEO at leading ERP implementer, Intentia Advanced Solutions. Having served in various positions during his 15 years at Intentia, Uzi brings a rich history of ERP experience and expertise in various ERP ecosystems and in various countries having lead many ERP projects both in the country and abroad. Uzi is an industrial engineer.

Arik Faingold has served as president of our Integration Solutions division since July 2012. Mr. Faingold has served as chairman of Comm-IT Group since 2009. Mr. Faingold was General Manager of Open TV Israel, part of OpenTV Global, from 2003 to 2009. Mr. Faingold served as Co-founder and CTO of Betting Corp from 1999 to 2003. Mr. Faingold holds a B.A. degree in Computer Science from the Interdisciplinary Center in Herzliya and an M.B.A. from Tel Aviv University.

Yuval Baruch has served as an officer of our company since his appointment in September 2012 as the chief executive officer of Hermes Logistics Technologies (HLT). Mr. Baruch has also served as the chief executive officer of Pilat HR solutions since April 2013. Mr. Baruch was chief executive officer of J.R. Holdings & Development from November 2007 to January 2012. Mr. Baruch has served as an external director of Matrix IT, a publicly traded company in Israel, since 2011. Between 2004 and 2008 Mr. Baruch launched, managed and divested a chain of fitness centers in Israel. Mr. Baruch holds a B.A. degree in Marketing and Finance from The College of Management in Israel and an M.B.A. degree from the Stanford Graduate School of Business.

Hanan Shahaf became an officer of our company in July 2016, as part of the Roshtov Software Industries Ltd. acquisition. Mr. Shahaf was one of Roshtov's founders in 1989 and has served as its Chief Executive Officer and a director since its inception. He also served as a director and chairman on several private companies' boards. Mr. Shahaf holds a B.sc in Industrial engineering and Management and an M.B.A. from Northwestern University (Kellogg School of Management) and Tel Aviv university (Recanati Graduate School of BA).

B. Compensation

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2018.

	Salaries, fees, commissions and bonuses	Pension, retirement and similar benefits
All directors and executive officers as a group (14 persons)	$ 3,738,408	$ 123,714

For so long as we qualify as a foreign private issuer, we are not required to comply with the proxy rules applicable to U.S. domestic companies, including the requirement to disclose information concerning the amount and type of compensation paid to our chief executive officer, chief financial officer and the three other most highly compensated executive officers, rather than on an aggregate basis. Nevertheless, a recent amendment to the regulations promulgated under the Israeli Companies Law requires us to disclose the annual compensation of our five most highly compensated officers on an individual basis, rather than on an aggregate basis, as was previously permitted for Israeli public companies listed overseas. Under the Companies Law regulations, this disclosure is required to be included in the annual proxy statement for our annual meeting of shareholders each year, which we furnish to the SEC under cover of a Report of Foreign Private Issuer on Form 6-K. Because of that disclosure requirement under Israeli law, we are also including such information in this annual report, pursuant to the disclosure requirements of Form 20-F.

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The table below reflects the compensation granted to our five most highly compensated officers during or with respect to the year ended December 31, 2018. All amounts reported in the table reflect the cost to our company, as recognized in our financial statements for the year ended December 31, 2018.

2018 Summary Compensation Table

Name and Position	Salary	**Bonus** [1]	**Equity Based Compensation** [2]	**All Other Compensation** [3]	Total
Arik Kilman, Chairman, Software Group	$399,344	$577,012	$ 64,387	$ 0	$1,040,743
Yakov Tsaroya, President, Coretech Consulting Group LLC	$225,000	$337,000	$ 0	$ 9,000	$571,000
Arik Faingold, President, Integration Solutions division	$321,139	$196,529	$ 0	$ 0	$517,668
Udi Ertel, President, Software Division	$222,142	$58,078	$ 0	$ 43,705	$323,925
Hanan Shahaf, Chief Executive Officer of Roshtov Software Industries Ltd	$284,433	$17,364	$ 0	$ 0	$301,797

(1) Amounts reported in this column represent annual incentive bonuses granted to the covered executives based on performance-metric based formulas set forth in their respective employment agreements.

(2) Amounts reported in this column represent the grant date fair value computed in accordance with accounting guidance for share-based compensation.

(3) Amounts reported in this column include personal benefits and perquisites, including those mandated by applicable law. Such benefits and perquisites may include, to the extent applicable to the respective covered executive, payments, contributions and/or allocations for savings funds (e.g., Managers Life Insurance Policy), education funds (referred to in Hebrew as “keren hishtalmut”), pension, severance, vacation, car or car allowance, medical insurances and benefits, risk insurance (e.g., life insurance or work disability insurance), telephone expense reimbursement, convalescence or recreation pay, relocation reimbursement, payments for social security, and other personal benefits and perquisites consistent with our company’s guidelines. All amounts reported in the table represent incremental cost to our company.

During the year ended December 31, 2018, we paid to each of our outside and independent directors an annual fee of approximately $18,442 and a per-meeting attendance fee of approximately $687. Such fees are paid based on the fees detailed in a schedule published semi-annually by the Committee for Public Directors under the Israeli Securities Law.

The above compensation excludes stock- based compensation costs in accordance with ASC 718.

As of December 31, 2018, our directors and executive officers as a group, then consisting of 14 persons, held options to purchase an aggregate of 126,000 ordinary shares, at exercise prices ranging from $2.26 to $4.00 per share. Of such options, options to purchase 66,000 ordinary shares expire in 2020 and options to purchase 60,000 ordinary shares expire in 2021. All such options were granted under our 2007 Incentive Compensation Plan. See Item 6E “Directors, Senior Management and Employees - Share Ownership - Stock-Based Compensation Plans.”

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C. Board Practices

Introduction

According to the Israeli Companies Law and our Articles of Association, the management of our business is vested in our board of directors. The board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our board of directors. Executive officers are appointed by and serve at the discretion of the board of directors, subject to any applicable agreements.

Election of Directors

Our articles of association provide for a board of directors consisting of no less than three and no more than eleven members or such other number as may be determined from time to time at a general meeting of shareholders. Our board of directors is currently composed of five directors.

Pursuant to our articles of association, all of our directors are elected at our annual general meeting of shareholders, which are required to be held at least once during every calendar year and not more than 15 months after the last preceding meeting. Except for our external directors (as described below), our directors are elected by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual meeting of shareholders following the annual meeting at which they were appointed. Directors (other than external directors) may be removed earlier from office by resolution passed at a general meeting of our shareholders. Our board of directors may temporarily fill vacancies in the board until the next annual meeting of shareholders, provided that the total number of directors will not exceed the maximum number permitted under our articles of association.

Under the Israeli Companies Law, our board of directors is required to determine the minimum number of directors who must have “accounting and financial expertise” (as such term is defined in regulations promulgated under the Israeli Companies Law). In determining such number, the board of directors must consider, among other things, the type and size of the company and the scope of and complexity of its operations. Our board of directors has determined that at least one director must have “accounting and financial expertise,” within the meaning of the regulations promulgated under the Israeli Companies Law.

External and Independent Directors

External Directors. The Israeli Companies Law requires companies organized under the laws of the State of Israel with shares that have been offered to the public in or outside of Israel to appoint at least two external directors. No person may be appointed as an external director if the person is a relative of the controlling shareholder of the company or if the person or the person's relative, partner, employer or any entity under the person's control has or had, on or within the two years preceding the date of the person's appointment to serve as an external director, any affiliation with the company or the controlling shareholder of the company or the controlling shareholder's relative or any entity controlled by the company or by the controlling shareholder of the company. If the company does not have a controlling shareholder or a person or entity which holds 25% of the total voting rights of the company, an external director may also not have an affiliation with chairman of the board, the chief executive officer, beneficial owner of 5% or more of the issued shares or the voting power of the company and the most senior executive officer of the company in the finance field. The term "affiliation" includes an employment relationship, a business or professional relationship maintained on a regular basis (other than negligible relationships), control and service as an "office holder" as defined in the Israeli Companies Law, however, "affiliation" does not include service as a director of a private company prior to its first public offering if the director was appointed to such office for the purpose of serving as an external director following the company's first public offering. In addition, no person may serve as an external director if the person's position or other activities create or may create a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director. In addition, a director in a company may not be appointed as an external director in another company if at that time, a director of the other company serves as an external director in the first company. Moreover, a person may not be appointed as an external director, if he or she is employed by the Israeli Securities Authority or by Tel-Aviv Stock Exchange. If, at the time external directors are to be appointed, all current members of the board of directors which are not the controlling shareholders of the company or their relatives are of the same gender, then at least one external director must be of the other gender.

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At least one of the external directors must have “accounting and financial expertise” and the other external directors must have “professional expertise,” as such terms are defined by regulations promulgated under the Israeli Companies Law.

The election of the nominee for external director requires the affirmative vote of (i) the majority of the votes actually cast with respect to such proposal including at least a majority of the voting power of the non-controlling shareholders (as such term is defined in the Israel Securities Law, 1968) or those shareholders who do not have a personal interest in approval of the nomination except for a personal interest that is not as a result of the shareholder’s connections with the controlling shareholder, who are present in person or by proxy and vote on such proposal, or (ii) the majority of the votes cast on such proposal at the meeting, provided that the total votes cast in opposition to such proposal by the non-controlling shareholders or those shareholders who do not have a personal interest in approval of the nomination except for a personal interest that is not as a result of the shareholder’s connections with the controlling shareholder (as such term is defined in the Israel Securities Law, 1968) does not exceed 2% of all the voting power in the Company.

External directors serve for a three-year term. However, in accordance with the Israeli Companies Law regulations, external directors of a public company whose shares are traded on the NASDAQ may be appointed for additional periods of three-year each provided that the audit committee and the board of directors have approved that, given the external director’s expertise and contribution to the board and committee meetings, such appointment is for the company’s benefit and provided further that the nomination to additional periods of three-year terms is approved through one of the following mechanisms: (i) the board of directors proposed the nominee and his appointment was approved by the shareholders in the manner required to appoint external directors for their initial term (described above); or (ii) one or more shareholders holding 1% or more of the voting rights proposed the nominee, and the nominee is approved by the majority of the votes actually cast with respect to such proposal and all of the following conditions are met: (a) the majority of votes does not include the votes of the controlling shareholder or votes of shareholders who have a personal interest in approval of the nomination except for a personal interest that is not as a result of the shareholder’s connections with the controlling shareholder and (b) the total votes cast in favor of such proposal by the non-controlling shareholders or those shareholders who do not have a personal interest in the approval of the nomination except for a personal interest that is not as a result of the shareholder’s connections with the controlling shareholder exceed 2% of all the voting power in the company

External directors may be removed from office only by the same percentage of shareholders as is required for their election, or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment, violate their duty of loyalty to the company or are found by a court to be unable to perform his or hers duties on a full time basis. External directors may also be removed by the court if they are found guilty of bribery, fraud, administrative offenses or use of inside information.

Each committee of the board of directors that may exercise a responsibility of the board of directors must include at least one external director. The audit committee must be comprised of at least three directors and include all the external directors. An external director is entitled to compensation as provided in regulations adopted under the Israeli

Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

Until the lapse of two years from termination of office, we may not engage an external director, or his or her spouse or child to service as an office holder and cannot employ or receive services from that person, either directly or indirectly, including through a corporation controlled by that person.

Independent Directors. NASDAQ Stock Market Rules require us to establish an audit committee comprised of at least three members and only of independent directors each of whom satisfies the respective "independence" requirements of the SEC and NASDAQ.

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Pursuant to the Israeli Companies Law, a director may be qualified as an independent director if such director is either (i) an external director; or (ii) a director that serves as a board member less than nine years and the audit committee has approved that he or she meets the independence requirements of an external director. A majority of the members serving on the audit committee must be independent under the Israeli Companies Law. In addition, an Israeli company whose shares are publicly traded may elect to adopt a provision in its articles of association pursuant to which a majority of its board of directors will constitute individuals complying with certain independence criteria prescribed by the Israeli Companies Law. We have not included such a provision in our articles of association. Pursuant to Israeli regulations adopted in January 2011, directors who comply with the independence requirements of NASDAQ and the SEC are deemed to comply with the independence requirements of the Israeli Companies Law.

Our board of directors has determined that Mr. Sagi Schliesser and Mr. Ron Ettlinger both qualify as independent directors under the SEC and NASDAQ requirements and as external directors under the Israeli Companies Law requirements. Our board of directors has further determined that Mr. Avi Zakay qualifies as an independent director under the SEC, NASDAQ and Israeli Companies Law requirements.

Committees of the Board of Directors

Audit Committee. Our audit committee, established in accordance with Sections 114-117 of the Israeli Companies Law and Section 3(a)(58)(A) of the Securities Exchange Act of 1934, assists our board of directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent public accountants' qualifications and independence, the performance of our internal audit function and independent public accountants, finding any irregularities in the business management of our company for which purpose the audit committee may consult with our independent auditors and internal auditor, proposing to the board of directors ways to correct such irregularities and such other duties as may be directed by our board of directors. The responsibilities of the audit committee also include approving related-party transactions as required by law. The audit committee is also required to determine whether any action is material and whether any transaction is an extraordinary transaction or non-negligible transaction, for the purpose of approving such action or transaction as required by the Israeli Companies Law. Under Israeli law, an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

Our audit committee is currently composed of Messrs. Ettlinger, Schliesser and Zakay, each of whom satisfies the respective "independence" requirements of the SEC and NASDAQ. We also comply with Israeli law requirements for audit committee members. Our board of directors has determined that Mr. Ettlinger qualifies as a financial expert. The audit committee meets at least once each quarter.

Compensation Committee. In accordance with the Israeli Companies Law, we have a compensation committee, whose role is to: (i) recommend a compensation policy for office holders and to recommend to the board, once every three years, on the approval of the continued validity of the compensation policy that was determined for a period exceeding three years; (ii) recommend an update the compensation policy from time to time and to examine its implementation; (iii) determine whether to approve the terms of service and employment of office holders that require the committee's approval; and (iv) exempt a transaction from the requirement of shareholders' approval in accordance with the provisions of the Israeli companies Law. The compensation committee also has oversight authority over the actual terms of employment of directors and officers and may make recommendations to the board of directors and the shareholders (where applicable) with respect to deviation from the compensation policy that was adopted by the company.

Under the Israeli Companies Law, a compensation committee must consist of no less than three members, including all of the external directors (who must constitute a majority of the members of the committee), and the remainder of the members of the compensation committee must be directors whose terms of service and employment were determined pursuant to the applicable regulations. The same restrictions on the actions and membership in the audit committee as discussed above under "Audit Committee," including the requirement that an external director serve as the chairman of the committee and the list of persons who may not serve on the committee, also apply to the compensation committee. We have established a compensation committee that is currently composed of Messrs. Ettlinger, Schliesser and Zakay.

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Internal Auditor

The Israeli Companies Law also requires the board of directors of a public company to appoint an internal auditor proposed by the audit committee. A person who does not satisfy the Israeli Companies Law's independence requirements may not be appointed as an internal auditor.

The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice. Our internal auditor complies with the requirements of the Israeli Companies Law. Mr. Eyal Weizman currently serves as our internal auditor.

Directors' Service Contracts

There are no arrangements or understandings between us and any of our subsidiaries, on the one hand, and any of our directors, on the other hand, providing for benefits upon termination of their employment or service as directors of our company or any of our subsidiaries.

Approval of Related Party Transactions Under Israeli Law

Fiduciary Duties of Office Holders

The Israeli Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An "office holder" is defined in the Israeli Companies Law as a chief executive officer, chief business manager, deputy general manager, vice general manager, any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title or a director or any other manager directly subordinate to the general manager. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires an office holder to act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (i) information regarding the appropriateness of a given action brought for his approval or performed by him by virtue of his position and (ii) all other information of importance pertaining to the foregoing actions. The duty of loyalty includes (i) avoiding any conflict of interest between the office holder's position in the company and any other position he holds or his personal affairs, (ii) avoiding any competition with the company's business, (iii) avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and (iv) disclosing to the company any information or documents relating to the company's affairs that the office holder has

received due to his position as an office holder.

Disclosure of Personal Interests of an Office Holder

The Israeli Companies Law requires that an office holder promptly, and no later than the first board meeting at which such transaction is considered, disclose any personal interest that he or she may have and all related material information known to him or her and any documents in their position, in connection with any existing or proposed transaction by us. In addition, if the transaction is an extraordinary transaction, that is, a transaction other than in the ordinary course of business, other than on market terms, or likely to have a material impact on the company's profitability, assets or liabilities, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing, or by any corporation in which the office holder or a relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager.

Approval of Transactions with Office Holders and Controlling Shareholders

Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has a personal interest) must be approved by the board of directors and, in some cases, by the audit committee or the compensation committee and by the board of directors, and under certain circumstances shareholder approval may also be required, provided, however, that such transactions are for the benefit of the company. Subject to certain exceptions. a person who has a personal interest in the approval of a transaction by the audit committee or the Board, may not be present and take part in the voting. An officer or a director who has a personal interest, may be present at the meeting for the purpose of presenting the transaction if the chairman of the audit committee or the Board, as relevant, has determined that the presence of the officer or director is required. A director may be present and vote at the meetings of the audit committee and Board if the majority of the directors have a personal interest in the approval of the transaction. In such case, the transaction also requires approval by the general meeting. The disclosure requirements which apply to an office holder also apply to such transaction with respect to his or her personal interest in the transaction.

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The Companies Law provides for certain procedural constraints on a public company entering into a transaction in which a controlling shareholder and other interested parties have a personal interest. More specifically, Section 275 of the Companies Law provides that an extraordinary transaction (which is defined as a transaction that is either not in a company's ordinary course of business; or a transaction that is not undertaken in market conditions; or a transaction that is likely to substantially influence the profitability of a company, its property or liabilities) between a public company and its controlling shareholder, or an extraordinary transaction of a public company with a third party in which the controlling shareholder has a personal interest, including a transaction of a public company with a controlling shareholder, directly or indirectly, for the receipt of services therefrom (and including a transaction concerning the compensation arrangement of a controlling shareholder in its capacity as an employee or office holder of the company) (a "Controlling Party Transaction"), requires the approval of the audit committee (and with respect to a transaction concerning the compensation arrangement – the compensation committee), the board of directors and the general meeting of shareholders, provided however that the majority approving the transaction shall include at least one half of the votes of shareholders who do not have a personal interest in the transaction and are participating in the vote, or that the aggregate number of votes against the approval of the transaction, voted by shareholders who do not have such personal interest do not exceed 2% of the entire voting rights in the company. Section 275 of the Companies Law further provides that if the term of the Controlling Party Transaction extends beyond three years, the above approvals are required once every three years. However, if such transaction does not relate to a compensation arrangement, then the audit committee may approve the transaction for a longer duration, provided that the audit committee determines that such duration is reasonable under the circumstances. In accordance with the Israeli Companies law the audit committee is responsible to determine that Controlling Party Transactions shall be subject to a competitive procedure or other similar procedure before such transactions are approved.

During the year ended December 31, 2018, we sold approximately $2.5 million of services to affiliated companies of Formula Systems. In 2018, we also purchased from those affiliated companies approximately $0.3 million of hardware and software. We also provided Formula Systems cash management, accounting and bookkeeping services for total consideration of $0.1 million.

Approval Process of Terms of Service and Employment of Office Holders

Under the Israeli Companies Law, the method of approval of Terms of Service and Employment of office holders must be approved as follows:

With respect to an office holder who is not the general manager, a director, a controlling shareholder or a relative of the controlling shareholder:

- In the event the transaction is in accordance with the compensation policy of the company – approval (in the following order) of: (i) compensation committee and (ii) board of directors.

- In the event the transaction is not in accordance with the compensation policy of the company – approval, in special cases (in the following order), by the (i) compensation committee, (ii) board of directors and (iii) company's shareholders, by a simple majority, provided that such majority shall include (i) at least one half of the votes of shareholders who are participating in the vote and are not controlling shareholders or do not have a personal interest regarding the approval of the compensation policy, or (ii) the aggregate number of the opposing votes, voted by shareholders who do not have such personal interest or are not controlling shareholders, do not exceed two percent (2%) of the entire voting rights in the company (the "**Special Majority**"). Under these circumstances, the compensation committee and board of directors are required to approve the transaction based on certain considerations and include certain instructions in connection with the compensation policy. In the event the company's shareholders do not approve the compensation of the office holder, the compensation committee and board of directors may still approve the transaction, in special cases and with detailed reasons and after discussion and examining the rejection of the company's shareholders.

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With respect to a company's general manager (generally the equivalent of a CEO):

- In the event the transaction is in accordance with the compensation policy - approval (in the following order) by the: (i) compensation committee, (ii) board of directors and (iii) company's shareholders with the "Special Majority" described above.

- In the event the transaction is not in accordance with the compensation policy – the approval process and requirements are the same as the approval process for such a transaction with an office holder who is not the general manager, a controlling shareholder or a relative of the controlling shareholder.

The Israeli Companies Law includes an exception from the shareholder approval requirement in connection with the approval of a transaction with a general manager candidate, subject to certain conditions. In addition, in the event the company's shareholders do not approve the compensation of the general manager, the compensation committee and board of directors may still approve the transaction, in special cases and with detailed reasons and after discussion and examining the rejection of the company's shareholders.

With respect to a director who is not a controlling shareholder or a relative of the controlling shareholder:

- In the event the transaction is in accordance with the compensation policy – approval (in the following order) by the: (i) compensation committee, (ii) board of directors and (iii) company's shareholders with a regular majority.

- In the event the transaction is not in accordance with the compensation policy – the approval process and requirements are the same as the approval process for such a transaction with an office holder who is not the general manager, a controlling shareholder or a relative of the controlling shareholder (other than the possibility to approve a transaction that was not approved by the shareholders).

With respect to a controlling shareholder or a relative of a controlling shareholder:

- In the event the transaction is in accordance with the compensation policy - approval (in the following order) by the: (i) compensation committee, (ii) board of directors and (iii) company's shareholders with the "Special Majority" described above.

- In the event the transaction is not in accordance with the compensation policy: the approval process and requirements are the same as the approval process for such a transaction with an office holder who is not the general manager, a controlling shareholder or a relative of the controlling shareholder (other than the possibility to approve a transaction that was not approved by the shareholders).

In accordance with the Israeli Companies Law, the audit committee is responsible to determine that Controlling Party Transactions shall be subject to a competitive procedure or other similar procedure before such transactions are approved.

Provisions Restricting Change in Control of Our Company

Tender Offer. In certain circumstances, an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would hold 25% or more of the voting rights in the company (unless there is already a 25% or greater shareholder of the company) or more than 45% of the voting rights in the company (unless there is already a shareholder that holds more than 45% of the voting rights in the company). If, as a result of an acquisition, the acquirer would hold more than 90% of a company's shares or voting rights, the acquisition must be made by means of a tender offer for all of the shares. A purchase by a tender offer is subject to additional requirements as specified in the Israeli Law and regulations promulgated thereunder.

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Merger. The Israeli Companies Law generally requires that a merger be approved by the board of directors and by the general meeting of the shareholders. Upon the request of any creditor of a merging company, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations. In addition, a merger may generally not be completed unless at least (i) 50 days have passed since the filing of the merger proposal with the Israeli Registrar of Companies, and (ii) 30 days have passed since the merger was approved by the shareholders of each of the merging companies. The approval of merger by the company is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder.

Exculpation, Indemnification and Insurance of Directors and Officers

Exculpation and Indemnification of Office Holders

The Israeli Companies Law and our Articles of Association authorize us, subject to the receipt of requisite corporate approvals, to indemnify and exempt our directors and officers, subject to certain conditions and limitations. Most recently, in November 2011 our shareholders approved a form of indemnification and exculpation letter to ensure that our directors and officers (including any director and officer who may be deemed to be a controlling shareholder, within the meaning of the Israeli Companies Law) are afforded protection to the fullest extent permitted by law as currently in effect. Under the approved form of indemnification and exculpation letter, the total amount of indemnification allowed may not exceed an amount equal to 25% of our shareholders' equity in the aggregate, calculated with respect to each of our directors and officers.

The Israeli Companies Law provides that an Israeli company may not exculpate an office holder from liability for a breach of the duty of loyalty of the office holder. The company may, however, approve an office holder's act performed in breach of the duty of loyalty, provided that the office holder acted in good faith, the act or its approval does not harm the company and the office holder discloses the nature of his or her personal interest in the act and all material facts and documents a reasonable time before discussion of the approval. An Israeli company may exculpate an office holder in advance from liability to the company, in whole or in part, for a breach of duty of care, but only if a provision authorizing such exculpation is inserted in its articles of association. An Israeli company may also not exculpate a director for liability arising out of a prohibited dividend or distribution to shareholders.

The Israeli Companies Law provides that a company may, if permitted by its articles of association, indemnify an office holder for acts or omissions performed by the office holder in such capacity for:

A financial liability imposed on the office holder in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court;

Reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any financial liability instead of criminal proceedings, or concluded without the filing of an indictment against the office holder and a financial liability was imposed on the officer holder instead of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent;

Reasonable litigation expenses, including attorneys' fees, incurred by such office holder or which were imposed on him by a court, in proceedings the company instituted against the office holder or that were instituted on the company's behalf or by another person, or in a criminal charge from which the office holder was acquitted, or in a criminal proceeding in which the office holder was convicted of a crime which does not require proof of criminal intent; and

Expenses, including reasonable litigation expenses and legal fees, incurred by such office holder as a result of a proceeding instituted against him in relation to (A) infringements that may result in imposition of financial sanction pursuant to the provisions of Chapter H'3 under the Israeli Securities Law or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Israeli Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Israeli Securities Law; and (e) payments to an injured party of infringement under Section 52ND(a)(1)(a) of the Israeli Securities Law.

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In accordance with the Israeli Companies Law, a company's articles of association may permit the company to:

Undertake in advance to indemnify an office holder, except that with respect to a financial liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the opinion of the company's board of directors, are, at the time of the undertaking, foreseeable due to the company's activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances; and

Retroactively indemnify an office holder of the company.

Insurance for Office Holders

The Israeli Companies Law provides that a company may, if permitted by its articles of association, insure an office holder for acts or omissions performed by the office holder in such capacity for:

A breach of his or her duty of care to the company or to another person;

A breach of his or her duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that his act would not prejudice the company's interests; and

A financial liability imposed upon the office holder in favor of another person.

Subject to the provisions of the Israeli Companies Law and the Israeli Securities Law, a company may also enter into a contract to insure an office holder for (A) expenses, including reasonable litigation expenses and legal fees, incurred by the office holder as a result of a proceeding instituted against such office holder in relation to (1) infringements that may impose financial sanction pursuant to the provisions of Chapter H'3 under the Israeli Securities Law or (2) administrative infringements pursuant to the provisions of Chapter H'4 under the Israeli Securities Law or (3) infringements pursuant to the provisions of Chapter I'1 under the Israeli Securities Law and (B) payments made to the injured parties of such infringement under Section 52ND(a)(1)(a) of the Israeli Securities Law.

Limitations on Exculpation, Insurance and Indemnification

The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exempting an office holder from duty to the company shall be valid, where such insurance, indemnification or exemption relates to any of the following:

A breach by the office holder of his duty of loyalty, except with respect to insurance coverage or indemnification if the office holder acted in good faith and had reasonable grounds to assume that the act would not prejudice the company;

A breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently;

Any act or omission committed with intent to derive an unlawful personal gain; and

Any fine, civil fine, financial sanction or forfeiture imposed on the office holder.

In addition, pursuant to the Israeli Companies Law, exemption of, procurement of insurance coverage for, an undertaking to indemnify or indemnification of an office holder must be approved by the compensation committee and the board of directors and, if such office holder is a director or a controlling shareholder or a relative of the controlling shareholder, also by the shareholders general meeting.

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Our articles of association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by law, subject to the provisions of the Israeli Companies Law.

The current coverage of our directors' and officers' liability insurance policy is up to a maximum of $40.0 million both per incident and in the aggregate, plus $10.0 million of Side A DIC coverage for which we currently pay an annual premium of approximately $67,000.

According to our compensation policy, any officers' liability insurance policy is conditioned on the following terms: (i) the total cover amount for an office holder under an insurance policy will not be greater than $80 million; (ii) the total annual premium will not be greater than $250,000; and (iii) our deductible for a claim will not be greater than $350,000.

D. Employees

The following table presents the number of our employees categorized by geographic location as of December 31, 2016, 2017 and 2018:

	Year ended December 31,		
	2016	2017	2018
Israel	843	921	999
Asia	122	139	164
North America	597	861	933
South Africa	10	16	14
Europe	127	115	116
Total	1,699	2,052	2,226

The following table presents the number of our employees categorized by activity as of December 31, 2016, 2017 and 2018:

	Year ended December 31,		
	2016	2017	2018
Technical support and consulting	1,238	1,615	1,761
Research and development	206	181	198

Marketing and sales	133	117	140
Operations and administrations	122	139	127
Total	1,699	2,052	2,226

Our relationships with our employees in Israel are governed by Israeli labor legislation and regulations, extension orders of the Israeli Ministry of Labor and personal employment agreements. Israeli labor laws and regulations are applicable to all of our employees in Israel. The laws concern various matters, including severance pay rights at termination, notice period for termination, retirement or death, length of workday and workweek, minimum wage, overtime payments and insurance for work-related accidents. We currently fund our ongoing legal severance pay obligations by paying monthly premiums for our employees' insurance policies and or pension funds. At the time of commencement of employment, our employees generally sign written employment agreements specifying basic terms and conditions of employment as well as non-disclosure, confidentiality and non-compete provisions.

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E. Share Ownership

Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information as of March 31, 2019 regarding the beneficial ownership by each of our directors and executive officers:

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Ownership (2)
Guy Bernstein	150,000	*
Asaf Berenstin (3)	78,670	*
Udi Ertel	--	*
Ron Ettlinger	--	--
Naamit Salomon(4)	6,000	*
Sagi Schliesser	--	--
Avi Zakay	--	--
Amit Birk (5)	129,062	*
Arik Faingold	--	--
Yuval Baruch	--	--
Arik Kilman	--	--
Yakov Tsaroya (6)	40,000	*

*Less than 1%

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

(2) The percentages shown are based on 48,891,038 Ordinary Shares issued and outstanding as of March 31, 2019.

(3) Includes 50,000 currently exercisable options granted under our 2007 Stock Option Plan, having an exercise price ranging from $1.59 to $3.33 per share that expire in 2021 at the latest and 28,670 Ordinary Shares.

(4) Includes 6,000 currently exercisable options granted under our 2007 Stock Option Plan, having an exercise price of $1.59 per share, with expiration dates through 2020.

(5) Includes 30,000 currently exercisable options granted under our 2007 Stock Option Plan, having an exercise price of $3.33 per share that expire in 2021 and 99,062 Ordinary Shares.

(6) Includes 40,000 currently exercisable options granted under our 2007 Stock Option Plan, having an exercise price of $1.59 per share, with expiration dates through 2020.

Stock-Based Compensation Plans

2000 Stock Option Plan

In 2000, we adopted our 2000 Employee Stock Option Plan, or the 2000 Plan, which terminated in November 2010. No award of options can be made under this plan after such date. An option may not be exercisable after the expiration of ten years from the date of its award, except that in case of an incentive stock option made to a 10% owner (as such term is defined in the 2000 Plan), such option may not be exercisable after the expiration of five years from its date of award. No option may be exercised after the expiration of its term. Options are not assignable or transferable by the optionee, other than by will or the laws of descent and distribution, and may be exercised during the lifetime of the optionee only by the optionee or his guardian or legal representative; provided, however, that during the optionee’s lifetime, the optionee may, with the consent of the Option Committee transfer without consideration all or any portion of his options to members of the optionee’s immediate family, a trust established for the exclusive benefit of members of the optionee’s immediate family, or a limited liability company in which all members are members of the optionee’s immediate family.

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During 2018, options to purchase an aggregate of 9,375 Ordinary Shares were exercised under the 2000 Plan at an average exercise price of $6.46 per share and options to purchase 21,875 Ordinary Shares forfeited. As of December 31, 2018, no options under the 2000 Plan remained outstanding.

2007 Incentive Compensation Plan

In 2007, we adopted our 2007 Incentive Compensation Plan, or the 2007 Plan, under which we may grant options, restricted shares, restricted share units and performance awards to employees, officers, directors and consultants of our company and its subsidiaries. The shares subject to the 2007 Plan may be either authorized or unissued shares or previously issued shares acquired by our company or any of its subsidiaries. The total number of shares that may be delivered pursuant to awards under the 2007 Plan shall not exceed 1,500,000 shares in the aggregate. If any award shall expire, terminate, be cancelled or forfeited without having been fully exercised or satisfied by the issuance of shares, then the shares subject to such award shall be available again for delivery in connection with future awards under the 2007 Plan.

In September 2013, our shareholders approved a 1,000,000 share increase in the number of Ordinary Shares available for issuance under the 2007 Stock Option Plan.

On December 31, 2015 our board of directors increased the amount of Ordinary Shares reserved for issuance by an additional 250,000 Ordinary Shares and extended the plan by 10 years until August 1, 2027. As of December 31, 2018, an aggregate of 962,500 Ordinary Shares are available for future grants under the Plan.

The 2007 Plan will terminate upon the earliest of: (i) August 31, 2027; (ii) the termination of all outstanding awards in connection with a corporate transaction; or (iii) in connection with, and as a result of, any other relevant event, including the 2007 Plan’s termination by the Board of Directors.

Under the 2007 Plan, the option committee shall have full discretionary authority to grant or, when so restricted by applicable law, recommend the Board of Directors to grant, pursuant to the terms of the 2007 Plan, options and restricted shares and restricted share units to those individuals who are eligible to receive awards.

The 2007 Plan provides that each option will expire on the date stated in the award agreement, which will not be more than ten years from its date of grant. The exercise price of an option shall be determined by the option committee of the Board of Directors and set forth in the award agreement. Unless determined otherwise by the Board of Directors,

the exercise price shall be equal to, or higher than, the fair market value of our company's shares on the date of grant.

Under the 2007 Plan, restricted shares and restricted share units shall not be purchased for less than the ordinary share's par value, unless determined otherwise by the Board of Directors.

Under the 2007 Plan in the event of any reclassification, recapitalization, merger or consolidation, reorganization, stock dividend, cash dividend, distribution of subscription rights or other distribution in securities of the Company, stock split or reverse stock split, combination or exchange of shares, repurchase of shares, or other similar change in corporate structure, that proportionally apply to all of our Ordinary Shares, we, shall substitute or adjust, as applicable, the number, class and kind of securities which may be delivered under Section 4.1; the number, class and kind, and/or price (such as the Option Price of Options) of securities subject to outstanding awards; and other value determinations applicable to outstanding awards, as determined by our Board of Directors, in order to prevent dilution or enlargement of participants' rights under the 2007 Plan; provided, however, that the number of Ordinary Shares subject to any award shall always be a whole number. The Board of Directors shall also make appropriate adjustments and modifications, in the terms of any outstanding awards to reflect such changes in our share capital, including modifications of performance goals and changes in the length of performance periods, if applicable.

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Our Board of Directors may, from time to time, alter, amend, suspend or terminate the 2007 Plan, with respect to awards that have not been granted, subject to shareholder approval, if and to the extent required by applicable law. In addition, no such amendment, alteration, suspension or termination of the 2007 Plan or any award theretofore granted, shall be made which would materially impair the previously accrued rights of a participant under any outstanding award without the written consent of such participant, provided, however, that the Board of Directors may amend or alter the 2007 Plan and the option committee may amend or alter any award, including any agreement, either retroactively or prospectively, without the consent of the applicable participant, (i) so as to preserve or come within any exemptions from liability under any law or the rules and releases promulgated by the SEC, or (ii) if the Board of Directors or the option committee determines in its discretion that such amendment or alteration either is (a) required or advisable for us, the 2007 Plan or the award to satisfy, comply with or meet the requirements of any law, regulation, rule or accounting standard, or (b) not reasonably likely to significantly diminish the benefits provided under such award, or that such diminishment has been or will be adequately compensated.

During 2018, options to purchase an aggregate of 94,792 Ordinary Shares were exercised under the 2007 Plan at an average exercise price of $2.54 per share and options to purchase 220,000 Ordinary Shares remained outstanding. As of December 31, 2017, our executive officers and directors as a group, consisting of 14 persons, held options to purchase 146,000 Ordinary Shares under the 2007 Plan, having an average exercise price of $3.12 per share.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

Formula Systems, an Israeli company traded on the NASDAQ Global Select Market and the TASE, holds 22,080,468 or 45.16% of our outstanding Ordinary Shares. Formula Systems is controlled by Asseco, a Polish company listed on the Warsaw Stock Exchange, which holds 25.35% of the Ordinary Shares of Formula Systems. Guy Bernstein owns 13.4% of the outstanding shares of Formula Systems. In addition, on October 4, 2018 Asseco entered into a shareholders agreement with Mr. Bernstein, under which agreement Asseco has been granted an irrecoverable proxy to vote an additional 1,971,973 Ordinary Shares of Formula, thereby effectively giving Asseco beneficial ownership (voting power) over an aggregate of 38.25% of Formula’s outstanding ordinary share. Therefore, based on the foregoing beneficial ownership by each of Formula and Asseco, each of Formula and Asseco may be deemed to directly or indirectly (as appropriate) control us.

The following table sets forth as of March 31, 2019 certain information regarding the beneficial ownership by all shareholders known to us to own beneficially 5.0% or more of our ordinary shares:

Name

	Number of Ordinary Shares Beneficially Owned[1]	Percentage of Ownership [2]	
Formula Systems (1985) Ltd. [3]	22,080,468	45.16	%
Clal Insurance Enterprises Holdings Ltd [4]	3,630,149	7.43	%
Yelin Lapidot [5]	2,858,607	5.86	%
Phoenix Holdings [6]	2, 936,180	6.01	%
Harel Insurance [7]	2,728,908	5.58	%

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

(2) The percentages shown are based on 48,891,038 Ordinary Shares issued and outstanding as of March 31, 2019.

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(3) Asseco owned 25.35% of the outstanding shares of Formula Systems based on the Schedule 13D filed by Asseco with the SEC on October 19, 2018. As such, Asseco may be deemed to be the beneficial owner of the aggregate 22,080,468 Ordinary Shares held directly by Formula Systems. Guy Bernstein owns 12.489% of the outstanding shares of Formula Systems. In addition, on October 4, 2018 Asseco entered into a shareholders agreement with Mr. Bernstein, under which agreement Asseco has been granted an irrecoverable proxy to vote an additional 1,971,973 Ordinary Shares of Formula, thereby effectively giving Asseco beneficial ownership (voting power) over an aggregate of 38.25% of Formula's outstanding ordinary shares. Therefore, based on the foregoing beneficial ownership by each of Formula and Asseco, each of Formula and Asseco may be deemed to directly or indirectly (as appropriate) control us. The address of Asseco is 35-322 Rzeszow, ul. Olchowa 14, Poland.

(4) Based on a Schedule 13G filed on February 14, 2019, Clal Insurance Enterprises Holdings Ltd. is an Israeli public company, with a principal business address at 36 Raul Wallenberg St., Tel Aviv 66180, Israel.

(5) Based on a Schedule 13G amendment filed on February 6, 2019. The Ordinary Shares beneficially owned by Yelin are held by provident funds managed by Yelin Lapidot Provident Funds Management Ltd., or Yelin Provident, and/or mutual funds managed by Yelin Lapidot Mutual Funds Management Ltd., or Yelin Mutual. Each of Yelin Provident and Yelin Mutual is a wholly-owned subsidiary of Yelin Holdings. Messrs. Dov Yelin and Yair Lapidot each own 24.38% of the share capital and 25% of the voting rights of Yelin Holdings, and are responsible for the day-to-day management of Yelin Holdings. The Ordinary Shares beneficially owned are held for the benefit of the members of the provident funds and the mutual funds. Each of Messrs. Yelin and Lapidot, Yelin Holdings, Yelin Provident and Yelin Mutual disclaims beneficial ownership of the subject Ordinary Shares. The address of Yalin is 50 Dizengoff Street, Dizengoff Center, Gate 3, Top Tower, 13th floor, Tel Aviv 64332, Israel.

(6) Based on written notification received from The Phoenix Holding Ltd., or Phoenix Holdings, and Delek Group Ltd., subsequent to the filing by such shareholder of Amendment No. 1 of a schedule 13G on February 13, 2019. The Ordinary Shares held by Phoenix Holdings are beneficially owned by various direct or indirect, majority or wholly-owned subsidiaries of Phoenix Holdings, or the Phoenix Subsidiaries. The Phoenix Subsidiaries manage their own funds and/or the funds of others, including for holders of exchange-traded notes or various insurance policies, members of pension or provident funds, unit holders of mutual funds, and portfolio management clients. Each of the Phoenix Subsidiaries operates under independent management and makes its own independent voting and investment decisions. Phoenix Holdings is a majority-owned subsidiary of Delek Group Ltd. The majority of Delek Group Ltd.'s outstanding share capital and voting rights are owned, directly and indirectly, by Itshak Sharon (Tshuva) through private companies wholly-owned by him, and the remainder are held by the public. The address of Phoenix Holdings is Derech Hashalom 53, Givataim, 53454, Israel.

(7) Based on a Schedule 13G filed on January 29, 2019, Harel Insurance Investments & Financial Services Ltd. is an Israeli public company, with a principal business address at Harel House; 3 Aba Hillel Street; Ramat Gan 52118, Israel.

Significant Changes in the Ownership of Major Shareholders

On March 14, 2016, Formula Systems filed a Schedule 13D/A with the SEC reflecting ownership of 20,867,734 of our Ordinary Shares. According to the Schedule 13D/A, from March 11, 2014 through March 8, 2016, Formula Systems purchased an aggregate of 1,007,690 of our Ordinary Shares in open market transactions, for an aggregate purchase price of $6,395,137 increasing its ownership interest in our shares to 47.1%. In July 2018, Formula participated in our private placement (together with other institutional investors) and reported on July 30, 2018 on Schedule 13D/A that it holds 22,080,468 Ordinary Shares reflecting ownership of 45.2%.

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In the past three years, Yelin Lapidot Holdings Management Ltd. jointly with Messrs. Dov Yelin and Yair Lapidot, filed several Schedules 13G with the SEC reflecting their level of investment in our company. As of March 31, 2019 their reports indicate ownership of 2,858,607 or 5.85% of our Ordinary Shares.

Based on a Schedule 13G filed on January 29, 2019, Harel Insurance Investments & Financial Services Ltd. holds 2,728,908 or 5.58% of our Ordinary Shares.

In January 2018, Clal first filed a Schedule 13G with the SEC reflecting ownership of 2,276,349 or 5.2% of our Ordinary Shares. A Schedule 13G filed with the SEC on February 14, 2019, reflected an increase in ownership to 3,630,149, or 7.43% of our Ordinary Shares.

In the past two years, Phoenix Holdings, filed several Schedules 13G with the SEC reflecting their level of investment in our company. A Schedule 13G filed with the SEC on February 14, 2019 reflected an increase in ownership to 2,936,180, or 6.01% of our Ordinary Shares.

Major Shareholders Voting Rights

Our major shareholders do not have different voting rights.

Record Holders

Based on a review of the information provided to us by our U.S. transfer agent, as of April 22, 2019, there were 60 record holders, of which 45 record holders holding approximately 96.2% of our Ordinary Shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of these Ordinary Shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 96.1% of our outstanding Ordinary Shares as of such date).

B. Related Party Transactions

For information about related party transactions see “Item 6C. Directors, Senior Management and Employees – Board Practices - Approval of Related Party Transactions Under Israeli Law.”

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See the consolidated financial statements, including the notes thereto, included in Item 18.

Legal Proceedings

In addition to the below mentioned legal proceedings, we and our subsidiaries are, from time to time, subject to legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to intellectual property, contracts, employment and other matters. Based upon the advice of counsel, we do not believe that the ultimate resolution of these matters will materially affect our consolidated financial position, results of operations or cash flows.

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In September 2016, an Israeli software company, that was previously involved in an arbitration proceeding with us in 2015 and won damages from us for $2.4 million, filed a lawsuit seeking damages of NIS 34,106,000 against us and one of our subsidiaries. This lawsuit was filed as part of an arbitration proceeding. In the lawsuit, the software company claimed that warning letters that we sent to its clients in Israel and abroad, warning those clients against the possibility that the conversion procedure offered by the software company may amount to an infringement of our copyrights (the "Warning Letters"), as well as other alleged actions, have caused the software company damages resulting from loss of potential business. The lawsuit is based on rulings given in the 2015 arbitration proceeding in which it was allegedly ruled that the Warning Letters constituted a breach of a non-disclosure agreement (NDA) signed between the parties.

We rejected the claims by the Israeli software company and moved to dismiss the lawsuit entirely. At this point, all the relevant motions have been filed and all witnesses deposed. We are unable to make a reasonably reliable estimate of our chances of successfully defending this lawsuit.

In February 2018, Comm-IT Ltd., a subsidiary of our company, commenced an action against a customer for payment of an overdue amount in the Supreme Court of the State of New York, New York County. In April 2018, the customer filed an answer in the action that included counterclaims asserting causes of action for breach of contract, fraud and trespass to chattel. In May 2018, Comm-IT filed a reply to the counterclaims. The parties agreed to participate in a mediation before a neutral mediator in March 2019. While it appears that the allegations against Comm-IT probably do not have merit, it is difficult to predict at this point whether Comm-IT's liability is remote or probable.

Dividend Distribution Policy

In September 2012, our Board of Directors adopted a policy for distributing dividends, under which we will distribute a dividend of up to 50% of our annual distributable profits each year, subject to any applicable law. On August 2018, our Board of Directors amended our dividend distribution policy, whereas, each year we will distribute a dividend of up to 75% of our annual distributable profit. It is possible that our Board of Directors will decide, subject to the conditions stated above, to declare additional dividend distributions. Our Board of Directors may at its discretion and at any time, change, whether as a result of a one-time decision or a change in policy, the rate of dividend distributions or not to distribute a dividend.

According to the Israeli Companies Law, a registrant may distribute dividends out of its profits provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due. Notwithstanding the foregoing, dividends may be paid with the approval of a court, provided that there is no reasonable concern that such dividend distribution will prevent the company from satisfying its current and foreseeable obligations, as they become due. Profits, for purposes of the Israeli Companies Law, means the greater of retained earnings or earnings accumulated during the preceding two years, after deducting

previous distributions that were not deducted from the surpluses.

Since the adoption of our dividend policy, the following dividends have been paid:

In September 2012, we declared a cash dividend of $0.10 per share ($3.7 million in the aggregate) that was paid on October 17, 2012.

In February 2013 we declared a cash dividend of $0.12 per share ($4.4 million in the aggregate) that was paid on March 14, 2013.

In August 2013, we declared a cash dividend of $0.09 per share ($3.4 million in the aggregate) that was paid on September 3, 2013.

In February 2014, we declared a cash dividend of $0.12 per share ($4.5 million in the aggregate) that was paid on March 14, 2014.

In September 2014, we declared a cash dividend in the amount of US $0.095 per share ($4.2 million in the aggregate) that was paid on September 4, 2014.

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In February 2015, we declared a cash dividend in the amount of US $0.081 per share ($3.6 million in the aggregate), that was paid on March 11, 2015.

In August 2015, we declared a cash dividend in the amount of $0.095 per share ($4.2 million in the aggregate) that was paid on September 10, 2015.

In February 2016, we declared a cash dividend in the amount of $0.09 per share ($4.0 million in the aggregate) that was paid on March 17, 2016.

In August 2016, we declared a cash dividend in the amount of $0.085 per share ($3.8 million in the aggregate) that was paid on September 22, 2016.

In February 2017, we declared a cash dividend in the amount of $0.085 per share ($3.8 million in the aggregate) that was paid on April 5, 2017.

In August 2017, we declared a cash dividend in the amount of $0.13 per share ($5.8 million in the aggregate) that was paid on September 13, 2017.

In February 2018, we declared a cash dividend in the amount of $0.13 per share ($5.8 million in the aggregate) that was paid on March 26, 2018.

In August 2018, we declared a cash dividend in the amount of $0.155 per share ($7.6 million in the aggregate) that was paid on September 5, 2018.

In March 2019, we declared a cash dividend in the amount of $0.15 per share ($7.3 million in the aggregate) that was paid on March 27, 2019.

B. Significant Changes

Except as otherwise disclosed in this annual report, no significant change has occurred since December 31, 2018.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

Our ordinary shares are traded on the NASDAQ Global Select Market under the ticker symbol “MGIC”.

B. Plan of Distribution

Not applicable.

C. Markets

Our Ordinary Shares were listed on the NASDAQ Global Market (symbol: MGIC) from our initial public offering in the United States on August 16, 1991 until January 3, 2011, at which date the listing of our Ordinary Shares was transferred to the NASDAQ Global Select Market. Since November 16, 2000, our Ordinary Shares have also traded on the TASE, and on December 15, 2011 they have been included in the TASE’s TA-125 Index.

D. Selling Shareholders

Not applicable.

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E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Set out below is a description of certain provisions of our Articles of Association and of the Israeli Companies Law related to such provisions. This description is only a summary and does not purport to be complete and is qualified by reference to the full text of the Articles of Association, which are incorporated by reference as an exhibit to this Annual Report.

Purposes and Objects of the Company

We are a public company registered with the Israeli Companies Registry as Magic Software Enterprises Ltd., registration number 52-003674-0. Section 2 of our memorandum of association provides that we were established for the purpose of engaging in all fields of the computer business and in any other lawful activity permissible under Israeli law.

The Powers of the Directors

According to our articles of association, and under the limitations described therein, our board of directors may cause the company to borrow or secure the payment of any sum or sums of money for the purposes of the company, and set aside any amount out of our profits as a reserve for any purpose.

Under our articles of association, retirement of directors from office is not subject to any age limitation and our directors are not required to own shares in our company in order to qualify to serve as directors.

Rights Attached to Shares

Our authorized share capital consists of 50,000,000 Ordinary Shares of a nominal value of NIS 0.1 each. All outstanding Ordinary Shares are validly issued, fully paid and non-assessable. The rights attached to the Ordinary Shares are as follows:

Dividend rights. Holders of our Ordinary Shares are entitled to the full amount of any cash or share dividend subsequently declared. The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. See “Item 8A. Financial Information – Consolidated and Other Financial Information – Dividend Distributions Policy.” All unclaimed dividends or other monies payable in respect of a share may be invested or otherwise made use of by the Board of Directors for our benefit until claimed. Any dividend unclaimed after a period of three years from the date of declaration of such dividend will be forfeited and will revert to us; provided, however, that the Board of Directors may, at its discretion, cause us to pay any such dividend to a person who would have been entitled thereto had the same not reverted to us. We are not obligated to pay interest or linkage differentials on an unclaimed dividend.

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Voting rights. Holders of Ordinary Shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future subject to the provisions of Israeli law.

The quorum required at any meeting of shareholders consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least one-third (33%) of the voting rights in the company. A meeting adjourned for lack of a quorum is generally adjourned to the same day in the following week at the same time and place or any time and place as the directors designate in a notice to the shareholders. At the reconvened meeting, the required quorum consists of any two members present in person or by proxy. Under our articles of association, all resolutions require approval of no less than a majority of the voting rights represented at the meeting in person or by proxy and voting thereon.

Pursuant to our articles of association, our directors (except external directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our Board of Directors (except the external directors) may be reelected upon completion of their term of office. Asseco, our controlling shareholder, and Formula Systems, our parent company, will be able to exercise control over the election of our directors (subject to a special majority required for the election of external directors). See “Item 7A. Major Shareholders and Related Party Transactions – Major Shareholders.” For information regarding the election of external directors, see “Item 6C. Directors, Senior Management and Employees – Board Practices -- Election of Directors.”

Rights to share in the company’s profits. Our shareholders have the right to share in our profits distributed as a dividend and any other permitted distribution. See this Item 10B. “Additional Information – Memorandum and Articles of Association – Rights Attached to Shares – Dividend Rights.”

Rights to share in surplus in the event of liquidation. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of Ordinary Shares in proportion to the nominal value of their holdings. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future ***subject to Israeli law.***

Liability to capital calls by the company. Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders to provide us with additional funds is limited to the par value of the shares held by them.

Limitations on any existing or prospective major shareholder. See Item 6C. "Directors and Senior Management –Board Practices – Approval of Related Party Transactions Under Israeli Law."

Changing Rights Attached to Shares

According to our articles of association, the rights attached to any class of shares may be modified or abrogated by us, subject to the consent in writing of, or sanction of a resolution passed by, the holders of a majority of the issued shares of such class at a separate general meeting of the holders of the shares of such class.

Annual and Extraordinary Meetings

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

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Limitations on the Rights to Own Securities in Our Company

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

Provisions Restricting Change in Control of Our Company

See Item 6C. “Provisions Restricting Change in Control of Our Company” and Item 6C “Directors, Senior Management and Employees – Board Practices – Approval of Related Party Transactions Under Israeli Law.”

C. Material Contracts

While we have numerous contracts with customers, resellers, distributors and property owners, we do not deem any such individual contract to be material contracts that are not in the ordinary course of our business.

D. Exchange Controls

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our Ordinary Shares.

Non-residents of Israel who purchase our Ordinary Shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our Ordinary Shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

E. Taxation

The following is a discussion of Israeli and United States tax consequences material to our shareholders. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the appropriate tax authorities or the courts. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

Holders of our Ordinary Shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of Ordinary Shares, including, in particular, the effect of any foreign, state or local taxes.

Israeli Tax Considerations

Tax regulations have a material impact on our business, particularly in Israel where we have our headquarters. The following is a summary of some of the current tax law applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of specified Israeli tax consequences to our shareholders and government programs benefiting us. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

General Corporate Tax Structure

Generally, Israeli companies are subject to corporate tax on their taxable income. As of 2018 the corporate tax rate is 23%. However, the effective tax rate payable by a company that derives income from an AE, BE, PFE or a PTE, in each case, as defined and further discussed below, may be considerably lower. See “Law for the Encouragement of Capital Investments” in this Item 5.A below. In addition, Israeli companies are currently subject to regular corporate tax rate on their capital gains. Besides being subject to the general corporate tax rules in Israel, certain of our Israeli subsidiaries have also, from time to time, applied for and received certain grants and tax benefits from, and participate in, programs sponsored by the Government of Israel, as described below.

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Law for the Encouragement of Industry (Taxes), 1969

The Law for the Encouragement of Industry (Taxes), 5729-1969 (the "**Industry Encouragement Law**") provides several tax benefits for an "Industrial Company." Pursuant to the Industry Encouragement Law, a company qualifies as an Industrial Company if it is an Israeli resident company which was incorporated in Israel and at least 90% of its income in any tax year (other than income from certain government loans) is generated from an "Industrial Enterprise" that it owns and is located in Israel. An "Industrial Enterprise" is defined as an enterprise whose major activity, in a given tax year, is industrial production.

An Industrial Company is entitled to certain tax benefits, including:

Deduction of the cost of the purchases of patents, or the right to use a patent or know-how used for the development or promotion of the Industrial Enterprise, over an eight-year period commencing on the year in which such rights were first exercised;

The right to elect, under certain conditions, to file a consolidated tax return together with Israeli Industrial Companies controlled by it; and

Accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

We believe that certain of our Israeli subsidiaries currently qualify as Industrial Companies within the definition under the Industry Encouragement Law. We cannot assure you that they will continue to qualify as Industrial Companies or that the benefits described above will be available in the future.

Law for the Encouragement of Capital Investments, 5719-1959

The Law for the Encouragement of Capital Investments, 5719-1959, or the Investment Law, provides certain incentives for capital investments in a production facility (or other eligible assets). Generally, an investment program that is implemented in accordance with the provisions of the Investment Law, referred to as an Approved Enterprise,

or AE, a Benefitted Enterprise, or BE, or a Preferred Enterprise, or PE, is entitled to benefits as discussed below. These benefits may include cash grants from the Israeli government and tax benefits, based upon, among other things, the geographic location in Israel of the facility in which the investment is made. In order to qualify for these incentives, an AE, a Benefitted Enterprise or a Preferred Enterprise is required to comply with the requirements of the Investment Law.

The Investment Law has been amended several times over the recent years, with the three most significant changes effective as of April 1, 2005 (referred to as the 2005 Amendment), as of January 1, 2011 (referred to as the 2011 Amendment) and as of January 1, 2017 (referred to as the 2017 Amendment). Pursuant to the 2005 Amendment, tax benefits granted in accordance with the provisions of the Investment Law prior to its revision by the 2005 Amendment remain in force but any benefits granted subsequently are subject to the provisions of the amended Investment Law. Similarly, the 2011 Amendment introduced new benefits instead of the benefits granted in accordance with the provisions of the Investment Law prior to the 2011 Amendment. However, companies entitled to benefits under the Investment Law as in effect up to January 1, 2011 were entitled to choose to continue to enjoy such benefits, provided that certain conditions are met, or elect instead, irrevocably, to forego such benefits and elect the benefits of the 2011 Amendment. The 2017 Amendment introduces new benefits for Technological Enterprises, alongside the existing tax benefits.

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Tax benefits for Approved Enterprises, or AE, approved before April 1, 2005

Under the Investment Law prior to the 2005 Amendment, a company that wished to receive benefits on its investment program that is implemented in accordance with the provisions of the Investment Law (referred to as an AE), had to receive an approval from the Israeli Authority for Investments and Development of the Industry and Economy (referred to as the Investment Center). Each certificate of approval for an AE relates to a specific investment program, delineated both by the financial scope of the investment, including sources of funds, and by the physical characteristics of the facility or other assets.

An AE may elect to forego any entitlement to the cash grants otherwise available under the Investment Law and, instead, participate in an alternative benefits program. Under the alternative benefits program, a company's undistributed income derived from an AE will be exempt from corporate tax for a period of between two and ten years from the first year of taxable income, depending on the geographic location within Israel of the AE, and a reduced corporate tax rate of between 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in the company in each year, as detailed below. The benefits period under AE status is limited to 12 years from the year in which the production commenced (as determined by the Investment Center), or 14 years from the year of receipt of the approval as an AE, whichever ends earlier. If a company has more than one AE program or if only a portion of its capital investments are approved, its effective tax rate is the result of a weighted combination of the applicable rates. The tax benefits available under any certificate of approval relate only to taxable income attributable to the specific program and are contingent upon meeting the criteria set out in the certificate of approval. Income derived from activity that is not integral to the activity of the AE will not enjoy tax benefits.

A company that has an AE program is eligible for further tax benefits, if it qualifies as a Foreign Investors' Company, or FIC. An FIC eligible for benefits is essentially a company with a level of foreign investment, as defined in the Investment Law, of more than 25%. The level of foreign investment is measured as the percentage of rights in the company (in terms of shares, rights to profits, voting and appointment of directors), and of combined share and loan capital, that are owned, directly or indirectly, by persons who are not residents of Israel. The determination as to whether or not a company qualifies as an FIC is made on an annual basis. An FIC that has an AE program will be eligible for an extension of the period during which it is entitled to tax benefits under its AE status (so that the benefits period may be up to ten years) and for further tax benefits if the level of foreign investment is 49% or more. If a company that has an AE program is a wholly owned subsidiary of another company, then the percentage of foreign investment is determined based on the percentage of foreign investment in the parent company.

The corporate tax rates and related levels of foreign investments with respect to an FIC that has an AE program are set forth in the following table:

Percentage of non-Israeli ownership

	Corporate Tax Rate	
Over 25% but less than 49%	25	%
49% or more but less than 74%	20	%
74% or more but less than 90%	15	%
90% or more	10	%

A company that has elected to participate in the alternative benefits program and that subsequently pays a dividend out of the income derived from the portion of its facilities that have been granted AE status during the tax exemption period will be subject to tax in respect of the amount of dividend distributed (grossed up to reflect such pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate that would have been otherwise applicable if such income had not been tax-exempted under the alternative benefits program. This rate generally ranges from 10% to 25%, depending on the level of foreign investment in the company in each year as explained above.

In addition, dividends paid out of income attributed to an AE (or out of dividends received from a company whose income is attributed to an AE) are generally subject to withholding tax at the rate of 15%, or at a lower rate provided under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). The 15% tax rate is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. After this period, the withholding tax is applied at a rate of up to 30%, or at a lower rate under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). In the case of an FIC, the 12-year limitation on reduced withholding tax on dividends does not apply.

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The Investment Law also provides that an AE is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program in the first five years of using the equipment. This benefit is an incentive granted by the Israeli government regardless of whether the alternative benefits program is elected.

The benefits available to an AE are subject to the fulfillment of conditions stipulated in the Investment Law and its regulations and the criteria in the specific certificate of approval with respect thereto, as described above. If a company does not meet these conditions, it would be required to refund the amount of tax benefits, adjusted to the Israeli consumer price index and interest, or other monetary penalty.

Tax Benefits Subsequent to the 2005 Amendment

The 2005 Amendment applies to new investment programs commencing after 2004, but does not apply to investment programs approved prior to April 1, 2005. The 2005 Amendment provides that terms and benefits included in any certificate of approval that was granted before the 2005 Amendment became effective (April 1, 2005) will remain subject to the provisions of the Investment Law as in effect on the date of such approval. Pursuant to the 2005 Amendment, the Investment Center will continue to grant AE status to qualifying investments. The 2005 Amendment, however, limits the scope of enterprises that may be approved by the Investment Center by setting criteria for the approval of a facility as an AE.

An enterprise that qualifies under the new provisions is referred to as a BE, rather than AE. The 2005 Amendment provides that a certificate of approval from the Investment Center will only be necessary for receiving cash grants. As a result, it was no longer necessary for a company to obtain the advance approval of the Investment Center in order to receive the tax benefits previously available under the alternative benefits track. Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set forth in the 2005 Amendment. A company that has a BE may, at its discretion, approach the Israel Tax Authority for a pre-ruling confirming that it is in compliance with the provisions of the Investment Law.

Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities) which are generally required to derive more than 25% of their business income from export to specific markets with a population of at least 14 million in 2012 (such export criteria will further be increased in the future by 1.4% per annum). In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment that meets certain conditions set forth in the amendment for tax benefits, including exceeding a minimum investment amount specified in the Investment Law. Such investment entitles a company to receive a BE status with respect to the investment, and may be made over a period of no more than three years ending in the end of the year in which the company chose to have the tax benefits apply to its BE. Where a company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered to be a BE and the company’s effective tax rate will be the weighted average of the applicable rates. In such case, the minimum investment required in order to qualify as a BE

must exceed a certain percentage of the value of the company's production assets before the expansion.

The extent of the tax benefits available under the 2005 Amendment to qualifying income of a BE depends on, among other things, the geographic location in Israel of the BE. The location will also determine the period for which tax benefits are available. Such tax benefits include an exemption from corporate tax on undistributed income generated by the BE for a period of between two to ten years, depending on the geographic location of the BE in Israel, and a reduced corporate tax rate of between 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in the company in each year, as explained above. The benefits period is limited to 12 or 14 years from the year the company first chose to have the tax benefits apply, depending on the location of the company.

A company qualifying for tax benefits under the 2005 Amendment which pays a dividend out of income derived by its BE during the tax exemption period will be subject to corporate tax in respect of the amount of the dividend distributed (grossed-up to reflect the pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate which would have otherwise been applicable. Dividends paid out of income attributed to a BE (or out of dividends received from a company whose income is attributed to a BE) are generally subject to withholding tax at source at the rate of 15% or at a lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). The reduced rate of 15% is limited to dividends and distributions out of income attributed to a Beneficiary Enterprise during the benefits period and actually paid at any time up to 12 years thereafter except with respect to an FIC, in which case the 12-year limit does not apply.

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The benefits available to a BE are subject to the continued fulfillment of conditions stipulated in the Investment Law and its regulations. If a company does not meet these conditions, it would be required to refund the amount of tax benefits, adjusted to the Israeli consumer price index, and interest, or other monetary penalties.

Tax benefits under the 2011 Amendment

The 2011 Amendment, effective January 1, 2011. canceled the availability of the benefits granted in accordance with the provisions of the Investment Law prior to 2011 and, instead, introduced new benefits for income generated by a "Preferred Company" through its PFE (as such terms are defined in the Investment Law) as of January 1, 2011. A Preferred Company is defined as either (i) a company incorporated in Israel which is not wholly owned by a governmental entity or (ii) a limited partnership that (a) was registered under the Israeli Partnerships Ordinance and (b) all of its limited partners are companies incorporated in Israel, but not all of them are governmental entities; which has, among other things, PFE status and is controlled and managed from Israel. Pursuant to the 2011 Amendment, a Preferred Company is entitled to a reduced corporate tax rate of 15% with respect to its preferred income, or PFI, attributed to its PFE in 2011 and 2012, unless the PFE is located in a certain development zone, in which case the rate will be 10%. Such corporate tax rate was reduced to 12.5% and 7%, respectively, in 2013 and was increased to 16% and 9%, respectively, in 2014 until 2016. Pursuant to the 2017 Amendment, in 2017 and thereafter, the corporate tax rate for a PFE that is located in a specified development zone was decreased to 7.5%, while the reduced corporate tax rate for other development zones remains 16%. Income derived by a Preferred Company from a 'Special PFE' (as such term is defined in the Investment Law) would be entitled, during a benefits period of 10 years, to further reduced tax rates of 8%, or 5% if the Special PFE is located in a certain development zone. As of January 1, 2017, the definition for 'Special PFE' includes less stringent conditions.

Dividends paid out of preferred income attributed to a PFE or to a Special PFE are generally subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). However, if such dividends are paid to an Israeli company, no tax is required to be withheld (although, if such dividends are subsequently distributed to individuals or a non-Israeli company, withholding tax at a rate of 20% or such lower rate as may be provided in an applicable tax treaty will apply).

The 2011 Amendment also provided transitional provisions to address companies already enjoying current benefits under the Investment Law. These transitional provisions provide, among other things, that unless an irrevocable request is made to apply the provisions of the Investment Law as amended in 2011 with respect to income to be derived as of January 1, 2011: (i) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, which chose to receive grants, before the 2011 Amendment became effective, will remain subject to the provisions of the Investment Law as in effect on the date of such approval, and subject to certain conditions; and (ii) the terms and benefits included in any certificate of approval that was granted to an AE, that had participated in an alternative benefits program, before the 2011 Amendment became effective, will remain subject to the provisions of the Investment Law as in effect on the date of such approval, provided that certain conditions are

met. We and one of our Israeli subsidiaries have elected to apply the new incentives regime under the Amendment to our industrial activity in Israel starting in 2014.

New Tax benefits under the 2017 Amendment that became effective on January 1, 2017

The 2017 Amendment was enacted as part of the Economic Efficiency Law that was published on December 29, 2016, and is effective as of January 1, 2017, subject to the publication of regulations expected to be released before March 31, 2017. The 2017 Amendment provides new tax benefits for two types of "Technology Enterprises", as described below, and is in addition to the other existing tax beneficial programs under the Investment Law.

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The 2017 Amendment provides that a technology company satisfying certain conditions will qualify as a "Preferred Technology Enterprise", or PTE, and will thereby enjoy a reduced corporate tax rate of 12% on income that qualifies as "Preferred Technology Income", or PTI, as defined in the Investment Law. The tax rate is further reduced to 7.5% for a PTE located in development zone A. In addition, a Preferred Technology Company will enjoy a reduced corporate tax rate of 12% on capital gain derived from the sale of certain "Benefited Intangible Assets" (as defined in the Investment Law) to a related foreign company if the Benefited Intangible Assets were acquired from a foreign company on or after January 1, 2017 for at least NIS 200 million, and the sale receives prior approval from the National Authority for Technological Innovation (referred to as NATI).

The 2017 Amendment further provides that a technology company satisfying certain conditions will qualify as a "Special Preferred Technology Enterprise", or Special PTE, (an enterprise for which total consolidated revenues of its parent company and all subsidiaries exceed NIS 10 billion) and will thereby enjoy a reduced corporate tax rate of 6% on "Preferred Technology Income", or PTI, regardless of the company's geographic location within Israel. In addition, a Special PTE will enjoy a reduced corporate tax rate of 6% on capital gain derived from the sale of certain "Benefited Intangible Assets" to a related foreign company if the Benefited Intangible Assets were either developed by an Israeli company or acquired from a foreign company on or after January 1, 2017, and the sale received prior approval from NATI. A Special PTE that acquires Benefited Intangible Assets from a foreign company for more than NIS 500 million will be eligible for these benefits for at least ten years, subject to certain approvals as specified in the Investment Law.

Dividends distributed by a PTE or a Special PTE, paid out of PTI, are subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). However, if such dividends are paid to an Israeli company, no tax is required to be withheld (although, if such dividends are subsequently distributed from such Israeli company to individuals or a non-Israeli company, withholding tax at a rate of 20% or such lower rate as may be provided in an applicable tax treaty will apply). If such dividends are distributed to a foreign company and other conditions are met, the withholding tax rate will be 4%.

We examined the impact of the 2017 Amendment and the degree to which we will qualify as a PTE or Special PTE, and the amount of PTI that we may have, or other benefits that we may receive, from the 2017 Amendment. Beginning in 2017, part of the Company taxable income in Israel is entitled to a preferred 12% tax rate under Amendment 73 to the Investment Law.

Tax Benefits and Grants for Research and Development

Israeli tax law allows, under certain conditions, a tax deduction for research and development expenditures, including capital expenditures, for the year in which they are incurred. Such expenditures must relate to scientific research and

development projects, and must be approved by the relevant Israeli government ministry, determined by the field of research. Furthermore, the research and development must be for the promotion of the company's business and carried out by or on behalf of the company seeking such tax deduction. However, the amount of such deductible expenses is reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period. However, expenditures made out of proceeds made available to us through government grants are not deductible according to Israeli law.

Israeli Capital Gains Tax

The following is a short summary of the material provisions of the tax environment to which shareholders may be subject. This summary is based on the current provisions of tax law. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the appropriate tax authorities or the courts.

The summary does not address all of the tax consequences that may be relevant to all purchasers of our Ordinary Shares in light of each purchaser's particular circumstances and specific tax treatment. For example, the summary below does not address the tax treatment of residents of Israel and traders in securities who are subject to specific tax regimes. As individual circumstances may differ, holders of our Ordinary Shares should consult their own tax adviser as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of Ordinary Shares. The following is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations. Each individual should consult his or her own tax or legal adviser.

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Tax Consequences Regarding Disposition of Our Ordinary Shares

Overview

Israeli law generally imposes a capital gain tax on the sale of capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares of Israeli companies, by both residents and non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the seller's country of residence provides otherwise. The Ordinance distinguishes between "Real Capital Gain" and "Inflationary Surplus". The Inflationary Surplus is a portion of the total capital gain, which is equivalent to the increase of the relevant asset's purchase price, which is attributable to the increase in the Israeli consumer price index or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The Real Capital Gain is the excess of the total capital gain over the Inflationary Surplus.

Israeli Resident Shareholders

As of January 1, 2006, the tax rate applicable to Real Capital Gain derived by Israeli individuals from the sale of shares which had been purchased on or after January 1, 2003, whether or not listed on a stock exchange, is 20%, unless such shareholder claims a deduction for interest and linkage differences expenses in connection with the purchase and holding of such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a Substantial Shareholder (i.e., a person who holds, directly or indirectly, alone or together with another, 10% or more of any of the company's "means of control" (including, among other things, the right to receive profits of the company, voting rights, the right to receive the company's liquidation proceeds and the right to appoint a director)) at the time of sale or at any time during the preceding 12-month period, such gain will be taxed at the rate of 25%. Individual shareholders dealing in securities in Israel are taxed at their marginal tax rates applicable to business income (up to 50% in 2017).

Notwithstanding the foregoing, pursuant to the Law for Change in the Tax Burden (Legislative Amendments) (Taxes), 2011, the capital gain tax rate applicable to individuals was raised from 20% to 25% from 2012 and onwards (or from 25% to 30% if the selling individual shareholder is a Substantial Shareholder at any time during the 12-month period preceding the sale and/or claims a deduction for interest and linkage differences expenses in connection with the purchase and holding of such shares). With respect to assets (not shares that are listed on a stock exchange) purchased on or after January 1, 2003, the portion of the gain generated from the date of acquisition until December 31, 2011 will be subject to the previous capital gain tax rates (20% or 25%) and the portion of the gain generated from January 1, 2012 until the date of sale will be subject to the new tax rates (25% or 30%).

Under current Israeli tax legislation, the tax rate applicable to Real Capital Gain derived by Israeli resident corporations from the sale of shares of an Israeli company is the general corporate tax rate. As described above, starting in 2018 the corporate tax rate is 23%.

Non-Israeli Resident Shareholders

Israeli capital gain tax is imposed on the disposal of capital assets by a non-Israeli resident if such assets are either (i) located in Israel; (ii) shares or rights to shares in an Israeli resident company; or (iii) represent, directly or indirectly, rights to assets located in Israel, unless a tax treaty between Israel and the seller's country of residence provides otherwise. As mentioned above, Real Capital Gain is generally subject to tax at the corporate tax rate (24% in 2017 and 23% in 2018 and thereafter) if generated by a company, or at the rate of 25% (for assets other than shares that are listed on stock exchange – 20% for the portion of the gain generated up to December 31, 2011) or 30% (for any asset other than shares that are listed on stock exchange – 25% with respect to the portion of the gain generated up to December 31, 2011), if generated by an individual from the sale of an asset purchased on or after January 1, 2003. Individual and corporate shareholders dealing in securities in Israel are taxed at the tax rates applicable to business income (a corporate tax rate for a corporation and a marginal tax rate of up to 50% for an individual in 2018).

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Notwithstanding the foregoing, shareholders who are non-Israeli residents (individuals and corporations) are generally exempt from Israeli capital gain tax on any gains derived from the sale, exchange or disposition of shares publicly traded on the Tel Aviv Stock Exchange or on a recognized stock exchange outside of Israel, provided, among other things, that (i) such gains are not generated through a permanent establishment that the non-Israeli resident maintains in Israel, (ii) the shares were purchased after being listed on a recognized stock exchange, and (iii) with respect to shares listed on a recognized stock exchange outside of Israel, such shareholders are not subject to the Israeli Income Tax Law (Inflationary Adjustments) 5745-1985. However, non-Israeli corporations will not be entitled to the foregoing exemptions if Israeli residents (a) have a controlling interest of more than 25% in such non-Israeli corporation, or (b) are the beneficiaries of or are entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly. Such exemption is not applicable to a person whose gains from selling or otherwise disposing of the shares are deemed to be business income.

In addition, a sale of shares may be exempt from Israeli capital gain tax under the provisions of an applicable tax treaty. For example, under the U.S.-Israel Tax Treaty, or the U.S-Israel Treaty, the sale, exchange or disposition of shares of an Israeli company by a shareholder who is a U.S. resident (for purposes of the U.S.-Israel Treaty) holding the shares as a capital asset is exempt from Israeli capital gain tax unless either (i) the shareholder holds, directly or indirectly, shares representing 10% or more of the voting rights during any part of the 12-month period preceding such sale, exchange or disposition; (ii) the shareholder, if an individual, has been present in Israel for a period or periods of 183 days or more in the aggregate during the applicable taxable year; or (iii) the capital gain arising from such sale are attributable to a permanent establishment of the shareholder which is maintained in Israel. In each case, the sale, exchange or disposition of such shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Treaty, a U.S. resident would be permitted to claim a credit for the Israeli tax against the U.S. federal income tax imposed with respect to the sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S-Israel Treaty does not provide such credit against any U.S. state or local taxes.

In some instances, where our shareholders may be liable for Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at source. Shareholders may be required to demonstrate that they are exempt from tax on their capital gains in order to avoid withholding at source at the time of sale. Specifically, in transactions involving a sale of all of the shares of an Israeli resident company, in the form of a merger or otherwise, the Israel Tax Authority may require from shareholders who are not liable for Israeli tax to sign declarations in forms specified by this authority or obtain a specific exemption from the Israel Tax Authority to confirm their status as non-Israeli resident, and, in the absence of such declarations or exemptions, may require the purchaser of the shares to withhold taxes at source.

Israeli Tax on Dividend Income

Israeli Resident Shareholders

Israeli residents who are individuals are generally subject to Israeli income tax for dividends paid on our Ordinary Shares (other than bonus shares or share dividends) at 25%, or 30% if the recipient of such dividend is a Substantial Shareholder at the time of distribution or at any time during the preceding 12-month period. However, dividends distributed from taxable income accrued during the benefits period of an AE are subject to withholding tax at the rate of 15% (if the dividend is distributed during the tax benefits period under the Investment Law or within 12 years after such period) or 20% with respect to PFE. An average rate will be set in case the dividend is distributed from mixed types of income (regular and Approved/ Preferred income).

Israeli resident corporations are generally exempt from Israeli corporate tax for dividends paid on shares of Israeli resident corporations (like our Ordinary Shares). However, dividends distributed from taxable income accrued during the benefits period of an Approved Enterprise are subject to withholding tax at the rate of 15%, if the dividend is distributed during the tax benefits period under the Investment Law or within 12 years after such period.

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Non-Israeli Resident Shareholders

Non-Israeli residents (whether individuals or corporations) are generally subject to Israeli income tax on the receipt of dividends paid on ordinary shares, like our Ordinary Shares, at the rate of 25% or 30% (if the dividend recipient is a Substantial Shareholder at the time of distribution or at any time during the preceding 12-month period) or 15% if the dividend is distributed from income attributed to our AE or 20% with respect to PFE. Such dividends are generally subject to Israeli withholding tax at a rate of 25% so long as the shares are registered with a Nominee Company (whether the recipient is a Substantial Shareholder or not), and 15% if the dividend is distributed from income attributed to an AE or 20% if the dividend is distributed from income attributed to a PFE, unless a reduced rate is provided under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). For example, under the U.S-Israel Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our Ordinary Shares who is a U.S. resident (for purposes of the U.S.-Israel Treaty) is 25%. However, generally, the maximum rate of withholding tax on dividends, not generated by our Approved Enterprise, that are paid to a U.S. corporation holding at least 10% or more of our outstanding voting capital from the start of the tax year preceding the distribution of the dividend through (and including) the distribution of the dividend, is 12.5%, provided that no more than 25% of our gross income for such preceding year consists of certain types of dividends and interest. Notwithstanding the foregoing, dividends distributed from income attributed to an AE are subject to a withholding tax rate of 15% for such a U.S. corporation shareholder, provided that the condition related to our gross income for the previous year (as set forth in the previous sentence) is met. If the dividend is attributable partly to income derived from an AE, or a PFE, and partly to other sources of income, the withholding rate will be a blended rate reflecting the relative portions of the two types of income. U.S. residents who are subject to Israeli withholding tax on a dividend may be entitled to a credit or deduction for U.S. federal income tax purposes in the amount of the taxes withheld, subject to detailed rules contained in United States tax legislation.

A non-Israeli resident who receives dividends from which tax was withheld is generally exempt from the obligation to file tax returns in Israel with respect to such income, provided that (i) such income was not generated from business conducted in Israel by the taxpayer, and (ii) the taxpayer has no other taxable sources of income in Israel with respect to which a tax return is required to be filed.

Excess Tax

Individuals who are subject to tax in Israel (whether any such individual is an Israeli resident or non-Israeli resident) are also subject to an additional tax for income exceeding a certain level. For 2018 and onwards, the additional tax is at a rate of 3% on annual income exceeding NIS 640,000, which amount is linked to the annual change in the Israeli consumer price index, including, but not limited to, dividends, interest and capital gain.

Estate and Gift Tax

Israeli law presently does not impose estate or gift taxes.

United States Federal Income Tax Considerations

The following is a description of the material U.S. federal income tax consequences of the acquisition, ownership and disposition of our Ordinary Shares. This description addresses only the U.S. federal income tax considerations that are relevant to U.S. Holders (as defined below) who hold our Ordinary Shares as capital assets. This summary is based on the U.S. Internal Revenue Code of 1986, as amended, or the Code, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, or the Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. There can be no assurance that the U.S. Internal Revenue Service, or the IRS, will not take a different position concerning the tax consequences of the acquisition, ownership and disposition of our Ordinary Shares or that such a position would not be sustained. This description does not address all tax considerations that may be relevant with respect to an investment in our Ordinary Shares. In addition, this description does not account for the specific circumstances of any particular investor, such as:

broker-dealers;

financial institutions;

certain insurance companies;

investors liable for alternative minimum tax;

regulated investment companies, real estate investment trusts, or grantor trusts;

dealers or traders in securities, commodities or currencies;

tax-exempt organizations;

non-resident aliens of the United States or taxpayers whose functional currency is not the U.S. dollar;

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persons who hold the ordinary shares through partnerships or other pass-through entities;

persons who acquire their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services;

direct, indirect or constructive owners of investors that actually or constructively own 10% or more of our shares by vote or value; or

investors holding ordinary shares as part of a straddle, appreciated financial position, a hedging transaction or conversion transaction.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns our Ordinary Shares, the U.S. federal income tax treatment of a partner in such a partnership will generally depend upon the status of the partner and the activities of the partnership. A partnership that owns our Ordinary Shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of Ordinary Shares.

This summary does not address the effect of any U.S. federal taxation (such as estate and gift tax) other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or non-U.S. taxation. You are urged to consult your tax advisors regarding the non-U.S. and U.S. federal, state and local tax consequences of an investment in ordinary shares.

For purposes of this summary, as used herein, the term “U.S. Holder” means a person that is eligible for the benefits of the Treaty and is a beneficial owner of an ordinary share who is, for U.S. federal income tax purposes:

an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;

a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any political subdivision thereof;

an estate the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust if such trust has validly elected to be treated as a U.S. person for U.S. federal income tax purposes or if (1) a court within the United States is able to exercise primary supervision over its administration and (2) one or more U.S.

persons have the authority to control all of the substantial decisions of such trust.

Unless otherwise specifically indicated, this discussion does not consider the U.S. tax consequences to a person that is not a U.S. holder (which we refer to as a non-U.S. holder) and considers only U.S. holders that will own our Ordinary Shares as capital assets (generally, for investment).

Furthermore, unless otherwise indicated, this discussion assumes that the Company is not, and will not become, a "passive foreign investment company," or a PFIC, for U.S. federal income tax purposes. See *"—**Passive Foreign Investment Companies***" below.

Taxation of Distributions

Subject to the discussion below under the heading *"—Passive Foreign Investment Companies*," the gross amount of any distributions received with respect to our Ordinary Shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Because we do not expect to maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that the entire amount of any distribution will generally be reported as dividend income to you. Dividends are included in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits would be treated as a non-taxable return of capital to the extent of your tax basis in our Ordinary Shares and any amount in excess of your tax basis will be treated as gain from the sale of ordinary shares. See "*—Disposition of Ordinary Shares*" below for a discussion of the taxation of capital gains. Our dividends would not qualify for the dividends-received deduction generally available to corporations under section 243 of the Code.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld therefrom, will be included in your income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day such dividends are received, regardless of whether the payment is in fact converted into U.S. dollars. A U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at an exchange rate other than the rate in effect on such day may have a foreign currency exchange gain or loss that would be treated as U.S.-source ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

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Subject to complex limitations, some of which vary depending upon the U.S. Holder's circumstances, any Israeli withholding tax imposed on dividends paid with respect to our Ordinary Shares, at a rate not exceeding the applicable rate provided by the Treaty, will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against income in determining such tax liability). Israeli taxes withheld in excess of the applicable rate allowed by the Treaty (if any) will not be eligible for credit against a U.S. Holder's federal income tax liability. The limitation on foreign income taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends generally will be treated as foreign-source passive category income or, in the case of certain U.S. Holders, general category income for U.S. foreign tax credit purposes. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate (see discussion below). A U.S. Holder may be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on our Ordinary Shares if such U.S. Holder fails to satisfy certain minimum holding period requirements or to the extent such U.S. Holder's position in ordinary shares is hedged. An election to deduct foreign taxes instead of claiming foreign tax credit applies to all foreign taxes paid or accrued in the taxable year. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your own tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations (including the PFIC rules discussed below), "qualified dividend income" received by a non-corporate U.S. Holder will be subject to tax at the lower long-term capital gain rates (currently at 20%). Distributions taxable as dividends paid on our Ordinary Shares should qualify for a reduced rate provided that either: (i) we are entitled to benefits under the Treaty, or (ii) our Ordinary Shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that our Ordinary Shares currently are readily tradable on an established securities market in the United States (see discussion below). However, no assurance can be given that our Ordinary Shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied, nor does it apply to dividends received from a PFIC (see discussion below), in respect of certain risk-reduction transactions, or in certain other situations. The legislation enacting the reduced tax rate on qualified dividend income contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of our Ordinary Shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

Sale or Disposition of Ordinary Shares

Subject to the discussion of PFIC rules below, if you sell or otherwise dispose of our Ordinary Shares, you will generally recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and your adjusted tax basis in our Ordinary Shares, in each case determined in U.S. dollars. Such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. Long-term capital gain realized by a non-corporate U.S. Holder is generally eligible for a preferential tax rate (currently 20%). In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of our Ordinary Shares, the amount realized will be based on the U.S. dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such exchange. A cash basis U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss, which would be treated as ordinary income or loss.

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An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to a sale or disposition of our Ordinary Shares that are traded on an established securities market, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the IRS. In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for U.S. federal income tax purposes because of differences between the U.S. dollar value of the currency received prevailing on the trade date and the settlement date. Any such currency gain or loss would be treated as U.S.- source ordinary income or loss and would be in addition to the gain or loss, if any, recognized by such U.S. Holder on the sale or disposition of such ordinary shares.

Passive Foreign Investment Companies

We would be a passive foreign investment company, or PFIC, for a taxable year if either (1) 75% or more of our gross income in the taxable year is passive income; or (2) the average percentage (by value determined on a quarterly basis) in a taxable year of our assets that produce, or are held for the production of, passive income is at least 50%. Passive income for this purpose generally includes, among other things, certain dividends, interest, royalties, rents and gains from commodities and securities transactions and from the sale or exchange of property that gives rise to passive income. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we would be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation's assets and as directly earning our proportionate share of the other corporation's income. As discussed below, we believe that we were not a PFIC for 2018.

If we were a PFIC, each U.S. holder would (unless it made one of the elections discussed below on a timely basis) be taxable on gain recognized from the disposition of our Ordinary Shares (including gain deemed recognized if our Ordinary Shares are used as security for a loan) and upon receipt of certain excess distributions (generally, distributions that exceed 125% of the average amount of distributions in respect to such shares received during the preceding three taxable years or, if shorter, during the U.S. holder's holding period prior to the distribution year) with respect to our Ordinary Shares as if such income had been recognized ratably over the U.S. holder's holding period for the shares. The U.S. holder's income for the current taxable year would include (as ordinary income) amounts allocated to the current taxable year and to any taxable year prior to the first day of the first taxable year for which we were a PFIC. Tax would also be computed at the highest ordinary income tax rate in effect for each other taxable year to which income is allocated, and an interest charge on the tax as so computed would also apply. The tax liability with respect to the amount allocated to the taxable year prior to the taxable year of the distribution or disposition cannot be offset by any net operating losses. Additionally, if we were a PFIC, U.S. holders who acquire our Ordinary Shares from decedents (other than nonresident aliens) would be denied the normally-available step-up in basis for such shares to fair market value at the date of death and, instead, would have a tax basis in such shares equal to the lesser of the decedent's basis or the fair market value of such shares on the decedent's date of death.

As an alternative to the tax treatment described above, a U.S. holder could elect to treat us as a “qualified electing fund” (a QEF), in which case the U.S. holder would be taxed, for each taxable year that we are a PFIC, on its pro rata share of our ordinary earnings and net capital gain (subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge). Special rules apply if a U.S. holder makes a QEF election after the first taxable year in its holding period in which we are a PFIC. We have agreed to supply U.S. holders with the information needed to report income and gain under a QEF election if we were a PFIC. Amounts includable in income as a result of a QEF election will be determined without regard to our prior year losses or the amount of cash distributions, if any, received from us. A U.S. holder’s basis in its Ordinary Shares will increase by any amount included in income and decrease by any amounts not included in income when distributed because such amounts were previously taxed under the QEF rules. So long as a U.S. holder’s QEF election is in effect with respect to the entire holding period for its Ordinary Shares, any gain or loss realized by such holder on the disposition of its Ordinary Shares held as a capital asset generally will be capital gain or loss. Such capital gain or loss ordinarily would be long-term if such U.S. holder had held such Ordinary Shares for more than one year at the time of the disposition and would be eligible for a reduced rate of taxation for certain non-corporate U.S. holders. The maximum long-term capital gains rate is 20% for individuals with annual taxable income that exceeds certain thresholds. The QEF election is made on a shareholder-by-shareholder basis, applies to all Ordinary Shares held or subsequently acquired by an electing U.S. holder and can be revoked only with the consent of the IRS. The QEF election must be made on or before the U.S. holder’s tax return due date, as extended, for the first taxable year to which the election will apply.

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As an alternative to making a QEF election, a U.S. holder of PFIC stock that is "marketable stock" (e.g., "regularly traded" on the NASDAQ Global Select Market) may, in certain circumstances, avoid certain of the tax consequences generally applicable to holders of stock in a PFIC by electing to mark the stock to market as of the beginning of such U.S. holder's holding period for our Ordinary Shares. Special rules apply if a U.S. holder makes a mark-to-market election after the first year in its holding period in which we are a PFIC. As a result of such an election, in any taxable year that we are a PFIC, a U.S. holder would generally be required to report gain or loss to the extent of the difference between the fair market value of the Ordinary Shares at the end of the taxable year and such U.S. holder's tax basis in such shares at that time. Any gain under this computation, and any gain on an actual disposition of our Ordinary Shares in a taxable year in which we are PFIC, would be treated as ordinary income. Any loss under this computation, and any loss on an actual disposition of our Ordinary Shares in a taxable year in which we are PFIC, would be treated as ordinary loss to the extent of the cumulative net-mark-to-market gain previously included. Any remaining loss from marking our Ordinary Shares to market will not be allowed, and any remaining loss from an actual disposition of our Ordinary Shares generally would be capital loss. A U.S. holder's tax basis in its Ordinary Shares is adjusted annually for any gain or loss recognized under the mark-to-market election. There can be no assurances that there will be sufficient trading volume with respect to our Ordinary Shares for the Ordinary Shares to be considered "regularly traded" or that our Ordinary Shares will continue to trade on the NASDAQ Capital Market. Accordingly, there are no assurances that our Ordinary Shares will be marketable stock for these purposes. As with a QEF election, a mark-to-market election is made on a shareholder-by-shareholder basis, applies to all Ordinary Shares held or subsequently acquired by an electing U.S. holder and can only be revoked with consent of the IRS (except to the extent our Ordinary Shares no longer constitute "marketable stock").

Based on an analysis of our assets and income, we believe that we were not a PFIC for 2018. We currently expect that we will not be a PFIC in 2019. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC in any future taxable years. U.S. holders who hold our Ordinary Shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC, subject to certain exceptions for U.S. holders who made QEF, mark-to-market or certain other special elections. U.S. holders are urged to consult their tax advisors about the PFIC rules, including the consequences to them of making a mark-to-market or QEF election with respect to our Ordinary Shares in the event that we qualify as a PFIC.

Non-U.S. holders of Ordinary Shares

Except as provided below, a non-U.S. holder of our Ordinary Shares will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, or the proceeds from the disposition of, our Ordinary Shares, unless, in the case of U.S. federal income taxes, that item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, such item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized on the disposition of our Ordinary Shares by an individual non-U.S. holder will be subject to tax in the United States if the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

Additional Tax on Investment Income

A U.S. holder that is an individual or estate, or a trust that does not fall into a special class of trusts that is exempt from the tax, will be subject to a 3.8% tax on the lesser of (1) the U.S. holder's "net investment income" for the relevant taxable year and (2) the excess of the U.S. holder's modified adjusted gross income for the taxable year over a certain threshold (which in the case of individuals will be between $125,000 and $250,000, depending on the individual's circumstances). A U.S. holder's net investment income generally will include its dividends on our Ordinary Shares and net gains from dispositions of our Ordinary Shares, unless those dividends or gains are derived in the ordinary course of the conduct of trade or business (other than trade or business that consists of certain passive or trading activities). Net investment income, however, may be reduced by deductions properly allocable to that income. A U.S. holder that is an individual, estate or trust is urged to consult its tax adviser regarding the applicability of the Medicare tax to its income and gains in respect of its investment in the Ordinary Shares.

Backup Withholding and Information Reporting

Except as provided below, a non-U.S. holder of our Ordinary Shares will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, or the proceeds from the disposition of, our Ordinary Shares, unless, in the case of U.S. federal income taxes, that item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, such item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized on the disposition of our Ordinary Shares by an individual non-U.S. holder will be subject to tax in the United States if the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

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A U.S. holder generally is subject to information reporting and may be subject to backup withholding at a rate of up to 28% with respect to dividend payments on, or receipt of the proceeds from the disposition of, our Ordinary Shares. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations and tax-exempt organizations, or if a U.S. holder provides a correct taxpayer identification number, certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Non-U.S. holders are not subject to information reporting or backup withholding with respect to dividend payments on, or receipt of the proceeds from the disposition of, our Ordinary Shares in the U.S., or by a U.S. payor or U.S. middleman, provided that such non-U.S. holder provides a taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a holder, or alternatively, the holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the IRS.

U.S. citizens and individuals taxable as resident aliens of the United States that own “specified foreign financial assets” with an aggregate value in a taxable year in excess of certain threshold (as determined under Treasury regulations) and that are required to file a U.S. federal income tax return generally will be required to file an information report with respect to those assets with their tax returns. IRS Form 8938 has been issued for that purpose. “Specified foreign financial assets” include any financial accounts maintained by foreign financial institutions, foreign stocks held directly, and interests in foreign estates, foreign pension plans or foreign deferred compensation plans. Under those rules, our Ordinary Shares, whether owned directly or through a financial institution, estate or pension or deferred compensation plan, would be “specified foreign financial assets”. Under Treasury regulations, the reporting obligation applies to certain U.S. entities that hold, directly or indirectly, specified foreign financial assets. Penalties can apply if there is a failure to satisfy this reporting obligation. A U.S. Holder is urged to consult his tax adviser regarding his reporting obligation.

The above description is not intended to constitute a complete analysis of all tax consequences relating to acquisition, ownership and disposition of our ordinary shares. You should consult your tax advisor concerning the tax consequences of your particular situation.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are subject to certain of the reporting requirements of the Exchange Act, as applicable to "foreign private issuers" as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we file with the SEC an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the SEC reports on Form 6-K containing (among other things) press releases and unaudited financial information. We post our annual report on Form 20-F on our website (www.magicsoftware.com) promptly following the filing of our annual report with the SEC. The information on our website is not incorporated by reference into this annual report.

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The Exchange Act file number for our SEC filings is 000-19415.

The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR (Electronic Data Gathering, Analysis, and Retrieval) system.

The documents concerning our company that are referred to in this annual report may also be inspected at our offices located at 5 Haplada Street, Or Yehuda 6021805, Israel.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We are exposed to a variety of market risks, primarily changes in interest rates affecting our investments in marketable securities and foreign currency fluctuations.

Cash Investments, Marketable Securities and Interest Rate Risk

Our cash investment policy seeks to preserve principal and maintain adequate liquidity while maximizing the income we receive from our investments without significantly increasing the risk of loss. To minimize investment risk, we maintain a diversified portfolio across various maturities, types of investments and issuers, which may include, from time to time, money market funds, U.S. government bonds, state debt, bank deposits and certificates of deposit, and investment grade corporate debt. Our cash management policy does not allow us to purchase or hold commodity instruments, structures or “sub-prime” related holdings (such as auction rate securities and collateralized debt obligation) or other financial instruments for trading purposes.

As of December 31, 2018, we had approximately $104.0 million in cash and cash equivalents and short term bank deposits and $9.9 million in marketable securities. Our marketable securities include investments in commercial and government bonds and foreign banks and equity funds. As of such date our marketable securities portfolio was

composed primarily of governmental and commercial bonds bearing average annual interest rates of approximately 3.2%, with average maturities of 0.9 years and maximum maturities of 1.6 years. The performance of the capital markets affects the values of the funds we hold in marketable securities. These assets are subject to market fluctuations. In such case, the fair value of our investments may decline. As of December 31, 2018, net unrealized losses in our marketable securities portfolio totaled $94,000 (ninety-four thousand dollars). We periodically monitor our investments for adverse material holdings related to the underlying financial solvency of the issuers of the marketable securities in our portfolio.

Our exposure to market risk for changes in interest rates relates primarily to our investment in marketable securities. Investments in both fixed rate and floating rate interest bearing securities carry a degree of interest rate risk. The fair market value of fixed rate securities may be adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than predicted if interest rates fall. Due in part to these factors, our future financial results may be negatively affected in the event that interest rates fluctuate.

Foreign Currency Exchange Risk

Our financial results may be negatively impacted by foreign currency fluctuations. Our foreign operations are transacted through a global network of subsidiaries. These sales and related expenses are generally denominated in currencies other than the U.S. dollar, except in Israel, where our sales are denominated in U.S. dollars and our expenses are denominated in NIS. Because our financial results are reported in U.S. dollars, our results of operations may be adversely impacted by fluctuations in the rates of exchange between the U.S. dollar and such other currencies as the financial results of our foreign subsidiaries are converted into U.S. dollars in consolidation. Our earnings are predominantly affected by fluctuations in the value of the U.S. dollar as compared to the NIS, as well as the value of the U.S. dollar as compared to the euro, Japanese Yen and British Pound.

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We measure and record non-monetary accounts in our balance sheet (principally fixed assets and prepaid expenses) in U.S. dollars. For this measurement, we use the U.S. dollar value in effect at the date that the asset or liability was initially recorded in our balance sheet (the date of the transaction).

Our operating expenses may be affected by fluctuations in the value of the U.S. dollar as it relates to foreign currencies, with NIS, euro and Japanese Yen having the greatest potential impact. In managing our foreign exchange risk, we periodically enter into foreign exchange hedging contracts. Our goal is to mitigate the potential exposure with these contracts. By way of example, an increase of 10% in the value of the NIS relative to the U.S. dollar in 2018 would have resulted in a decrease in the U.S. dollar reporting value of our operating income of $1.1 million for that year, while a decrease of 10% in the value of the NIS relative to the U.S. dollar in 2018 would have resulted in an increase in the U.S. dollar reporting value of our operating income of $0.9 million for the year. An increase of 10% in the value of the euro, the Japanese yen and the British Pound relative to the U.S. dollar in 2018 would have resulted in an increase in the U.S. dollar reporting value of our operating income of $1.1 million, $0.2 million and $0.1 million, respectively, for that year, while a decrease of 10% in the value of the euro, Japanese Yen and British Pound relative to the U.S. dollar in 2018 would have resulted in a decrease in the U.S. dollar reporting value of our operating income of $1.1 million, $0.3 million and $0.1 million, respectively, for that year.

Equity Price Risk

As of December 31, 2018, we had $8.8 million of trading securities that are classified as available for sale. Those securities have exposure to equity price risk. The estimated potential loss in fair value resulting from a hypothetical 10% decrease in prices quoted on stock exchanges is approximately $0.8 million.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, including our Chief Executive Officer, and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of December 31, 2018. Based on such evaluation, the Chief Executive Officer, and the Chief Financial Officer, have concluded that, as of December 31, 2018, the Company's disclosure controls and procedures are effective.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Our management, including our Chief Executive Officer and our Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as of the end of the period covered by this report. Such evaluation did not cover the internal controls of Futurewave Systems, Inc. since it was first acquired in the last quarter of 2018.

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Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2018. Notwithstanding the foregoing, there can be no assurance that our internal control over financial reporting will detect or uncover all failures of persons within the Company to comply with our internal procedures, as all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements.

Attestation Report of the Registered Public Accounting Firm

The attestation report of Kost Forer Gabbay & Kasierer, a member of EY Global, an independent registered public accounting firm in Israel, on our management's assessment of our internal control over financial reporting as of December 31, 2018 is provided on page F-3, as included under Item 18 of this annual report.

Changes in Internal Control over Financial Reporting

Based on the evaluation conducted by our Chief Executive Officer and our Chief Financial Officer pursuant to Rules 13a-15(d) and 15d-15(d) under the Exchange Act, our management has concluded that there was no change in our internal control over financial reporting that occurred during the year ended December 31, 2018 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. RESERVED

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Ettlinger, an external director within the meaning of the Israeli Companies Law, meets the definition of an audit committee financial expert, as defined by rules of the SEC. For a brief listing of Mr. Ettlinger's relevant experience, see Item 6A. "Directors, Senior Management and Employees -- Directors and Senior Management."

ITEM 16B. CODE OF ETHICS

We have adopted a code of ethics that applies to any chief executive officer and all senior financial officers of our company, including the chief financial officer, chief accounting officer or controller, or persons performing similar

functions. The code of ethics is publicly available on our website at www.magicsoftware.com. Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the codes of ethics, we will disclose the nature of such amendment or waiver on our website.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Independent Registered Public Accounting Firm Fees

The following table sets forth, for each of the years indicated, the fees billed by our principal independent registered public accounting firm. All of such fees were pre-approved by our Audit Committee.

	Year Ended December 31,	
Services Rendered	2017	2018
Audit [(1)]	$357,000	$361,500
Tax and other [(2)]	$46,000	$201,000
Total	$403,000	$562,500

(1) Audit fees relate to audit services provided for each of the years shown in the table, including fees associated with the annual audit, the filing of a shelf registration statement, various accounting issues and audit services provided in connection with other statutory or regulatory filings.

(2) Tax fees relate to services performed by the tax division for tax compliance, planning and advice.

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Pre-Approval Policies and Procedures

Our Audit Committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered public accountants, Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global. Pre-approval of an audit or non-audit service may be given as a general pre-approval, as part of the audit committee's approval of the scope of the engagement of our independent auditor, or on an individual basis. Any proposed services that exceed general pre-approved levels also require specific pre-approval by our audit committee. The policy prohibits retention of the independent public accountants to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act of 2002 or the rules of the SEC, and also requires the Audit Committee to consider whether proposed services are compatible with the independence of the public accountants.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

NASDAQ Stock Market Rules and Home Country Practice

Under NASDAQ Stock Market Rule 5615(a)(3), foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of the NASDAQ Stock Market Rules. A foreign private issuer that elects to follow a home country practice instead of any of such NASDAQ requirements must submit to NASDAQ, in advance, a written statement from an independent counsel in such issuer's

home country certifying that the issuer's practices are not prohibited by the home country's laws. We provided NASDAQ with such a letter of non-compliance with respect to:

The Rule requiring maintaining a majority of independent directors (Rule 5605(b)(1)). Instead, under Israeli law and practice, we are required to appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors.

The Rule requiring that our independent directors have regularly scheduled meetings at which only independent directors are present (Rule 5605(b)(2)). Instead, we follow Israeli law according to which independent directors are not required to hold executive sessions.

The Rule regarding independent director oversight of director nominations process for directors (Rule 5605(e)). Instead, we follow Israeli law and practice according to which our board of directors recommends directors for election by our shareholders.

The requirement to obtain shareholder approval for the establishment or amendment of certain equity based compensation plans (Rule 5635(c)), an issuance that will result in a change of control of the company (Rule 5635(b)), certain transactions other than a public offering involving issuances of a 20% or more interest in the company (Rule 5635(d)) and certain acquisitions of the stock or assets of another company (Rule 5635(a)). Instead, we follow Israeli law and practice in approving such procedures, according to which Board approval may suffice in certain circumstances.

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ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

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ITEM 19. EXHIBITS

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Exhibit	Description
1.1	Memorandum of Association of the Registrant[1]
1.2	Articles of Association of the Registrant[2]
2.1	Specimen of Ordinary Share Certificate[3]
4.1	2000 Employee Stock Option Plan[4]
4.2	2007 Incentive Compensation Plan[5]
8.1	List of Subsidiaries of the Registrant

12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended
12.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended
13.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1	Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global
15.2	Consent of KDA Audit Corporation (relating to Magic Software Japan K.K.)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

(1) Filed as Exhibit 3.2 to the registrant's registration statement on Form F-1, registration number 33-41486, and incorporated herein by reference.

(2) Filed as an Item to the registrant's Form 6-K for the month of December 2011, filed on December 7, 2011, and incorporated herein by reference.

(3) Filed as Exhibit 4.1 to the registrant's registration statement on Form F-1, registration number 33-41486, and incorporated herein by reference.

(4) Filed as Exhibit 10.2 to the registrant's annual report on Form 20-F for the year ended December 31, 2000, and incorporated herein by reference.

(5) Filed as Exhibit 4.3 to the registrant's annual report on Form 20-F for the year ended December 31, 2007, and incorporated herein by reference.

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2018

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of

MAGIC SOFTWARE ENTERPRISES LTD.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Magic Software Enterprises Ltd. ("the Company") as of December 31, 2017 and 2018, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, based on our audits and the report of other auditors, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We did not audit the financial statements of Magic Software Japan K.K., a wholly-owned subsidiary, which reflect total assets of constituting 1% and 1% at December 31, 2017 and 2018, respectively, and total revenues of 6%, 4% and 3% for the years ended December 31, 2016, 2017 and 2018, respectively, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Magic Software Japan K.K., is based solely on the report of the other auditors.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the

Treadway Commission (2013 framework) and our report dated April 30, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

/s/ Kost Forer Gabbay & Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

We have served as the Company's auditor since 1984.

Tel-Aviv, Israel

April 30, 2019

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of

MAGIC SOFTWARE ENTERPRISES LTD.

Opinion on Internal Control over Financial Reporting

We have audited Magic Software Enterprises Ltd.'s ("the Company") internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) ("the COSO criteria"). In our opinion, the Company, based on our audit and the report of other auditors, maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We did not examine the effectiveness of internal control over financial reporting of Magic Software Japan K.K, a wholly owned subsidiary, whose financial statements reflect total assets and revenues constituting 1% and 3%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2018. The effectiveness of Magic Software Japan K.K.'s internal control over financial reporting was audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the effectiveness of Magic Software Japan K.K.'s internal control over financial reporting, is based solely on the report of the other auditors.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2017 and 2018, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of

the three years in the period ended December 31, 2018 and the related notes and our report dated April 30, 2019 expressed an unqualified opinion thereon based on our audit and the report of the other auditors.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit and the report of other auditors provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become

inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Kost Forer Gabbay & Kasierer

KOST FORER GABBAY & KASIERER

A Member of Ernst & Young Global

Tel-Aviv, Israel

April 30, 2019

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands

	December 31,	
	2017	2018
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$76,076	$87,126
Short-term bank deposits	732	16,881
Marketable securities (Note 4)	14,138	9,913
Trade receivables (net of allowance for doubtful accounts of $ 3,852 and $ 2,992 at December 31, 2017 and 2018, respectively)	82,051	90,274
Other accounts receivable and prepaid expenses (Note 6)	8,643	7,029
Total current assets	181,640	211,223
LONG-TERM RECEIVABLES:		
Severance pay fund	3,226	3,284
Deferred tax asset (Note 13)	2,990	1,858
Other long-term receivables	2,015	6,363
Total long-term receivables	8,231	11,505
PROPERTY AND EQUIPMENT, NET (Note 7)	3,468	3,072
INTANGIBLE ASSETS, NET (Note 8)	51,011	41,479
GOODWILL (Note 9)	98,189	95,006
Total assets	$342,539	$362,285

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

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands (except share data)

	December 31,	
	2017	2018
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Short term debt (Note 10)	$9,771	$8,661
Trade payables	12,185	14,036
Accrued expenses and other accounts payable (Note 11)	27,789	24,458
Liabilities due to acquisition activities	3,906	910
Deferred revenues and customer advances	5,586	4,857
Total current liabilities	59,237	52,922
LONG TERM LIABILITIES:		
Long-term debt (Note 12)	27,814	19,388
Long-term liabilities due to acquisition activities (Note 3)	581	94
Deferred tax liability (Note 13)	11,331	10,343
Accrued severance pay	4,174	3,934
	43,900	33,759
COMMITMENTS AND CONTINGENCIES (Note 16)		
REDEEMABLE NON-CONTROLLING INTEREST (Note 2)	25,839	27,235
EQUITY (Note 14):		
Magic Software Enterprises equity:		
Share capital:		
Ordinary shares of NIS 0.1 par value - Authorized: 50,000,000 shares at December 31, 2017 and 2018; Issued and Outstanding: 44,488,578 and 48,861,038 shares at December 31, 2017 and 2018, respectively	1,040	1,159
Additional paid-in capital	183,445	218,400
Accumulated other comprehensive income (loss)	83	(6,125)
Retained earnings	25,713	30,522
Total equity attributable to Magic Software Enterprises shareholders	210,281	243,956
Non-controlling interests	3,282	4,413
Total equity	213,563	248,369

Total liabilities, redeemable non-controlling interest and equity	$342,539	$362,285

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

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF INCOME
U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2016	2017	2018
Revenues (Note 18-19):			
Software	$19,626	$21,644	$25,454
Maintenance and technical support	25,885	30,386	30,951
Consulting services	156,135	206,110	227,970
Total revenues	201,646	258,140	284,375
Cost of revenues:			
Software	8,674	9,564	9,960
Maintenance and technical support	2,952	3,888	4,120
Consulting services	121,756	161,709	181,477
Total cost of revenues	133,382	175,161	195,557
Gross profit	68,264	82,979	88,818
Operating costs and expenses:			
Research and development, net (Note 20a)	5,839	6,942	5,696
Selling and marketing	23,776	27,244	27,197
General and administrative	17,562	22,837	24,227
Total operating costs and expenses	47,177	57,023	57,120
Operating income	21,087	25,956	31,698
Financial income (expense), net (Note 20b)	(430)	(1,711)	149
Income before taxes on income	20,657	24,245	31,847
Taxes on income (Note 13)	3,949	6,331	7,071
Net income	16,708	17,914	24,776
Net income attributable to redeemable non-controlling interests	2,258	1,536	3,383
Net income attributable to non-controlling interests	281	936	1,510
Net income attributable to Magic Software Enterprises shareholders	$14,169	$15,442	$19,883
Net earnings per share attributable to Magic Software Enterprises' shareholders (Note 2, 17):			

Basic and Diluted earnings per share	$0.27	$0.35	$0.39

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

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2016	2017	2018
Net income	$16,708	$17,914	$24,776
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments, net	(1,006)	10,134	(8,217)
Unrealized losses from available-for-sale securities	(11)	(4)	(36)
(Gain) loss reclassified into earnings from marketable securities	16	(94)	-
Total other comprehensive (loss), net of tax	(1,001)	10,036	(8,253)
Total comprehensive income	15,707	27,950	16,523
Comprehensive income attributable to redeemable non-controlling interests	4,211	4,007	1,649
Comprehensive income attributable to non-controlling interests	322	990	1,200
Comprehensive income attributable to Magic Software Enterprises' shareholders	$11,174	$22,953	$13,674

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

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MAGIC SOFTWARE ENTERPRISES LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
U.S. dollars in thousands (except per share data)

	Attributable to the Company's shareholders						
	Number of Shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Non-controlling interests	Total equity
Balance as of January 1, 2016	44,335,220	1,035	180,989	(6,695)	15,679	2,098	193,106
Exercise of stock options	20,550	1	40	-	-	-	41
Stock-based compensation	-	-	103	-	-	49	152
Increase in value of put options of redeemable non-controlling interests	-	-	-	-	(2,262)	-	(2,262)
Exercise of stock options in a subsidiary	-	-	1,012	-	-	(1,304)	(292)
Acquisition of non-controlling interests (Note 3)	-	-	641	-	-	(644)	(3)
Dividend	-	-	-	-	(7,761)	(98)	(7,859)
Other comprehensive income (loss)	-	-	-	(733)	-	41	(692)
Net income	-	-	-	-	14,169	281	14,450
Balance as of December 31, 2016	44,355,770	1,036	182,785	(7,428)	19,825	423	196,641
Exercise of stock options	132,808	4	582	-	-	-	586
Stock-based compensation	-	-	78	-	-	-	78
Redeemable non-controlling interests reclassification to non-controlling interests	-	-	-	-	-	2,440	2,440
Dividend	-	-	-	-	(9,554)	(571)	(10,125)
Other comprehensive income	-	-	-	7,511	-	54	7,565
Net income	-	-	-	-	15,442	936	16,378
Balance as of December 31, 2017	44,488,578	1,040	183,445	83	25,713	3,282	213,563
Issue of share capital, net of issuance costs of $ 400	4,268,293	117	34,452				34,569
Exercise of stock options	104,167	2	309	-	-	-	311
Stock-based compensation	-	-	194	-	-	-	194
Increase in value of put options of redeemable non-controlling interests	-	-	-	-	(1,726)	-	(1,726)
Dividend	-	-	-	-	(13,348)	(69)	(13,417)
Other comprehensive loss	-	-	-	(6,208)	-	(310)	(6,518)

Net income	-	-	-	-	19,883	1,510	21,393
Balance as of December 31, 2018	48,861,038	1,159	218,400	(6,125)	30,522	4,413	248,369

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

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Year ended December 31,		
	2016	2017	2018
Cash flows from operating activities:			
Net income	$16,708	$17,914	$24,776
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	11,608	13,611	12,564
Stock-based compensation	152	78	194
Amortization of marketable securities premium and accretion of discount	257	218	189
Loss (gains) reclassified into earnings from marketable securities	16	(94)	-
Increase in trade receivables, net	(2,571)	(15,752)	(11,367)
Increase in other long-term and short-term accounts receivable and prepaid expenses	(56)	(1,773)	(4,364)
Increase in trade payables	1,426	3,604	2,203
Change in exchange rate of loans	-	3,200	(2,099)
Increase in accrued expenses and other accounts payable	1,553	4,435	1,802
Increase (decrease) in deferred revenues	(180)	1,175	(374)
Change in deferred taxes, net	(958)	(1,108)	526
Net cash provided by operating activities	27,955	25,508	24,050

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

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Year ended December 31,		
	2016	2017	2018
Cash flows from investing activities:			
Capitalized software development costs	(4,224)	(3,771)	(3,666)
Purchase of property and equipment	(799)	(1,400)	(863)
Cash paid in conjunction with acquisitions, net of acquired cash	(29,657)	(1,787)	(1,218)
Proceeds from maturity and sale of marketable securities	2,643	4,225	4,000
Proceeds from short-term bank deposits	8,467	-	-
Investment in long-term bank deposits	-	-	(932)
Investment in marketable securities and short-term bank deposits	(9,401)	(5,766)	(16,875)
Short term loan to a related-party	(1,183)	1,183	-
Change in loans to employees and other deposits, net	(49)	-	-
Net cash used in investing activities	(34,203)	(7,316)	(19,554)
Cash flows from financing activities:			
Proceeds from exercise of options by employees	41	586	311
Issuance of ordinary shares, net	-	-	34,569
Dividend paid	(7,761)	(9,359)	(13,543)
Dividend paid to non-controlling interests	(456)	(571)	(69)
Dividend paid to redeemable non-controlling interests	(1,574)	(5,312)	(2,671)
Short-term credit, net	936	-	(437)
Purchase of non-controlling interest	(352)	-	-
Cash paid in conjunction with acquisitions, net of acquired cash	(1,779)	(5,103)	(3,126)
Long-term loan received	31,356	8,535	26
Repayment of long-term loans	-	(8,190)	(6,634)
Net cash provided by (used in) financing activities	20,411	(19,414)	8,426
Effect of exchange rate changes on cash and cash equivalents	(1,037)	1,984	(1,872)
Increase in cash and cash equivalents	13,126	762	11,050
Cash and cash equivalents at the beginning of the year	62,188	75,314	76,076
Cash and cash equivalents at end of the year	$75,314	$76,076	$87,126

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

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MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Year ended December 31,		
	2016	2017	2018
Supplementary information on investing and financing activities not involving cash flows:			
Non-cash activities:			
Deferred acquisition payment	$2,035	$652	$-
Contingent acquisition consideration	$4,771	$-	$-
Dividend declared and not yet paid	$-	$195	$-
Dividend declared and not yet paid to redeemable non-controlling interests	$1,579	$692	$-
Supplemental disclosure of cash flow activities:			
Cash paid during the year for:			
Income taxes	$4,510	$5,373	$5,419
Interest	$358	$572	$312

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

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL

MAGIC SOFTWARE ENTERPRISES LTD., an Israeli company ("the Group" or "the Company"), is a global provider of: (i) proprietary application development and business process integration platforms that accelerate the planning, development, deployment and integration of on-premise, mobile and cloud business applications ("the Magic Technology"); (ii) selected packaged vertical software solutions; and (iii) a vendor of software services and IT outsourcing software services.

Magic Technology enables enterprises to accelerate the process of delivering business solutions that meet current and future needs and allow customers to dramatically improve their business performance and return on investment. To complement its software products and to increase its traction with customers, the Group also offers a complete portfolio of software services in the areas of infrastructure design and delivery, application development, technology planning and implementation services, communications services and solutions, and supplemental IT professional outsourcing services. The Company reports its results on the basis of two reportable business segments: software services (which include proprietary and non-proprietary software solutions, maintenance and support and related services) and IT professional services (see Note 18 for further details).

The principal markets of the Group are the United States, Israel, Europe and Japan (see Note 18).

For information about the Company's holdings in subsidiaries and affiliates, see Appendix A to the consolidated financial statements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles ("U.S. GAAP"), applied on a consistent basis, as follows, unless otherwise stated:

Use of estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Financial statements in United States dollars

A substantial portion of the revenues and expenses of the Company and of certain subsidiaries is generated in U.S. dollars ("dollar"). The Company's management believes that the dollar is the currency of the primary economic environment in which the Company and certain subsidiaries operate. Thus, the functional and reporting currency of the Company and certain subsidiaries is the dollar.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 830, "Foreign Currency Matters". All transaction gains and losses of the remeasurement of monetary balance sheet items are reflected in the statements of income as financial income or expenses, as appropriate. Monetary accounts and transactions maintained in dollars are presented at their original amounts.

For those foreign subsidiaries whose functional currency is not the dollar, all balance sheet amounts have been translated using the exchange rates in effect at each balance sheet date. Statement of income amounts have been translated using the average exchange rate prevailing during each year. Such translation adjustments are reported as a component of accumulated other comprehensive income (loss) in equity.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Intercompany balances and transactions, including profit from intercompany sales not yet realized outside the Group, have been eliminated upon consolidation.

Changes in the Company's ownership interest in a subsidiary with no change of control are treated as equity transactions, with any difference between the amount of consideration paid and the change in the carrying amount of the non-controlling interest, recognized in equity.

Non-controlling interests of subsidiaries represent the non-controlling shareholders' share of the total comprehensive income (loss) of the subsidiaries and fair value of the net assets upon the acquisition of the subsidiaries. The non-controlling interests are presented in equity separately from the equity attributable to the equity holders of the Company. Redeemable non-controlling interests are classified as mezzanine equity, separate from permanent equity, on the consolidated balance sheets and measured at each reporting period at the higher of their redemption amount or the non-controlling interest book value, in accordance with the requirements of ASC 810 "Consolidation" and ASC

480-10-S99-3A, “Distinguishing Liabilities from Equity”.

The following table provides a reconciliation of the redeemable non-controlling interests for the year ended December 31, 2018:

January 1, 2018	$25,839
Net income attributable to redeemable non-controlling interest	3,383
Increase in value of put options of redeemable non-controlling interests	1,726
Dividend declared to redeemable non-controlling interest	(1,979)
Foreign currency translation adjustments	(1,734)
December 31, 2018	$27,235

Out of the closing balance, an amount of $ 25,778 become exercisable during 2019.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Cash and cash equivalents

Cash and cash equivalents are short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less, at acquisition.

Cash and cash equivalents include amounts held primarily in NIS, dollar, Euro, Japanese Yen and British Pound.

Short-term deposits and restricted deposits

Short-term deposits include deposits with original maturities of more than three months and less than one year. Such deposits are presented at cost (including accrued interest) which approximates their fair value. Restricted deposits are used to secure certain of the Group's ongoing projects and are classified under other long-term receivables.

Marketable securities

The Company accounts for all its investments in marketable securities in accordance with ASC No. 320, "Investments – Debt and Equity Securities". The Company classifies all of its marketable securities as available for sale and held for trading. Available for sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in "accumulated other comprehensive income (loss)" in equity. Realized gains and losses on sale of investments are included in "financial expense (income), net" and are derived using the specific identification method for determining the cost of securities.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization together with interest on securities is included in “financial expense (income), net”.

The Company recognizes an impairment charge when a decline in the fair value of its investments in debt securities below the cost basis of such securities is judged to be other-than-temporary. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value, the potential recovery period and the Company’s intent to sell, including whether it is more likely than not that the Company will be required to sell the investment before recovery of cost basis. For securities that are deemed other-than-temporarily impaired, the amount of impairment is recognized in “net gain (impairment net of gains) on sale of marketable securities previously impaired” in the statements of income and is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income.

The Company classifies its marketable debt securities as either short-term or long-term based on each instrument’s underlying contractual maturity date and the entity’s expectations of sales and redemptions in the following year.

Held for trading securities are measured at fair value through profit or loss.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Property and equipment, net

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	Years
Computers and peripheral equipment	3 - 5
Office furniture and equipment	7 - 15 (mainly 7)
Motor vehicles	7
Software	3 – 5 (mainly 5)

Leasehold improvements are amortized using the straight-line method over the term of the lease (including option terms that are deemed to be reasonably assured) or the estimated useful life of the improvements, whichever is shorter.

Business combinations

The Company accounts for business combinations under ASC 805, “Business Combinations”. ASC 805 requires recognition of assets acquired, liabilities assumed, contingent consideration, non-controlling interest and redeemable non-controlling interest in the acquiree at the acquisition date, to be measured at their fair values as of that date. As required by ASC 820, “Fair Value Measurements and Disclosures” the Company applies assumptions, judgments and estimates that marketplace participants would consider in determining the fair value of assets acquired, liabilities assumed, non-controlling interest and redeemable non-controlling interest in the acquiree at the acquisition date. Any excess of the fair value of net assets acquired over purchase price and any subsequent changes in estimated contingencies are to be recorded in earnings. Acquisition related costs are expensed to the statements of income in the period incurred. The cumulative impact of measurement period adjustments, including the impact to prior periods, is

recognized in the reporting period in which the adjustment is identified.

During the years ended December 31, 2016, 2017 and 2018 the Company recorded $ 665, $ 300 and $ (38), with respect to changes in the fair value of contingent consideration liability, respectively.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Research and development costs

Research and development costs incurred in the process of software development before establishment of technological feasibility are charged to expenses as incurred. Costs incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in ASC 985-20, “Costs of Software to be Sold, Leased or Marketed”.

The Company and its subsidiaries establish technological feasibility upon completion of a detailed program design or working model.

ASC 985-20-35 requires that a product be amortized when the product is available for general release to customers. The Company considers a product to be available for general release to customers when the Company completes its internal validation of the product that is necessary to establish that the product meets its design specifications including functions, features, and technical performance requirements. Internal validation includes the completion of coding, documentation and testing that ensure bugs are reduced to a minimum. The internal validation of the product takes place a few weeks before the product is made available to the market. In certain instances, the Company enters into a short pre-release stage, during which the product is made available to a selected number of customers as a beta program for their own review and familiarization. Subsequently, the release is made generally available to customers from the Company’s download area. Once a product is considered available for general release to customers, the capitalization of costs ceases and amortization of such costs to “cost of sales” begins.

Capitalized software costs are amortized on a product by product basis by the straight-line method over the estimated useful life of the software product (approximately 5 years, due to their high rates of acceptance, the continued reliance on these products by existing customers, and the demand for such products from prospective customers, all of which validate the Company’s expectations) which provides greater amortization expense compared to the revenue-curve method.

The Company assesses the recoverability of these intangible assets on a regular basis by assessing the net realizable value of these intangible assets based on the estimated future gross revenues from each product reduced by the estimated future costs of completing and disposing of it, including the estimated costs of performing maintenance and customer support over its remaining economical useful life using internally generated projections of future revenues generated by the products, cost of completion of products and cost of delivery to customers over its remaining economical useful life. During the years ended December 31, 2016, 2017 and 2018, no such unrecoverable amounts were identified.

Research and development costs incurred in the process of developing product enhancements are generally charged to expenses as incurred.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Long-Lived Assets

The Company's long-lived, non-current assets are comprised mainly of goodwill, identifiable intangible assets and property, plants and equipment.

Impairment of long-lived assets and intangible assets subject to amortization

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360, "Property, Plant and Equipment" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

As required by ASC 820, "Fair Value Measurements and Disclosures" the Company applies assumptions, judgments and estimates that marketplace participants would consider in determining the fair value of long-lived assets (or asset groups).

Intangible assets with finite lives are amortized over their economic useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. Acquired technology and non-compete agreements were amortized on a straight line basis and customer relationships and backlog were amortized on an accelerated method basis over a period between 1 - 15 years based on the intangible assets identified.

During the years ended December 31, 2016, 2017 and 2018, no impairment losses have been identified.

Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net tangible and intangible assets acquired. Under ASC 350, “Intangibles - Goodwill and Other”, goodwill is subject to an annual impairment test or more frequently if impairment indicators are present. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. As of December 31, 2018, the Company operates in four reporting units within its operating segments.

Goodwill reflects the excess of the consideration paid or transferred plus the fair value of contingent consideration and any non-controlling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired.

ASC 350 allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the qualitative assessment does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the two-step impairment test is performed. Alternatively, ASC 350 permits an entity to bypass the qualitative assessment for any reporting unit and proceed directly to performing the first step of the goodwill impairment test.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The provisions of ASC 350 require that the quantitative two-step impairment test will be performed on goodwill at the level of the reporting units. In the first step, or "Step one", the Company compares the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then the Company must perform the second step, or "Step two", of the impairment test in order to determine the implied fair value of goodwill. To determine the fair value used in Step one, the Company uses discounted cash flows. If and when the Company is required to perform a Step two analysis, determining the fair value of its net assets and its off-balance sheet intangibles, then the Company would be required to make judgments that involve the use of significant estimates and assumptions.

The Company determines the fair value of each reporting unit by using the income approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The Company considers historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.

The Company performed an annual impairment test as of December 31, of each of 2016, 2017 and 2018 and did not identify any impairment losses (see Note 9).

Revenue recognition

Effective as of January 1, 2018, The Company implements the provisions of Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers ("ASC 606") using the modified retrospective method. no cumulative effect adjustment as of the date of the adoption was required. Prior years information has not been restated and continues to be reported under the old accounting standard 605, "Revenue Recognition" (ASC 605). See Note 19 for further disclosures required under ASC 606.

Revenues are recognized when control of the promised goods or services are transferred to the customers, in an amount that reflects the consideration that the company expects to receive in exchange for those goods or services.

The Company determines revenue recognition through the following steps:

- identification of the contract with a customer;
- identification of the performance obligations in the contract;
- determination of the transaction price;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, the Company satisfies a performance obligation.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company enters into contracts that can include various combinations of products, software and professional services, as detailed below, which are generally capable as being distinct from each other and accounted for as separate performance obligations.

The Company derives its revenues from licensing the rights to use its software (proprietary and non-proprietary), provision of related professional services, maintenance and technical support as well as from other software and IT professional services (either fixed price or based on time and materials). The Company sell its products primarily through direct sales force and indirectly through distributors and value added resellers.

Under ASC 606, an entity recognizes revenue when or as it satisfies a performance obligation by transferring software license or software related services to the customer, either at a point in time or over time. The company recognizes its revenues from software sales at a point in time upon delivery of its software license. The software license is considered a distinct performance obligation, as the customer can benefit from the software on its own. Revenues from contracts that involve significant customization to customer-specific specifications are performance obligations the Company generally accounts for as performance obligations satisfied over time. The underlying deliverable is owned and controlled by the customer, and does not create an asset with an alternative use to the Company. The Company recognizes revenue of such contracts over time using cost inputs, which recognize revenue and gross profit as work is performed based on a ratio between actual costs incurred compared to the total estimated costs for the contract, to measure progress toward completion of its performance obligations, which is similar to the method prior to the adoption of ASC 606. 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 for the entire contract. During the years ended December 31, 2016, 2017 and 2018, no material estimated losses were identified. In addition, the Company provides professional services that do not involve significant customization to customer-specific specifications. For contracts that do not involve significant customization to customer-specific specifications (typically staffing or consulting services) revenue is recognized as the services are performed, either on a straight-line basis or based on the hours of services that were provided to the customer, in accordance with the terms of the contracts.

The Company’s revenues from post contract support are derived from annual maintenance contracts providing for unspecified upgrades for new versions and enhancements on a when-and-if-available basis for an annual fee. The right for an unspecified upgrade for new versions and enhancements on a when-and-if-available basis do not specify the features, functionality and release date of future product enhancements for the customer to know what will be made

available and the general timeframe in which it will be delivered. The Company considers the post contract support performance obligation as a distinct performance obligation that is satisfied over time, and recognized on a straight-line basis over the contractual period.

Revenue from professional services both related to software and IT professional services businesses consists of either fixed price or Time and Materials (T&M), and are considered performance obligations that are satisfied over time, and revenues are recognized as the services are provided.

The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software licenses are estimated using the residual approach, due to the lack of selling software licenses on a standalone basis, or the fact the Company sells the license to different customers for a broad range of amounts. Standalone selling prices of services are determined by considering several external and internal factors including, but not limited to, transactions where the specific performance obligation is sold separately.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company generally does not grant a right of return to its customers. When a right of return exists, the Company defers revenue until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria are met.

Deferred revenues include unearned amounts received under maintenance and support (mainly) and amounts received from customers for which revenues have not yet been recognized.

Revenue from third-party sales is recorded at a gross or net amount according to certain indicators. The application of these indicators for gross and net reporting of revenue depends on the relative facts and circumstances of each sale.

The Company pays commissions to sales and marketing and certain management personnel based on their attainment of certain predetermined sales or profit goals. When sales commissions are considered incremental costs of obtaining a contract with a customer they are deferred and amortized on a systematic basis that is consistent with the transfer to the customer of the performance obligations to which the asset relates. The Company expenses sales commissions as they are incurred when the amortization period would have been less than one year. In addition, generally, sales commission which are paid upon contract renewal are commensurate with the initial commissions as the renewal amounts are substantially identical to the initial commission costs. During the year ended December 31, 2018, no costs have been capitalized.

The Company does not assess whether a contract has a significant financing component if the expectation at contract inception is such that the period between payment by the customer and the transfer of the promised goods or services to the customer will be one year or less.

Accrued severance pay and retirement plans

The Company's and its Israeli subsidiaries' obligation for severance pay with respect to their Israeli employees (for the period for which the employees were not included under Section 14 of the Severance Pay Law, 1963) is calculated pursuant to the Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date, and are presented on an undiscounted basis (referred to as the "Shut Down Method"). Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's obligation for all of its Israeli employees is fully provided for by monthly deposits with insurance policies and severance pay funds and by an accrual.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The carrying value of deposited funds includes profits (losses) accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligations pursuant to the Israeli Severance Pay Law or labor agreements and are recorded as an asset in the Company's consolidated balance sheet.

The Company and its Israeli subsidiaries' agreements with most of their Israeli employees are in accordance with Section 14 of the Severance Pay Law -1963, mandating that upon termination of such employees' employment; all the amounts accrued in their insurance policies shall be released to them instead of severance compensation. Upon release of deposited amounts to the employee, no additional liability exists between the parties regarding the matter of severance pay and no additional payments are payable by the Company or its subsidiaries to the employee. Further, the related obligation and amounts deposited on behalf of such obligation are not stated on the balance sheet, as the Company and its subsidiaries are legally released from their obligations to employees once the deposit amounts have been paid.

The Group has a number of savings plans in the United States that qualify under Section 401(k) of the Internal Revenue Code. U.S. employees may contribute up to 100% of their pretax or post-tax salary, but not more than statutory limits. Matching contributions are discretionary and if made, are up to 3% of the participants annual contributions. When contributions are granted, they are invested in proportion to each participant's voluntary contributions in the investment options provided under the plan.

Severance expenses for the years ended December 31, 2016, 2017 and 2018 amounted to approximately $ 2,248, $ 3,748 and $ 4,052, respectively.

Advertising expenses

Advertising expenses are charged to selling and marketing expenses, as incurred. Advertising expenses for the years ended December 31, 2016, 2017 and 2018 amounted to $ 423, $ 384 and $ 304, respectively.

Income taxes

The Company accounts for income taxes in accordance with ASC 740, “Income Taxes”. ASC 740 prescribes the use of the “asset and liability” method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value. Deferred tax assets and liabilities are classified as non-current.

The Company utilizes a two-step approach for recognizing and measuring uncertain tax positions accounted for in accordance with an amendment of ASC 740 “Income Taxes.” Under the first step the Company evaluates a tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, based on its technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement with the tax authorities. The Company accrued interest and penalties related to unrecognized tax benefits in its provisions for income taxes.

Basic and diluted net earnings per share

Basic net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year, in accordance with ASC 260, “Earnings Per Share.”

A portion of the outstanding stock options have been excluded from the calculation of the diluted earnings per share because such securities are anti-dilutive. The total weighted average number of Ordinary shares related to the outstanding options excluded from the calculations of diluted earnings per share was 21,998 and 2,093 for the years ended December 31, 2016 and 2017, respectively. As of December 31, 2018, there were no outstanding options excluded from the calculations of diluted earnings per share.

The Company changed its accounting policy regarding the presentation of the adjustment to the net income attributable to Magic Software Enterprises’ shareholders as a result of the accretion of redeemable non-controlling interest. According to the new accounting policy, the Company presents the accretion amount in the calculation of the earnings per share in the notes of the financial statements, compared to the previous presentation on the face of the consolidated statements of income, since Company’s management believes that reflecting the effects of the accretion as an adjustment to income available to Magic Software Enterprises’ shareholders in the earnings per share note is a more appropriate presentation. The change in the accounting policy was retrospectively effected reported net income attributable to Magic Software Enterprises’ shareholders during December 31, 2016 in the amount of $ 2,262 (also refer to note 17).

Stock-based compensation

The Company accounts for stock-based compensation in accordance with ASC 718, “Compensation - Stock Compensation” which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made. ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company’s consolidated statement of income.

The Company recognizes compensation expenses for the value of its awards, which have graded vesting based on the accelerated method over the requisite service period of each of the awards, net of estimated forfeitures.

The Company uses the Binomial option-pricing model (“the Binomial model”) to estimate the fair value for any options granted. The Binomial model takes into account variables such as volatility, dividend yield rate, and risk-free interest rate and also allows for the use of dynamic assumptions and considers the contractual term of the option, the probability that the option will be exercised prior to the end of its contractual life, and the probability of termination or retirement of the option holder in computing the value of the option.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value of each option granted using the Binomial model, was estimated on the date of grant with the following assumptions: expected volatility was based upon actual historical stock price movements and was calculated as of the grant dates for different periods, since the Binomial model can be used for different expected volatilities for different periods. The risk-free interest rate was based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term to the contractual term of the options. The expected term of options granted was derived from the output of the option valuation model and represented the period of time that options granted were expected to be outstanding. Estimated forfeitures were based on actual historical pre-vesting forfeitures. Since dividend payments are applied to reduce the exercise price of the option, the effect of the dividend protection was reflected by using an expected dividend assumption of zero.

For awards with performance conditions, compensation cost is recognized over the requisite service period if it is ‘probable’ that the performance conditions will be satisfied.

No grants were made to employees or directors in 2016 and 2017.

During the years ended December 31, 2016, 2017 and 2018, the Company recognized stock-based compensation expense related to employee stock options in the amount of $ 152, $ 78 and $ 194, respectively, as follows:

	Year ended December 31,		
	2016	2017	2018
Cost of revenue	$15	$ 7	$2
Research and development	17	8	4
Selling and marketing	71	-	4
General and administrative	49	63	184
Total stock-based compensation expense	$152	$ 78	$194

Concentrations of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents, short-term deposits, restricted cash, marketable securities, trade receivables and foreign currency derivative contracts.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company's cash and cash equivalents, short-term deposits and restricted cash are invested primarily in bank deposits with major banks worldwide, mainly in the United States and Israel, however, such cash and cash equivalents and short-term deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. The Company believes that since these deposits may be redeemed upon demand and since such institutions are of high rating they bear low risk.

The Company's marketable securities include investments in commercial and government bonds and foreign banks. The Company's marketable securities are considered to be highly liquid and have a high credit standing (also refer to Note 4). In addition, management considered its portfolios in foreign banks to be well-diversified.

The Company's trade receivables are derived from sales to customers located primarily in the United States, Israel, Europe and Japan. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. The expense related to doubtful accounts for the years ended December 31, 2016, 2017 and 2018 was $ 437, $ 1,164 and $ 1,070, respectively.

From time to time the Company enters into foreign exchange forward contracts and option contracts intended to protect against the changes in value of forecasted non-dollar currency cash flows related to salary and related expenses. These derivative instruments are designed to offset the Company's non-dollar currency exposure.

Fair value measurements

The Company accounts for certain assets and liabilities at fair value under ASC 820, "Fair Value Measurements and Disclosures". Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2 -	Includes other inputs that are directly or indirectly observable in the marketplace, other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets with insufficient volume or infrequent transactions, or other inputs that are observable (model-derived valuations in which significant inputs are observable), or can be derived principally from or corroborated by observable market data;
Level 3 -	Unobservable inputs which are supported by little or no market activity;

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company categorized each of its fair value measurements in one of these three levels of hierarchy. Assets and liabilities measured at fair value on a recurring basis are comprised of marketable securities, foreign currency forward contracts and contingent consideration of acquisitions (see Note 5).

The carrying amounts reported in the balance sheet for cash and cash equivalents, short term bank deposits, trade receivables, other accounts receivable, short-term bank credit, trade payables and other accounts payable approximate their fair values due to the short-term maturities of such instruments.

Comprehensive income (loss)

The Company accounts for comprehensive income (loss) in accordance with ASC 220, “Comprehensive Income.” This Statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income (loss) generally represents all changes in equity during the period except those resulting from investments by, or distributions to, shareholders. The Company determined that its items of other comprehensive income (loss) relate to gain and loss on foreign currency translation adjustments, unrealized gain and loss on derivative instruments designated as hedges and unrealized gain and loss on available-for-sale marketable securities.

Recently adopted accounting pronouncement

In May 2014, the FASB issued ASU 2014-09 establishing Accounting Standards Codification (ASC) Topic 606, “Revenue from Contracts with Customers” (ASC 606). ASC 606 establishes a comprehensive new revenue recognition model designed to depict the transfer of goods or services to a customer in an amount that reflects the consideration the entity expects to be entitled to receive in exchange for those goods or services and requires significantly enhanced revenue disclosures. The Company adopted the standard effective January 1, 2018 using the modified retrospective method. Results for reporting periods beginning after January 1, 2018, were presented under Topic 606, while prior

period amounts were not adjusted and were reported in accordance with the Company's historic accounting practices, under legacy revenue recognition standards. See Note 19 to the financial statements for further information regarding the initial application of ASC 606.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15 “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” (ASU 2016-15). ASU 2016-15 provides specific guidance on eight cash flow classification issues, including debt prepayment, payments of contingent liabilities as part of business combinations, or debt extinguishment costs and distributions received from equity method investees, to reduce diversity in practice. ASU 2016-15 is effective for interim and annual periods beginning after December 15, 2017. The Company adopted this standard during 2018.

As a result of the adoption of ASU 2016-15, the Company adjusted the previously reported consolidated statement of cash flows for the years ended December 31, 2017 and 2016 as follows:

	Year Ended December 31, 2017		
	As previously reported	Adjustments	**As Adjusted**
Net cash used in investing activities	$(12,419)	$ 5,103	$(7,316)
Net cash used in financing activities	$(14,311)	$ (5,103)	$(19,414)

	Year Ended December 31, 2016		
	As previously reported	Adjustments	**As Adjusted**
Net cash used in investing activities	$(35,982)	$ 1,779	$(34,203)
Net cash provided by financing activities	$22,190	$ (1,779)	$20,411

In January 2017, FASB issued ASU 2017-01, Business Combinations (Topic 805) Clarifying the Definition of Business. ASU 2017-01 clarifies the definition of a business with the objective of adding standard to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The update to the standard is effective for interim and annual periods beginning after December 15, 2017, and applied prospectively. The Company adopted this standard during 2018, with no material impact on its financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”), which gives direction on which changes to the terms or conditions of share-based payment awards require an entity to apply modification accounting in Accounting Standard Codification (“ASC”) Topic 718. In general, entities will apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company adopted this standard during 2018, with no material impact on its financial statements.

Recently issued accounting pronouncements and not yet adopted

In February 2016, the FASB issued ASU 2016-02, “Leases” (Topic 842). Topic 842 supersedes the lease requirements in Accounting Standards Codification (ASC) Topic 840, “Leases”. Under Topic 842 lessees will be required to recognize for all leases at the commencement date a lease liability; and a right-of-use asset (“ROU”). In July 2018, the FASB issued amendments in ASU 2018-11, which provide another transition method in addition to the existing transition method, by allowing entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption, and to not apply the new guidance in the comparative periods they present in the financial statements. The modified retrospective approach does not require applying the new standard to all leases existing at the date of initial application. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018. The Company will adopt this standard at January 1, 2019 (“the Transition Date”), using the modified retrospective approach at the beginning of the period of adoption through a cumulative-effect adjustment. The Company also expects to elect certain relief options offered in ASU 2016-02 including the package of practical expedients. Additionally, the Company intends to elect an accounting policy, by class of underlying asset to combine, lease and non-lease components.

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The Company expects the adoption of the standard will have a material impact on its consolidated balance sheets which will result in the recognition of ROU and lease liabilities of approximately $12,322 at the Transition Date. The most significant impact from recognition of ROU assets and lease liabilities relates to the Company's leased office space. However, the Company does not anticipate that the adoption of this standard will have a material impact on the operating expenses in its consolidated statements of operations since the expense recognition under this new standard will be similar to current practice.

In June 2016, the FASB Issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new standard requires financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The standard will be effective for the Company beginning January 1, 2020, with early adoption permitted. The Company is evaluating the impact of adopting this new accounting guidance on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04 (ASU 2017-04): Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. ASU 2017-04 eliminates step two of the goodwill impairment test and specifies that goodwill impairment should be measured by comparing the fair value of a reporting unit with its carrying amount. Additionally, the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets should be disclosed. ASU 2017-04 is effective for annual or interim goodwill impairment tests performed in fiscal years beginning after December 15, 2019, and early adoption is permitted. The Company is evaluating the impact of adopting this new accounting guidance on its consolidated financial statements.

NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS

a. On April 14, 2015, the Company acquired a 70% interest in Comblack IT Ltd. ("Comblack"), an Israeli-based company that specializes in software professional and outsourced management services mainly for mainframes and complex large-scale environments, for a total consideration of $1,821, of which $ 1,523 was paid upon closing and $ 298 which was payable contingent upon the acquired business meeting certain operational targets in 2015. The Company and the seller hold mutual Call and Put options respectively for the remaining 30% interest in Comblack. As a result of the Put option, the Company recorded redeemable non-controlling interest in the amount of $ 989.

Acquisition related costs were immaterial. The acquisition was accounted for by the purchase method.

The results of operations were included in the consolidated financial statements of the Company commencing April 1, 2015.

The following table summarizes the estimated fair values of the assets acquired and liabilities at the date of acquisition:

Net assets, excluding cash acquired	$(405)
Redeemable non-controlling interest	(989)
Intangible assets	1,249
Goodwill	1,966
Total assets acquired net of acquired cash	$1,821

In March 2016, the Company paid the seller the remaining contingent payments for meeting 2015 operational targets. As of December 31, 2018, the Comblack redeemable non-controlling interest amounted to $ 7,245.

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NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)

b. On June 30, 2015, the Company acquired a 70% interest in Infinigy Solutions LLC ("Infinigy"), a U.S.-based services company focused on expanding the development and implementation of technical solutions throughout the telecommunications industry with offices across the U.S., providing nationwide coverage and support for wireless engineering, deployment services, surveying, environmental service and project management, for a total consideration of $ 6,527, of which $ 5,600 was paid upon closing and $ 927 was payable contingent upon the acquired business meeting certain operational targets in 2016 and 2017. The Company and the seller hold mutual Call and Put options respectively for the remaining 30% interest in Infinigy. As a result of the Put option, the Company recorded redeemable non-controlling interest in the amount of $ 3,590. Acquisition related costs were immaterial. The acquisition was accounted for by the purchase method.

The results of operations were included in the consolidated financial statements of the Company commencing July 1, 2015.

The following table summarizes the estimated fair values of the assets acquired and liabilities at the date of acquisition:

Net assets, excluding cash acquired	$1,182
Redeemable Non-controlling interest	(3,590)
Intangible assets	3,675
Goodwill	5,260
Total assets acquired net of acquired cash	$6,527

In July 2016, the Company paid the seller $ 534 with respect to the acquired business meeting certain of its 2016 operational targets. In 2017, the acquired business did not meet its operational targets and therefore as of December 31, 2017, the seller is not entitled to any additional contingent payments.

As of December 31, 2018, the Infinigy redeemable non-controlling interest amounted to $ 3,886.

c. On July 11, 2016, the Company acquired a 60% interest in Roshtov Software Industries Ltd ("Roshtov"), an Israeli-based software company that is a market leader in Israel in patient record information systems, for a total cash consideration of $ 20,550, which was paid upon closing. The purchaser and the seller hold mutual Call and Put options respectively for the remaining 40% interest in Roshtov. As a result of the Put option, the Company recorded redeemable non-controlling interest in the amount of $ 14,012. Acquisition related costs were immaterial. The acquisition was accounted for by the purchase method.

The results of operations were included in the consolidated financial statements of the Company commencing July 2016.

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NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)

The following table summarizes the estimated fair values of the assets acquired and liabilities at the date of acquisition:

Net assets, excluding cash acquired	$15
Redeemable Non-controlling interest	(14,012)
Intangible assets	22,439
Deferred tax liability	(5,610)
Goodwill	17,718
Total assets acquired net of acquired cash	$20,550

As of December 31, 2018, Roshtov redeemable non-controlling interest amount to $ 14,408.

d. On October 31, 2016, the Company acquired a 100% interest in Shavit Software (2009) Ltd., an Israeli-based company that specializes in software professional and outsourced management services, for a total consideration of $ 6,836, of which $ 4,699 was paid upon closing, $ 2,137 (measured based on present value) was allocated to a deferred payment and contingent payment upon the acquired business meeting certain operational targets in 2017. The Company's management believes the acquisition will broaden its professional service offering to its existing and new customers in Israel. Acquisition related costs were immaterial. The acquisition was accounted for by the purchase method.

The results of operations were included in the consolidated financial statements of the Company commencing November 1, 2016.

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NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)

The following table summarizes the estimated fair values of the assets acquired and liabilities at the date of acquisition:

Net assets, excluding cash acquired	$533
Intangible assets	3,489
Deferred tax liability	(871)
Goodwill	3,685
Total assets acquired net of acquired cash	$6,836

During the years ended December 31, 2017 and 2018, the Company paid the seller $ 924 and $ 2,535, respectively with respect to deferred payment and contingent payment.

e. During the years ended December 31, 2017 and 2018, the Company acquired additional activities whose influence on the financial statements of the Company was immaterial, for a total consideration of $ 1,050 and $ 588, respectively.

The following table summarizes the provisional estimated fair values of the assets acquired and liabilities at the date of acquisitions:

	December 31,	
	2017	2018
Net assets, excluding cash acquired	$(1,822)	$306
Intangible assets	1,149	23
Goodwill	1,723	259
Total assets acquired net of acquired cash	$1,050	$588

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NOTE 4:- MARKETABLE SECURITIES

The Group invests in marketable debt securities, which were classified at fair value through profit or loss and as available-for-sale securities. The following is a summary of marketable securities:

a. Composition:

	December 31,	
	2017	2018
Fair value through profit or loss [1]	$1,209	$1,156
Available-for-sale	12,929	8,757
	$14,138	$9,913

(1) The Group recognized trading gains in the amount of $ 53 during the year ended December 31, 2018.

b. The following is a summary of marketable securities which are classified as available-for-sale:

	December 31, 2017				2018			
	Amortized cost	**Unrealized losses**	Unrealized gains	**Market value**	Amortized cost	**Unrealized losses**	Unrealized gains	**Market value**
Available-for-sale:								
Corporate bonds	$12,987	$ (58)	$ -	$12,929	$8,851	$ (94)	$ -	$ 8,757

Marketable securities with contractual maturities within one year and from one to three years are as follows:

	Amortized cost	Unrealized Gains	Unrealized Losses	Market value
Due within one year	$ 3,326	$ -	$ (21)	$ 3,305
Due after one year through three years	$ 5,525	$ -	$ (73)	$ 5,452
Total	$ 8,851	$ -	$ (94)	$ 8,757

As of December 31, 2017 and 2018, management believes the impairments are not other than temporary and therefore the impairment losses were recorded in accumulated other comprehensive income (loss).

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NOTE 4:- MARKETABLE SECURITIES (Cont.)

The following is the change in the other comprehensive income of available-for-sale securities during 2017:

	Other comprehensive income (loss)
Other comprehensive income from available-for-sale securities as of January 1, 2017	$ 40
Gains reclassified into earnings from marketable securities	(94)
Unrealized losses from available-for-sale securities	(4)
Other comprehensive loss from available-for-sale securities as of December 31, 2017	$ (58)

The following is the change in the other comprehensive income of available-for-sale securities during 2018:

	Other comprehensive loss
Other comprehensive loss from available-for-sale securities as of January 1, 2018	$ (58)
Unrealized losses from available-for-sale securities	(36)
Other comprehensive loss from available-for-sale securities as of December 31, 2018	$ (94)

NOTE 5:- FAIR VALUE MEASUREMENTS

In accordance with ASC 820, the Company measures its investment in marketable securities and foreign currency derivative contracts at fair value. Generally equity funds are classified within Level 1, this is because these assets are valued using quoted prices in active markets. Foreign currency derivative contracts, certain corporate bonds and convertible bonds are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

Contingent consideration is classified within Level 3. The Company values the Level 3 contingent consideration using discounted cash flow of the expected future payments, whose inputs include interest rate.

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NOTE 5:- FAIR VALUE MEASUREMENTS (Cont.)

The Company's financial assets and liabilities measured at fair value on a recurring basis, consisted of the following types of instruments:

	December 31, 2017 Fair value measurements using input type			
	Level 1	Level 2	Level 3	Total
Assets:				
Corporate bonds	$-	$12,929	$-	$12,929
Convertible bonds	-	1,209	-	1,209
Total financial assets	$-	$14,138	$-	$14,138
Liabilities:				
Contingent consideration	$-	$-	$1,333	$1,333
Total financials liabilities	$-	$-	$1,333	$1,333

	December 31, 2018 Fair value measurements using input type			
	Level 1	Level 2	Level 3	Total
Assets:				
Corporate bonds	$-	$8,757	$-	$8,757
Convertible bonds	-	1,156	-	1,156
Total financial assets	$-	$9,913	$-	$9,913
Liabilities:				
Contingent consideration	$-	$-	$414	$414
Total financials liabilities	$-	$-	$414	$414

Fair value measurements using significant unobservable inputs (Level 3):

	December 31,	
	2017	2018
Opening balance	$3,088	$1,333
Increase in contingent consideration due to acquisitions	-	124
Payment of contingent consideration	(2,109)	(974)
Increase in fair value of contingent consideration	1,587	210
Decrease in fair value of contingent consideration	(1,287)	(248)
Decrease in liability against other receivables	(118)	-
Amortization of interest and exchange rate	172	(31)
Closing balance	$1,333	$414

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NOTE 6:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2017	2018
Prepaid expenses	$2,659	$3,712
Government authorities	4,900	2,053
Related parties	314	303
Other	770	961
	$8,643	$7,029

NOTE 7:- PROPERTY AND EQUIPMENT

	December 31,	
	2017	2018
Cost:		
Leasehold improvements	$918	$981
Computers and peripheral equipment	14,842	15,221
Office furniture and equipment	3,778	3,774
Motor vehicles	1,237	1,217
Software	3,094	3,084
	23,869	24,277
Accumulated depreciation:		
Leasehold improvements	429	470
Computers and peripheral equipment	14,194	14,528
Office furniture and equipment	2,471	2,699
Motor vehicles	447	564
Software	2,860	2,944
	20,401	21,205
Depreciated cost	$3,468	$3,072

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NOTE 7:- PROPERTY AND EQUIPMENT (Cont.)

Depreciation expenses amounted to $ 893, $ 1,046 and $ 1,175 for the years ended December 31, 2016, 2017 and 2018, respectively.

NOTE 8:- INTANGIBLE ASSETS

a. Intangible assets:

	December 31,	
	2017	2018
Original amounts:		
Capitalized software costs	$75,126	$78,793
Customer relationships	56,296	54,850
Backlog and non-compete agreement	2,712	2,712
Acquired technology	13,087	12,722
	147,221	149,077
Accumulated amortization:		
Capitalized software costs	61,834	66,123
Customer relationships	27,967	33,578
Backlog and non-compete agreement	2,486	2,674
Acquired technology	3,923	5,223
	96,210	107,598
Intangible assets, net	$51,011	$41,479

b. Amortization expenses amounted to $ 10,715, $ 12,565 and $ 11,389 for the years ended December 31, 2016, 2017 and 2018, respectively.

c. The estimated future amortization expense of intangible assets as of December 31, 2018 is as follows:

2019	$10,323
2020	8,572
2021	7,057
2022	4,749
2023	3,546
2024 and thereafter	7,232
	$41,479

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NOTE 9:- GOODWILL

Changes in the carrying amount of goodwill for the years ended December 31, 2017 and 2018 according to the Company's reportable segments are as follows (see also Note 18):

	IT professional services	Software services	Total
As of January 1, 2017	$ 43,874	$47,128	$91,002
Business combination	1,723	-	1,723
Measurement period adjustments	614	28	642
Foreign currency translation adjustments	2,192	2,630	4,822
As of December 31, 2017	$ 48,403	$49,786	$98,189
Business combination	-	277	277
Measurement period adjustments	(18)	-	(18)
Foreign currency translation adjustments	(1,694)	(1,748)	(3,442)
As of December 31, 2018	$ 46,691	$48,315	$95,006

The Company performed an annual impairment tests as of December 31, of each of 2016, 2017 and 2018 and did not identify any impairment losses (see Note 2).

NOTE 10:- SHORT TERM DEBT

	Linkage basis	Interest rate %	December 31, 2017	2018
Short-term credit from banks	USD	U.S Prime -0.2	$2,125	$2,362
Short-term credit from banks	NIS	2.0	618	-

Short-term loans from banks	NIS	1.6-2.0	259	-
Current maturities of long-term loans from financial institution	NIS	2.6-3.0	6,769	6,299
			$9,771	$8,661

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NOTE 11:- ACCRUED EXPENSES AND OTHER ACCOUNTS PAYABLE

	December 31,	
	2017	2018
Employees and payroll accruals	$15,203	$16,242
Accrued expenses	6,234	6,219
Government authorities	4,738	1,426
Other	1,614	571
	$27,789	$24,458

NOTE 12:- LONG TERM DEBT

	Linkage basis	Interest rate %	December 31, 2017	2018
Loan from banks and other [1]	NIS	2.6-5	$34,447	$25,572
Other long term debt			136	115
			$34,583	$25,687
Current maturities	NIS		(6,769)	(6,299)
			$27,814	$19,388

(1) On November 2016, the Company obtained a loan in the amount of $ 31,356 linked to the New Israel Shekel from an Israeli financial institution. The principal amount of the loan is payable in seven equal annual installments with the final payment due on November 2, 2023 and bears a fixed interest rate of 2.60% per annum, payable in two semi-annual payments.

Under the terms of the loan with the Israeli financial institution, the Company has undertaken to maintain the following financial covenants, as they will be expressed in its consolidated financial statements, as described:

a. Total equity attributable to Magic Software Enterprises shareholders shall not be lower than $ 100,000 at all times;

b. The Company's consolidated cash and cash equivalent and marketable securities available for sales shall not be less than $ 10,000;

c. The ratio of the Company's consolidated total financial debts to consolidated total assets will not exceed 50%;

d. The ratio of the Company's total financial debts less cash, short-term deposits and short-term marketable securities to the annual EBITDA will not exceed 3.25 to 1; and

e. The Company shall not create any pledge on all of its property and assets in favor of any third party without the financial institution's consent.

As of December 31, 2018, the Company was in compliance with the financial covenants.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 13:- TAXES ON INCOME

a. Israeli taxation:

1. Corporate tax rate in Israel:

The Israeli corporate income tax rate was 25% in 2016, 24% in 2017 and 23% in 2018.

In December 2016, the Israeli Parliament approved the 2016 Amendment which reduced the corporate income tax rate to 24% (instead of 25%) effective from January 1, 2017 and to 23% effective from January 1, 2018.

2. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (“the Law”):

Effective January 1, 2011, the Knesset enacted the Law for Economic Policy for 2011 and 2012 (Amended Legislation), and among other things, amended the Law, (“the Amendment”). According to the Amendment, a flat corporate tax rate of 16% was established for exporting industrial enterprises (over 25%). The reduced tax rate will not be program dependent and will apply to the “Preferred Enterprise’s” (as such term is defined in the Investment Law) entire “preferred income”.

The Amendment also prescribes that any dividends distributed to individuals or foreign residents from the preferred enterprise’s earnings as above will be subject to tax at a rate of 20%.

The Company and one of its Israeli subsidiaries have elected to apply the new incentives regime under the Amendment to their industrial activity in Israel, subject to meeting its requirements, starting in 2011.

New Amendment- Preferred Technology Enterprise

In December 2016, the Israeli Knesset passed Amendment 73 to the Investment Law which included a number of changes to the Investments Law regimes. Certain changes were scheduled to come into effect beginning January 1, 2017, provided that regulations are promulgated by the Finance Ministry to implement the "Nexus Principles" based on OECD guidelines recently published as part of the Base Erosion and Profit Shifting (BEPS) project. The regulations were approved on May 1, 2017 and accordingly, these changes have come into effect. Applicable benefits under the new regime include:

Introduction of a benefit regime for "Preferred Technology Enterprises" granting a 12% tax rate in central Israel – on income deriving from Intellectual Property, subject to a number of conditions being fulfilled, including a minimal amount or ratio of annual R&D expenditure and R&D employees, as well as having at least 25% of annual income derived from exports. A Preferred Technology Enterprise ("PTE") is defined as an enterprise which meets the aforementioned conditions and for which total consolidated revenues of its parent company and all subsidiaries are less than NIS 10 billion.

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NOTE 13:- TAXES ON INCOME (Cont.)

A 12% capital gains tax rate on the sale of a preferred intangible asset to a foreign affiliated enterprise, provided that the asset was initially purchased from a foreign resident at an amount of NIS 200 million or more.

A withholding tax rate of 20% for dividends paid from PTE income (with an exemption from such withholding tax applying to dividends paid to an Israeli company). Such rate may be reduced to 4% on dividends paid to a foreign resident company, subject to certain conditions regarding percentage of foreign ownership of the distributing entity.

Starting 2017, part of the Company's taxable income in Israel is entitled to a preferred 12% tax rate under Amendment 73 to the Investment Law.

3. The Company's Israeli entities have received final tax assessments for their Israeli tax return filings through the year 2013.

4. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969:

The Company qualifies as an Industrial Company within the meaning of the Law for the Encouragement of Industry (Taxes), 1969 (the "Industrial Encouragement Law"). The Industrial Encouragement Law defines an "Industrial Company" as a company that is resident in Israel and that derives at least 90% of its income in any tax year, other than income from defense loans, capital gains, interest and dividends, from an enterprise whose major activity in a given tax year is industrial production. Under the Industrial Encouragement Law, the Company is entitled to amortization of the cost of purchased know-how and patents over an eight-year period for tax purposes as well as accelerated depreciation rates on equipment and buildings.

Eligibility for the benefits under the Industrial Encouragement Law is not subject to receipt of prior approval from any governmental authority.

5. Foreign Exchange Regulations:

Under the Foreign Exchange Regulations, the Company and one of its Israeli subsidiaries calculate their tax liability in U.S. dollars according to certain orders. The tax liability, as calculated in U.S. dollars is translated into NIS according to the exchange rate as of December 31 of each year.

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NOTE 13:- TAXES ON INCOME (Cont.)

b. Non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective domiciles of residence. If earnings are distributed to Israel in the form of dividends or otherwise, the Company may be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and foreign withholding tax rates.

Neither Israeli income taxes, foreign withholding taxes nor deferred income taxes were provided in relation to undistributed earnings of the non-Israeli subsidiaries. This is because the Company intends to permanently reinvest undistributed earnings in the foreign subsidiaries in which those earnings arose. If these earnings were distributed in the form of dividends or otherwise, the Company would be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and non-Israeli withholding taxes.

The amount of the Company’s cash and cash equivalents that are currently held outside of Israel that would be subject to income taxes if distributed as dividends is $ 12,865. However, a determination of the amount of the unrecognized deferred tax liability for temporary difference related to those undistributed earnings of foreign subsidiaries is not practicable due to the complexity of the structure of our group of subsidiaries for tax purposes and the difficulty of projecting the amount of future tax liability.

Tax Reform- United States of America

The U.S. Tax Cuts and Jobs Act of 2017 (“TCJA”) was approved by the U.S. Congress on December 20, 2017 and signed into law by U.S. President Donald J. Trump on December 22, 2017. This legislation makes complex and significant changes to the U.S. Internal Revenue Code. Such changes include a reduction in the corporate tax rate and limitations on certain corporate deductions and credits, among other changes.

The TCJA reduces the U.S. federal corporate income tax rate from 35% to 21% effective January 1, 2018. In addition, the TCJA makes certain changes to the depreciation rules and implements new limits on the deductibility of certain expenses and deduction.

The Company’s subsidiaries in the United States do not have any foreign subsidiaries and, therefore, the remaining provisions of the TCJA have no material impact on the Company’s results of operations.

The Company re-measured its U.S. deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future. The estimated tax benefit recorded related to the re-measurement of the provisional net deferred taxes was approximately $ 428 for the year ended December 31, 2017.

In March 2018, the FASB issued Accounting Standards Update No. 2018-05, “Income Taxes Topic (740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118” (“ASU 2018-05”) to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the TCJA.

The Company completed the accounting treatment related to the tax effects of the TCJA. As a result, the Company recognized its accounting for changes in the U.S. federal rate and deferred tax impact for the rate change to be complete.

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NOTE 13:- TAXES ON INCOME (Cont.)

c. Net operating loss carryforwards:

As of December 31, 2018, three Israeli subsidiaries of the Company had operating loss carryforwards of $ 13,542 (mainly F.T.S Formula Telecom Solutions, Ltd.) which accounts for $ 11,360), which can be carried forward to offset against taxable income in the future for an indefinite period.

One of the Company's subsidiaries in England had estimated total available tax loss carryforwards of $ 3,876 as of December 31, 2018, which can be carried forward to offset against future taxable income.

d. Income before taxes on income:

	Year ended December 31,		
	2016	2017	2018
Domestic	$15,334	$19,442	$25,839
Foreign	5,323	4,803	6,008
	$20,657	$24,245	$31,847

e. Taxes on income:

Taxes on income (tax benefit) consist of the following:

	Year ended December 31,		
	2016	2017	2018
Current:			
Domestic	$2,919	$5,928	$5,186

Foreign	1,863	1,511	1,359
	4,782	7,439	6,545
Deferred taxes:			
Domestic	(666)	(1,160)	81
Foreign	(167)	52	445
	(833)	(1,108)	526
Taxes on income	$3,949	$6,331	$7,071

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NOTE 13:- TAXES ON INCOME (Cont.)

f. Deferred tax assets and liabilities:

Deferred 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 assets are as follows:

	December 31,	
	2017	2018
Net operating loss carryforwards	$4,355	$3,914
Allowances, reserves and intangible assets	1,974	1,361
Deferred tax assets before valuation allowance	6,329	5,275
Less - valuation allowance	(3,339)	(3,417)
Deferred tax assets, net	$2,990	$1,858

	December 31,	
	2017	2018
Long-term tax assets	$2,990	$1,858
Long-term tax liabilities	(11,331)	(10,343)
Net deferred tax liabilities	$(8,341)	$(8,485)

Deferred tax liabilities are mainly in respect of certain property and equipment, acquired intangible assets and capitalized software costs.

The Company has provided valuation allowances in respect of certain deferred tax assets resulting from operating losses carry forwards and other reserves and allowances due to uncertainty concerning realization of these deferred tax

assets.

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NOTE 13:- TAXES ON INCOME (Cont.)

g. Reconciliation of the theoretical tax expense to the actual tax expense:

A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income for an Israeli company (2016, 2017 and 2018 statutory tax rate 25%, 24% and 23%, respectively), and the actual tax expense as reported in the statements of income is as follows:

	Year ended December 31,		
	2016	2017	2018
Income before taxes, as reported in the consolidated statements of income	$20,657	$24,245	$31,847
Statutory tax rate	25 %	24 %	23 %
Theoretical tax expenses on the above amount at the Israeli statutory tax rate	$5,164	$5,819	$7,325
Tax adjustment in respect of different tax rates	(1,214)	268	(826)
Deferred taxes on losses for which full valuation allowance was provided in the past	(455)	658	(11)
Tax-deductible costs, not included in the accounting costs	(342)	(38)	-
Tax benefits (expenses) in respect of prior years, net	1,262	(488)	(22)
Nondeductible expenses	(232)	70	45
Uncertain tax position and other differences	(234)	42	560
Income tax	$3,949	$6,331	$7,071

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NOTE 13:- TAXES ON INCOME (Cont.)

h. The Company applies ASC 740, "Income Taxes" with regards to tax uncertainties. During the years ended December 31, 2016, 2017 and 2018 the Company recorded $ 159, $ 300 and $ 1,050 (respectively) of tax expenses as a result of this application.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

Gross unrecognized tax benefits at January 1, 2016	$666
Increase in tax positions taken in prior years	159
Decrease in tax positions taken in prior years	-
Gross unrecognized tax benefits at December 31, 2016	825
Increase in tax positions taken in prior years	300
Decrease in tax positions taken in prior years	-
Gross unrecognized tax benefits at December 31, 2017	1,125
Increase in tax positions taken in prior years	1,050
Decrease in tax positions taken in prior years	-
Gross unrecognized tax benefits at December 31, 2018	$2,175

Although the Company believes that it has adequately provided for any reasonably foreseeable outcomes related to tax audits and settlement, there is no assurance that the final tax outcome of its tax audits will not be different from that which is reflected in the Company's income tax provisions. Such differences could have a material effect on the Company's income tax provision, cash flow from operating activities and net income in the period in which such determination is made.

NOTE 14:- EQUITY

a. The Ordinary shares of the Company are listed on the NASDAQ Global Select Market in the United States and are traded on the Tel-Aviv Stock Exchange in Israel.

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NOTE 14:- EQUITY (Cont.)

b. Stock Option Plans:

Under the Company's 2007 Stock Option Plan, as amended ("the 2007 Plan"), options may be granted to employees, officers, directors and consultants of the Company and its subsidiaries. Pursuant to the original 2007 Stock Option Plan, the Company reserved 1,500,000 Ordinary shares for issuance. In 2012, the Company increased the number of Ordinary shares reserved for issuance under the 2007 Plan by additional 1,000,000 Ordinary shares.

On December 31, 2015 the Company's Board of Directors increased the amount of Ordinary shares reserved for issuance under the 2007 Plan by additional 250,000 Ordinary shares and extended the 2007 Plan by 10 years whereas it will expire on August 1, 2027. As of December 31, 2018, an aggregate of 962,500 Ordinary shares of the Company are available for future grants under the 2007 Plan. Each option granted under the 2007 Plan is exercisable for a period of ten years from the date of the grant of the option

The exercise price for each option is determined by the Board of Directors and set forth in the Company's award agreement. Unless determined otherwise by the Board of Directors, the option exercise price shall be equal to or higher than the share market price at the grant date. The options generally vest over 3-4 years. Any option that is forfeited or canceled before expiration becomes available for future grants under the 2007 Plan.

A summary of employee option activity under the 2007 Plan as of December 31, 2018 and changes during the year ended December 31, 2018 are as follows:

Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value

Outstanding at January 1, 2018	309,309	$ 4.38	3.97	$ 1,237
Granted	37,500	$ -		
Exercised	(104,167)	$ 2.99		
Forfeited	(21,875)	$ 6.89		
Outstanding at December 31, 2018	220,767	$ 3.83	3.81	$ 1,684
Exercisable at December 31, 2018	190,767	$ 4.43	2.92	$ 1,456

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NOTE 14:- EQUITY (Cont.)

The aggregate intrinsic value in the table above represents the total intrinsic value that would have been received by the option holders had all option holders exercised their options on December 31, 2018. This amount is changed based on the market value of the Company's Ordinary shares. Total intrinsic value of options exercised during the years ended December 31, 2016, 2017 and 2018 was $ 112, $ 502 and $ 617, respectively. As of December 31, 2018, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plans.

The options outstanding as of December 31, 2018, have been separated into ranges of exercise price categories, as follows:

Exercise price	Options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable	**Weighted average exercise price of exercisable options**
In $					
0-1	30,000	9.49	$ -	-	$ -
2.01-3	66,000	1.26	$ 2.32	66,000	$ 2.32
3.01-4	73,517	2.77	$ 4.00	73,517	$ 4.00
5.01-6	6,250	4.61	$ 6.00	6,250	$ 6.00
8.01-9	45,000	5.35	$ 8.01	45,000	$ 8.01
	220,767	3.81	$ 3.83	190,767	$ 4.43

c. Accumulated other comprehensive income (loss):

December 31,

	2016	2017	2018
Accumulated realized and unrealized gain (loss) on available-for-sale securities, net	$40	$(58)	$(94)
Accumulated foreign currency translation adjustments	(7,494)	115	(6,057)
Accumulated unrealized gain on derivative instruments, net	26	26	26
Total other comprehensive income (loss)	$(7,428)	$83	$(6,125)

d. On September 4, 2012, the Company's Board of Directors adopted a dividend distribution policy, subject to any applicable law. According to this policy, each year the Company will distribute a dividend of up to 50% of its annual distributable profits. It is possible that the Board of Directors will decide, subject to the conditions stated above, to declare additional dividend distributions. The Company's Board of Directors may at its discretion and at any time, change, the rate of dividend distributions and/or not to distribute a dividend, whether as a result of a one-time decision or a change in policy, all at its discretion.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 14:- EQUITY (Cont.)

In respect to the policy mentioned above, from September 10, 2012 through September 4, 2014 the Company declared accumulated cash dividend distributions of $ 0.525 per share ($ 20,111 in the aggregate). On February 5, 2015, the Company declared a dividend distribution of $ 0.081 per share ($ 3,582 in the aggregate) which was paid on March 11, 2015. On August 12, 2015, the Company declared a dividend distribution of $ 0.095 per share ($ 4,204 in the aggregate) which was paid on September 10, 2015. On February 21, 2016, the Company declared a dividend distribution of $ 0.09 per share ($ 3,991 in the aggregate) which was paid on March 17, 2016. On August 14, 2016, the Company declared a dividend distribution of $ 0.085 per share ($ 3,770 in the aggregate) which was paid on September 22, 2016. On February 22, 2017, the Company declared a dividend distribution of $ 0.085 per share ($ 3,775 in the aggregate) which was paid on April 5, 2017.

On August 9, 2017, the Company’s Board of Directors decided to amend the dividend distribution policy announced in 2012. According to the Company’s amended policy, each year the Company will distribute a dividend of up to 75% of its annual distributable profits. The Company’s Board of Directors may at its discretion and at any time, change, whether as a result of a one-time decision or a change in policy, the rate of dividend distributions and/or decide not to distribute a dividend, all at its discretion. On August 13, 2017, the Company declared a dividend distribution of $ 0.13 per share ($ 5,779 in the aggregate) which was paid on September 13, 2017. On February 28, 2018, the Company declared a dividend distribution of $ 0.13 per share ($ 5,785 in the aggregate) which was paid on March 26, 2018. On August 8, 2018, the Company declared a dividend distribution of $ 0.155 per share ($ 7,563 in the aggregate) which was paid on September 5, 2018.

Subsequent to the balance sheet date, on March 4, 2019, the Company declared a dividend distribution of $ 0.15 per share ($ 7,334 in the aggregate) which was paid on March 27, 2019 (Note 21).

e. On July 12, 2018, the Company issued 4,268,293 ordinary shares at a price of $8.2 per share and in a total amount of $34,569 net of issuance expenses. The shares were issued to Israeli institutional investors and to our controlling shareholder, Formula Systems (1985) Ltd.

NOTE 15:- RELATED PARTIES TRANSACTIONS

Agreements with controlling shareholder and its affiliates:

The Company has in effect agreements with affiliated companies pursuant to which the Company has rendered services amounting to approximately $ 3,950, $ 2,511 and $ 2,535, in aggregate for the years ended December 31, 2016, 2017 and 2018, respectively and acquired services amounting to approximately $ 102, $ 165 and $ 309 for the years ended December 31, 2016, 2017 and 2018, respectively.

As of December 31, 2017 and 2018, the Company had trade and other receivables balances due to its related parties in amount of approximately $ 931 and $ 601, respectively. In addition, as of December 31, 2017 and 2018, the Company had trade payables balances due from its related parties in amount of approximately $ 64 and $ 106, respectively.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 16:- COMMITMENTS AND CONTINGENCIES

a. Lease commitments:

Certain of the motor vehicles, facilities and equipment of the Company and its subsidiaries are rented under long-term operating lease agreements. Future minimum lease commitments under non-cancelable operating leases as of December 31, 2018, are as follows:

2019	$2,224
2020	1,698
2021	977
2022 and thereafter	1,336
	$6,235

Rent expenses for the years ended December 31, 2016, 2017 and 2018 were approximately $ 2,204, $ 2,729 and $ 2,843, respectively.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 16:- COMMITMENTS AND CONTINGENCIES (Cont.)

The Company and its subsidiaries currently occupy approximately 170,363 square feet of space based on a lease agreement as of December 31, 2018. The remaining terms of the outstanding leases range from six months to five years.

As of December 31, 2018, the aggregated amount of lease commitment in all locations mentioned above is approximately $ 6,235.

b. Guarantees and Collaterals:

As of December 31, 2018, the Company has provided performance bank guarantees in the amount of $453 as security for the performance of various contracts with customers. As of December 31, 2018, the Company has restricted bank deposits of $ 408 in favor of the issuing banks.

c. From time to time, the Company and/or its subsidiaries are subject to legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to intellectual property, contracts, employment and other matters. The Company accrues a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. These accruals are reviewed and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter.

Lawsuits have been brought against the Company in the ordinary course of business. The Company intends to defend itself vigorously against those lawsuits.

d.

In September 2016, an Israeli software company, that was previously involved in an arbitration proceeding with us in 2015 and won damages from us for $2.4 million, filed a lawsuit seeking damages of NIS 34,106 against the Company and one its subsidiaries. This lawsuit was filed as part of an arbitration proceeding.. In the lawsuit, the software company claimed that warning letters that the Company sent to its clients in Israel and abroad, warning those clients against the possibility that the conversion procedure offered by the software company may amount to an infringement of the Company's copyrights (the "Warning Letters"), as well as other alleged actions, have caused the software company damages resulting from loss of potential business. The lawsuit is based on rulings given in the 2015 arbitration proceeding in which it was allegedly ruled that the Warning Letters constituted a breach of a non-disclosure agreement (NDA) signed between the parties.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 16:- COMMITMENTS AND CONTINGENCIES (Cont.)

The Company rejects the claims by the Israeli software company and moved to dismiss the lawsuit entirely. At this point, all the relevant motions have been filed and all witnesses deposed. The Company is unable to make a reasonably reliable estimate of its chances of successfully defending this lawsuit.

In February 2018, Comm-IT Ltd., a subsidiary of the Company commenced an action against a customer for payment of an overdue amount in the Supreme Court of the State of New York, New York County. In April 2018, the customer filed an answer in the action that included counterclaims asserting causes of action for breach of contract, fraud, and trespass to chattel. In May 2018, Comm-IT filed a reply to the counterclaims. The parties have agreed to participate in a mediation before a neutral mediator in March 2019. While it appears that the allegations against Comm-IT probably do not have merit, it is difficult to predict at this point whether Comm-IT’s liability is remote or probable.

NOTE 17:- NET EARNINGS PER SHARE

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

	Year ended December 31,		
	2016	2017	2018
Net income attributable to Magic shareholders	$14,169	$15,442	$19,883
Accretion of redeemable non-controlling interests	$(2,262)	$-	$(1,726)
Net income attributable to Magic shareholders after accretion of redeemable non-controlling interests	$11,907	$15,442	$18,157
Weighted average Ordinary shares outstanding:			
Denominator for basic net earnings per share	44,347,083	44,435,671	46,665,042
Effect of dilutive securities	168,953	161,548	131,648
Denominator for diluted net earnings per share	44,516,036	44,597,219	46,796,690

Basic and Diluted earnings per share	$0.27	$0.35	$0.39

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 18:- SEGMENT GEOGRAPHICAL INFORMATION AND MAJOR CUSTOMERS

a. The Company reports its results on the basis of two reportable business segments: software services (which include proprietary and none proprietary software technology) and IT professional services.

The Company evaluates segment performance based on revenues and operating income of each segment. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. This data is presented in accordance with ASC 280, “Segment Reporting.”

Headquarters’ general and administrative costs have not been allocated between the different segments.

Software services

The Company develops markets, sells and supports a proprietary and none proprietary application platform, software applications, business and process integration solutions and related services.

IT professional services

The Company offers advanced and flexible IT services in the areas of infrastructure design and delivery, application development, technology planning and implementation services, communications services and solutions, as well as supplemental outsourcing services.

There are no significant transactions between the two segments.

b. The following is information about reported segment results of operation:

	Software services	**IT professional services**	**Unallocated expense**	Total
2016				
Total revenues	$ 70,834	$ 130,812	$ -	$ 201,646
Expenses	58,847	118,414	3,298	180,559
Segment operating income (loss)	$ 11,987	$ 12,398	$ (3,298)	$ 21,087
Depreciation and amortization	$ 7,531	$ 3,769	$ 308	$ 11,608

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 18:- SEGMENT GEOGRAPHICAL INFORMATION AND MAJOR CUSTOMERS (Cont.)

	Software services	**IT professional services**	**Unallocated expense**	Total
2017				
Total revenues	$ 77,100	$ 181,040	$ -	$ 258,140
Expenses	63,649	164,558	3,977	232,184
Segment operating income (loss)	$ 13,451	$ 16,482	$ (3,977)	$ 25,956
Depreciation and amortization	$ 9,242	$ 4,100	$ 269	$ 13,611
2018				
Total revenues	$ 81,332	$ 203,043	$ -	$ 284,375
Expenses	63,902	183,985	4,790	252,677
Segment operating income (loss)	$ 17,430	$ 19,058	$ (4,790)	$ 31,698
Depreciation and amortization	$ 8,727	$ 3,611	$ 226	$ 12,564

c. The Company’s business is divided into the following geographic areas: United States, Israel, Europe, Japan and other regions. Total revenues are attributed to geographic areas based on the location of the customers.

The following table presents total revenues classified according to geographical destination for the years ended December 31, 2016, 2017 and 2018:

	Year ended December 31,		
	2016	2017	2018
United States	$ 100,470	$ 123,113	$ 137,066

Israel	58,079	91,917	103,850
Europe	23,642	26,635	28,257
Japan	11,226	9,253	9,797
Other	8,229	7,222	5,405
	$201,646	$258,140	$284,375

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 18:- SEGMENT GEOGRAPHICAL INFORMATION AND MAJOR CUSTOMERS (Cont.)

d. The Company's long-lived assets are located as follows:

	December 31,	
	2017	2018
Israel	$111,217	$100,206
United States	32,223	30,222
Japan	5,008	5,082
Other	2,931	2,800
Europe	1,289	1,247
	$152,668	$139,557

e. The Company does not allocate its assets to its reportable segments; accordingly, asset information by reportable segments is not presented.

f. In 2016, 2017 and 2018, the Company had one major customer, included in the IT professional services segment, which accounted for 9%, 13% and 13% of the group revenues, respectively.

NOTE 19:- REVENUE RECOGNITION

The Company adopted ASC 606 on January 1, 2018 for all open contracts at the date of initial application, and applied the standard using modified retrospective approach, with the cumulative effect of applying ASC 606 recognized as an adjustment to the opening retained earnings balance. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 19:- REVENUE RECOGNITION (Cont.)

The following table includes estimated revenue expected to be recognized in future periods related to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period and are part of a contract that has an original expected duration of more than one year:

	2019	2020	2021 and thereafter
Software license and related revenues and consulting services	$5,281	$5,183	$ 969

The following table includes the impact of the adoption of ASC 606 on the Company's financial statements. There was no material impact on other line items of statements of income and balance sheets:

	Year ended December 31, 2018		
	As reported	Balance without adoption ASC 606	**Effect of change higher/ (lower)**
	(U.S. dollars in thousands)		
Revenue	$284,375	$282,263	$ 2,112
Taxes on income	7,071	6,809	262
Net income	24,776	22,926	1,850
Net income attributable to Magic Software Enterprises' shareholders	$19,883	$18,033	$ 1,850
Basic and diluted earnings per share	0.39	0.35	0.04

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 19:- REVENUE RECOGNITION (Cont.)

	December 31, 2018		
	As reported	Balance without adopting ASC 606	Effect of change higher/(lower)
	(U.S. dollars in thousands)		
Trade receivables (net of allowance for doubtful accounts)	$90,274	$87,853	$ 2,421
Other accounts receivable and prepaid expenses	7,029	8,984	(1,955)
Other long-term receivables	6,363	4,717	1,646
Accrued expenses and other accounts payable	24,458	24,196	262
Total equity attributable to Magic Software Enterprises' shareholders	$243,956	$242,106	$ 1,850

The most significant impact of the new standard relates to term-license arrangements. Under ASC 605, the Company recognized both the term-license and post contract support revenues ratably over the contract period whereas under the new revenue standard term-license revenues are considered as a separate performance obligation and recognized upon delivery and the associated post contract support revenues are recognized over the contract period.

There was no material impact on other line items of consolidated statements of income, consolidated balance sheets and no impact on the Company's cash from or used in operating, financing, or investing activities in consolidated cash flows statements.

For disaggregation of revenue, refer to note 18.

Contract balances:

The following table provides information about trade receivables, contract assets (unbilled receivables) and contract liabilities (deferred revenues) from contracts with customers (in thousands):

	December 31,	
	2017	2018
Trade receivables (net of allowance for doubtful accounts)	$82,051	$90,274
Deferred revenues	$5,586	$4,857

Trade receivable are recorded when the right to consideration becomes unconditional, and an invoice is issued to the customer. Unbilled receivables related to the Company’s contractual right to consideration for services performed and not yet invoiced.

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MAGIC SOFTWARE ENTERPRISES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 19:- REVENUE RECOGNITION (Cont.)

Billing terms and conditions generally vary by contract type. Amounts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals (e.g., monthly or quarterly) or upon achievement of contractual milestones.

Deferred revenues represent contract liabilities, and include unearned amounts received under contracts with customers and not yet recognized as revenues.

During the year ended December 31, 2018, the Company recognized $5,586 that was included in deferred revenues (short-term contract liability) balance at January 1, 2018.

NOTE 20:- SELECTED STATEMENTS OF INCOME DATA

a. Research and development costs, net:

	Year ended December 31,		
	2016	2017	2018
Total costs	$10,063	$10,713	$9,362
Less - capitalized software costs	(4,224)	(3,771)	(3,666)
Research and development, net	$5,839	$6,942	$5,696

b. Financial income (expenses), net:

Bank charges and interest from loans offset by interest from short term deposits	$(199)	$(1,124)	$(986)
Interest expenses related to liabilities in connection with acquisitions	(257)	(62)	(4)
	240	284	284

Interest income from marketable securities, net of amortization of premium on marketable securities			
Gain (loss) arising from foreign currency translation and other	(214)	(809)	855
Financial income (expenses), net	$(430)	$(1,711)	$149

NOTE 21:- SUBSEQUENT EVENTS

On March 4, 2019, the Company declared a dividend distribution of $ 0.15 per share ($ 7,334 in the aggregate) which was paid on March 27, 2019. The dividend distribution relates to the Company’s earnings in the second half of 2018.

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MAGIC SOFTWARE ENTERPRISES LTD.

APPENDIX TO CONSOLIDATED FINANCIAL STATEMENTS

DETAILS OF SUBSIDIARIES AND AFFILIATE

Details of the percentage of control of the share capital and voting rights of subsidiaries and an affiliate as of December 31, 2018:

Name of Company	Percentage of ownership and control %	Place of incorporation
Magic Software Japan K.K.	100	Japan
Magic Software Enterprises Inc.	100	U.S.A.
Magic Software Enterprises (UK) Ltd.	100	U.K.
Hermes Logistics Technologies Limited.	100	U.K.
Magic Software Enterprises Spain Ltd.	100	Spain
Coretech Consulting Group Inc.	100	U.S.A
Coretech Consulting Group LLC.	100	U.S.A
Fusion Solutions LLC.	100	U.S.A
Fusion Technical Solutions LLC.	49	U.S.A
Xsell Resources Inc.	100	U.S.A
Magic Software Enterprises (Israel) Ltd.	100	Israel
Magic Software Enterprises Netherlands B.V.	100	Netherlands
Magic Software Enterprises France	100	France
Magic Beheer B.V.	100	Netherlands
Magic Benelux B.V.	100	Netherlands
Magic Software Enterprises GMBH	100	Germany
Magic Software Enterprises India Pvt. Ltd.	100	India
Onyx Magyarorszag Szsoftverhaz .	100	Hungary
Magix Integration (Proprietary) Ltd.	100	South Africa
Appbuilder Solutions Ltd.	100	U.K.
Complete Business Solutions Ltd.	100	Israel
DataMind Technologies Ltd.	80	Israel
Comm-IT Technology Solutions Ltd.	77.8	Israel
Comm-IT Software Ltd. (a subsidiary of Comm-IT Technology Solutions Ltd.)	100	Israel
Comm-IT Embedded Ltd. (a subsidiary of Comm-IT Technology Solutions Ltd.)	75	Israel
Valinor Ltd. (a subsidiary of Comm-IT Technology Solutions Ltd.)	100	Israel
Dario IT Solutions Ltd. (a subsidiary of Comm-IT Technology Solutions Ltd.)	100	Israel

Quickode Ltd. (a subsidiary of Comm-IT Technology Solutions Ltd.)	100	Israel
Twingo Ltd. (a subsidiary of Comm-IT Technology Solutions Ltd.)	60	Israel
Pilat (North America), Inc	100	U.S.A
Pilat Europe Ltd.	100	U.K.
Roshtov Software Industries Ltd.	60	Israel
BridgeQuest Labs, Inc	100	U.S.A
BridgeQuest, Inc.	100	U.S.A
Allstates Consulting Services LLC	100	U.S.A
F.T.S Formula Telecom Solutions, Ltd.	100	Israel
F.T.S Bulgaria Ltd.	100	Bulgaria
Comblack IT Ltd.	70	Israel
Yes-IT Ltd. (a subsidiary of Comblack IT Ltd.)	100	Israel

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MAGIC SOFTWARE ENTERPRISES LTD.

APPENDIX TO CONSOLIDATED FINANCIAL STATEMENTS

DETAILS OF SUBSIDIARIES AND AFFILIATE (Cont.)

Name of Company	Percentage of ownership and control %	Place of incorporation
Shavit Software (2009) Ltd. (a subsidiary of Comblack IT Ltd.)	100	Israel
Infinigy (UK) holdings limited	100	U.K.
Infinigy (US) holding Inc.	100	U.S.A
Infinigy Solutions LLC.	70	U.S.A
Infinigy Engineering LLP (a subsidiary of Infinigy Solutions LLC.)	99.9	U.S.A
Skysoft Solutions Ltd.	75	Israel
Futurewave Systems, INC.	100	U.S.A

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Magic Software Japan K. K.

Opinion on the Financial Statements

We have audited the accompanying statements of financial position of Magic Software Japan K.K. (the "Company") as of December 31, 2017 and 2018, and the related statements of comprehensive income and cash flows for each of the three years in the period ended December 31, 2018. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2018, and the related statements of comprehensive income and cash flows for each of the three years in the period ended December 31, 2018 in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on Section 404 of the Sarbanes-Oxley Act ("SOA") and our report dated February 6, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall

presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Tokyo, Japan

February 6, 2019 /s/ KDA Audit Corporation
KDA Audit Corporation

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Magic Software Japan K. K.

Opinion on Internal Control over Financial Reporting

We have audited Magic Software Japan K.K.'s (the "Company") internal control over financial reporting as of December 31, 2018, based on Section 404 of the Sarbanes-Oxley Act ("SOA"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on Section 404 of the Sarbanes-Oxley Act ("SOA").

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statements of financial position of the Company as of December 31, 2017 and 2018, and the related statements of comprehensive income and cash flows for each of the three years in the period ended December 31, 2018 and our report dated February 6, 2019 expressed unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assessment of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the entity's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and directors of the entity; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Tokyo, Japan

February 6, 2019 /s/ KDA Audit Corporation
KDA Audit Corporation

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Magic Software Enterprises LTD.

By: /s/ Guy Bernstein
Name: Guy Bernstein
Title: Chief Executive Officer

Dated: April 30, 2019