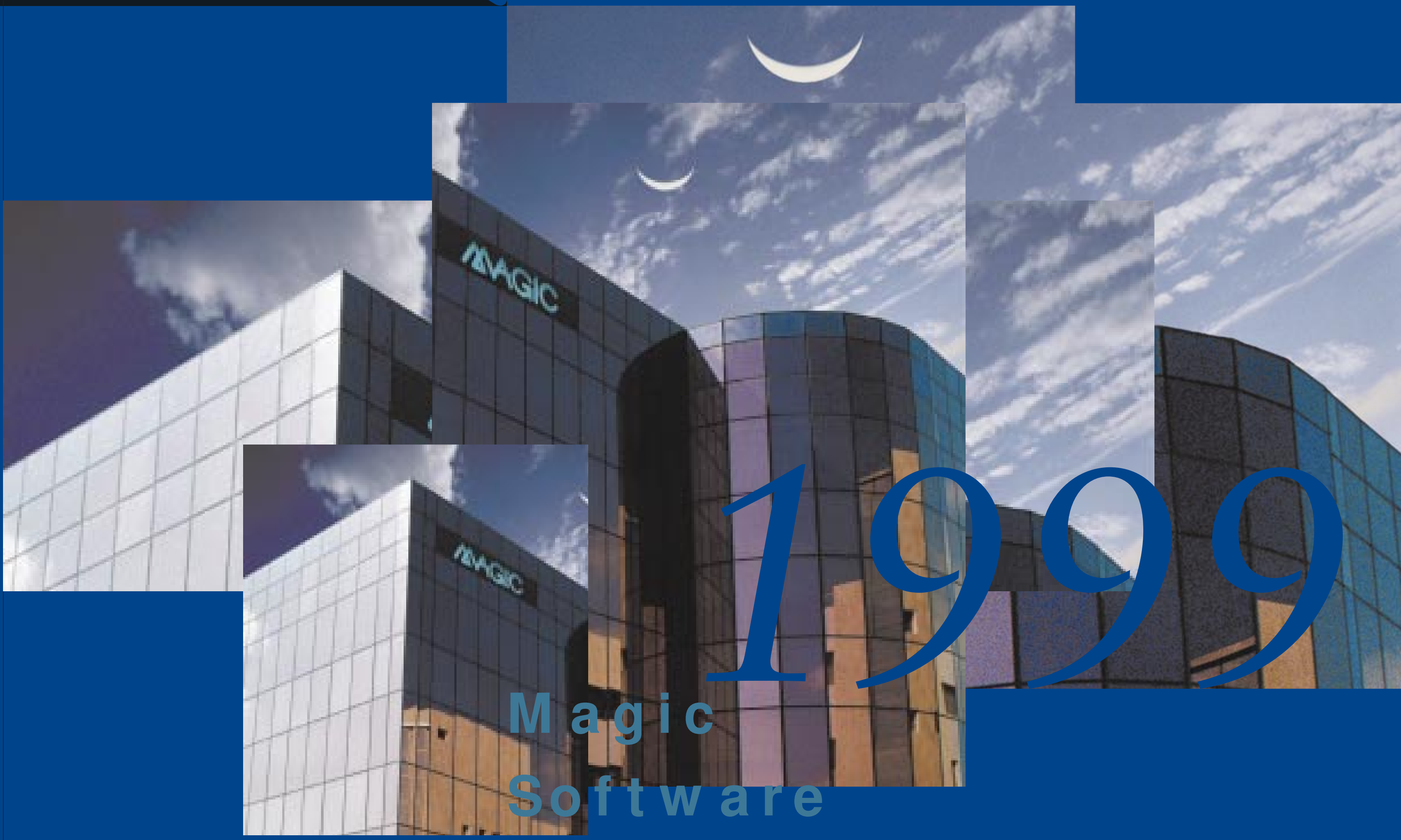
Integrating
Tomorrow's Solutions
Today

Annual Report & Accounts 1999



1999

Magic Software Enterprises Ltd.

Magic Software Enterprises

A Formula Group Company


MAGIC

To Our Shareholders:

1999 was a good year for Magic Software Enterprises. The Magic Community increased in both size and strength as we began implementing our growth strategy. We built on the turnaround we had begun in 1998 to deliver sustained profitability throughout the year. Revenues for 1999 increased to $64.0 million from $38.8 million recorded in the previous year. Net income for the year was $10.9 million compared to the $6.5 million loss posted for 1998. Other signs of Magic's strengthening financial position are evident in its improved margins and cash position. Magic increased its gross profit from $23 million in 1998 to $45 million in 1999. Magic's cash position rose significantly, from $5.8 million in the fourth quarter of 1998 to $8.3 million. For the fourth quarter ended December 31, 1999, Magic reported record revenues of $18.6 million, the highest sales ever recorded by the Company in a single quarter.

Magic's decision to move into the applications arena began to bear fruit in 1999. Revenues from our e-commerce application "Magic eMerchant" increased with sales to Seabrex, NoRegrets, Al Friedman, Bonfiglioli, MiTAC, and others. We invested time in 1999 building our Customer Relationship Management (CRM) strategy for introduction in 2000. Magic's integrated CRM Suite of eService, eContact, eSales, and eCapture applications will contain all the components necessary for a company to incrementally implement a CRM strategy. The CRM Suite has already received the CRM Excellence Award from Technology Marketing Corporation.

We continue to invest in our core technology, which maintains its position at the heart of our Magic Community and of our growth strategy. Without their solid foundation in this powerful e-business engine, our applications would not be able to effectively compete in today's markets. In 1999 we introduced Magic V8.30 for the Windows, AS/400, UNIX, and Linux platforms. This release included Magic Web Online, an advanced technology that enables client/server-like functionality in the Web environment. In this coming year, we plan for the 2001 release of the Web-centric Magic V9 with extra Development and Quality Assurance personnel.

Awareness of Magic in the Linux developer community increased in 1999, as Magic took a seat on the Board of Directors of Linux International and announced a developer partnership agreement with Red Hat, Inc.

Last year also saw continued growth with the acquisition of Magic distributors and key Magic Solution Providers from the Magic Community. We increased our holdings in Magic Japan to 100%, in Magic India to 51%, in Magic Thailand to 70%, and in Magic Australia to 100%. Magic acquired majority holdings in Onyx, its Hungarian distributor, and in Open Sesame Systems, its Canadian distributor. We also acquired a majority share in Caswell Logistics BV, a Magic Solution Provider based in the Netherlands, and a minority holding in Manov, the Israeli software house responsible for the development of eContact, Magic's new call center software offering. These acquisitions help to grow our company size, while bringing us the skills and human resources essential to the services side of our business.

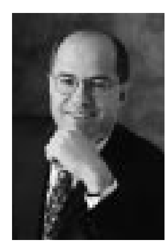
In February 2000 we completed a Secondary Public Offering of 3.5 million shares, comprised of a 3:1 share dividend and priced at $25 per share. This successful Offering raised $80.6 million that will be used to help fund our growth strategy.

As predicted in last year's Annual Report, 1999 was indeed a record-breaking year for our Company. We plan to increase the momentum still further in the year 2000.

Yours sincerely,

Jack Dunietz
Co-Chairman & CEO

Israel Teiblum
President & CFO



David Assia
Co-Chairman

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 20-F

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

For the Fiscal Year Ended December 31, 1999	**Commission File No. 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 60218, Israel
(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Ordinary Shares, NIS 0.1 Par Value
(Title of Class)

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

Indicate number of shares outstanding of each of the registrant's classes of capital or common stock as of December 31, 1999:

26,068,185 Ordinary Shares, NIS 0.1 Par Value

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, and (2) has been subject to such filing requirements for the past 90 days.

Yes _X_ No

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 ___ Item 18 _X_

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PART I

This Annual Report on Form 20-F contain various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward looking statements usually include the verbs "anticipate," "believe," "estimate," "expect," "intend," "plan," "project," "understand" and other verbs suggesting uncertainty. We remind our shareholders that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or achievements expressed or implied by such forward-looking statements.

We have attempted to identify additional significant uncertainties and other factors affecting forward-looking statements in Exhibit 99 to this Form 20-F ("Additional Information Regarding Forward-Looking Statements"). We will provide copies of Exhibit 99 to registered shareholders free of charge upon receipt of a written request submitted to our Secretary at Magic Software Enterprises Ltd., 5 Haplada Street, Or Yehuda 60218, Israel. Shareholders may also obtain copies of Exhibit 99 for a nominal charge from the Public Reference Section of the Securities and Exchange Commission at 450 Fifth Street, N.W., Washington, D.C. 20549.

Item 1. DESCRIPTION OF BUSINESS

General

We develop, market and support Magic software development and deployment technology. Our Magic technology enables enterprises to accelerate the process of building and deploying business software applications that can be rapidly customized and integrated with existing systems. During 1999, we expanded our business to include the sale of applications developed using Magic technology. These applications are designed for e-Business, customer relationship management, or CRM, and other enterprise uses. Magic technology and Magic-based applications are used by over 2,500 software solution providers and thousands of enterprises in approximately 50 countries. We refer to these software solution providers and enterprises as the Magic community. We also provide maintenance and technical support as well as professional services to the Magic community.

Our Magic technology, which is based on a visual table-driven programming methodology, enables developers to quickly create and easily modify applications by filling in forms and tables that define data structures, business rules and program logic. This methodology does not require developers to write any program code, significantly reducing development time and programming errors. Applications developed with our Magic technology can be deployed on the Internet and on multiple computer operating systems including Windows 98/NT, Unix, OS/400 and Linux and interface with major databases including, Oracle, MS-SQL, DB2 and Informix.

We have introduced applications based on Magic technology, including Magic eMerchant, Magic eService, and Magic eContact, for e-Business and CRM. We believe that the expanding Magic community is a ready market for Magic applications and we work closely with Magic solution providers to market and support these applications within and outside the Magic community.

Industry Background

Businesses today face the constant need to react quickly to changes in their marketplace. Factors such as deregulation, industry consolidation, globalization, the increasing demand for improved and more responsive customer service and the continuing emergence of new technologies such as the Internet have intensified competition and have presented businesses with the opportunity and the need to continually develop and implement new strategies on a rapid basis. At the same time, businesses have been deploying custom-developed and packaged software applications in geographically dispersed, complicated technology environments. The multitude of different protocols, operating systems, devices and architectures makes deployment of technology solutions a difficult challenge. In order to meet this challenge, businesses require information technology infrastructure that can be developed, deployed and modified in a rapid and cost effective manner to support their business strategies.

Internet. The Internet is rapidly becoming a critical resource for business and is fundamentally changing how companies do business. Companies that successfully build an on-line presence can more efficiently conduct business with partners and suppliers, communicate with customers and employees and address the rapidly growing, global base of on-line consumers. According to International Data Corporation, or IDC, the number of worldwide Internet users is expected to grow from 159 million in 1998 to 510 million in 2003, and the market for Internet commerce software applications is expected to grow from $444 million to $13.2 billion during the same period. To remain competitive, companies are being compelled to offer more sophisticated Internet services more rapidly. As a result, computing environments are becoming more complex and demand for Internet infrastructure is growing.

CRM. With advances in the Internet, the importance of customer relationship management has intensified and become more sophisticated and complex. Customer expectations have increased, barriers to market entry have decreased and competitors are only a click away. The Internet also enables companies to obtain additional customer information and feedback at considerably reduced costs. To meet new customer expectations, ward off competitors and make use of new customer information, companies need to link their existing CRM applications to the Internet. According to IDC, the market for CRM applications is expected to grow from $1.9 billion in 1998 to $11 billion by 2003, growing at a five year compound annual growth rate of 42.1%.

Linux. Linux has emerged as a leading operating system for Internet servers. According to an IDC report dated December 1999, the use of Linux grew at an annual rate of 93.2% in 1999 and accounted for 24.6% of new server operating environment shipments including non-Internet servers. In its report, IDC also projected that the use of Linux will grow faster than the use of any other operating system through 2003. At present, there is a scarcity of business applications designed to operate on the Linux based operating system and there is a need to develop these critical business applications in an accelerated fashion.

The growing demand for more powerful, flexible and useable applications presents major challenges to corporate information technology departments. These departments have historically not been able to keep up with the demand for applications, and for the past several years they have been asked to provide applications that are more powerful, easier to implement and use, enable higher levels of reliability and performance, create faster time-to-market and are more readily adaptable to rapidly changing business requirements. These challenges have grown more complex with increased corporate use of the Internet for many basic business functions. To meet these challenges and provide applications that are portable across hardware platforms and operating systems and independent of any specific database, powerful application development and integration techniques are required. Overall, these business applications must provide enterprises with cost-effective software solutions that protect their significant investments in legacy hardware, software systems and databases.

The Magic Solution

Our Magic technology offers software developers and end-users of Magic-based applications the following benefits:

- *Time to Market.* We believe that the methodology of our Magic technology allows enterprises to prototype, develop and deploy complex, mission-critical applications rapidly and in a cost-effective manner. Most program functionality, which usually requires repetitive and tedious coding, is provided by our Magic development technology. Our Magic technology includes a Magic application server, which is software we developed to run all Magic-based applications on most operating systems, including Windows 98/NT, Unix, OS/400 and Linux.

- *Scalability and Adaptability.* Applications developed with Magic technology can be easily modified as business requirements change, computing environments evolve and end-user usage and transaction volumes increase. As a result, Magic-based applications can quickly be adapted to support increased functionality and wider use throughout an organization. Because of their scalability, the use of applications developed with our Magic technology can grow within an enterprise from the departmental level to the enterprise level by accommodating additional platforms, databases and operating systems and increased usage and application complexity. Our Magic technology also enables partitioning of applications by allowing application logic to be distributed across a system in order to achieve optimal system performance and flexibility. The Magic technology enables enterprises to respond quickly to unanticipated changes in their business requirements and protect their investments in software and hardware.

- *Portability.* We designed our Magic technology to enable enterprises to develop applications that can be used with most hardware platforms, operating systems and databases. Applications developed with our Magic technology for one platform can also be deployed on other supported platforms. Porting an application developed with the Magic technology from one platform to another is accomplished by simply changing the relevant table parameters in an application and initiating the file conversion of the application. As a result, porting applications can be accomplished without the lengthy coding, compiling, linking and testing phases typically required with other development methodologies. Applications developed with Magic technology can also be partitioned across multiple platforms. Developers can therefore take advantage of the flexibility and performance advantages inherent in multi-tiered architectures. The portability of applications developed with our software development technology enables enterprises to migrate quickly to new computing environments without having to rewrite their applications.

- *Database Access and Technology Independence.* The Magic technology architecture allows enterprises to access and manipulate data from multiple databases, each based on a different technology, into a single integrated application. Developers and end-users can access multiple legacy and relational databases across the enterprise from within the same application and from within the same data view. Our Magic technology can easily move data across platforms and convert the data from one database format to another.

Strategy

Our goal is to achieve a worldwide leadership position in the markets for software development and deployment technology and for e-Business, CRM and other enterprise requirements. In particular, we intend to become a leading supplier of application development technology and business applications for the Linux market. Our focus is on providing software development and deployment technology, applications and services that enable enterprises to meet their business needs on time and budget. The key elements of our strategy to achieve this goal are:

- cultivate and expand the Magic community;

- develop additional Magic applications based on our Magic technology;

- become the leading provider of business applications and development technology for Linux;

- acquire Magic solution providers;

- maintain technological leadership;
- increase penetration into existing markets, especially North America; and
- maintain and develop strategic alliances.

Products

Magic Technology

Magic development technology eliminates the need for conventional coding and enables programming to be a single stage process by eliminating the compile and link stages. Tables are used not only for data definitions, but also to develop the actual application logic. The application logic, including data structure, business rules, program logic and presentation, is stored in a file called the Magic control file. Much of the Magic technology approach is declarative in nature, using built-in task modes for database manipulation, as well as property dialogues for attribute settings. Magic has significant built-in end-user functionality that may be conditionally turned on or off by the developer according to the needs of the specific application. Individual and group rights are defined in Magic's table-driven interface and are centrally managed. Our Magic development technology is currently available for Windows and Linux.

The Magic deployment system is built around an application server that is available as both a client and an application server. In order to use an application developed with Magic technology, a Magic application server which is specific to the operating system is required. Magic software application servers are available for all the major operating systems including Windows, Unix, OS/400 and Linux, thus enabling deployment in complex heterogeneous environments, working concurrently over the Internet and locally in traditional client/server mode.

Our Magic technology provides enterprise-level scalability and connectivity via the Magic request broker, which prioritizes and manages traffic to the server and database gateways. Our Magic request broker technology enables a multi-tier architecture supporting a distributed environment. The Magic request broker helps optimize application performance, and provides fault tolerance, load balancing and partitioning capabilities. Multi-database support is achieved through specific database gateway modules for each Database Management System, or DBMS, and legacy systems. These database gateways serve as the bridges through which applications developed with the Magic technology can access databases from multiple vendors.

Magic applications thrive in complex heterogeneous environments supporting legacy software via the database gateways and state-of-the-art middleware such as CORBA, a standard for communicating between distributed objects, and IBM's MQSeries messaging software. Magic's Java based web on-line technology brings additional benefits to the Internet, giving browser-based applications the usability and look and feel of an online client/server application.

Magic-based applications can be deployed on a wide range of computing platforms, including Windows 98, Windows NT, most Unix platforms, IBM OS/400 and Linux. The Unix platforms on which Magic-based applications can be used include IBM RS/6000, HP 9000, Sun SPARC and SCO. We intend to release a new version of Magic technology which will support Windows 2000 during the year 2000.

Magic technology is currently available in numerous languages including English, Spanish, French, German, Italian, Dutch, Danish, Hungarian, Czech, Slovak, Portuguese, Chinese, Japanese, Korean, Thai, Arabic and Hebrew.

Magic Applications

Magic eMerchant. Magic eMerchant is a customizable business platform that combines business solutions for supply chain management with a powerful virtual order center. Magic eMerchant delivers enterprise-level processing power and security along with rapid integration with back-end systems, and can be easily customized to fit an organization's business rules.

CRM Suite. We are developing a suite of CRM applications which will assist companies to provide superior service in acquiring, developing and retaining their customer base. We are presently marketing two CRM applications and expect to begin marketing two additional applications by the end of the year. CRM products provide for the automation of sales, marketing and service applications while focusing on improving customer satisfaction. Our comprehensive integrated approach to CRM focuses on superior customer experience and real time business pulsing.

Superior customer experience will be provided by our comprehensive management solution, which will allow users to provide customers with consistent, accurate and relevant information. This information will be tailored to the specific needs of the customer and will be accessible when requested via the preferred media of the customer. Real time business pulsing provides a company's management with the ability to be consistently aware of the enterprise's performance relative to management's expectations regarding all customer related activities. This up-to-date knowledge is intended to promote informed decision making and better control of the business.

Our CRM suite will be composed of:

- *Magic eContact* — Magic eContact, which we distribute pursuant to an agreement with a Magic solution provider in which we own an interest of approximately 34.3%, manages all aspects of a contact center, from sales and marketing to customer care and support. We believe that Magic eContact is one of the most rapid-to-implement contact center systems available on the market.

- *Magic eService* — Magic eService is an Internet-based customer service management system. With Magic eService, customers are able to find solutions on their own, using a sophisticated scripted online help-desk or the knowledge base of tech notes and previously offered customer solutions, or they can interact with customer service agents by opening a service request directly on the Internet site and tracking it to completion. Customers are able to track their service requests via the Internet site or via automatic notification by e-mail. Communications between customers and service agents are saved in the Magic eService system.

- *Magic eCapture* — Magic eCapture will capture sales leads for Internet marketing. The application will capture leads from the website, provide contact management to sales leads via e-mail and also provide a report facility via an Internet browser to run statistics on sales leads for sales and marketing purposes.

- *Magic eSales* — Magic eSales will provide a set of tools for control of sales force targeting, opportunity management, forecast management and win and lose analysis.

We have begun to market Magic eContact and Magic eService. The remaining two modules of our CRM suite, Magic eCapture and Magic eSales are scheduled for launch later in 2000. End-users can deploy one or more modules from our CRM suite and can integrate these modules with Magic eMerchant.

RentPro. RentPro, developed by a 75% owned subsidiary, Magic Rental Technologies Ltd., is an application developed with Magic technology that consists of more than 2,000 programs and includes more than 90% of all of the functions handled by multiple facility car and truck rental companies worldwide. RentPro can handle varied functions such as purchasing and selling vehicles, reservations management, leasing and rental arrangements, and fleet control and management. RentPro also has the ability to interface with virtually any accounting system. RentPro is multilingual, enabling the operator to communicate in his or her own language on screen and in reports, while rental agreements and invoices are generated in the language of the customer. Translation is transparent to the customer and the user. Like all applications developed with Magic technology, RentPro can operate on multiple platforms and integrate with most commercial databases.

Sleuth Suite. We market a suite of applications which are targeted to the law enforcement and correctional facilities markets. This suite consists of:

- *Sleuth Jail Package.* This application maintains inmate data.

- *Sleuth Records Package.* This application provides intake file management for accidents, crime scenes, evidence and property photos, service calls, incidents and intelligence.

- *Sleuth Calls For Service Package.* This application provides reports, inquiries and statistics for law enforcement agencies.

Services

Professional Services. We provide a broad range of consulting and software development project management services to customers developing and deploying distributed and Internet applications with Magic technology. We believe that the availability of effective consulting services is an important factor in achieving widespread market acceptance.

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 both generating additional revenues and ensuring successful implementation of Magic technology through knowledge transfer. Our consultants provide a value-added service on large development projects supporting existing teams in the design or implementation cycle, and maximizing the utilization of resources in large development environments. The consultants help developers design prototype applications. Program components written by our consultants may also be added onto existing programs or programs in development. We also offer consulting services in rapid prototyping, multi-platform integration and migration to more efficient environments. Specialized consultants are also available to assist customers in all facets of migration from host character-based applications to distributed and Internet applications.

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 joint ventures with our Magic solution providers and distributors to deliver successful solutions in focused market sectors. We promote these solutions and help tailor them to enterprises. An integration of the know-how from a particular market sector with local expertise has proven to both save time and enables building solutions that better meet customers' needs.

Maintenance. We offer our customers annual maintenance contracts providing for upgrades and new versions of our products for an annual fee.

Technical 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.

In the third quarter of 1998, we instituted a new online support system for the Magic community in the United States and Canada, which provides members of the Magic community with the ability to instantaneously enter, confirm and track support requests via the Internet. Magic eService was recently implemented by our technical support organization as a virtual support center which provides support to Magic solution providers and end-users worldwide.

Training. We conduct formal and organized training through our Magic University. Magic University staff members have developed several courses, each of which includes trainer and student guidebooks. The courses and course materials are designed to accelerate the learning process, using an intensive technical curriculum in an atmosphere conducive to productive training. Magic University also assists our professional services managers in designing and implementing custom made client-site courses. These courses are conducted by either our employees or distributors' employees who are certified instructors.

Customers, End-Users and Markets

We market and sell our products and services in approximately 50 countries worldwide. Industries that are significantly represented in our Magic community base include finance, retail, media, telecommunications, manufacturing, tourism, and government agencies. Our Magic technology is used by a wide variety of developers that can be generally divided into two distinct segments: those performing in-house development (corporate information technology departments) and Magic solution providers that perform development for third parties. Magic solution providers include large system integrators that use our Magic technology in large customized system projects and smaller independent Magic solution providers that generally perform development work for small to medium sized business clients. Magic solution providers that are packaged software publishers use our Magic technology to write standard packaged software products that are sold to multiple clients, typically within a vertical industry segment or a horizontal business function.

Among the thousands of end-users of our Magic technology are the following organizations: Banque de France, Cap Gemini Finance, Chase Manhattan Bank, Club Med, Financial Times, Gannet Media, Hitachi, Hutchison Telecom, Israel Discount Bank, Kodak, Matsushita, McKesson HBOC, Minolta, Nestle, Philip Morris, Steelcase and the United Nations.

Sales, Marketing and Distribution

We market and support our products primarily through our own direct sales force in Europe, Australia, Canada, India, Israel, Japan, Thailand and the United States, and through a network of distributors and Magic solution providers in those countries and a variety of other countries in Asia and Latin America. We sell and support our products directly in Israel, through our subsidiaries in Australia, Canada, France, Germany, Hungary, India, Italy, Japan, the Netherlands, Thailand, the United Kingdom and the United States, and through local distributors elsewhere.

Sales. We maintain a direct sales force in the field for pursuing large accounts. They carry out strategic sales with a direct approach to decision makers, managing a constantly monitored consultative type of sales cycle. At March 31, 2000 we had approximately 103 direct sales personnel in the field. Most of these sales persons are supported by sales engineers who provide pre-sale technical support, presentations and demonstrations. Sales efforts are targeted to large enterprises performing internal application development and Magic solution providers which use Magic technology to develop solutions for their customers. We also employ an in-house telesales staff to sell to small and medium sized accounts and to generate and qualify leads for larger accounts.

Some larger Magic solution providers may also resell development systems when selling sophisticated applications requiring on-site development, maintenance, and diagnostics. We carry out marketing activities with our Magic solution providers, such as publishing solutions directories and newsletters. We have a marketing program that supports Magic solution providers by providing a wide range features and advantages in the areas of application development, sales and marketing to them.

In North America we have offices in Irvine, California; New York, New York; Angelfire, New Mexico; and Montreal and Toronto, Canada. At March 31, 2000 we employed approximately 13 persons in our North American sales and marketing operations.

Our European sales subsidiaries have offices in Bracknell, U.K.; Bunnik and Zaandam, the Netherlands; Milan, Italy; Munich, Germany; Paris, France; and Budapest, Hungary, and at March 31, 2000 we employed approximately 68 persons in our European sales and marketing operations.

Our Asian sales subsidiaries have offices in Sydney, Australia; Tokyo, Japan; Bangkok, Thailand; and Pune, India and at March 31, 2000 we employed 67 persons in our sales and marketing operations in Australia, India, Japan and Thailand.

Distributors. In general, we distribute our products through local distributors in those countries where we do not have a sales subsidiary. A local distributor is typically a software marketing organization with the capability to add value with consulting, training, and support. Distributors are generally responsible for the localization of our software development technology and applications into their native language. 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 client 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 30 distributors, most of whom also act as Magic solution providers.

Marketing Activities. We carry out a wide range of marketing activities aimed at generating awareness of our products and sales leads, including an extensive program of exhibitions, advertising and public relations, attendance at trade shows and exhibitions, user conferences, direct mail, response mail, telemarketing and seminars. We also devote substantial efforts to marketing our products on the Internet. We regularly advertise our products in prominent trade publications. These activities are intended both to maintain the general public awareness of the products and to generate sales leads. We participate in many major industry trade shows and fairs worldwide. We also conduct distributor and user conferences to update our worldwide affiliates and user base concerning our new releases, marketing strategies, pricing, technical information and the like. These events are conducted approximately twice a year.

In order to foster improved relationships with our Magic solution providers we sponsor periodic events and other marketing programs and activities. We host on our corporate Internet site an online solutions directory which highlights applications developed by our Magic solution providers and an information sharing section which enables our Magic solution providers to participate with us at trade shows and conferences. *Magic Magazine,* a publication that has been developed as a public relations activity, is produced quarterly and distributed to the Magic community and potential customers, includes articles that highlight our Magic solution providers.

Strategic Alliances

The important strategic alliances formed by us to date include:

IBM. We currently offer Magic technology which supports the IBM AS/400 and RS/6000 platforms. In 1994, we entered into a cooperative development agreement and joint sales and marketing agreements with IBM for its AS/400 product line, which has the largest market share in the mid-range computer marketplace. In 1997, we concluded the development project and began joint sales and marketing of our products for use with the AS/400 product line. We are an IBM Business Partner and an All-Star member of the Software Developer Marketing Program. As a member of IBM's Application Development Partners Program and the IBM Porting Center, our software development technology enables developers in the AS/400 community to create solutions for AS/400 and web environments.

In 1997, we established a technology enablement center in IBM's Rochester Labs to work with IBM in enabling developers and independent solutions vendors in the AS/400 community to create solutions for AS/400 and heterogeneous client/server, intranet and Internet environments with Magic/400. We have since extended this activity to e-Business applications and native Internet enabling on the AS/400. Our eMerchant application is being hosted by IBM marketing centers in Europe.

Oracle. As an Oracle Alliance member, we work closely with Oracle to provide gateways from our Magic technology to Oracle's database. As part of our relationship, we have the ability to obtain special development and marketing support including licenses, technical assistance and cooperative marketing.

Pervasive Software. We have a strategic alliance with Pervasive Software to develop and market a bundled product comprised of Pervasive's Scalable SQL and database engines and our Magic technology. The alliance provides for joint technical development and product integration, international co-marketing and channel development programs.

Red Hat, Inc. We participate as a member of Red Hat's Developer Partners Program which provides us with access to the Red Hat Linux installed base. Currently, Red Hat distributes our Magic deployment technology as part of their application. This program provides developer support and partnership opportunities for Linux distribution and market development.

TurboLinux. In 1999, we entered into a joint marketing alliance with TurboLinux, the largest Linux distributor in Japan. The alliance includes the bundling of our Magic technology for Linux with the Japanese version of the TurboLinux operating system. The marketing alliance includes a wide range of activities, including joint sales and marketing campaigns and seminars.

Research and Development

The software industry is characterized by rapid technological change and is highly competitive with respect to timely product innovation. We must maintain compatibility and competitiveness in the face of ongoing changes in industry standards.

We place considerable emphasis on research and development to improve and expand the functionality of our Magic technology and to develop new applications. We believe that our future success will depend 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 Magic technology is the most effective means of achieving our strategic objective of providing an extensive, integrated and feature-rich development technology. Research and development activities take place in our facilities in Israel, India and Japan. At March 31, 2000, we employed approximately 73 persons in research and development in Israel, 37 persons in India, 15 persons in Thailand, 11 persons in Japan, 8 persons in France, 2 persons in Hungary and 1 person in the U.K. As part of our product development team, we employ technical writers who prepare user documentation for our products and have employed subcontractors in connection with the documentation and some development work.

Our research and development and support personnel work closely with our customers and prospective customers to determine their requirements and to design enhancements and new releases to meet their needs. We periodically release enhancements and upgrades to our core products.

Competition

The markets for our Magic technology and applications are characterized by rapidly changing technology, evolving industry standards, frequent new product introductions and rapidly changing customer requirements. These markets are therefore highly competitive and we expect competition to intensify in the future. We may not be able to compete effectively in these markets and we may lose market share to our competitors. The principal competitors in the market for our Magic technology are Visual Basic (Microsoft), Progress, Delphi (Inprise), Developer 2000 (Oracle), Uniface (Compuware), Powerbuilder (Sybase), Unify, Silverstream, Visual Age (IBM), Sterling, Lansa, SAP, BaaN, and PeopleSoft. The principal competitors in the market for our e-Business applications are IBM's Net.Commerce, Intershop, Broadvision, Open Market, Commerce One, Oracle's Internet Commerce Server and Microsoft's Site Server Commerce Edition. The principal competitors in the market for our CRM applications currently include Siebel, Vantive (PeopleSoft), Clarify, Remedy, Pivotal, Oracle, Lucent, Quintas and

Onyx. Additional competitors may enter each of our markets at any time. Moreover, our customers may seek to develop internally the products that we currently sell to them and thereafter compete with us.

Most of our competitors have greater financial, personnel and other resources than we do, which may limit our ability to compete effectively with them. These competitors may be able to respond more quickly to new or emerging technologies or changes in customer requirements. These competitors may also benefit from greater economies of scale, offer more aggressive pricing, devote greater resources to the promotion of their products or bundle their products into existing products in a manner that renders our technology partially or fully obsolete, thereby discouraging customers from purchasing our Magic technology or applications.

We believe that the principal competitive factors affecting the market for our products include developer productivity, product functionality, performance, reliability, 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 and, to a lesser degree, price.

Intellectual Property

We do not hold any patents and 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. Also, 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. However, in the case of large accounts, site license agreements are often required to be signed by the end-users. 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.

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 Australia, Austria, Belgium, Bulgaria, Canada, Chile, China, the Czech Republic, Egypt, France, Germany, Israel, Italy, Luxembourg, Mexico, the Netherlands, Poland, Portugal, Romania, Slovakia, South Africa, Spain, Switzerland, Thailand and the United States. Other registrations are pending in Argentina, Brazil, India, the United Kingdom and the United States. 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 do not believe that patent laws are a significant source of protection for our products. Copyright registration for software is available in the United States and Japan. We have registered a copyright for our software in the United States and Japan. Also, we have registered copyrights for some of our manuals in the United States and have acquired ISBN numbers for some of our manuals. Our copyrights expire 70 years from date of first publication. The initial terms of the registration of our trademarks range from 10 to 20 years and are renewable thereafter.

Since the software industry is characterized by rapid technological changes, the policing of the 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 rather difficult, software piracy can be expected to be a persistent potential problem.

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.

Employees

At March 31, 2000, we had approximately 766 employees worldwide, of whom 207 employees were based in Israel, 287 employees were based in Asia and Australia, 188 employees were based in Europe and 84 employees were based in North America. Of these 766 employees, 147 employees were employed in research and development, 314 employees were employed in technical support and training, 167 employees were employed in marketing and sales and 138 employees were employed in operations and administration.

At the time of commencement of employment, our employees in Israel generally sign written employment agreements specifying basic terms and conditions of employment as well as non-disclosure, confidentiality and non-compete provisions.

We are subject to Israeli labor laws and regulations with respect to our Israeli employees. These laws principally concern matters such as paid annual vacation, paid sick days, length of the workday and work week, minimum wages, pay for overtime, insurance for work-related accidents, severance pay and other conditions of employment.

Furthermore, our Israeli employees and we are subject to some provisions of the collective bargaining agreements between the Histadrut, the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialists association, by order of the Israeli Ministry of Labor and Welfare. These provisions principally concern cost of living increases, recreation pay and other conditions of employment. We provide our employees with benefits and working conditions above the required minimums. Our employees are not represented by a labor union. To date, we have not experienced any work stoppages and we consider our relations with our employees to be excellent.

Item 2. DESCRIPTION OF PROPERTY

Facilities

Our headquarters and principal administrative, finance, marketing and sales and research and development operations are located in an office building of approximately 34,000 square feet in Or Yehuda, Israel. The building was constructed and completed by us and Mashov Computers Ltd, our parent company, in 1994 on a parcel of land leased from the Israel Land Authority. The lease expires in 2040 and can be renewed for an additional period of 49 years. In July 1999, we purchased Mashov Computers' 50% interest in the building and now own 100% of the building. We lease approximately 4,600 square feet from Mashov Computers in an adjoining building in Or Yehuda.

Our Dutch subsidiary owns a 4,720 square foot building in Zaandam, Netherlands and our Hungarian subsidiary owns a 9,440 square foot building in Budapest, Hungary.

Our U.S. subsidiary leases a 12,000 square foot facility in Irvine, California pursuant to a lease that expires in July 2002. Our subsidiaries also lease office space in Sydney, Australia; Paris, France; Munich, Germany; Pune, India; Milan, Italy; Tokyo, Japan; Bunnik, the Netherlands; New York, New York; Bangkok, Thailand; and Bracknell, U.K. We expect that we will need additional space as we expand our business and believe that we will be able to obtain space as needed on commercially acceptable terms.

Item 3. LEGAL PROCEEDINGS

From time to time, claims arising in the ordinary course of our business are brought against us. In the opinion of our management, no currently existing claims will have a material adverse effect on our financial position, liquidity or results of operations.

Item 4. CONTROL OF REGISTRANT

The following table sets forth certain information as of the date of this Annual Report regarding the beneficial ownership by (i) all shareholders known to us to own beneficially more than 10% of our ordinary shares, (ii) each director, and (iii) all directors and executive officers as a group:

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Outstanding Ordinary Shares (2)
Formula Systems (1985) Ltd. (3)(4)......	14,058,000	46.7%
Mashov Computers Ltd. (3)(5).............	9,000,000	29.9%
David Assia (6)(7)	654,424	2.2%
Jack Dunietz (8)	259,650	*
Gad Ariav	—	—
Yigal Berman...	—	—

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Outstanding Ordinary Shares (2)
Dan Goldstein	—	—
Gad Goldstein	—	—
All officers and directors as a group (7 persons)(9)	1,102,499	3.7%

* Less than 1%.

(1) Ordinary shares beneficially owned include shares that may be acquired pursuant to options that are currently exercisable or which will first become exercisable within 60 days of the date of this Annual Report.

(2) Based on 29,963,359 ordinary shares outstanding as of April 21, 2000. Ordinary shares deemed beneficially owned by virtue of the right of any person or group to acquire such shares within 60 days of the date of this prospectus are treated as outstanding only for purposes of determining the percent owned by such person or group.

(3) Formula Systems (1985) Ltd. and Mashov Computers are parties to a shareholders agreement, pursuant to which each party has agreed to vote its shares in favor of director nominees designated by the other party, subject to shareholding thresholds.

(4) Includes 9,000,000 ordinary shares owned of record by Mashov Computers. The address of Formula Systems is 3 HaGalim Boulevard, Herzliya Pituach, Israel. Dan Goldstein, an officer and director of Formula Systems, and Gad Goldstein, a director of Formula Systems, who are both directors of our company, disclaim beneficial ownership of the ordinary shares held by Formula Systems, except to the extent of their proportional interest therein.

(5) The address of Mashov Computers is 5 Ha'Plada Street, Or Yehuda 60218, Israel. Dan Goldstein and Gad Goldstein, directors of Mashov Computers, and directors of our company, disclaim beneficial ownership of the ordinary shares held by Mashov Computers except to the extent of their proportional interest therein.

(6) David Assia, Chairman of our Board of Directors and chairman of the board of directors and beneficial owner of 7.5% of the shares of Mashov Computers, disclaims beneficial ownership of the ordinary shares held by Mashov Computers.

(7) Includes 11,205 ordinary shares issuable upon the exercise of currently exercisable options or which will first become exercisable within 60 days of the date of this Annual Report.

(8) Jack Dunietz, our Chief Executive Officer and a director, who is the beneficial owner of less than 0.1% of the shares of Mashov Computers disclaims beneficial ownership of the ordinary shares held by Mashov Computers.

(9) Includes 145,705 ordinary shares issuable upon the exercise of currently exercisable options or which will first become exercisable within 60 days of the date of this Annual Report.

Item 5. **NATURE OF TRADING MARKET**

Our ordinary shares are traded on the Nasdaq National Market under the symbol "MGIC." The following table sets forth, for the periods indicated, the high and low sale prices of our ordinary shares as reported by the Nasdaq National Market:

	High	Low
1998		
First Quarter	$ 1.92	$ 1.38
Second Quarter	1.83	1.21
Third Quarter	1.33	.67
Fourth Quarter	1.48	.65
1999		
First Quarter	3.08	1.35
Second Quarter	4.04	2.69
Third Quarter	8.04	3.48
Fourth Quarter	27.67	6.35

At May 9, 2000, there were 97 holders of record and approximately 8,309 beneficial holders of our ordinary shares, of which, 78 record holders holding approximately 54.2% of our ordinary shares had registered addresses in the United States.

We have never declared or paid any cash dividends on our ordinary shares. We do not anticipate paying any cash dividends on our ordinary shares in the foreseeable future. We currently intend to retain all future earnings to finance operations and to expand our business.

We participate in the "alternative benefit program" under the Law for the Encouragement of Capital Investments, 1959, under which we realize some tax exemptions. If we distribute a cash dividend from income which is tax exempt, we would have to pay corporate tax at the rate of up to 25% on an amount equal to the amount distributed and the corporate tax which would have been due in the absence of the tax exemption.

On February 1, 2000, the new Israeli Companies Law became effective, implementing new dividend rules. According to the Companies Law, a company may distribute dividends out of its profits, so long as the company reasonably believes that such dividend distribution will not prevent the company from paying all its current and future debts. Profits, for purposes of the Companies Law, means the greater of retained earnings or earnings accumulated during the preceding two years.

Item 6. EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Dividends (if any) paid to the holders of our ordinary shares and any amounts payable with respect to our ordinary shares upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of the ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable U.S. dollars at the rate of exchange prevailing at the time of conversion.

Neither the Memorandum of Association and the Articles of Association of our company 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.

Item 7. TAXATION

General Corporate Tax Structure

Israeli companies are subject to "Company Tax" at the rate of 36% of taxable income. However, the effective tax rate payable by a company, which derives income from an approved enterprise (as further discussed below), may be considerably less.

Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959

The Law for the Encouragement of Capital Investments, 1959, as amended, commonly referred to as the Investment Law, provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Trade of the State of Israel, be designated as an approved enterprise. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program. An approved enterprise is entitled to benefits including Israeli Government cash grants and tax benefits in specified development areas. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its capital investments is approved, its effective tax rate is the result of a weighted average of the applicable rates.

Taxable income of a company derived from an approved enterprise is subject to company tax at the maximum rate of 25% (rather than 36%) for the benefit period. This period is ordinarily seven years (or ten years if the company qualifies as a foreign investors' company as described below) commencing with the year in which the approved enterprise first generates taxable income, and is limited to twelve years from commencement of production or 14 years from the date of approval, whichever is earlier. The Investment Law also provides that a company that has an approved enterprise within Israel will be eligible for a reduced tax rate for the remainder of the benefit period and is entitled to claim accelerated depreciation on buildings, machinery and equipment used by the approved enterprise during the first five years of the benefit period.

A company owning an approved enterprise may elect to forego entitlement to the grants otherwise available under the Investment Law and in lieu thereof participate in an alternative package of benefits. Under the alternative package of benefits, a company's undistributed income derived from an approved enterprise will be exempt from company tax for a period of between two and ten years from the first year of taxable income, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder, if any, of the otherwise applicable benefits period.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company more than 25% of whose share capital and combined share and loan capital is owned by non-Israeli residents. A company which qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten year benefit period. The company tax rate applicable to distributed income earned in the benefit period and to income (distributed or not) earned in the benefit period is as follows:

For a company with foreign investment of	The company tax rate is
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%

In addition, the dividend recipient is taxed at the reduced rate applicable to dividends from approved enterprises (15%), if the dividend is distributed during the tax benefit period or within 12 years thereafter, yet, no time limit is applicable to dividends from a foreign investment company. The company must withhold this tax at source, regardless of whether the dividend is converted into foreign currency.

Subject to applicable provisions concerning income under the alternative package of benefits, all dividends are considered to be attributable to the entire enterprise and their effective tax rate is the result of a weighted average of the various applicable tax rates. We currently intend to reinvest any income derived from our approved enterprise programs and not to distribute such income as a dividend.

The Investment Center bases its decision as to whether or not to approve an application on the criteria set forth in the Investment Law and regulations, the then prevailing policy of the Investment Center and the specific objectives and financial criteria of the applicant. Accordingly, we cannot assure you that any of our applications, if made, will be approved in the future.

The Investment Center of the Ministry of Industry and Trade has granted "approved enterprise" status under Israeli law to seven investment programs at our manufacturing facility. We have elected the alternative package of benefits with respect to each of these approved enterprise programs. The tax benefits with respect to each of the approved programs are as follows:

- The portion of our retained income derived from the first program approved in May 1984 was tax-exempt for a period of two years ended December 31, 1991 and was subject to a reduced tax rate of 25% for the subsequent period of five years ended December 31, 1996.

- The portion of our retained income derived from our second program approved in February 1990 was tax-exempt for a period of two years ended December 31, 1991 and was subject to a reduced tax rate of 25% for the subsequent period of five years ended December 31, 1996.

- The portion of our retained income derived from our third program approved in March 1992 was tax-exempt for a period of four years ended December 31, 1995 and is subject to a reduced tax rate of 25% for the subsequent period of six years ending December 31, 2001.

- The portion of our retained income derived from our fourth program approved in June 1990 was tax-exempt for a period of four years ended December 31, 1997 and is subject to a reduced tax rate of 25% for the subsequent period of six years ending December 31, 2003.

- Our fifth program approved in February 1996 will entitle us to a tax exemption on the portion of our retained income derived from this program for a period of four years commencing on the first year in which there is taxable income and to a reduced rate of 25% for the subsequent period of six years.

- Our sixth program approved in January 1998 will entitle us to a tax exemption on the portion of our retained income derived from this program for a period of two years commencing on the first year in which there is taxable income and to a reduced rate of 25% for the subsequent period of eight years.

- Our seventh program approved in November 1998 will entitle us to a tax exemption on the portion of our retained income derived from this program for a period of two years commencing on the first year in which there is taxable income and to a reduced rate of 25% for the subsequent period of eight years.

The tax benefit periods provided by the fifth, sixth and seventh programs end the earlier of 12 years from the commencement of operations or production or 14 years from receipt of the approval.

The portion of our taxable income derived from the third and fourth programs during the period of six years ending December 31, 2001 and December 31, 2003 and our portion of taxable income derived from the fifth, sixth and seventh programs during the above period of eight years will be subject to a reduced tax rate of 20% if the foreign investment in our company is between 49% to 74%.

The benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investment Law and its regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage adjustment and interest. In our opinion, we have been in full compliance with the conditions of the above programs through December 31, 1999 and, with respect to the 1984 and 1992 programs, have received written confirmation to this effect from the Investment Center.

Grants under the Law for the Encouragement of Industrial Research and Development, 1984

Under the Law for the Encouragement of Industrial Research and Development, 1984, research and development programs which meet specified criteria and are approved by a governmental committee of the Office of the Chief Scientist are eligible for grants of up to 50% of the project's expenditure, as determined by the research committee, in exchange for the payment of royalties from the sale of products developed in accordance with the program. Regulations promulgated under the Research Law generally provide for the payment of royalties to the Office of the Chief Scientist of 3%-5% on sales of products and services derived from our technology developed using these grants until 100% of the U.S. dollar-linked grant is repaid. Following the full repayment of the grant, there is no further liability for repayment.

The terms of the Israeli government participation also require that the manufacture of products developed with government grants be performed in Israel. However, under the regulations promulgated under the Research Law, in the event that any of the manufacturing is performed outside Israel if approval is received from the Office of the Chief Scientist for such foreign manufacturing and the identity of the foreign manufacturers, we may be required to pay increased royalties. If the manufacturing volume that is performed outside of Israel is less than 50%, the total amount to be repaid to the Office of the Chief Scientist may be adjusted to 120% of the grant. If the manufacturing volume that is performed outside of Israel is between 50% and 90%, the total amount may be adjusted to 150% of the grant and if it is more than 90%, the total amount may be adjusted to 300% of the grant. The technology developed pursuant to the Office of the Chief Scientist grants may not be transferred to third parties without the prior approval of a governmental committee under the Research Law. Such approval, however, is not required for the export of any products developed using the grants. Approval of the transfer of technology may be granted in specific circumstances, only if the recipient abides by the provisions of the Research Law and regulations promulgated thereunder, including the restrictions on the transfer of know-how and the obligation to pay royalties in an amount that may be increased. We cannot assure you that such consent, if requested, will be granted.

Effective for grants received from the Office of the Chief Scientist under programs approved after January 1, 1999, the outstanding balance of such grants will be subject to interest equal to the 12 month LIBOR applicable to U.S. dollar deposits that is published on the first business day of each calendar year. However, we did not receive any grants in 1999.

The funds generally available for grants from the Office of the Chief Scientist were reduced for 1998, and the Israeli authorities have indicated that the government may further reduce or abolish grants from the Office of the Chief Scientist in the future. Even if these grants are maintained, we cannot assure you that we will receive from the Office of the Chief Scientist grants in the future. In addition, each application to the Office of the Chief Scientist is reviewed separately, and grants are based on the program approved by the Research Committee. Generally, expenditures supported under other incentive programs of the State of Israel are not eligible for grants from the Office of the Chief Scientist. We cannot assure you that applications to the Office of the Chief Scientist will be approved and, until approved, the amounts of any such grants are not determinable.

From mid-1989 to 1997, we received grants from the Office of the Chief Scientist for selected research and development projects. We accrued grants of $285,000 in 1997 from the Office of the Chief Scientist. In November 1998, we reached an agreement with the Office of the Chief Scientist, pursuant to which we paid approximately $1.0 million to cover all our outstanding liabilities to the Office of the Chief Scientist. In 1998 and 1999, we did not submit any applications for grants to the Office of the Chief Scientist. We believe that the current policy of the Office of the Chief Scientist with respect to research and development grants is not beneficial to us and, therefore, have no intention to seek additional grants under the current policy.

Tax Benefits and Grants for Research and Development

Israeli tax law allows, under specific conditions, a tax deduction in the year incurred for expenditures, including capital expenditures, relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli Government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. Expenditures not so approved are deductible over a three-year period. However, expenditures from proceeds made available to us through government grants are not deductible according to Israeli law.

Tax Benefits Under the Law for the Encouragement of Industry (Taxes), 1969

According to the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law, an Industrial Company is a company resident in Israel, at least 90% of the income of which, in a given tax year, determined in Israeli currency (exclusive of income from some government loans, capital gains, interest and dividends), is derived from an Industrial Enterprise owned by it. An "Industrial Enterprise" is defined as an enterprise whose major activity in a given tax year is industrial production activity.

Under the Industry Encouragement Law, Industrial Companies are entitled to the following preferred corporate tax benefits:

- amortization of purchases of know-how and patents over an eight-year period for tax purposes;
- amortization of specified expenses incurred in connection with a public issuance of securities over a three-year period for tax purposes;

- right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli Industrial Companies; 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 cannot assure you that we will continue to qualify as an Industrial Company or that the benefits described above will be available to us in the future.

Special Provisions Relating to Taxation under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Its features which are material to us can be summarized as follows:

There is a special tax adjustment for the preservation of equity whereby some corporate assets are classified broadly into fixed assets and non-fixed assets. Where a company's equity, as defined in such law, exceeds the depreciated cost of fixed assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis. If the depreciated cost of fixed assets exceeds a company's equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.

- Subject to specific limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index.
- Capital gains on specific traded securities, are normally exempt from tax for individuals and are taxable for companies. However, dealers in securities are subject to the regular tax rules applicable to business income in Israel.

Capital Gains Tax on Sales of Our Ordinary Shares

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain that is equivalent to the increase of the relevant asset's purchase price which is attributable to the increase in the Israeli consumer price index between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus. The inflationary surplus accumulated from and after December 31, 1993, is exempt from any capital gains tax in Israel while the real gain is added to ordinary income, which is taxed at ordinary rates of 30% to 50% for individuals and 36% for corporations.

Under current law, sales of our ordinary shares are exempt from Israeli capital gains for individuals so long as they are quoted on Nasdaq or listed on a stock exchange in some countries and we qualify as an Industrial Company. We cannot assure you that we qualify or will maintain such qualification or our status as an Industrial Company. Notwithstanding the foregoing, dealers in securities in Israel are taxed at regular tax rates applicable to business income.

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

Taxation of Non-Resident Holders of Shares

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends other than bonus shares or stock dividends, income tax at the rate of 25% (12.5% for dividends not generated by an approved enterprise if the non-resident is a U.S. corporation and holds 10% of our voting power, and 15% for dividends generated by an approved enterprise) is withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident will be 25%. However, under the Investment Law, dividends generated by an approved enterprise are taxed at the rate of 15%.

Under an amendment to the Inflationary Adjustments Law, non-Israeli entities might be subject to Israeli taxes on the sale of traded securities in an Israeli company, subject to the provisions of any applicable double taxation treaty.

Item 8. SELECTED FINANCIAL DATA

This section presents our selected consolidated financial data. You should read carefully the financial statements included in this Annual Report, including the notes to the consolidated financial statements. The selected consolidated financial data in this section are not intended to replace the consolidated financial statements.

We derived the following income statement data for the years ended December 31, 1997, 1998 and 1999, and the consolidated balance sheet data as of December 31, 1998 and 1999 from our audited consolidated financial statements and notes included in this Annual Report. We derived the consolidated income statement data for the years ended December 31, 1995 and 1996 and the consolidated balance sheet data as of December 31, 1995, 1996 and 1997 from our audited consolidated financial statements that are not included in this Annual Report.

Income Statement Data:

	Year ended December 31,				
	1995	**1996**	**1997**	**1998**	**1999**
	(U.S. dollars in thousands, except per share data)				
Revenues:					
Software	$19,856	$28,085	$24,026	$20,479	$37,024
Maintenance and technical support(1)	—	1,146	4,196	5,780	9,218
Professional services(1)	5,528	7,185	9,210	12,501	17,750
Total revenues	25,384	36,416	37,432	38,760	63,992
Cost of revenues:					
Software	3,103	4,085	4,327	2,994	3,972
Maintenance and technical support(1)	—	802	2,694	3,306	3,450
Professional services(1)	4,484	6,306	7,708	9,046	11,365
Total cost of revenues	7,587	11,193	14,729	15,346	18,787
Gross profit	17,797	25,223	22,703	23,414	45,205
Operating expenses:					
Research and development, net	2,878	2,611	3,348	2,797	2,953
Selling and marketing, net	11,391	15,963	17,520	16,073	20,935
General and administrative	3,757	4,112	6,090	7,817	10,241
Restructuring and other non-recurring costs	—	—	5,421	2,677	—
Total operating expenses	18,026	22,686	32,379	29,364	34,129
Operating income (loss)	(229)	2,537	(9,676)	(5,950)	11,076
Financial expenses, net	66	521	488	322	(175)
Income (loss) before income taxes	(295)	2,016	(10,164)	(6,272)	11,251
Income taxes	333	456	476	50	2
	(628)	1,560	(10,640)	(6,322)	11,249
Equity in earnings (losses) of affiliates	67	(115)	(51)	(149)	52
Minority interest in losses (earnings) of consolidated subsidiaries	123	(47)	237	12	(394)
Net income (loss)	$ (438)	$1,398	$(10,454)	$(6,459)	10,907
Basic earnings (loss) per share	$(0.03)	$0.10	$(0.72)	$(0.37)	$0.45
Diluted earnings (loss) per share	$(0.03)	$0.10	$(0.72)	$(0.37)	$0.43
Shares used to compute basic earnings (loss) per share	12,909	14,160	14,559	17,610	24,281
Shares used to compute diluted earnings (loss) per share	12,909	14,385	14,559	17,610	25,391

(1) In 1995, revenues from professional services included maintenance and technical support revenues and cost of revenues for professional services included cost of revenues for maintenance and technical support.

Balance Sheet Data:

	December 31,				
	1995	1996	1997	1998	1999
	(U.S. dollars in thousands)				
Working capital (deficit)	$ 6,213	$ 9,820	$ (519)	$ 5,269	$ 9,663
Cash and cash equivalents	824	2,410	1,380	5,828	8,298
Total assets	24,559	34,007	29,192	32,381	56,759
Shareholders' equity	15,109	21,956	11,436	17,136	33,709

Item 9. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and 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.

Overview

We develop, market and support our Magic software development and deployment technology. Our Magic technology enables enterprises to accelerate the process of building and deploying software applications that can be rapidly customized and integrated with existing systems. During 1999, we expanded our business to include the sale of applications developed using Magic technology. These applications are designed for e-Business, CRM and other enterprise uses. Magic technology and Magic-based applications are used by over 2,500 software solution providers and thousands of enterprises in approximately 50 countries. We also provide maintenance and technical support as well as professional services to the Magic community.

We began operations in 1983 and completed an initial public offering of our ordinary shares in the United States in August 1991. In 1994, we began to experience a number of changes in our business environment which affected our operating and financial performance. For example, as a result of the broad acceptance of Microsoft's Windows operating system and Visual Basic development technology, sales of the DOS version of Magic technology began to decline. In response, we accelerated the development of our Magic for Windows product, which was released in September 1995. In addition, we focused on the development of our application server technology to target the enterprise market. With the introduction and shipment of our Magic for Windows product and our beginning to offer advanced client and server functionality to the enterprise market, we realized accelerated sales growth and returned to profitability in 1996. We also completed a follow-on public offering of our ordinary shares in 1996.

In 1997, we intensified our focus on the enterprise market and increased our fee-based maintenance and technical support and professional services throughout the product life cycle. In targeting the enterprise market we began to face a longer sales cycle and were required to provide additional resources for technology transfer and other activities early in the sales cycle. At the same time, we experienced increased competition from other software development technologies and from large solution providers including Oracle, SAP, BaaN and PeopleSoft.

In addition to these specific conditions which affected us, the following market trends had a substantial adverse effect on our financial condition and results of operations:

- An increasing tendency of large enterprise organizations, our prime target market, to outsource ready-made software solutions rather than develop them internally.
- A shift in the purchasing practices of enterprise customers from products to services. The shift to services required a corresponding increase in the need for skilled personnel, a difficult task in the prevailing worldwide shortage of highly skilled programmers.
- A large portion of information technology budgets of enterprises was allocated to solving problems relating to the Year 2000 issue.

The cumulative impact of these factors was a decline in our software sales, which was offset by an increase in maintenance and technical support as well as professional services. We also experienced an increase in sales, marketing and research and development expenses, resulting in a net loss of approximately $10.5 million in 1997. Of this amount, approximately $5.4 million was attributable to a restructuring plan implemented by us and to non-recurring costs.

During 1997, we recorded a restructuring charge of $4.4 million or $0.30 per share to cover the costs of a restructuring program approved in June 1997 by our Board of Directors. This charge relates to the termination of distribution agreements in Southeast Asia, Brazil and Israel in the total amount of $1.4 million and includes the termination of approximately 37 employee positions in the total amount of $789,000. The 1997 restructuring charge also includes a one time expense of approximately $2.0 million to write off capitalized computer software development costs for terminating a line of products. In addition, we wrote off unused fixed assets designated for abandonment. The restructuring program was completed in the first quarter of 1998.

In addition, during the second quarter of 1997 we also recognized other non-recurring charges of $1.0 million, principally due to a cancellation of an agreement with the Office of the Chief Scientist in the Israeli Ministry of Industry and Trade.

In the second quarter of 1998, we recorded a restructuring charge of $2.3 million or $0.13 per share to cover the costs of a restructuring program approved in June 1998 by our Board of Directors. This charge relates to the termination of distribution agreements in Southeast Asia, Brazil and Israel in the total amount of $372,000 and severance and other costs relating to the termination of 41 employee positions in the total amount of $1.2 million. The restructuring charge also includes a one time expense of approximately $512,000 to write off capitalized computer software development costs for terminating a new line of products. In addition, we wrote off unused fixed assets designated for abandonment. The restructuring program was completed by the end of 1998.

During the second quarter of 1998, we also recognized other non-recurring charges of $350,000, principally due to our determination to cancel an agreement with the Israel-U.S. Binational Industrial Research and Development Foundation, or BIRD-F.

Beginning in the third quarter of 1998, we benefited from cost savings derived from the implementation of our restructuring plan and the lower cost structure of our operations in India, as well as increased revenues, which resulted in improved margins and a return to profitability in the second half of 1998. We also benefited from a sharp increase in revenues derived from maintenance and technical support and professional services. This increase was primarily due to an increase in maintenance fees derived from the release of a new version of our Magic technology and an increase in marketing efforts related to fee-based professional services.

In late 1998 and 1999, we implemented our strategy of providing both Magic technology and applications through the acquisitions of some of our distributors and Magic solution providers. Accordingly, in 1999 we acquired interests or increased our ownership interests in our distributors or Magic solution providers in Australia, Canada, Hungary, India, Japan, Thailand and the United States. Our Japanese subsidiary acquired the distribution rights for our products in Japan from our previous distributor, Wacom Co. Ltd. As a result, we now consolidate all of the sales of our Japanese subsidiary, Magic Software Japan, in our revenues rather than the royalty percentage we received in the past. In addition, our sales also increased as a result of our enhanced focus on development and sale of applications. As a result, we generated record revenues and profits in each of the quarters of 1999.

In the first quarter of 2000, we completed a follow-on offering of our ordinary shares in the United States.

Our consolidated financial statements are stated in U.S. dollars, the currency of our primary economic environment and our functional and reporting currency, and prepared in accordance with generally accepted accounting principles in the United States. Nevertheless, we conduct our operations in the local currencies of the countries in which many of our subsidiaries are located. Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transactions and balances in other currencies are remeasured into U.S. dollars in accordance with the principles set forth in Financial Accounting Standards Board Statement No. 52. Gains and losses arising from conversion are included in accumulated other comprehensive loss in shareholders' equity.

The following table presents our consolidated revenues according to the geographical regions to which such revenues are attributable for the periods indicated:

	Year ended December 31,					
	1997		1998		1999	
	Revenues	%	Revenues	%	Revenues	%
	(U.S. dollars in thousands)					
Europe (excluding the United Kingdom)	$14,794	39.5%	$17,310	44.7%	$21,205	33.1%
Japan	3,743	10.0	1,550	4.0	13,134	20.6
United Kingdom	6,024	16.1	7,320	18.9	6,041	9.4
North America	5,945	15.9	6,289	16.2	7,605	11.9
Israel	4,101	11.0	3,726	9.6	5,192	8.1
Other	2,825	7.5	2,565	6.6	10,815	16.9
	$37,432	100.0%	$38,760	100.0%	$63,992	100.0%

Revenues. Revenues are derived primarily from sales of software licenses and applications and fees from maintenance and technical support and professional services. Software sales are recognized pursuant to Statement of Position 97-2, as amended, upon delivery of the software if: collection is probable, all license payments are due within one year, the license fee is fixed or determinable, and persuasive evidence of an arrangement exists. Revenues from maintenance and technical support are recognized ratably over the contractual period. Revenues from professional services are recognized as project milestones are reached or pursuant to the contract.

Cost of Revenues. Cost of revenues for software sales consists primarily of software production costs and royalties and licenses payable to third parties, and amortization of capitalized software. Cost of revenues for maintenance and technical support and professional services consists primarily of personnel expenses and other related costs.

Research and Development Expenses, Net. Research and development costs consist primarily of salaries of employees engaged in on-going research and development activities and other related expenses. Grants for research and development and the capitalization of software development costs are applied as reductions to gross research and development costs to calculate net research and development expenses.

The following table sets forth the gross research and development costs, the amount of royalty-bearing grants received primarily from the Government of Israel, software development costs capitalized, and the net research and development expenses for the periods indicated:

	Year ended December 31		
	1997	1998	1999
	(U.S. dollars in thousands)		
Gross research and development costs	$6,758	$4,080	4,081
Less royalty bearing grants	(285)	—	—
Less capitalization of software development costs	(3,125)	(1,283)	(1,128)
Research and development expenses, net	3,348	$2,797	$ 2,953

Research and development expenses, net of government and other grants, are charged to income as incurred until technological feasibility is established. Technological feasibility is established upon completion of a detailed program design. Expenses incurred between the completion of the working model and the point at which the product is ready for general release are capitalized in accordance with Statement of Financial Accounting Standards No. 86. Capitalized software costs are amortized on a product-by-product basis. The annual amortization is the greater of the amount computed using the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or the straight-line method over the remaining estimated economic life of the product, including the period being reported on. Amortization begins when the product is available for general release to customers.

Royalty-bearing grants from the Office of the Chief Scientist and others for funding approved research projects and marketing activities are recognized, on the basis of the related expenses incurred, at the time we are entitled to such grants. We believe that the current policy of the Office of the Chief Scientist with respect to research and development grants is not beneficial to us and, therefore, we have not sought any new grants from the Office of the Chief Scientist since 1998, and we do not currently intend to seek any additional grants under this policy.

Since the beginning of 1998, we transferred a substantial part of our research and development operations to India, due to the relatively low cost structure for research and development in India.

Selling and Marketing Expenses, Net. Selling and marketing expenses consist primarily of compensation and related expenses for sales and marketing personnel, sales commissions, marketing programs, web site related expenses, public relations, promotional materials, travel expenses and trade show exhibit expenses. Selling and marketing expenses are presented net of marketing grants received from the Government of Israel.

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, provisions for doubtful accounts, amortization of goodwill, and other general corporate expenses.

Financial Expenses, Net. Financial expenses consist of interest expense and currency translation expenses adjustments. Financial income consists of interest on cash and cash equivalent balances, and currency translation gains.

Taxes. Under Israeli tax law, Israeli companies are generally subject to income tax at the corporate tax rate of 36%. However, income recognized by us from our seven investment programs which have been granted “approved enterprise” status are tax exempt or taxed at a lower rate for a specified period commencing the date we begin to report taxable income and exhaust any net operating loss carry-forwards. These tax benefits are not available to us with respect to any income of our foreign subsidiaries.

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		
	1997	**1998**	**1999**
Revenues Software	64.2%	52.8%	57.9%
Maintenance and technical support	11.2	14.9	14.4
Professional services	24.6	32.3	27.7
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Software	11.6	7.7	6.2
Maintenance and technical support	7.2	8.5	5.4
Professional services	20.6	23.4	17.8
Total cost of revenues	39.4	39.6	29.4
Gross profit	60.6	60.4	70.6
Operating expenses:			
Research and development, net	8.9	7.2	4.6
Selling and marketing, net	46.8	41.5	32.7
General and administrative	16.3	20.2	16.0
Restructuring and other non-recurring costs	14.5	6.9	-
Total operating expenses	86.5	75.8	53.3
Operating income (loss)	(25.9)	(15.4)	17.3
Financial expenses, net	(1.3)	(0.8)	(0.3)
Income (loss) before income taxes	(27.2)	(16.2)	17.6
Income taxes	(1.3)	(0.1)	—
Equity in earnings (losses) of affiliates	0.1	0.4	0.1
Minority interest in (earnings) losses of consolidated subsidiaries	0.6		0.6
Net income (loss)	(27.8%)	(16.7%)	17.0

Year Ended December 31, 1999 Compared with Year Ended December 31, 1998

Revenues. Total revenues increased 65.% to $64.0 million in 1999 from $38.8 million in 1998. Software sales increased 81% to $37.0 million in 1999 from 20.5 million in 1998. This increase was principally attributable to our consolidation of the revenues of Magic Software Japan in 1999 and to sales of applications of approximately $4.4 million. Revenues from maintenance and technical support increased 51% to $9.2 million in 1999 from $5.8 million in 1998, mainly as a result of our increased marketing efforts and regaining our customers' confidence in our maintenance and technical support as a result of the implementation of our strategic plan. Revenues from professional services increased 45% to $17.8 million in 1999 from $12.5 million in 1998. This growth reflects our increased efforts to expand our fee-based professional services including consulting to and training of external contractors mainly in Europe.

Cost of Revenues. Cost of revenues increased 22% to $18.8 million in 1999 from $15.3 million in the 1998. Costs of revenues for software sales increased 33% to $4.0 million in 1999 from $3.0 million in 1998, as a result of our consolidation of the revenues of Magic Software Japan in 1999. Cost of revenues for maintenance and technical support remained constant at approximately $3.5 million in both periods due to the relatively low cost structure of our operations in India. Cost of revenues for professional services increased 28% to $11.4 million in 1999 from $9.0 million in 1998 as a result of our efforts to expand our professional services.

Gross Profit. Gross profit increased 93% to $45.2 million in 1999 from $23.4 million in 1998. Our gross margin, or gross profit as a percentage of total revenues, on software sales increased to 89% in 1999 from 85% in 1998. Our gross margin on maintenance and technical support increased to 63% in 1999 from 43% in 1998, and our gross margin on professional services increased to 28% in 1998.

Research and Development Expenses, Net. Gross research and development costs remained constant at $4.1 million in both periods. Net research and development expenses increased 6% to $3.0 million in 1999 from $2.8 million in 1998. We did not receive any grants from the Office of the Chief Scientist in either 1999 or 1998, nor did we accrue any grants from BIRD-F. At March 31, 2000, we employed 147 persons in research and development, of which 37 persons were based in our research and development facility in India. Net research and development expenses as a percentage of revenues decreased to 6% in 1999 from 7% in 1998. We expect that the gross research and development costs as a percentage of revenues will increase for the foreseeable future.

Selling and Marketing Expenses, Net. Selling and marketing expenses increased 30% to $20.9 million in 1999 from $16.1 million in 1998, mainly due to the consolidation of the selling and marketing expenses of Magic Software Japan and the general growth in sales. Selling and marketing expenses as a percentage of revenues decreased to 33% in 1999 from 42% in 1998, mainly as a result of the increase in sales, principally software, which grew more rapidly than the selling and marketing expenses, net.

General and Administrative Expenses. General and administrative expenses increased 31% to $10.2 million in 1999 from $7.8 million in 1998. The increase was primarily attributable to expenses associated with our increase in sales, mainly in Japan. General and administrative expenses as a percentage of revenues decreased to 16% in 1999 as compared to 20% in 1998. We expect that general and administrative expenses will increase in the future, but will decrease as a percentage of revenues as a result of the continued growth in our operations.

Restructuring and Other Non-Recurring Costs. We did not incur any restructuring or other non-recurring costs in 1999 as compared to 1998 when we incurred $2.8 million of restructuring and non-recurring costs.

Financial Expenses, Net. Financial expenses were immaterial in both 1999 and 1998.

Income Taxes. We incurred income taxes of $2,000 in 1999 and $50,000 in 1998. These taxes are primarily attributable to taxes paid in Japan and India.

Equity in Earnings (Losses) of Affiliates. In 1999, we recognized income of $52,000 from our minority interests as compared to a loss of $149,000 in 1998. The improvement is attributable to our share in the profits from our minority interests in our non-consolidated affiliates.

Minority Interest in Profits of Consolidated Subsidiaries. Minority interest in the profits of our consolidated subsidiaries represents the minority shareholders' share of the profits of some of our majority owned subsidiaries. In 1999, we recognized minority interest of $394,000 from the income attributed to the minority shareholders of our subsidiaries as compared to $12,000 from losses attributed to our minority shareholders of our subsidiaries in 1998.

Net Income (Loss). As a result of the foregoing, we reported net income of $10.9 million or $0.43 per share for the year ended December 31, 1999 as compared to a net loss of $6.5 million or ($0.37) per share for the year ended December 31, 1998.

Year Ended December 31, 1998 Compared with Year Ended December 31, 1997

Revenues. Total revenues increased 4% to $38.8 million in 1998 from $37.4 million in 1997. Software sales decreased 15% to $20.5 million in 1998 from $24.0 million in 1997. This decrease was principally attributable to the decline in software sales in Japan and Southeast Asia where economic turmoil disrupted sales. Revenues from maintenance and technical support increased 38% to $5.8 million in 1998 from $4.2 million in 1997, and revenues from professional services increased 36% to $12.5 million in 1998 from $9.2 million in 1997. This growth, mainly in Europe, reflects our increased efforts to expand fee-based professional services including consulting and training to external contractors.

Cost of Revenues. Cost of revenues increased 4% to $15.3 million in 1998 from $14.7 million in 1997. Costs of revenues for software sales decreased 31% to $3.0 million in 1998 from $4.3 million in 1997, as a result of the decline in costs of software produced for the Japanese market. Cost of revenues for maintenance and technical support increased 23% to $3.3 million in 1998 from $2.7 million in 1997, corresponding to our increase in revenues. Cost of revenues for professional services increased 17% to $9.0 million in 1998 from $7.7 million in 1997 as a result of our continued change of focus from software sales to professional services.

Gross Profit. Gross profit increased 3% to $23.4 million in 1998 from $22.7 million in 1997. In 1998, gross margin on software sales increased to 85% from 82% in 1997. Gross margin on maintenance and technical support increased to 43% in 1998 from 36% in 1997, and gross margin on professional services increased to 28% in 1998 from 16% in 1997.

Research and Development Expenses, Net. Gross research and development costs decreased 40% to $4.1 million in 1998 from $6.8 million in 1997. The decrease was primarily a result of the decreased costs associated with our restructuring plan and the beginning of the transfer of part of our research and development operations to India, which resulted in a lower cost structure. Net research and development expenses decreased 15% to $2.8 million in 1998 from $3.3 million in 1997. We did not receive any grants from the Office of the Chief Scientist in 1998 as compared to $285,000 in 1997. We did not accrue any grants from BIRD-F in 1998.

Selling and Marketing Expenses, Net. Selling and marketing expenses decreased 8% to $16.1 million in 1998 from $17.5 million in 1997. Selling and marketing expenses as a percentage of revenues decreased to 42% in 1998 from 47% in 1997, principally as a result of our restructuring plan.

General and Administrative Expenses. General and administrative expenses increased 28% to $7.8 million in 1998 from $6.1 million in 1997. The increase was primarily attributable to a charge of $1.1 million with respect to doubtful accounts. General and administrative expenses as a percentage of revenues increased to 20% in 1998 as compared to 16% in 1997.

Restructuring and Other Non-Recurring Costs. We incurred restructuring and other non-recurring costs of $2.7 million in 1998 as compared to restructuring and other non-recurring costs of $5.4 million in 1997.

Financial Expenses, Net. Financial expenses decreased 34% to $322,000 in 1998 from $488,000 in 1997. Equity investment in our company by Formula Systems and Mashov Computers during 1998 helped us to reduce bank liabilities and interest expense. We also benefited from the positive trend in the strength of European currencies compared to the U.S. dollar.

Income Taxes. We incurred income taxes of $50,000 in 1998 compared to $476,000 in 1997. These taxes were primarily attributable to withholding taxes paid in Japan on the royalty payments we received from our Japanese distributor. We did not pay any taxes in Israel in either period.

Equity in Earnings (Losses) of Affiliates. In 1998, we recognized a loss of $149,000 from our minority interests in our affiliates as compared to a loss of $51,000 in 1997.

Minority Interest in Profits of Consolidated Subsidiaries. In 1998, we recognized minority interest of $12,000 from the losses attributed to the minority shareholders of our subsidiaries as compared to $237,001 from the losses attributed to such minority shareholders in 1997.

Net Income (Loss). As a result of the foregoing, we incurred a net loss of $6.5 million or ($0.37) per share for the year ended December 31, 1998 as compared to a net loss of $10.5 million or ($0.72) per share in the year ended December 31, 1997.

Quarterly Results of Operations

The following tables set forth unaudited quarterly results of operations in U.S. dollars and as a percentage of revenues for each of the nine fiscal quarters ended December 31, 1999. We have prepared this information on a basis consistent with our audited consolidated financial statements included in this prospectus and include all necessary adjustments, consisting only of normal recurring accruals that we consider necessary for a fair presentation of the information for the periods indicated. The results of operations for any quarter are not necessarily indicative of results for any future periods.

	Three months ended								
	Dec. 31, 1997	Mar. 31, 1998	June 30, 1998	Sept. 30, 1998	Dec. 31, 1998	Mar. 31, 1999	June 30, 1999	Sep. 30, 1999	Dec. 31, 1999
	(U.S. dollars in thousands)								
Revenues:									
Software	$ 6,135	$ 4,594	$ 4,642	$ 4,701	$ 6,542	$ 7,604	$ 8,815	$ 9,685	$10,920
Maintenance and technical support	948	1,076	1,210	1,830	1,664	1,985	2,540	2,345	2,348
Professional services	2,550	2,515	2,990	2,813	4,183	4,042	3,968	4,379	5,361
Total revenues	9,633	8,185	8,842	9,344	12,389	13,631	15,323	16,409	18,629
Cost of revenues:									
Software	1,086	604	725	938	727	796	1,021	1,066	1,089
Maintenance and technical support	690	900	939	808	659	798	861	911	880
Professional services	2,032	2,073	2,214	1,920	2,839	2,600	2,777	2,705	3,284
Total cost of revenues	3,808	3,577	3,878	3,666	4,225	4,194	4,659	4,682	5,252
Gross profit	5,825	4,608	4,964	5,678	8,164	9,437	10,664	11,727	13,377
Operating expenses:									
Research and development, net	856	806	717	661	613	615	679	837	822
Selling and marketing, net	5,102	3,445	4,454	3,797	4,377	4,663	4,809	5,220	6,242
General and administrative	1,782	1,463	3,565	1,182	1,607	2,300	2,505	2,668	2,768
Restructuring and other non-recurring costs	2,718	—	2,677	—	—	—	—	—	—
Total operating expenses	10,458	5,714	11,413	5,640	6,597	7,578	7,993	8,725	9,832
Operating income (loss)	(4,633)	(1,106)	(6,449)	38	1,567	1,859	2,671	3,002	3,545
Financial income (expenses), net	(59)	(112)	(47)	110	(273)	(292)	(239)	524	177
Capital gain	5	—	—	—	—	—	—	—	5
Income (loss) before income taxes	(4,687)	(1,218)	(6,496)	148	1,294	1,567	2,432	3,526	3,727
Income taxes	(128)	(25)	(11)	—	(14)	(42)	(20)	(69)	(129)
Equity in earnings (losses) of affiliates	39	(70)	16	(30)	(65)	23	22	81	75
Minority interest in losses (earnings) of consolidated subsidiaries	174	73	(29)	—	(32)	(135)	(154)	(128)	(23)
Net income (loss)	$ (4,602)	$(1,240)	$(6,520)	$ 118	$ 1,183	$ 1,413	$ 2,280	$ 3,410	$ 3,805

	Three months ended								
	Dec. 31, 1997	Mar. 31, 1998	June 30, 1998	Sept. 30, 1998	Dec. 31, 1998	Mar. 31, 1999	June 30, 1999	Sep. 30, 1999	Dec. 31, 1999
	(As percentage of total revenues)								
Revenues:									
Software	63.7%	56.1%	52.5%	50.3%	52.8%	55.8%	57.5%	59.0%	58.6 %
Maintenance and technical support	9.8	13.1	13.7	19.6	13.4	14.6	16.6	14.3	12.6
Professional services	26.5	30.8	33.8	30.1	33.8	29.6	25.9	26.7	28.8
Total revenues	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cost of revenues:									
Software	11.3	7.4	8.2	10.0	5.9	5.8	6.7	6.5	5.8
Maintenance and technical Support	7.1	11.0	10.7	8.6	5.3	5.9	5.6	5.6	4.7
Professional services	21.1	25.3	25.0	20.6	22.9	19.1	18.1	16.4	17.6
Total cost of revenues	39.5	43.7	43.9	39.2	34.1	30.8	30.4	28.5	28.2
Gross profit	60.5	56.3	56.1	60.8	65.9	69.2	69.6	71.5	71.8
Operating expenses:									
Research and development, net	8.9	9.8	8.1	7.1	4.9	4.5	4.4	5.1	4.4
Selling and marketing, net	53.0	42.1	50.4	40.6	35.3	34.2	31.4	31.8	33.5
General and administrative	18.5	17.9	40.3	12.7	13.0	16.9	16.4	16.3	14.9
Restructuring and other non-recurring costs	28.2	—	30.2	—	—	—	—	—	
Total operating expenses	108.6	69.8	129.0	60.4	53.2	55.6	52.2	53.2	52.8

	Three months ended								
	Dec. 31, 1997	Mar. 31, 1998	June 30, 1998	Sept. 30, 1998	Dec. 31, 1998	Mar. 31, 1999	June 30, 1999	Sep. 30, 1999	Dec. 31, 1999
	(As percentage of total revenues)								
Operating income (loss)	(48.1)	(13.5)	(72.9)	0.4	12.7	13.6	17.4	18.3	19.0
Financial income (expenses), net	(0.6)	(1.4)	(0.6)	1.2	(2.2)	(2.1)	(1.5)	3.2	1.0
Income (loss) before income Taxes	(48.7)	(14.9)	(73.5)	1.6	10.5	11.5	15.9	21.5	20.0
Income taxes	(1.3)	(0.3)	—	—	(0.1)	(0.3)	(0.1)	(0.4)	0.7
Equity in earnings (losses) of affiliates	0.4	(0.8)	0.1	(0.3)	(0.5)	0.2	0.1	0.5	0.4
Minority interest in losses (earnings) of consolidated subsidiaries	1.8	0.9	(0.3)	—	(0.4)	(1.0)	(1.0)	(0.8)	0.1
Net income (loss)	(47.8%)	(15.1%)	(73.7%)	1.3%	9.5%	10.4%	14.9%	20.8%	20.4 %

Our quarterly results of operations have varied significantly in the past as a result of various factors, many of which are beyond our control. Accordingly, revenues and net income, if any, in any particular period may be lower than revenues and net income, if any, in a preceding or comparable period. Period-to-period comparisons of our result of operations may not be meaningful, and you should not rely upon them as indications of our future performance.

Liquidity and Capital Resources

Historically, we have financed our operations through cash generated by operations, funds generated by our public offerings in 1991 (approximately $8.5 million), 1996 (approximately $5.0 million) and 2000 (approximately $80.6 million), private equity investments in 1998 (approximately $12.2 million), as well as from research and development and marketing grants primarily from the Government of Israel. In addition, we have also financed our operations through short-term loans and borrowings under available credit facilities.

Our principal commitments consist of obligations outstanding under operating leases. Capital expenditures were approximately $3.3 million for 1999 and $846,000 for 1998. In 1999, the majority of capital expenditures was attributable to a purchase from Mashov Computers of a 50% interest in our building in Or Yehuda for $2.0 million and the balance of our capital expenditures were principally for computer and electronic equipment and software, office furniture and equipment, and vehicle purchases. We currently do not have significant capital spending or purchase commitments. However, we anticipate an increase in capital expenditures and lease commitments consistent with our anticipated growth in operations, infrastructure and personnel.

Net cash provided by operating activities was $10.2 million for 1999. This amount was attributable primarily to our net income of $10.9 million for the period, and an increase in trade payables of $2.0 million, an increase in accrued expenses and other liabilities of $700,000, an increase in trade receivables of $4.0 million, an increase in other receivables and pre-paid expenses of $2.9 million and depreciation and amortization of $3.1 million. Net cash used in operating activities was $1.6 million in 1998. This amount was primarily due to a net loss of approximately $6.5 million, an increase in related party receivables of $731,000 and a decrease in trade payables of $1.1 million, offset in part by depreciation and amortization of $2.8 million, a decrease in trade receivables of $1.0 million and an increase in accrued expenses and other liabilities of $1.9 million.

Net cash used in investing activities was approximately $12.1 million in 1999 and $3.3 million in 1998. The increase in investing activities in 1999 was primarily attributable to our investment in our Japanese subsidiary and the purchase of a 50% interest in our headquarters building in Or Yehuda from Mashov Computers.

Net cash provided by financing activities was $4.5 million for 1999 mainly due to proceeds from the exercise of stock option by our employees. Net cash provided by financing activities was $9.3 million in 1998, primarily attributable to proceeds of $12.2 million from the issuance of ordinary shares to Mashov Computers and Formula Systems in three private placements, offset in part by our repayment of $2.9 million in short-term bank debt.

As of December 31 1999, we had $8.3 million in cash and cash equivalents and working capital of $9.7 million as compared to $5.8 million in cash and cash equivalents and working capital of $5.3 million at December 31, 1998. In March 2000, we augmented our cash reserves with $80.6 million of proceeds from our follow-on public offering.

As of December 31, 1999, we had a bank line of credit of approximately $2.0 million with the First International Bank LeIsrael Ltd., which was not withdrawn as of that date. The short-term bank credit is secured by a first priority floating charge on all our assets and by a fixed charge on goodwill (intangible assets), unpaid share capital and insurance rights (rights to proceeds on insured assets in the event of damage). In addition, the agreement with the First International Bank LeIsrael Ltd. prohibits us from selling or otherwise transferring any assets except in the ordinary course of business, from placing a lien on our assets without the bank's consent and from declaring dividends to our shareholders.

Corporate Tax Rate

Israeli companies are generally subject to income tax at the corporate tax rate of 36% of taxable income. However, seven investment programs at our facility in Or Yehuda have been granted "approved enterprise" status under the Law for Encouragement of Capital Investments, 1959 and we are, therefore, eligible for some tax benefits. Subject to compliance with applicable requirements, the portion of our income derived from the approved enterprise programs will be tax-exempt for a period of two to four years commencing in the first year in which it generates taxable income and will be subject, for a period of five to eight years, to a reduced corporate tax of 25%. However, these benefits will not be available to us with respect to any income derived by our non-Israeli subsidiaries.

As of December 31, 1999, our net operating loss carry-forwards for Israeli tax purposes were immaterial and the net operating loss carry-forwards of our U.S. subsidiary for U.S. tax purposes amounted to approximately $11.7 million. Our U.S net operating loss carry-forwards are available to offset any future U.S. taxable income of our U.S. subsidiary and will expire in the years 2007 through 2013.

Impact of Currency Fluctuations and of Inflation

Our financial statements are denominated in U.S. dollars, our functional currency. Nevertheless, a majority of our sales are made, and a majority of our expenses are incurred, in other currencies, particularly Euros, Japanese yen and U.K. pounds sterling. We maintain substantial non-U.S. dollar balances of assets, including cash and accounts receivable, and liabilities, including accounts payable. Fluctuations in the value of the currencies in which we do business relative to the U.S. dollar could have a material adverse effect on 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.

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 the devaluation of the NIS in relation to the U.S. dollar. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our profitability as we incur expenses, principally salaries and related personnel expenses, in NIS. For several years prior to 1997, the rate of inflation in Israel exceeded the rate of devaluation of the NIS against the U.S. dollar and companies experienced increases in the U.S. dollar cost of their operations in Israel. This trend was reversed during 1997 and 1998. In 1999, the rate of inflation exceeded the rate of devaluation of the NIS against the U.S. dollar. We cannot assure you that we will not be materially and adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind inflation in Israel.

The following table sets forth, for the periods indicated, information with respect to the rate of inflation in Israel, the rate of devaluation of the NIS against the U.S. dollar, and the rate of inflation in Israel adjusted for such devaluation:

Year ended December 31,	Israeli consumer price index	Israeli inflation rate %	Israeli devaluation rate %	Israeli inflation adjusted for devaluation %
1995	310.0	8.1	3.9	4.1
1996	335.2	10.6	3.7	6.6
1997	370.7	7.0	8.8	(1.7)
1998	402.6	8.6	17.6	(7.7)
1999	408.0	1.3	—	1.3

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

Because exchange rates between the NIS and the U.S. dollar fluctuate continuously (albeit with a historically declining trend in the value of the NIS), exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

Conditions in Israel

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel.

Political Conditions

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Israel signed a peace treaty with Egypt in 1979 and a peace treaty with Jordan in 1994. Since 1993, a joint Israeli-Palestinian Declaration of Principles and several other agreements have been signed between Israel and the Palestinians. As of the date of this Annual Report, Israel has not entered into any peace agreement with Syria or Lebanon. We cannot assure you as to whether any peace agreement with Syria or Lebanon will be signed.

Despite the progress towards peace between Israel and its Arab neighbors and the Palestinians, some countries, companies and organizations continue to participate in a boycott of Israeli firms and others doing business with Israel or with Israeli companies. Although we are precluded from marketing our products to such countries, we believe that in the past, the boycott has not had a material adverse effect on us. However, restrictive laws, policies or practices directed towards Israel or Israeli businesses could have an adverse impact on the expansion of our business.

All male adult citizens and permanent residents of Israel under the age of 48 are, unless exempt, obligated to perform up to 30 days of military reserve duty annually. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. Many of our officers and employees are currently obligated to perform annual reserve duty. While we have operated effectively under these requirements since we began operations, we cannot assess the full impact of such requirements on our workforce or business if conditions should change, and we cannot predict the effect on us of any expansion or reduction of such obligations.

Economic Conditions

Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980s, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. The Israeli government has, for these and other reasons, intervened in various sectors of the economy, by utilizing, among other means, fiscal and monetary policies, import duties, foreign currency restrictions and control of wages, prices and foreign currency exchange rates. In 1998, the Israeli currency control regulations were liberalized significantly, as a result of which Israeli residents may deal in foreign currency and non-residents of Israel may purchase and sell Israeli currency and assets. The Israeli government has periodically changed its policies in all these areas. There are currently no Israeli currency control restrictions on remittances of dividends on the ordinary shares or the proceeds from the sale of the shares; however, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time. In addition, Israeli residents are required to file reports pertaining to specific types of actions or transactions.

The Israeli government's monetary policy contributed to relative price and exchange rate stability in recent years, despite fluctuating rates of economic growth and a high rate of unemployment. We cannot assure you that the Israeli government will be successful in its attempts to keep prices and exchange rates stable. Price and exchange rate instability may have a material adverse effect on us.

Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the EEC, known now as the "European Union," concluded a Free Trade Agreement in July 1975 which confers some advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the "EFTA," established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes redefinement of rules of origin and other improvements, such as allowing Israel to become a member of the Research and Technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and Asia.

Item 9A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS.

Interest Rate Risk

We currently invest our cash in short-term deposits based on LIBOR for dollar denominated deposits. However, from time to time we use our NIS credit facility, which is linked to the Israeli prime, for very short-term liabilities and whenever it’s worthwhile. As a result, changes in the general level of interest rates is insignificant. We expect our exposure to market risk from changes in interest rates will not be material. Therefore, no quantitative tabular disclosures are required.

Foreign Currency Exchange Risk

In the normal course of our business we are exposed to fluctuations in foreign currency exchange rate as the financial results of our foreign subsidiaries are converted into U.S. dollars in consolidation. Generally, we do not use derivative instruments or hedge to cover exposures.

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF REGISTRANT

Directors and Officers

The following table lists our directors and executive officers:

Name	Age	Position
David Assia	48	Chairman of the Board of Directors
Jack Dunietz	44	Chief Executive Officer and Director
Israel Teiblum	46	President and Chief Financial Officer
Gad Ariav (1)	49	Director
Yigal Berman (1)	50	Director
Dan Goldstein	45	Director
Gad Goldstein	40	Director

The following table lists our other key employees:

Name	Age	Position
Guy Bernstein	32	Vice President-Worldwide Finance and Controller
Nachman Chefner	46	Vice President-Sales, Europe
Raphael Inbar	37	Chief Executive Officer, Magic Software Enterprises, Inc.
Moshe Leder	42	Vice President-International Sales
David Leichner	37	Vice President-Worldwide Marketing
Yoshimi Ogawa	55	President, Magic Software Japan K.K.
Avikam Perry	43	Vice President-Research and Development
Benjamin Rosenbaum	40	Vice President-Applications and Professional Services
Yohai Shaked	50	Chairman of the Board of Directors, Magic Software Japan K.K.

(1) Messrs. Ariav and Berman are our independent directors.

David Assia, a co-founder of our company, has served as a director since our inception in 1983 and as Chairman of the Board of Directors since 1986. From 1986 until September 1997, he served as Chief Executive Officer. Mr. Assia was Managing Director of Mashov Computers between 1980 and 1986 and has served as the Chairman of its board of directors since 1989. Mr. Assia also serves as a director of Walla! Ltd., Aladdin Knowledge Systems Ltd., Enigma Information Systems Ltd. and PortalPrise Ltd. Mr. Assia holds a B.A. degree in Economics and Statistics and an M.B.A. degree from Tel Aviv University.

Jack Dunietz, a co-founder of our company, has served as Chief Executive Officer since September 1997. Mr. Dunietz has been a director of our company since our inception in 1983. Mr. Dunietz was Managing Director of Mashov Computers from 1978 until 1987 and served as its Chief Executive Officer from 1987 until December 1991. Mr. Dunietz also serves as a director of BVR Technologies Ltd., Dunietz Bros. Ltd., Paradigm Geophysical Ltd., and Walla! Ltd. Mr. Dunietz holds a B.Sc. in Computer Science from the Technion, Israel Institute of Technology.

Israel Teiblum has served as President of our company since January 2000. Mr. Teiblum joined us as Chief Financial Officer in February 1997 and retained his position as Chief Financial Officer when he was appointed as President. Prior to joining us and since May 1995, Mr. Teiblum served as Chief Executive Officer of Data Automation Ltd., in which Mashov Computers held an interest. From October 1993 until April 1995, Mr. Teiblum served as Chief Financial Officer of Walla! Ltd. Mr. Teiblum holds a B.A. degree in Economics and Accounting from Tel Aviv University and is a Certified Public Accountant in Israel.

Gad Ariav has served as a director of our company since November 1994. Since July 1994, he has been a Senior Lecturer in the Information Systems Program of the Faculty of Management of Tel Aviv University. From July 1993 until June 1994, Dr. Ariav was a visiting Associate Professor at the University of California at Irvine and at the Claremont Graduate School. From 1990 until June 1993, Dr. Ariav was a Lecturer at Tel Aviv University. He has also taught at Erasmus University (the Netherlands), Fordham University and the Stern School of Business of New York University. Dr. Ariav is a public director of Ya'ana Computers (1993) Ltd., a publicly-traded company in Israel. He received his Ph.D. degree in Decision Sciences from the Wharton School of the University of Pennsylvania, an M.Sc. degree in Management Science-Information Systems from Tel Aviv University, and a B.A. degree in Economics and Statistics from Tel Aviv University.

Yigal Berman has served as a director of our company since October 1997. Since 1981 he has served as Vice President-Finance of Intergama Investment Ltd., an Israeli holding company. Mr. Berman serves as a director of Rapac Electronics Ltd., an Israeli company engaged in the electronics industry whose shares are traded on the Tel Aviv Stock Exchange. Until June 1997, Mr. Berman served as director of Mashov Computers. Mr. Berman holds an M.B.A. degree and a B.A. degree in Economics and Statistics from Tel Aviv University.

Dan Goldstein has served as a director of our company since April 1998. Mr. Goldstein has served as Chairman of the board of directors and Chief Executive Officer of Formula Systems since January 1985. Mr. Goldstein is also the Chairman of the board of directors of other companies in the Formula Systems group, including ForSoft Ltd., Sintec Advanced

Technologies Ltd., F.C.T. Formula Computer Technologies Ltd. and Applicom Software Industries (1990) Ltd., and is a director of Crystal Systems Solutions Ltd. Mr. Goldstein holds a B.A. degree in Mathematics and Computer Sciences and an M.B.A. degree from Tel Aviv University. Dan Goldstein and Gad Goldstein are brothers.

Gad Goldstein has served as a director of our company since December 1998. Mr. Goldstein has been President of Formula Systems since April 1995. Prior thereto and since 1985, he was the Vice President-Finance and a director of Formula Systems. Mr. Goldstein is also a director of other companies within the Formula Systems group, including ForSoft, Sintec Advanced Technologies, Nikuv Computers (Israel), F.C.T. Formula Computer Technologies and Applicom Software Industries, and is Chairman of the board of directors of Crystal Systems Solutions. Mr. Goldstein holds a B.A. degree in Economics and an M.B.A. from Tel Aviv University. Gad Goldstein and Dan Goldstein are brothers.

Guy Bernstein has served as Vice President-Worldwide Finance since December 1999 and as Controller since he joined us in October 1997. Prior to joining us and from March 1995, Mr. Bernstein was a Senior Manager with Kost Forer & Gabbay, a member of Ernst & Young International. Mr. Bernstein holds a B.A. degree in Accounting and Finance from Tel Aviv University and is a Certified Public Accountant in Israel.

Nachman Chefner has served as Vice President-Sales, Europe since January 1999. Mr. Chefner joined us in March 1994 as Managing Director of our French subsidiary, Magic Software France.

Raphael Inbar has served as Chief Executive Officer of our U.S. subsidiary, Magic Software Enterprises, Inc. since June 1999. Previously and since February 1998, Mr. Inbar served as Senior Vice President-Global Consulting Organization of Platinum Technologies, Inc. From July 1994 until January 1998, Mr. Inbar was President of Unidata Canada, Inc. Mr. Inbar holds a B.Sc. degree in Computer Sciences from Tel Aviv University.

Moshe Leder has served as Vice President-International Sales since January 1999. Mr. Leder joined us in September 1992 as Regional Manager for European Distribution and since then also held the position of Vice President-Worldwide Distribution. Mr. Leder holds a B.A. degree in Economics and Administration from Tel Aviv University and an M.B.A. degree from the University of Toronto.

David Leichner has served as Vice President-Worldwide Marketing since August 1998. From September 1997 until July 1998, Mr. Leichner served as Director of Marketing of eSim Ltd. From May 1994 until August 1997, Mr. Leichner was our market analyst and later our Product Marketing Manager. Mr. Leichner holds a B.A. degree in Computer Information Systems and an M.B.A. degree in International Business from Baruch College.

Yoshimi Ogawa has served as President and a director of our Japanese subsidiary, Magic Software Japan, since January 1999. From October 1998 until December 1998, Mr. Ogawa served as Executive Advisor of Sterling Software Applications K.K. From 1995 until January

1998, Mr. Ogawa served as President of Sybase K.K. and Chairman of Powersoft K.K. Mr. Ogawa holds a B.A. degree in Physics from National Aichi Educational University.

Avikam Perry has served as Vice President-Research and Development since July 1997. Mr. Perry joined us in July 1992 and held various positions, including Group and Product Manager, Development Department Manager and Vice President-Product Development. Mr. Perry holds a B.Sc. degree in Mathematics and Computer Science from Tel Aviv University.

Benjamin Rosenbaum has served as Vice President-Applications and Professional Services since January 1999. Mr. Rosenbaum joined us in 1987 and served in various positions, including Sales Manager for Israel, New Branch Manager and Business Development Manager. Mr. Rosenbaum holds a degree in Economics from Bar Ilan University.

Yohai Shaked has served as Chairman of the board of directors of our Japanese subsidiary, Magic Software Japan, since December 1998. Mr. Shaked joined us in June 1986 as Vice President and was appointed Senior Vice President in June 1991. Mr. Shaked served as a director on our Board of Directors from June 1991 until April 1998.

Board of Directors

Pursuant to our Articles of Association, directors are elected at our annual general meeting of the shareholders by a vote of the holders of a majority of the voting power represented at that meeting. Each director holds office until the next annual general meeting of the shareholders.

Outside Directors

Under the new Israeli Companies Law which became effective February 1, 2000 public companies are required to elect two outside directors who must meet specified standards of independence. Companies that are registered under the laws of Israel and whose shares are listed for trading on a stock exchange outside of Israel, such as our company, are treated as public companies, but the outside directors requirement will take effect on August 1, 2000. The outside directors may not have any economic relationship with us. Controlling shareholders of a company, 25% shareholders, and their relatives or employees cannot serve as outside directors. Outside directors are elected by shareholders. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who are present at the meeting. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company. Outside directors serve for a three-year term, which may be renewed for only one additional three-year term. Outside directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the outside directors cease to meet the statutory qualifications with respect to their appointment or if they violate their duty of loyalty to the company.

If, when an outside director is elected, all members of the board of directors of a company are of one gender, the outside director to be elected must be of the other gender.

Any committee of the board of directors must include at least one outside director. An outside director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

Pursuant to regulations promulgated under the Companies Law, our two independent directors may be deemed to be outside directors.

Audit Committee

The Companies Law provides that public companies must appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related-party transactions as required by law. An audit committee must consist of at least three members, and include all of the company's outside directors. However, the chairman of the board of directors, any director employed by the company or providing services to the company on a regular basis, any controlling shareholder and any relative of a controlling shareholder may not be a member of the audit committee. 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 outside directors are serving as members of the audit committee and at least one of the outside directors was present at the meeting in which an approval was granted.

In addition, the Companies Law requires the board of directors of a public company to appoint an internal auditor nominated by the audit committee. A person who does not satisfy the 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 Companies Law.

Approval of Related Party Transactions Under Israeli Law

The Companies Law codifies the fiduciary duties that "office holders", including directors and executive officers, owe to a company. An "office holder" as defined in the Companies Law is a director, general manager, chief business manager, deputy general manager, vice general manager, chief business manager, executive vice president, vice president, other manager directly subordinate to the managing director or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. 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 which a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (1) information regarding the appropriateness of a given action brought for his approval or performed by him by virtue of his position and (2) all other information of importance pertaining to the foregoing actions. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and his personal affairs, avoiding any competition with the company, avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and disclosing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder. Each person listed as a director or executive officer in the table under "— Directors and Officers" above is an office holder. Under the Companies Law, all arrangements as to compensation of office holders who are not directors require approval of our Board of Directors, and the compensation of office holders who are directors must be approved by our Audit Committee, Board of Directors and shareholders.

The Companies Law requires that an office holder promptly disclose any personal interest that he or she may have and all related material information known to him or her, 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 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. Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has an interest) must be approved by the board of directors or as otherwise provided for in a company's articles of association, as not being adverse to the company's interest. In some cases, such a transaction must be approved by the audit committee and by the board of directors itself (with further shareholder approval required in the case of extraordinary transactions). An office holder who has a personal interest in a matter, which is considered at a meeting of the board of directors or the audit committee, may not be present during the board of directors or audit committee discussions and may not vote on this matter.

The Companies Law also provides that some transactions between a public company and a controlling shareholder, or transactions in which a controlling shareholder of the company has a personal interest but which are between a public company and another entity, require the approval of the board of directors and of the shareholders. Moreover, an extraordinary transaction with a controlling shareholder or the terms of compensation of a controlling shareholder must be approved by the audit committee, the board of directors and shareholders. The shareholder approval for an extraordinary transaction must include at least one-third of the shareholders who have no personal interest in the transaction and are present at the meeting. The transaction can be approved by shareholders without this one-third approval, if the total shareholdings of those shareholders who have no personal interest and voted against the transaction do not represent more than one percent of the voting rights in the company. In addition, a private placement of securities that will increase the relative holdings of a shareholder that holds 5% or more of the company's outstanding share capital or that will cause any person to become, as a result of the issuance, a holder of more than five percent of the company's outstanding share capital, requires approval by the board of directors and the shareholders of the company. The Companies Law provides that 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 become a 25% shareholder of the company. This rule does not apply if there is already another 25%

shareholder of the company. Similarly, the Companies Law provides that 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 become a 45% shareholder of the company, unless there is a 50% shareholder of the company. Regulations under the Companies Law provide that the Companies Law's tender offer rules do not apply to a company whose shares are publicly traded outside of Israel, if pursuant to the applicable foreign securities laws and stock exchange rules there is a restriction on the acquisition of any level of control of the company, or if the acquisition of any level of control of the company requires the purchaser to make a tender offer to the public shareholders.

Indemnification of Directors and Officers

The Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his duty of loyalty, but may exculpate in advance an office holder from his liability to the company, in whole or in part, with respect to a breach of his duty of care. Our Articles of Association provide that, subject to any restrictions imposed by corporate law, we may enter into a contract for the insurance of the liability of any of our office holders with respect to:

- a breach of his duty of care to us or to another person;
- a breach of his duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his act would not prejudice our interests; or
- a financial liability imposed upon him in favor of another person in respect of an act performed by him in his capacity as an office holder.

In addition, we may indemnify an office holder against:

- a financial liability imposed on him in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court in respect of an act performed in his capacity as an office holder; and
- reasonable litigation expenses, including attorneys' fees, expended by such office holder or charged to him by a court, in proceedings we institute against him or instituted on our behalf or by another person, or in a criminal charge from which he was acquitted, all in respect of an act performed in his capacity as an office holder.

These provisions are specifically limited in their scope by the Companies Law, which provides that a company may not indemnify an office holder, nor enter into an insurance contract which would provide coverage for any monetary liability incurred as a result of any of the following:

- a breach by the office holder of his duty of loyalty unless the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;

- a breach by the office holder of his duty of care if such breach was done intentionally or in disregard of the circumstances of the breach or its consequences;

- any act or omission done with the intent to derive an illegal personal benefit; or

- any fine levied against the office holder as a result of a criminal offense.

Under the Companies Law, our shareholders may amend our Articles of Association to include either of the following provisions:

- A provision authorizing us to grant in advance an undertaking to indemnify an office holder, provided that the undertaking is limited to types of events which the board of directors deems to be anticipated and limited to an amount determined by the board of directors to be reasonable under the circumstances.

- A provision authorizing us to retroactively indemnify an office holder.

In addition, pursuant to the Companies Law, indemnification of, and procurement of insurance coverage for, our office holders must be approved by our Audit Committee and our Board of Directors and, in specified circumstances, by our shareholders.

We have indemnified our office holders to the fullest extent permitted by law. We currently maintain a directors and officers liability insurance policy with a per claim and aggregate coverage limit of $5.0 million including legal costs incurred in Israel.

Audit Committee

Our Board of Directors has formed an Audit Committee which consists of Gad Ariav, Yigal Berman and Dan Goldstein. The Audit Committee exercises the powers of the Board of Directors with respect to our accounting, reporting and financial control practices.

Item 11. COMPENSATION OF DIRECTORS AND OFFICERS

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, 1999.

	Salaries, fees, commissions and bonuses	**Pension, retirement and similar benefits**
All directors and executive officers as a group, consisting of seven persons.........................	$2,541,917	$79,269

During the year ended December 31, 1999, we paid to each of our independent directors an annual fee of approximately $4,540 and a per meeting attendance fee of approximately $222. As of December 31, 1999, the annual fee was $5,000 and the per meeting attendance fee was $218. Those 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.

As of December 31, 1999, our directors and executive officers as a group, consisting of seven persons, held options to purchase an aggregate of 111,480 ordinary shares. All our executive officers work full time for us, except for David Assia and Jack Dunietz, who are employed on a part-time basis.

Item 12. <u>OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES</u>

In 1991, we adopted our Employee Stock Option Plan. Employees and directors of our company and its subsidiaries are eligible to participate in the plan. The plan, as amended, authorizes the grant of options to purchase an aggregate of 6,750,000 ordinary shares. The plan has a 10-year term and will terminate on July 31, 2001.

Our Board of Directors administers the plan. Pursuant to the plan, our Board of Directors has the authority in its sole discretion to:

- designate the persons to whom options are granted;
- designate options as incentive stock options;
- determine the number of shares underlying each option award;
- determine the terms and provisions of the option agreements, including the exercise price, time and extent to which options may be exercised and the nature and duration of restrictions regarding transferability and risk of forfeiture; and
- provide for any other matter necessary or desirable for the administration of the plan.

Our Board of Directors may terminate or amend the plan, provided that any action by the Board of Directors, which would alter or impair the rights of an option holder, requires the prior consent of that option holder.

The exercise price of an incentive stock option granted under the plan may not be less than 100% (110% in the case of a 10% shareholder) of the fair market value of our ordinary shares on the date of grant.

Options granted under the plan are non-assignable except by the laws of descent. Except for some grants made to United States-based individuals, options granted under the plan generally vest in three annual installments. Each option granted under the plan may terminate no later than ten years from the date of grant (five years from the date of grant in the case of a 10% shareholder).

As of April 30, 2000, options to purchase 6,627,191 ordinary shares had been granted, out of which 4,006,870 options had been exercised into ordinary shares, at an average exercise price of $1.820743 per share, and options to purchase 2,620,321 ordinary shares were outstanding at an average exercise price of $4.351299 per share.

As of April 30, 2000, our executive officers and directors as a group, consisting of seven persons, held options to purchase 80,880 ordinary shares, at an average exercise price of approximately $2.75 per share.

Israel's securities laws provide that an "offer" of securities to the "public" requires the publication of a prospectus that meets the Israeli prospectus requirements and which has been approved by the Israel Securities Authority in accordance with Israeli law. Israel's securities laws do not define the terms "offer" or "public." The Israel Securities Authority has informally taken the position that the grant of options in any 12 month period to more than 35 Israeli resident employees of an Israeli company is an "offer" to the "public" within in the meaning of Israel's securities laws. An action initiated by another company which challenges this interpretation of the Israel Securities Authority is currently pending in the District Court of Tel-Aviv.

In an effort to provide an incentive to our employees, we granted options to more than 35 Israeli resident employees. We believe that such grants do not violate Israel's securities laws. Should a court determine in favor of the position of the Israel Securities Authority, we may be deemed to have acted in contravention of Israel's securities laws.

Item 13. INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS

The Formula Systems Group

Lease and Real Estate Sale Agreements

We currently occupy approximately 90% of a 34,000 square foot office building located at 5 Ha'Plada Street in Or Yehuda, Israel. Mashov Computers, our principal direct shareholder, and we contracted for the construction of the building in 1994 and each of us initially owned a 50% interest in the building. From August 1994 until December 1998, we leased 41% of the building's space from Mashov Computers for our use at a monthly rent of $12,388, which monthly rent was adjusted on August 28th of each year for changes in the U.S. national consumer price index. In 1997 and 1998, we paid a total of approximately $211,000 and $204,000 in rent to Mashov Computers.

In July 1999, we entered into an agreement with Mashov Computers pursuant to which we purchased Mashov Computers' 50% interest in the building at 5 Ha'Plada Street for $2.0 million plus value added tax. The purchase price was determined pursuant to an independent appraisal. As part of the transaction, Mashov Computers agreed to reimburse us for the rent paid by us for the period January 1, 1999 until July 19, 1999, the date of the agreement. We also entered into an agreement with Mashov Computers effective January 1, 1999, pursuant to which Mashov Computers leased approximately 1,300 square feet from us in the 5 Ha'Plada Street building at a monthly rent of $3,120 plus value added tax. The initial term of the lease was for one year ending December 31, 1999, and is subject to automatic renewals for additional one-year periods. The parties may terminate the lease upon providing the other party with a prior notice of 90 days.

In January 2000, we entered into an agreement with Mashov Computers pursuant to which we sublease from Mashov Computers approximately 4,600 square feet in a building located at 3 Ha'Plada Street in Or Yehuda at a monthly rent of $7,424 plus value added tax. We previously subleased the same space from Mashov Computers and an affiliate of Mashov Computers pursuant to a five-year lease which commenced in March 1995. The annual rent for such premises was $65,000 in 1998 and $42,000 in 1999.

Supply Arrangement

In November 1998, we acquired a 25% interest in Barter The Israeli Clearing House for Trade Exchange Ltd., which is a 50% owned subsidiary of Mashov Computers. Barter purchases computer hardware and software for us for a fee of approximately $5,800 per month. In the year ended December 31, 1998 and 1999, we paid Barter approximately $57,000 and $75,000 for such services.

Purchase of Sintec Call Centers Ltd.'s Shares

In January 2000, we converted a capital note in the amount of $250,000 which had been issued to us in August 1999 by Sintec Call Centers Ltd. (formerly known as Manov Ltd.), a Magic solutions provider and an affiliate of Formula Systems, into shares representing a 19.9% interest in Sintec Call Centers. On February 1, 2000, we exercised an option and increased our interest in Sintec Call Centers to approximately 34.3% for an additional investment of $440,000. Our investment in Sintec Call Centers will be used by Sintec Call Centers to continue the development of Magic eContact, which we will market as part of our CRM suite. The parties further agreed that holders of 9.5% of the shares of Sintec Call Centers will be entitled to appoint one director to the board of directors of Sintec Call Centers.

In addition, on February 1, 2000 we notified Sintec Advanced Technologies Ltd., the principal shareholder of Sintec Call Centers and an affiliate of Formula Systems, that we will exercise an option to purchase up to an additional 3% of Sintec Call Centers from it for approximately $60,000. The transaction is subject to the approvals of the board of directors and shareholders of both companies.

We believe that the terms of the transactions in which we have engaged and currently are engaged with companies in the Formula Systems group are beneficial and no less favorable to us than the terms which might be available to us from unaffiliated third parties. All future transactions and arrangements with any members of the Formula Systems group in which our office holders have a personal interest will require approval of the audit committee and our board of directors and may require approval by our shareholders.

Loans to Officers and Directors

During the period December 1993 through June 1995, we provided to David Assia, Chairman of our Board of Directors, loans totaling approximately $561,489. In June 1994 and June 1995, we provided to Roy Machnes, who served as a director of our company until June 1997, loans totaling approximately $71,439. In 1995, we provided loans of approximately $264,184 to Jack Dunietz, Chief Executive Officer, $280,763 to Eli Gonen and $111,235 to Yohai Shaked. Both Messrs. Gonen and Shaked served as our Senior Vice Presidents until December 1998. These loans, which were issued in connection with the exercise of options under our 1991 employee stock option plan, were initially repayable on the earlier of three years of issuance or the sale of the shares purchased with these loans. The loans were adjusted to changes in the Israeli consumer price index with annual interest at the rate of 2% beginning in April 1997. The loans were secured with the ordinary shares that were issued upon the exercise of the options. Our Audit Committee, Board of Directors and shareholders approved the extension of the term of the loans until May 31, 2001. In addition, we provided to Mr. Dunietz a loan of approximately $100,000 in 1997 upon the same terms as the other loan granted to him. As of December 31, 1999, the loans to Messrs. Assia, Machnes, Dunietz and Gonen were repaid in full and the balance of the loan to Mr. Shaked was repaid in January 2000.

In February 1998, we provided a loan of approximately $141,400 to Israel Teiblum, our President and Chief Financial Officer. The loan is adjusted to reflect changes in the Israeli consumer price index, bears no interest and has a term of five years. Initially, the loan was repayable in five equal annual installments, plus linkage differences, to be offset against the payment of a bonus to Mr. Teiblum. The loan is payable upon demand or upon the termination of Mr. Teiblum's employment. In January 1999, we agreed that the balance of the loan would be repaid in equal monthly installments plus linkage differences, totaling approximately $2,000. At the same time, we increased Mr. Teiblum's salary in an amount which offsets the loan payments. Israel tax law imputes to him taxable income at the rate of 2% per annum on the outstanding principal balance of the loan. We have agreed to pay the tax on such imputed income on Mr. Teiblum's behalf. At December 31, 1998 and 1999, the outstanding amount of this loan, consisting of principal and linkage differences, was $120,192 and $72,238.

Private Placements

Pursuant to an agreement dated March 12, 1998, we issued 800,000 ordinary shares (pre-stock dividend) in a private placement to Formula Systems, for a purchase price of $4.0 million, or $5.00 per share, and warrants to purchase an additional 1,400,000 ordinary shares (pre-stock dividend), at an exercise price of $5.00 per share. The purchase price for the shares was the price at which the ordinary shares traded on the Nasdaq National Market at the time of the agreement. None of these warrants was exercised prior to expiring on September 30, 1998. We also granted preemptive rights to Formula Systems in the event that we issue additional securities during the period which ended on June 30, 1999 and after July 1, 1999 for as long as Formula Systems holds at least 17% of our shares on a fully diluted basis. We also granted Mashov Computers preemptive rights in the event we issue additional securities after July 1, 1999 and for as long as Mashov Computers holds at least 400,000 of our shares (pre-stock dividend). As a result of Formula Systems' purchase, in transactions effected in July and August 1998, of a majority interest in Mashov Computers, our principal direct shareholder, Formula Systems became our principal beneficial shareholder.

On July 31, 1998, we issued 1,000,000 ordinary shares (pre-stock dividend) in a private placement to Mashov Computers, for a purchase price of $3.5 million, or $3.50 per share, the price at which the ordinary shares traded on the Nasdaq National Market at the time of the agreement.

Pursuant to a share purchase agreement dated December 31, 1998, we issued 1,200,000 ordinary shares (pre-stock dividend) in a private placement to Formula Systems, for a purchase price of $4.8 million, or $4.00 per share, the price at which the ordinary shares traded on the Nasdaq National Market at the time of the agreement.

Registration Rights

In connection with the private placement of our ordinary shares to Formula Systems in March 1998, we granted Formula Systems and Mashov Computers registration rights with respect to their shares in our company. Pursuant to the agreement, Formula Systems has the right to make two demands for the registration of its ordinary shares purchased in the March and December 1998 private placements and Mashov Computers has the right to make two demands for the registration of its ordinary shares in our company as of September 1, 1998; provided that each such demand must relate to shares representing a market value of at least $3.0 million.

In addition, Formula Systems and Mashov Computers have the right to have ordinary shares held by them included in some of our registration statements. Formula Systems exercised this registration right in connection with our follow-on offering effected in March 2000.

Shareholders Agreement between Mashov Computers and Formula Systems

On March 12, 1998, Mashov Computers and Formula Systems entered into a shareholders agreement, pursuant to which, among other things, each of Mashov Computers and Formula Systems agreed to vote its shares in our company in favor of director nominees designated by the other subject to the following shareholding thresholds. In the event Formula Systems holds a larger portion of the issued and outstanding share capital of our company than is held at such time by Mashov Computers, Mashov Computers agreed to vote its shares together with Formula Systems for the election of a majority of the directors to our Board of Directors who are designated by Formula Systems. In such case, Formula Systems agreed to vote its shares together with Mashov Computers for the election of the directors designated by Mashov Computers for the remaining members of our Board of Directors so long as Mashov Computers' holdings in our company does not decrease below 3,000,000 ordinary shares. If Mashov Computers holds less than 3,000,000 ordinary shares but more than 1,200,000 of our ordinary shares, Formula Systems agreed to vote its shares for the election of one designee of Mashov

Computers to our Board of Directors. However, if the number of shares held directly by Mashov Computers is greater than the number of shares held directly by Formula Systems, as is presently the case, Formula Systems agreed to vote its shares together with Mashov Computers for the election of the majority of the directors to our Board of Directors (presently four out of seven) who are designated by Mashov Computers. In such case, Mashov Computers agreed to vote its shares with Formula Systems for the election of directors designated by Formula Systems for the remaining members of our Board of Directors so long as Formula Systems holdings in our company does not decrease below 3,000,000 ordinary shares. If Formula Systems holds less than 3,000,000 ordinary shares but more than 1,200,000 of our ordinary shares or we owe Formula Systems more than $1.0 million, Mashov Computers agreed to vote its shares with Formula Systems for the election of one of Formula Systems' designee to our Board of Directors. In addition, Formula Systems and Mashov Computers have agreed that so long as Formula Systems holds at least 2,400,000 of our ordinary shares, or we owe Formula Systems more than $1.0 million, or Mashov Computers holds at least 17% of our issued and outstanding ordinary shares, those resolutions concerning amendments to our Memorandum of Association and Articles of Association, or concerning a merger, consolidation, or sale or lease of substantially all of our assets will require the consents of both of them. These two shareholders also granted to each other a right of first refusal in the event either of them attempts to transfer their ordinary shares to a third party.

PART II

Item 14. DESCRIPTION OF SECURITIES TO BE REGISTERED

Not applicable.

PART III

Item 15. DEFAULTS UPON SENIOR SECURITIES

None.

Item 16. CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES

None.

Item 17. FINANCIAL STATEMENTS

Not applicable.

Item 18. FINANCIAL STATEMENTS

Attached. See Item 19(a).

Item 19. FINANCIAL STATEMENTS AND EXHIBITS

(a) Financial Statements

(b) Exhibits

1.1 Consent of BDO Shlomo Ziv & Co.
1.2 Consent of Kost Forer & Gabbay
1.3 Consent of Blick, Rothenberg
99 Additional Information Regarding Forward-Looking Statements

S I G N A T U R E S

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

MAGIC SOFTWARE ENTERPRISES LTD.
(REGISTRANT)

BY: /s/Jack Dunietz
Jack Dunietz
Chief Executive Officer

BY: /s/Israel Teiblum
Israel Teiblum
President and
Chief Financial Officer

Dated: June 28, 2000

MAGIC SOFTWARE ENTERPRISES LTD. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

EXHIBIT INDEX

Exhibit Number	Description	Sequentially Numbered Page
1.1	Consent of BDO Shlomo Ziv & Co.	
1.2	Consent of Kost Forer & Gabbay	
1.3	Consent of Blick Rothenberg Chartered Accountants	
99	Additional Information Regarding Forward-Looking Statements	

The Board of Directors
Magic Software Enterprises Ltd.

We consent to incorporation by reference in the Registration Statement on Form S-8 (Registration No. 33-73632, 333-1946, 333-10794 and 333-11220) pertaining to the 1991 Stock Option Plan, as amended of Magic Software Enterprises Ltd. (the "Company"), of our report dated March 8, 2000, relating to the consolidated balance sheets of the Company and its subsidiaries as of December 31, 1999, and the related statements of income, changes in shareholders' equity and cash flow for the year ended December 31, 1999, which report appears in the Annual Report on Form 20 - F of Magic Software Enterprises Limited.

Tel-Aviv, Israel
June 28, 2000

BDO Shlomo Ziv & Co.

BDO Shlomo Ziv & Co.
Certified Public Accountants (Israel)

consent 99 s-8\\magic\\SHLOMO_ZIV\\VOL1\\TYPIST\\MARGALIT GR\\

ERNST & YOUNG

• Kost Forer & Gabbay
3 Aminadav St.
Tel-Aviv 61575, Israel

• Phone: 972-3-6232525
Fax: 972-3-5622555

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
Magic Software Enterprises Ltd.

We consent to incorporation by reference in the Registration Statements on Form S-8 (Registrations No. 33-73632, 333-1946, 333-10794 and 333-11220) pertaining to the 1991 Stock Option Plan, as amended, of Magic Software Enterprises Ltd., of our report , dated February 8 1999, relating to the balance sheets of Magic Software Enterprises Ltd. as of December 31 1998, and the related statements of income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31 1998, which report appears in the Annual Report on Form 20-F of Magic Software Enterprises Ltd.

Tel-Aviv, Israel
June 28, 2000

Kost, Forer and Gabbay
KOST FORER & GABBAY
A Member of Ernst & Young International

BLICK ROTHENBERG
CHARTERED ACCOUNTANTS

12 YORK GATE, REGENT'S PARK, LONDON NW1 4QS
TELEPHONE +44(0)20 7486 0111 FAX +44(0)20 7935 6852
E-MAIL email@blickrothenberg.com

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors,
Magic Software Enterprises (UK) Limited.

We consent to incorporation by reference in the Registration Statements on Form S-8 (Registration nos. 33-73632, 333-1946, 333-10794 and 333-11220) pertaining to the 1991 Stock Option Plan, as amended, of Magic Software Enterprises Limited, of our report dated March 8 2000, relating to the balance sheets of Magic Software Enterprises (UK) Limited as of December 31 1999 and December 31 1998, and the related statements of income, changes in shareholders' equity for each of the two years in the period ended December 31 1999, which report appears in the Annual Report on Form 20-F of Magic Software Enterprises Limited.

Blick Rothenberg

BLICK ROTHENBERG
Chartered Accountants
Registered Auditor

London NW1 4QS
England

27th June 2000

R. M. ROTHENBERG
W. D. ROTHENBERG
M. C. KORN
M. GOLDSTEIN
J. A. NEWMAN
C. I. LEHMANN
P. B. McALPINE

C. H. M. GIBBON
M. A. MILLARD
M. H. GOLDSTEIN
N. SHAH
M. S. DONN*
M. W. JONES*
F. WALMAN

R. J. LEVY
F. M. BRUCK
I. D. LEAMAN
J. BARRINGTON
N. V. GILL
L. F. JOYCE*
C. J. SHEPHERD

CONSULTANTS:
H. ROTHENBERG O.B.E.*
A. N. HOMBURGER

*NON CHARTERED ACCOUNTANT

A MEMBER OF BKR INTERNATIONAL

WEBSITE: www.blickrothenberg.com
[illegible]

Exhibit 99

EXHIBIT 99

ADDITIONAL INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

Our Annual Report on Form 20-F for the year ended December 31, 1999 contains various forward-looking statements which reflect our current views with respect to future events and financial results. Forward-looking statements usually include the verbs "anticipate," "believe," "estimate," "expect," "intend," "plan," "project," "understand" and other verbs suggesting uncertainty. We remind shareholders that forward-looking statements are merely predictions which are inherently subject to uncertainties and other factors which could cause the actual results to differ materially from the forward-looking statement. Some of these uncertainties and other factors are discussed in the Annual Report. See Item 9 "Management's Discussion and Analysis of Financial Condition and Results of Operations." In this Exhibit 99, we have attempted to identify additional uncertainties and other factors which may affect our forward-looking statements.

Shareholders should understand that the uncertainties and other factors identified in the Annual Report and this Exhibit 99 do not constitute a comprehensive list of all the uncertainties and other factors which may affect forward-looking statements. We have merely attempted to identify those uncertainties and other factors which, in our view at the present time, have the highest likelihood of significantly affecting our forward-looking statements. In addition, we do not undertake any obligation to update or revise any forward-looking statements or the list of uncertainties and other factors which could affect such statements.

Risks related to our business and our industry

We have a history of losses.

We incurred net losses of approximately $1.4 million for the year ended December 31, 1994; $438,000 for the year ended December 31, 1995; $10.5 million for the year ended December 31, 1997; and $6.5 million for the year ended December 31, 1998. Although we have operated profitably in each quarter since the quarter ended September 30, 1998, we cannot assure you that we will be able to operate profitably in the future.

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

We have experienced and may continue to experience in the future significant fluctuations in our quarterly results of operations and we expect these fluctuations to continue. 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 product introductions or enhancements or those of our competitors or of providers of complementary products;

- market acceptance of our new products;

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

- seasonality, including the relatively low level of general business activity during the summer months in Europe;

- the mix of product sales;

- exchange rate fluctuations; and

- general economic conditions.

Our customers ordinarily require the delivery of products promptly after we accept their orders. We usually do not have a significant backlog of accepted orders. Consequently, revenues in any quarter depend on orders received and accepted in that quarter. The deferral of the placing and acceptance of any large order from one quarter to another could materially adversely affect our results of operations for the former quarter. In addition, we anticipate that our operating expenses will continue to increase significantly. If sales in any quarter 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 quarter would be materially 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.

Currency exchange rate fluctuations in the world markets in which we conduct business could have a material adverse affect on our business, results of operations and financial condition.

Our financial statements are stated in U.S. dollars, our functional currency. Nevertheless, a majority of our sales are made, and a majority of our expenses are incurred, in other currencies, particularly Euros, Japanese yen and U.K. pounds sterling. We maintain substantial non-U.S. dollar balances of assets, including cash and accounts receivable, and liabilities, including accounts payable. Fluctuations in the value of the currencies in which we do business relative to the U.S. dollar could have a material adverse effect on 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. We generally do not engage in hedging transactions to mitigate this risk.

Our rapid growth may strain our management, operational and financial resources.

Our rapid growth has significantly strained our management, operational and financial resources. Any future growth may increase this strain. In addition, we anticipate incurring expenses related to our expansion before receiving any associated revenues.

To manage growth effectively, we must:

- expand our operational, management, financial, manufacturing, marketing and research and development functions;
- train, motivate, manage and retain qualified employees; and
- hire additional personnel.

We may not succeed in managing future growth.

We face intense competition in the markets for our Magic technology and applications.

Many companies compete with us in the software development and deployment technology and applications markets in which we operate. We expect that competition will increase in the future, both with respect to the Magic technology and applications which we currently offer and applications which other members of the Magic community and we are developing. Increased competition, direct and indirect, could adversely affect our business, financial condition and results of operations.

Many of our existing and potential competitors are far larger, have substantially greater resources including financial, technological, marketing and distribution capabilities, and enjoy greater market recognition than we have. We may not be able to differentiate our products 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 those of our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

We may not succeed in penetrating the e-Business, CRM and other enterprise application markets.

We may not have the resources, skills and product offerings that will be required to successfully penetrate the markets for e-Business, CRM and other enterprise applications. To succeed in these markets, we will need to:

- develop expertise in marketing and selling Internet-based applications;
- develop and cultivate new sales channels to market our applications to prospective customers;
- hire, train and integrate new technical and sales personnel; and

- effectively establish and support relationships with end-users, with whom we have had limited interaction to date.

Our efforts to enter additional enterprise applications markets may not succeed. The e-Business, CRM, and other enterprise applications markets that we may attempt to penetrate may not become substantial commercial markets for our applications or may not evolve in a manner that will enable our applications to achieve market acceptance.

Our success in selling Internet-based applications is dependent on the growth of the Internet as a commercial marketplace.

Our success in selling Internet-based applications is dependent in large part upon the continued acceptance and growth of the Internet as a commercial marketplace. Because the use of the Internet for e-Business and other applications is new and evolving, we cannot predict with any certainty that the Internet will continue to grow as a commercial marketplace in the long term. If the Internet does not continue to grow as a commercial marketplace, the marketing of our Internet-based applications will not succeed.

Our success in selling Magic technology and applications for Linux depends, in part, upon the commercial acceptance of the Linux operating system.

The evolution of a market for software development and deployment technology and applications for Linux depends on the commercial adoption of Linux-based products. These products include databases, Internet browsers, and e-Business applications designed to operate on a Linux operating system. There is currently a scarcity of business applications for Linux. In the second half of 1999, we ported our Magic eMerchant application to the Linux platform and released a version of our software deployment technology that runs on Linux. We launched our software development technology for Linux in the first quarter of 2000. To date, we have not had substantial revenues from these products. It is possible that the market for Linux business applications may not become a substantial commercial market or evolve in a manner that will enable our products to achieve market acceptance.

If we are unable to identify and acquire suitable Magic solution providers, our growth could be impeded; we may meet difficulty in realizing the potential financial or strategic benefits of future business acquisitions and investments.

Our ability to identify and acquire suitable acquisition candidates from within the Magic community on acceptable commercial terms is crucial to our strategy. We cannot assure you that we will be able to identify, acquire or make investments in promising acquisition candidates on acceptable commercial terms.

We believe that the acquisition of and the investment in Magic solution providers will assist us in reaching our goals of becoming a leading provider of software development and deployment technology and Magic applications. Any acquisition or investment would present risks commonly encountered in the acquisition of or investment in other businesses. The following are examples of such risks, one or more of which may apply to any such acquisition or investment:

- difficulty in combining the technology, operations or work force of the acquired business;
- adverse effects on our reported operating results due to the amortization of goodwill associated with acquisitions;
- diversion of management attention from running our existing business; and
- increased expenses, including compensation expenses resulting from newly-hired employees.

Changes in the ratio of revenues from software licenses to revenues from services may adversely affect our gross profit margins.

In 1997 and 1998, our revenues from services, including maintenance and technical support and professional services, increased at a greater rate than our software license revenues, resulting in a change in the ratio between higher margin software license revenues and lower margin services revenues. In 1999, our software license revenues increased at a greater rate than our revenues from services. Any future decrease in the percentage of revenues derived from software licenses as compared to revenues from services may adversely affect our gross profit margin.

We derive a substantial portion of our revenues, and an even greater percentage of our operating profit, from independent distributors who are under no obligation to purchase our products.

We sell our products through our direct sales representatives and through Magic solution providers and independent distributors. These independent distributors then resell our products to end-users. We are dependent upon the acceptance of our products by our 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 non-competitive products. The independent distributors may not continue, or may not give a high priority to, marketing and supporting our products. We extend credit to our independent distributors and there is no assurance that such credit will be paid back to us. Our results of operations could be materially adversely affected by changes in the financial condition, business, marketing strategies or results of our independent distributors.

We may lose independent distributors on which we currently depend and we may not succeed in developing new distribution channels.

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, including our Magic applications, and we may not succeed in doing so. Any changes in our distribution and sales channels, particularly the loss of a major distributor or our inability to establish effective distribution and sales channels for new markets, will impact our ability to sell our products and result in a loss of revenues.

Our efforts to increase our presence in the United States may not be profitable.

Our success in becoming a stronger competitor in the sale of software development and deployment technology and a leading provider of applications is dependent upon our ability to increase our sales in North America, especially in the United States. Our efforts to increase our penetration of the North American market is subject to risks inherent to this market including the high cost of doing business in the United States, which has historically caused our United States operations to incur operating losses.

Our products have a lengthy sales cycle.

Our customers typically use our Magic technology to develop and deploy applications that are critical to their business. As a result, the licensing and implementation of our Magic technology 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 can be further extended for sales made through third party distributors. We have recently begun to market our Magic applications and do not as yet have significant experience in determining the length of the sales cycle for these applications. Delay in the sales cycle of our Magic technology and applications could result in significant fluctuations in our quarterly operating results.

Rapid technological change may adversely affect the market acceptance of our products and services.

We compete in a market that is characterized by rapid technological change. The introduction of new technologies 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 keep pace with such technological developments, emerging new markets and changing customer requirements.

Delay in the release of Windows versions of our products negatively impacted our sales and profitability in 1994, 1995 and 1996. If release dates of any future products or enhancements are delayed or if, when released, they fail to achieve market acceptance, our business, financial condition and results of operations would be materially adversely affected.

We may be unable to attract, train and retain qualified engineering, administrative, operational, sales and technical support personnel.

As our business continues to grow, we will need to hire additional qualified engineering, administrative, operational, sales and technical support personnel. The process of locating, training and successfully integrating qualified personnel into our operations can be lengthy and expensive. We may not be able to compete effectively for the personnel we need. Competition for these employees in the industry in which we operate is intense around the world, especially in Israel and the United States. Any loss of members of senior management or key technical personnel, or any failure to attract or retain highly qualified employees as needed, could have a material adverse effect on our business, financial condition and results of operations.

Our products may contain defects that may be costly to correct, delay market acceptance of our products and expose us to litigation.

Despite testing by us, Magic solution providers and end-users, errors may be found in our software products, or in applications developed with Magic technology. This risk is exacerbated by the fact that a significant percentage of the applications developed with Magic technology were and are likely to continue to be developed by Magic solution providers over whom 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 and could damage our reputation.

Although our standard license agreement with our customers contains provisions designed to limit our exposure to potential product liability claims, it is possible that these provisions may not be effective or enforceable under the laws of some jurisdictions, and we could fail to realize revenues and suffer damage to our reputation as a result of, or in defense of, a substantial claim. We currently do not carry product liability insurance.

We rely on third party technology licenses.

We incorporate software that we license from third parties in our Magic technology. If we lose or are unable to maintain any software licenses, we could suffer harm until equivalent software can be developed, identified, licensed and integrated. Loss of third party software licensing would materially adversely affect our business, financial condition and results of operations.

Our proprietary technology is 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 protecting our proprietary technology. We rely on a combination of trade secret and copyright law and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. We do not have any patents. Our policy is to require employees and consultants to execute confidentiality 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 products may infringe on the intellectual property rights of others.

Third parties may assert infringement claims against us or claims that we have violated a patent or infringed on a copyright, trademark or other proprietary right belonging to them. In addition, any infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend.

We may encounter difficulties with our international operations and sales.

While our principal executive offices are located in Israel, over 90% of our sales in 1998 and in 1999 were generated from the other countries in which we operate. This subjects us to many risks inherent in international business activities, including:

- limitations and disruptions resulting from the imposition of government controls;
- changes in regulatory requirements;
- export license requirements;
- economic or political instability;
- trade restrictions;
- changes in tariffs;
- currency fluctuations;
- greater difficulty in safeguarding intellectual property; and
- difficulties in managing overseas subsidiaries and international operations.

We may encounter significant difficulties in connection with the sale of our products in international markets as a result of one or more of these factors.

Formula Systems (1985) Ltd. may continue to control us.

Formula Systems (1985) Ltd., whose shares trade on the Nasdaq National Market and the Tel Aviv Stock Exchange, directly owns 5,058,000 or 16.8% of our currently outstanding ordinary shares and Mashov Computers, whose shares trade on the Tel Aviv Stock Exchange, owns 9,000,000 or 29.9% of our ordinary shares. The total shareholdings of Formula Systems and Mashov Computers in the aggregate is 14,058,000 ordinary shares or 46.7% of our ordinary shares. Formula Systems, which owns 53.1% of the ordinary shares of Mashov Computers, and Mashov Computers have entered into a shareholders' agreement which provides that each of

Formula Systems and Mashov Computers will vote for the nominees of the other to our Board of Directors. Formula Systems is and may continue to be in a position to exercise control over most matters requiring shareholder approval, including the election of our directors, approval of significant corporate transactions and the ability generally to direct our affairs. Such concentration of ownership may have the effect of delaying or preventing a change in control.

Risks Relating to Our Offering Shares

Our ordinary share price has been volatile in the past and may be volatile in the future.

Our ordinary shares have experienced significant market price and volume fluctuations in the past and may experience significant market price and volume fluctuations in the future for reasons related or unrelated to our performance. You may not be able to resell your ordinary shares in our company at or above the price you paid for them. Fluctuations or decreases in the market price of our ordinary shares may also adversely affect our ability to raise capital in the future.

We do not anticipate paying cash dividends in the foreseeable future and, therefore, it may be difficult for you to earn a positive return on your investment.

We have never declared or paid cash dividends on our shares. We currently intend to retain all future earnings to fund the growth of our business and do not anticipate paying any cash dividends in the foreseeable future. As a result, you will only be able to earn a positive return on your investment if you are able to sell your ordinary shares for more than you paid for them.

Risks Relating to Our Location in Israel

Conducting business in Israel entails special risks.

We are incorporated under Israeli law and our principal executive offices and research and development facilities are located in the State of Israel. Political, economic and military conditions in Israel directly affect our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. We could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel. Despite the progress towards peace between Israel and its Arab neighbors, the future of these peace efforts is uncertain. Moreover, several countries still restrict business with Israel and with Israeli companies. We could be adversely affected by restrictive laws or policies directed towards Israel or Israeli business.

Most of our directors, officers and employees are obligated to perform annual military reserve duty in Israel. We cannot assess the potential impact of these obligations on our business.

Our directors, officers and employees who are male adult citizens and permanent residents of Israel under the age of 48, including Jack Dunietz, our Chief Executive Officer, and Israel Teiblum, our President and Chief Financial Officer, are, unless exempt, obligated to perform annual military reserve duty and are subject to being called to active duty at any time under emergency circumstances. We cannot assess the full impact of these requirements on our workforce or business, if conditions should change, and we cannot predict the effect on us of any expansion or reduction of these obligations.

We may be adversely affected if the rate of inflation in Israel exceeds the rate of devaluation of the New Israeli Shekel against the U.S. dollar.

A portion of our expenses, primarily labor expenses, is incurred in New Israeli Shekels, or NIS. As a result, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the NIS in relation to the U.S. dollar or that the timing of this devaluation lags behind inflation in Israel. In 1997 and 1998, the rate of devaluation of the NIS against the U.S. dollar has exceeded the rate of inflation, a reversal from prior years which has benefited us. However, in 1999 the rate of inflation exceeded the rate of devaluation of the NIS against the U.S. dollar. If the U.S. dollar costs of our operations in Israel increase, our U.S. dollar-measured results of operations will be adversely affected.

We currently benefit from government tax benefits which may be discontinued or reduced in the future.

We currently receive tax benefits under Government of Israel programs. In order to maintain our eligibility for these tax benefits, we must continue to meet specific conditions, including making specified investments in fixed assets. If we fail to comply with these conditions in the future, the tax benefits received could be canceled and we could also be required to pay increased taxes. The Government of Israel has reduced the tax benefits available under these programs in recent years and we cannot guarantee that these tax benefits will be continued in the future at their current levels or at all. If the Government of Israel ends these tax benefits, our business, financial condition and results of operations could be materially adversely affected.

Provisions of Israeli law could inhibit our acquisition by others.

Some of the provisions of Israeli law could:

- discourage potential acquisition proposals;
- delay or prevent a change in control over us; and

- limit the price that investors might be willing to pay in the future for our ordinary shares.

Generally, under Israeli corporate law, a merger must be approved by at least 75% of the shareholders present and voting on the proposed merger at a shareholders meeting that has been called on at least 21 days advance notice. Court approval of a merger may also be required. Alternatively, an acquiror can eliminate minority shareholders if it acquires at least 90% of all outstanding shares, excluding shares held by the acquiror prior to the acquisition, and none of the minority shareholders seeks to block the acquisition in court. Additionally, a tender offer for us, or the acquisition of the interests of our minority shareholders, may be subject to the requirements of Israeli corporate law. The requirements of Israeli corporate law generally make these forms of acquisition significantly more difficult than under United States corporate laws.

Finally, Israeli tax law treats some acquisitions, particularly stock-for-stock swaps between an Israeli company and a foreign company, less favorably than United States tax law. Israeli tax law may, for instance, subject a shareholder who exchanges his or her shares in us for shares in a foreign corporation to immediate taxation.

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 1999

IN U.S. DOLLARS

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Independent Auditors' Report

To the Shareholders of

MAGIC SOFTWARE ENTERPRISES LTD.

We have audited the accompanying consolidated balance sheets of Magic Software Enterprises Ltd. and its subsidiaries (the "Company") as of December 31, 1999 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year then ended. 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 audit. We did not audit the financial statements of a subsidiary, which statements reflect assets constituting 6% of the consolidated assets as of December 31, 1999, and revenues constituting 9% of the related consolidated revenues for the year then ended. Those statements were audited by another auditor whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for that subsidiary, is based solely on the report of the other auditor.

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

In our opinion, based on our audit and the report of the other auditor, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 1999, and the related consolidated results of its operations and cash flows for the year then ended, in conformity with generally accepted accounting principles in the United States.

Tel-Aviv, Israel
March 8, 2000

BDO Shlomo Ziv & Co.
Certified Public Accountants (Isr.)

Report of Independent Auditors

To the Shareholders of

MAGIC SOFTWARE ENTERPRISES LTD.

We have audited the accompanying consolidated balance sheets of Magic Software Enterprises Ltd. and its subsidiaries as of December 31, 1998, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain subsidiaries, which statements reflect assets constituting 6% of the consolidated assets as of December 31, 1998, and revenues constituting 16% and 19% of the related consolidated revenues for each of the two years in the period ended December 31, 1998. These statements were audited by an auditor whose reports have been furnished to us, and our opinion, insofar as it relates to data included for this subsidiary, is based solely on the reports of the other auditor.

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

In our opinion, based on our audits and the report of the other auditor, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Magic Software Enterprises Ltd. and its subsidiaries as of December 31, 1998, and the related consolidated results of their operations and cash flows for each of the two years in the period ended December 31, 1998, in conformity with generally accepted accounting principles in the United States.

Tel-Aviv, Israel
February 8, 1999

KOST FORER & GABBAY
A Member of Ernst & Young
International

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED BALANCE SHEETS

	December 31,	
	1998	1999
	(in thousands)	
A S S E T S		
CURRENT ASSETS:		
Cash and cash equivalents	$ 5,828	$ 8,298
Trade receivables (net of allowance for doubtful accounts of $ 990 and $ 1,112 as of December 31, 1998 and 1999, respectively)	11,466	16,111
Related parties receivables (Note 14E)	40	-
Other receivables and prepaid expenses (Note 3)	1,724	4,965
Inventories	-	188
Total current assets	19,058	29,562
LONG-TERM INVESTMENTS:		
Investments in affiliates and other companies (Note 4)	404	376
Severance pay fund (Note 9)	988	1,507
	1,392	1,883
FIXED ASSETS, NET (Note 5)	5,108	8,649
OTHER ASSETS, NET (Note 6)	6,823	16,757
	$ 32,381	$ 56,851

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

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED BALANCE SHEETS

	December 31, 1998	December 31, 1999
	(in thousands)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit (Note 7)	$ 436	$ 688
Trade payables	1,918	5,525
Related parties payables (Note 14E)	-	164
Accrued expenses and other liabilities (Note 8)	11,435	13,577
Total current liabilities	13,789	19,954
ACCRUED SEVERANCE PAY (Note 9)	1,445	1,899
LONG-TERM LOANS (Note 10)	-	235
MINORITY INTEREST	11	917
SHAREHOLDERS' EQUITY (Note 12):		
Share capital:		
Authorized: 50,000,000 Ordinary Shares of NIS 0.1 par value; issued and outstanding: 23,559,450 shares and 26,068,185 shares as of December 31, 1998 and 1999, respectively.	261	684
Additional paid-in capital, net	29,362	34,862
Accumulated other comprehensive loss	(249)	(369)
Accumulated deficit	(12,238)	(1,331)
Total shareholders' equity	17,136	33,846
	$ 32,381	$ 56,851

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

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	1997	**1998**	**1999**
	(in thousands except per share data)		
Revenues (Note 13A):			
Software sales	$ 24,026	$ 20,479	$ 37,024
Maintenance and technical support	4,196	5,780	9,218
Professional services	9,210	12,501	17,750
Total revenues	37,432	38,760	63,992
Cost of revenues:			
Software sales	4,327	2,994	3,972
Maintenance and technical support	2,694	3,306	3,450
Professional services	7,708	9,046	11,365
Total cost of revenues	14,729	15,346	18,787
Gross profit	22,703	23,414	45,205
Operating expenses:			
Research and development, net (Note 13C)	3,348	2,797	2,953
Selling and marketing, net	17,520	16,073	20,935
General and administrative	6,090	7,817	10,241
Restructuring and other non-recurring costs (Note 1E)	5,421	2,677	-
Total operating expenses	32,379	29,364	34,129
Operating income (loss)	(9,676)	(5,950)	11,076
Financial income (expenses), net (Note 13E)	(488)	(322)	175
Income (loss) before taxes on income	(10,164)	(6,272)	11,251
Taxes on income (Note 11)	476	50	2
	(10,640)	(6,322)	11,249
Equity in earnings (losses) of affiliates	(51)	(149)	52
Minority interest in losses (earnings) of consolidated subsidiaries	237	12	(394)
Net income (loss)	$ (10,454)	$ (6,459)	$ 10,907
Earnings (loss) per share (Note 16):			
Basic earnings (loss) per share	$ (0.72)	$ (0.37)	$ 0.45
Diluted earnings (loss) per share	$ (0.72)	$ (0.37)	$ 0.43

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

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital	Additional paid-in capital, net*	Accumulated other comprehensive income (loss)	Retained earnings (accumulated deficit)	Comprehensive income (loss)	Total shareholders' equity
			(in thousands)			
Balance as of January 1, 1997	$ 178	$ 17,080	$ 23	$ 4,675		$ 21,956
Other comprehensive loss:						
Amortization of deferred compensation	-	72	-	-		72
Foreign currency translation adjustments	-	-	(204)	-	$ (204)	(204)
Net loss	-	-	-	(10,454)	(10,454)	(10,454)
Total comprehensive loss					$ (10,658)	
Exercise of stock options	5	61	-	-		66
Balance as of December 31, 1997	183	17,213	(181)	(5,779)		11,436
Other comprehensive loss:						
Foreign currency translation adjustments	-	-	(68)	-	$ (68)	(68)
Net loss	-	-	-	(6,459)	(6,459)	(6,459)
Total comprehensive loss					$ (6,527)	
Issuance of shares, net	78	12,149	-	-		12,227
Balance as of December 31, 1998	261	29,362	(249)	(12,238)		$ 17,136
Other comprehensive income:						
Foreign currency translation adjustments	-	-	(120)	-	$ (120)	(120)
Net income	-	-	-	10,907	10,907	10,907
Total comprehensive income					$ 10,787	
Exercise of stock options	14	4,787	-	-		4,801
Issuance of shares for investment in subsidiaries	3	982	-	-		985
Compensation resulting from options granted for acquisitions	-	137	-	-		137
Three-for-one Ordinary Share split effected in the form of a 200% stock dividend (see Note 12A.1)	406	(406)	-	-		-
Balance as of December 31, 1999	$ 684	$ 34,862	$ (369)	$ (1,331)		$ 33,846

* Additional paid-in capital is stated net of loans granted to officers and directors of the Company for the purchase of stock (see note 12B).

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

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	1997	**1998**	**1999**
		(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ (10,454)	$ (6,459)	$ 10,907
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Write-off of capitalized computer software development costs	1,950	512	-
Depreciation and amortization	2,508	2,783	3,516
Equity in losses (earnings) of affiliates	51	149	(52)
Minority interest in earnings (losses) of consolidated subsidiaries	(237)	(12)	394
Amortization of deferred compensation	72	-	-
Translation loss on long-term loans	-	-	(62)
Increase (decrease) in accrued severance pay, net	7	(120)	(65)
Decrease (increase) in deferred income taxes, net	66	-	-
Changes in operating assets and liabilities:			
Decrease (increase) in trade receivables	1,983	1,003	(3,582)
Decrease (increase) in related parties	981	(731)	(124)
Decrease (increase) in other receivables and prepaid expenses	175	232	(2,863)
Decrease (increase) in inventories	282	234	28
Increase (decrease) in trade payables	1,216	(1,102)	2,828
Increase (decrease)in accrued expenses and other liabilities	2,423	1,894	(571)
Net cash provided by (used in) operating activities	1,023	(1,617)	10,354
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capitalized software costs	(3,125)	(1,283)	(1,334)
Purchase of fixed assets	(1,204)	(846)	(4,184)
Additional investment in subsidiaries	(306)	(176)	(1,701)
Investment in affiliates and other companies	-	(351)	(165)
Proceeds from sale of fixed assets	238	118	-
Investment in other assets	-	(750)	(3,441)
Long-term investments	(52)	-	-
Newly consolidated subsidiaries (Schedule A)	-	-	(1,783)
Net cash used in investing activities	(4,449)	(3,288)	(12,608)

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

MAGIC SOFTWARE ENTERPRISES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS (cont.)

	Year ended December 31,		
	1997	1998	1999
		(in thousands)	
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from exercise of stock options	66	-	4,801
Proceeds from issuance of Ordinary Shares, net	-	12,227	-
Changes in short-term bank credit, net	2,400	(2,909)	128
Long-term loan received	-	-	(118)
Net cash provided by financing activities	2,466	9,318	4,811
Effect of exchange rate changes on cash and cash equivalent	(70)	35	(87)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,030)	4,448	2,470
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	2,410	1,380	5,828
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	$ 1,380	$ 5,828	8,298
SUPPLEMENTAL DICLOSURE OF CASH FLOW INFORMATION:			
Net cash paid during the year for:			
Income taxes	$ 403	$ 50	$ 52
Interest	$ 237	$ 140	$ 36
NON-CASH ACTIVITIES:			
Investment in subsidiaries recorded against accounts payable	$ -	$ 479	$1,836

Schedule A:

	1997	1998	1999
NEWLY-CONSOLIDATED SUBSIDIARIES:			
Working capital deficiency	$ -	$ -	$ (834)
Fixed assets	-	-	855
Other assets	-	-	3,557
Investment in affiliate	-	-	(245)
Minority interest	-	-	(428)
Issuance of shares and compensation resulting from the acquisition	-	-	(1,122)
	$ -	$ -	$ 1,783

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

NOTE 1 - GENERAL:

A. Magic Software Enterprises Ltd. (the "Company") develops, markets and supports software development and deployment technology (the “Magic technology”). Magic technology enables enterprises to accelerate the process of building and deploying software applications that can be rapidly customized and integrated with existing systems. During 1999 the Company expanded its business to include the sale of applications developed using its Magic technology. These applications are designed for e-Business, customer relationship management and other enterprise uses. Magic technology and Magic-based applications are used by software solution providers and enterprises (the “Magic community”). The Company also provides professional services and maintenance and technical support to the Magic community.

The Company distributes its products and services in approximately fifty countries worldwide. The Company markets and supports its products primarily through its own direct sales force in Europe, Asia, the United States and Israel, and through a network of distributors and software solution providers.

As to data about geographic areas - see note 13A.

B. During 1998, the Company issued a total of 9,000,000 Ordinary Shares to Mashov Computers Ltd. (“Mashov”) and Formula Systems (1985) Ltd. (“Formula”) (see note 12).

Pursuant to a voting agreements between Mashov and Formula, 0Mashov controls as of March 8, 2000 approximately 50.01% of the voting stock of the Company and therefore, the Company continues to be a consolidated subsidiary of Mashov.

C. In January 1998, the Company, in collaboration with its distributor in Japan, Wacom Co. Ltd. ("Wacom") established a joint venture, Magic Software Japan ("MSJ"). MSJ was 57% owned by the Company and 43% owned by Wacom. In January 1999, MSJ acquired from Wacom all the rights relating to the Japanese version of Magic's products, in consideration of $3,300 thousand.
In a shareholder agreement entered into in January 1999 the parties agreed that MSJ would issue additional shares to the Company in order to increase its holdings to 80%.

In August 1999, the Company and Wacom invested another $515 thousand in MSJ, in proportion to their holdings in MSJ. In October 1999, the Company acquired the remaining 20% of the share capital of MSJ from Wacom, in consideration of $3,600 thousand. Such acquisition was accounted for under the purchase method of accounting. The Company currently owns 100% of MSJ.

NOTE 1 - GENERAL (cont.):

D. In November 1999, the Company acquired 100% of the operations and assets and assumed all the liabilities of Criterion Design and Programming Ltd. ("OSS"), a Canadian company, in consideration of $1,030 thousand in cash and $685 thousand in Ordinary Shares of the Company. In an employment agreement signed with two key employees and shareholders of OSS, the Company agreed to allot them options to purchase Ordinary Shares of the Company in the equivalent of $410 thousand, for no additional consideration. This acquisition was accounted for under the purchase method of accounting. The excess of cost over the estimated fair value of net assets acquired in the amount of $1,877 thousands was allocated to goodwill.

In November 1999, the Company acquired 51% of the share capital of ONYX Szoftverhaz Korlatolf Felelossegu Tarsasag ("Onyx") and its fully owned subsidiary, a Hungarian companies, in consideration of $100 thousand in cash and $300 thousand in Ordinary Shares of the Company, which was paid to existing shareholders, and an additional $210 thousand which is to be invested in Onyx.

In November 1999, the Company acquired 51% of the share capital of Access Data Corporation ("Access Data"), a New Mexico corporation, for $460 thousand.

E. Restructuring and other non-recurring costs:

During 1997 and 1998, the Company incurred costs of $4,395 thousand and $2,327 thousand, respectively, in implementing its restructuring plan. The restructuring plan included the termination of distributor agreements in certain areas, a reduction in the number of employees and the termination of a product line.

In addition, during 1998 the Company approached the Binational Industrial Research and Development Foundation ("BIRD-F") with the objective of canceling its agreement with BIRD-F. Under such agreement, the Company had received $350 thousand in grants.

In 1997 the Company reached an agreement with the Office of the Chief Scientist of the Israeli Ministry of Industry and Commerce ("OCS") according to which the Company agreed to pay royalties on all of its consolidated revenues. As a result, the Company provided for the full amount of its royalty commitment, which amounted to $1,026 thousand.

Following is a breakdown of the costs incurred:

	Year ended December 31,	
	1998	**1999**
	(in thousands)	
Write-off of capitalized computer software development costs	$ 512	-
Expenses for termination of employment	1,208	-
Termination of distributor agreements	372	-
Other	235	-
Total restructuring	2,327	-
Provision for repayment of grants	350	-
	$ 2,677	-

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States.

A. Use of Estimates:

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

B. Financial Statements in United States Dollars:

A substantial portion of the Company's revenues on a consolidated basis are made outside Israel in U.S. dollars ("dollars"). In additional a substantial portion of the Company's costs on a consolidated basis are incurred in dollars. Since the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate, the dollar is their functional and reporting currency. Accordingly, monetary accounts maintained in currencies other than the dollar are translated using the applicable foreign currency exchange rate at 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 other subsidiaries, the functional currency has been determined to be their local currency, and operations items are translated at average rates prevailing during the year. Translation adjustments relating to the investment in such subsidiaries are recorded as other comprehensive income (loss) in shareholders' equity.

C. Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation.

D. Cash Equivalents:

Cash equivalents include short-term, highly liquid investments that are readily convertible into cash and with maturities of three months or less when purchased.

E. Inventories:

Inventories consist of software packaging, diskettes, printed materials and hardware production devices, and are stated at the lower of cost or market value. Cost is determined by the "first-in, first-out" method.

F. Investments in Affiliates and Other Companies:

Investments in affiliates are accounted for by the equity method. Investments in companies owned less than 20% are accounted for using the cost method. As to goodwill - see Note H below.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

G. Fixed Assets:

Fixed assets are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates:

	%
Buildings	4
Computers and peripheral equipment	20 - 33
Office furniture and equipment	6 - 15
Motor vehicles	15
Internet software developed for self use	33

H. Goodwill:

Goodwill is amortized by the straight-line method over ten years. The Company examines the realizability of the intangible assets annually and the appropriateness of the amortization period based on the estimated future undiscounted cash flows derived from the acquired businesses. Any impairment loss is recognized in the statement of operations.

I. Revenue Recognition:

The Company generates revenues from licensing the rights to use its software. The Company also generates revenues from sales of consulting services, training, support and maintenance.

Revenues from software license agreements are recognized, in accordance with Statement Of Position (SOP) 97-2 "Software Revenue Recognition" (as amended by SOP 98-4), upon delivery of the software when collection is probable; all license payments are due within one year, the license fee is otherwise fixed or determinable and persuasive evidence of an arrangement exists.

Revenues from professional services, maintenance contracts and training are recognized progressively over the contractual period or as services are performed .

In December 1998, the AICPA issued Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions" ("SOP 98-9"). SOP 98-9 amends SOP 98-4 to extend the deferral of the application of certain passages of SOP 97-2 provided by SOP 98-4 through fiscal years beginning on or before March 15, 1999. All other provisions of SOP 98-9 are effective for transactions entered into in fiscal years beginning after March 15, 1999. The Company believes that the effect of the final adoption of SOP 98-9 on its financial condition or results of operations would be insignificant.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

J. Research and development costs:

Research and development costs net of grants are charged to expenses as incurred. Statement of Financial Accounting Standards ("SFAS") No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon completion of a detailed program design. Costs incurred by the Company between completion of the detailed program design and the point at which the product is ready for general release have been capitalized.

Capitalized software costs are amortized by the greater of (i) the ratio of current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software or (ii) the straight-line method over the remaining estimated useful life of the product (not greater than five years).

The Company wrote down to net realizable value during 1998 ,capitalized software costs for certain products in the amount of $512 thousand. See Note 1D.

K. Royalty-bearing grants:

Royalty-bearing grants from the Government of Israel and others for funding certain approved research projects and for funding marketing activity are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred.

L. Advertising costs:

Advertising costs are charged to selling and marketing expenses, as incurred. Advertising expenses for the years ended December 31, 1997, 1998 and 1999 were $1,017 thousand, $669 thousand and $990 thousand, respectively.

M. Income Taxes:

The Company accounts for income taxes in accordance with SFAS 109, "Accounting for Income Taxes". This statement prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

N. Basic and Diluted Earnings (Loss) Per Share:

Basic earnings (loss) per share are computed based on the weighted average number of Ordinary Shares outstanding during each year. Diluted earnings (loss) per share is computed based on the weighted average number of Ordinary Shares outstanding during each year, plus the dilutive potential of Ordinary Shares considered outstanding during the year, in accordance with SFAS 128, "Earnings Per Share".

O. Accounting for Stock-based Compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees" in accounting for its employee stock options plans. Under APB 25, if the exercise price of the Company's share options equals or is above the market price of the underlying stock on the date of grant, no compensation expense is recognized.

The Company applies SFAS 123 "Accounting for Stock Based Compensation" with respect to options issued to non-employees. SFAS 123 requires use of an option valuation model to measure the fair value of the options at the grant date. The pro forma disclosures required by SFAS 123 are provided in Note 12.

P. Concentrations of Credit Risk:

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents, and accounts receivable. The Company's cash and cash equivalents are invested primarily in deposits with major banks worldwide. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments. The Company’s trade receivables are derived from sales to customers located primarily in the U.S., Europe, Asia, Japan and Israel. The allowance for doubtful accounts is provided with respect to all balances deemed doubtful of collection.

Q. Fair Value of Financial Instruments:

The carrying amounts reported in the balance sheet of cash and cash equivalents, short-term bank credit and long-term loans approximate their fair value due to the short-term nature of these instruments.

R. Comprehensive Income:

As of January 1, 1998, the Company adopted SFAS 130, "Reporting Comprehensive Income". SFAS 130 establishes new rules for the reporting and display of comprehensive income and its components.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

S. Impact of recently issued accounting standards:

In June 1998, the FASB issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 123 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133 also requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement and requires that a company formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS 133 is effective for fiscal years beginning after June 15, 2000 and cannot be applied retroactively. The Company does not expect the impact of this new statement on the Company's consolidated balance sheets or results of operations to be material.

NOTE 3 - OTHER RECEIVABLES AND PREPAID EXPENSES:

	December 31,	
	1998	1999
	(in thousands)	
Prepaid expenses and others	$ 1,333	$ 2,999
Government agencies	-	602
Employee loans (1)	391	1,364
	$ 1,724	$ 4,965
(1) Including loans to directors and officers, linked to the Israeli Consumer Price Index ("CPI")	$ 181	$ 1,156

NOTE 4 - INVESTMENTS IN AFFILIATES AND OTHER COMPANIES:

The composition of the investments in affiliates and other companies is as follows:

	December 31,	
	1998	1999
	(in thousands)	
Equity:		
Cost of shares	$ 1,007	$ 376
Goodwill	(269)	-
Equity in losses	(324)	-
Foreign currency translation adjustments	(10)	-
	404	376
Goodwill:		
Cost	269	-
Amortization	(269)	-
	-	-
	$ 404	$ 376

As of December 31, 1999, the Company has no investments in affiliates.

NOTE 5 - FIXED ASSETS:

	December 31,	
	1998	1999
	(in thousands)	
Cost:		
Buildings	$ 3,500	$ 6,267
Computers and peripheral equipment	5,968	7,038
Office furniture and equipment	946	1,484
Motor vehicles	239	471
Internet software developed for self use	-	469
	10,653	15,729
Accumulated depreciation:		
Buildings	588	1,019
Computers and peripheral equipment	4,438	5,186
Office furniture and equipment	441	726
Motor vehicles	78	149
	5,545	7,080
Undepreciated cost:	$ 5,108	$ 8,649

Depreciation expenses amounted to $1,115 thousand and $1,480 thousand and $1,497 thousand for the years ended December 31, 1997, 1998 and 1999, respectively. As for charges, see Note 15C.

NOTE 6 - OTHER ASSETS:

	December 31, 1998	December 31, 1999
	(in thousands)	
Cost:		
Capitalized software	$ 9,081	$ 10,415
Goodwill	2,262	12,211
Distribution rights	-	600
Issuance costs	-	70
	11,343	23,296
Accumulated amortization:		
Capitalized software	3,961	5,152
Goodwill	559	1,237
Distribution rights	-	150
	4,520	6,539
Other assets, net	$ 6,823	$ 16,757

Amortization expenses amounted to $1,059 thousand $1,554 thousand and $2,019 thousand for the years ended December 31, 1997, 1998 and 1999, respectively.

NOTE 7 - SHORT-TERM BANK CREDIT:

As of December 31, 1999, the Company has an additional authorized and unused credit facility in the amount of $2,000 thousand denominated in dollars.

The weighted average interest rate of the credit facility as of December 31, 1998 and 1999 was approximately 8%, and 7%, respectively.

NOTE 8 - ACCRUED EXPENSES AND OTHER LIABILITIES:

	December 31, 1998	December 31, 1999
	(in thousands)	
Employees and payroll accruals	$ 2,536	$ 3,060
Liabilities in respect of acquisition of a subsidiary	-	1,836
Accrued expenses	4,947	3,482
Deferred revenues	2,868	3,738
Fund for Encouragement of Marketing Activities	842	477
Government agencies and other	242	984
	$ 11,435	$ 13,577

NOTE 9 - ACCRUED SEVERANCE PAY:

Under Israeli law, the Company is required to make severance payments when dismissing employees and terminating their employment under certain circumstances. The Company liability for severance pay pursuant to Israeli law is fully provided for. Part of the liability is funded through insurance policies. The value of these policies is recorded as an asset in the Company's balance sheets. The severance pay liability is calculated on the basis of one month’s salary for each year of service, based on the most recent salary of each employee. Severance pay expenses for the years ended December 31, 1997, 1998 and 1999 were $482 thousand $728 thousand and $454 thousand, respectively.

NOTE 10 - LONG-TERM LOANS:

	Currency	Interest rate %	December 31, 1999 (in thousands)
Bank loans	Rupees	17-18	$ 295
Less current portion			$ (60)
			$ 235

NOTE 11 - TAXES ON INCOME:

A. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the “Law”):

The Company's production facilities in Israel have been granted status as an "Approved Enterprise" under the Law. The main benefit arising from such status is the reduction in tax rates on income derived from “Approved Enterprises”. The Company is entitled to a seven year period of benefits (and to a ten - year period of benefits for programs in which the Company qualifies as a “foreign investor company” as defined by the Law) including tax exemption for certain periods and reduced tax rates thereafter.

The Company has elected an alternative package of benefits under the Law, which entitles the Company to a tax exemption on undistributed income derived from "Approved Enterprises" for a period of between two and ten year from the first year in which taxable income is earned and reduced tax rates for the remainder of the benefits period.

Seven expansion projects have been granted status of "Approved Enterprises" under the Law.

The seven expansion programs are as follows:

1. Income derived from the first program was tax-exempt for the two-year period ended December 31, 1991, and was subject to a reduced tax rate of 25% for the five-year period ended December 31, 1996.

2. The second program was tax-exempt for the two-year period ended December 31, 1991 and was subject to a reduced tax rate of 25% for the five-year period ended December 31, 1996.

NOTE 11 - TAXES ON INCOME (cont.):

A. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the "Law") (cont.):

3. The third program entitles the Company to a tax exemption for the four-year period ended December 31, 1995, and is subject to a reduced tax rate of 25% for the six-year period ending December 31, 2001.

4. The fourth program entitles the Company to a tax exemption for the four-year period ended December 31, 1997, and is subject to a reduced tax rate of 25% for the-six year period ending December 31, 2003.

5. In February 1996, the Company received approval for the fifth program, which entitles the Company to a two-year tax exemption period and to a reduced tax rate of 25% for an additional period of eight-years. The period of benefits for this expansion has not yet commenced.

6. In January 1998, the Company received approval for another expansion of its "Approved Enterprises" status. This program will entitle the Company to a two-year tax exemption period and to a reduced tax rate of 25% for an additional period of eight years. The period of benefits for this expansion has not yet commenced.

7. In November 1998, the Company received approval for another expansion of its "Approved Enterprises" status. This program will entitle the Company to a two-year tax exemption period and to a reduced tax rate of 25% for an additional period of eight years. The period of benefits for this expansion has not yet commenced.

The tax benefit periods provided by the fifth, sixth and seventh programs end the earlier of 12 years from the commencement of operation or production, or 14 years from receipt of the approval.

If a dividend were to be distributed out of tax-exempt profits deriving from an expansion program, the Company would be liable to corporate tax at a rate of 25%. The Company does not anticipate paying dividends in the foreseeable future.

The Law also entitles the Company to claim accelerated depreciation on buildings, machinery and equipment used by the "Approved Enterprise" during the first five tax years.

The benefits available to an enterprise are conditional upon the fulfillment of conditions stipulated in the Law and its regulations and the criteria set forth in the specific certificate of approval. In the event that the Company does not meet these conditions, it would be required to refund the amount of tax benefits, with the addition of the CPI linkage adjustment and interest. In the Company's management's opinion, the Company has been in full compliance with the conditions of the above programs through December 31, 1999, and with respect to the 1984 and 1992 programs, has received written confirmation to this effect from the Investment Center.

Should the Company and its Israeli subsidiary derive income from sources other than the Approved Enterprises during the relevant benefit periods, such income will be taxable at a regular corporate tax rate of 36%.

NOTE 11 - TAXES ON INCOME (cont.):

B. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969 (the "Encouragement Law"):

The Company is an "Industrial Company", as defined by the Encouragement Law and, as such, is entitled to certain tax benefits, mainly: accelerated depreciation of machinery and equipment, as prescribed by regulations published under the Inflationary Adjustments Law, the right to deduct for tax purposes public issuance expenses and patents and other intangible property rights, and the right to file, under specified conditions, a consolidated tax return with additional related Israeli "Industrial Companies".

C. Non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed based upon tax laws in their countries of domicile.

D. Net operating losses carryforwards:

Through December 31, 1999, Magic Inc. had U.S. federal net operating loss carryforwards of approximately $11,700 thousand, that can be carried forward and offset against taxable income for 15 years and will expire from 2007 to 2013.

E. Income tax assessments:

The Company has received final tax assessments through the 1995 tax year.

F. The domestic and foreign components of income (loss) before taxes are as follows:

Income (loss) before taxes on income:

	Year ended December 31,		
	1997	1998	1999
		(in thousands)	
Domestic	$ (5,151)	$ (3,285)	$ 9,762
Foreign	(5,013)	(2,987)	1,489
	$ (10,164)	$ (6,272)	$ 11,251

NOTE 11 - TAXES ON INCOME (cont.):

G. The provision for taxes consists of the following:

	Year ended December 31,		
	1997	**1998**	**1999**
		(in thousands)	
Current:			
Domestic	$ 406	$ 47	$ (100)
Foreign	4	3	102
	410	50	2
Deferred:			
Domestic	66	-	-
Foreign	-	-	-
	66	-	-
Taxes on income	$ 476	$ 50	$ 2

H. Deferred tax assets consist of the following:

	December 31,	
	1998	**1999**
	(in thousands)	
Deferred tax assets:		
Loss carryforwards	$ 8,588	$ 4,248
Allowances and reserves	826	583
	9,414	4,831
Less: valuation allowance	(9,414)	(4,831)
Net deferred tax	$ -	$ -

The Company provided a 100% valuation allowance against the deferred tax assets in respect of its tax losses carryforward and other temporary differences due to uncertainty concerning its ability to realize these deferred tax assets in the future.

NOTE 11 - TAXES ON INCOME (cont.):

I. Reconciliation of the theoretical tax expense (benefit) to the actual tax expense (benefit):

A reconciliation between theoretical tax expense, assuming all income is taxed at the statutory rate applicable to the income of companies in Israel of 36% and the actual tax expense, is as follows:

	Year ended December 31,		
	1997	1998	1999
		(in thousands)	
Income (loss) before taxes on income, as reported in the consolidated statements of operations	$ (10,164)	$ (6,272)	$ 11,251
Statutory tax rate in Israel	36%	36%	36%
Theoretical tax expense (benefit)	(3,659)	(2,258)	4,050
Increase (decrease) in taxes resulting from:			
"Approved Enterprise" (benifit)	-	-	(1,741)
Carryforward (utilization of) losses and other deferred taxes for which valuation allowance was provided	3,518	1,993	(2,874)
Tax adjustment in respect of inflation in Israel	(266)	(82)	(45)
Non-deductible expenses, mainly amortization of goodwill	883	397	612
Taxes on income in the statements of operations	$ 476	$ 50	$ 2

NOTE 12 - SHAREHOLDERS' EQUITY:

A. The Ordinary Shares of the Company are quoted on the Nasdaq National Market in the United States.

1. In December 1999, the Company's Board of Directors approved a three-for-one stock split effected in the form of a 200% stock dividend. On January 24, 2000, an extraordinary meeting of the Company's shareholders approved the said stock split, which was made to shareholders of record as of February 4, 2000. This stock split has been recorded by a transfer of $406 thousand from additional paid-in capital, net, to share capital, representing NIS 0.1 par value for each additional share issued.

   All share and per share data in these financial statements including stock option plan information, have been restated retroactively to reflect this stock split.

2. On March 12, 1998, the Company issued Formula 2,400,000 Ordinary Shares at a price of $1.67 per share, in consideration of approximately $4 million.

   The Company granted Formula for no additional consideration options to purchase 1,800,000 Ordinary Shares (first option) and 2,400,000 Ordinary Shares (second option) at an exercise price of $1.67 per share. Since the first option was not exercised during the exercise period ended September 30,1998, the second option was terminated as well.

3. On July 30, 1998, the Company issued Mashov 3,000,000 Ordinary Shares at a price of $1.17 per share, in consideration of approximately $3.5 million.

NOTE 12 - SHAREHOLDERS' EQUITY (cont.):

A. (cont.):

4. On December 31, 1998, the Company issued Formula 3,600,000 Ordinary Shares at a price of $1.33 per share, in consideration of approximately $4.8 million.

5. In December 1999, the Company's Board of Directors approved an increase in the authorized share capital of the Company by NIS 4,000 thousand , divided into 40,000,000 Ordinary Shares of NIS 0.1 par value each. The increase was approved in the shareholders' meeting on January 24, 2000.

B. Stock Option Plan:

Under the Company's 1991 Stock Option Plan (the "Plan"), as amended, options may be granted to employees, officers, directors and consultants of the Company or any subsidiary.

Under the Plan, 5,100,000 Ordinary Shares of the Company were reserved for issuance. Options which are canceled or not exercised within the option period become available for future grants. The Plan has a ten-year term and will terminate on July 31, 2001, unless terminated earlier by the Board of Directors.

On December 7, 1998, the Company implemented a re-pricing plan, with respect to 1,835,967 options issued to employees, whose new exercise price was established at $1 per share. The original exercise price of these options ranged from $1.708 to $3 per share. The re-pricing had no effect on the Company's consolidated financial statements.

In July 1999, the Company approved an increase in the number of shares authorized for issuance under the Plan by an additional 900,000 options to 6,000,000 options.

In December 1999, the Company increased the number of shares authorized for issuance under the Plan by an additional 750,000 options to a total of 6,750,000 options. On January 24, 2000 an extraordinary meeting of the Company's shareholders approved the increase in the number of shares authorized for issuance under the Plan.

During the period 1993-1995 the Company granted loans to several directors and officers of the Company in connection with the exercise of options under the Plan. Such loans, which amounted to $1,300 thousand as of December 31, 1999 were initially repayable at the earlier of three years after issuance or upon sale of the shares purchased with these loans. The loans are adjusted for changes in the Israeli CPI and bear annual interest of 2% beginning April 1997. The loans were secured with the ordinary shares which were issued upon the exercise of the options. The Company extended the term of the loans through May 31, 2001, which is not later than the expiration date of the original options. Subsequent to the balance sheet date, substantially all of these loans were repaid.

NOTE 12 - SHAREHOLDERS' EQUITY (cont.):

B. Stock Option Plan (cont.):

The following table is a summary of the status of the Company's Plan as of December 31, 1997, 1998 and 1999, and changes in the years then ended:

	Year ended December 31, 1997		Year ended December 31, 1998		Year ended December 31, 1999	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at beginning of period	2,371,248	$2.44	2,891,205	$1.59**	3,007,092	$1.41
Granted	1,107,966	2.19	699,507	1.41	1,701,413	2.82
Exercised	(16,128)	2.91	-	-	(2,074,782)	1.68
Forfeited *	(571,881)	2.43	(583,620)	2.30	(372,491)	2.14
Outstanding at end of year	2,891,205	$2.37	3,007,092	$1.41	2,261,232	2.10
Exercisable at end of year	1,314,984	$2.40	1,634,217	$1.41	615,930	$2.02
Weighted average fair value of options granted during the year		$1.13		$0.55		$0.96

* Forfeited options are returned to the pool of options for future grant.

** After giving effect to the re-pricing.

The options outstanding as of December 31, 1999 have been separated into exercise price categories, as follows:

	Options outstanding			Options exercisable	
Range of exercise price	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
$1.00-$1.33	604,587	7.55	$1.15	344,466	$1.10
$1.33-$2.00	1,039,926	8.99	$1.47	132,627	$1.52
$2.67-$3.33	139,674	7.91	$2.45	62,172	$2.34
$3.33-$4.00	377,280	9.65	$3.94	3,000	$3.93
$4.00-$6.67	99,765	9.79	$6.89	73,665	$6.89

NOTE 12 - SHAREHOLDERS' EQUITY (cont.):

B. Stock Option Plan (cont.):

Pro forma information regarding net income and earnings per share is required by SFAS No. 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Valuation Model with the following weighted-average assumptions for 1997, 1998 and 1999: risk-free interest rates of 6.00%; dividend yields of 0%; volatility factors of the expected market price of the Company's Ordinary Shares of 0.532 for 1997, 0.584 for 1998 and 0.694 for 1999; and a weighted-average expected life of the option of four years.

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

For purposes of pro-forma disclosure, the estimated fair value of the options is amortized as an expense over the options' vesting period. The pro forma information is as follows:

	Year ended December 31,		
	1997	1998	1999
	(in thousands, except per share data)		
Net income (loss) for the year - as reported	$ (10,454)	$ (6,459)	$ 10,907
Pro forma net income (loss)	$ (11,612)	$ (7,344)	$ 9,417
Pro forma basic earnings (loss) per share	$ (0.80)	$ (0.42)	$ 0.39
Pro forma diluted earnings (loss) per share	$ (0.80)	$ (0.42)	$ 0.37

C. In 1996, the Company issued a five-year warrant to purchase 30,000 ordinary shares to the placement agent for the Company's 1996 public offering of ordinary shares. The exercise price of the warrant is $11.40 per share. As of December 31, 1999 the warrant had not been exercised.

D. Dividends:

Dividends on Ordinary Shares, if any, will be paid in NIS. Dividends paid to shareholders outside Israel will be converted into dollars on the basis of the exchange rate prevailing at the date of payment.

NOTE 13 - SELECTED STATEMENTS OF OPERATIONS DATA:

A. Summary information about geographic areas:

The Company manages its business on a basis of one reportable segment. See Note 1 for a brief description of the Company's business. The Company's business is divided into six main geographic areas: Israel, Europe (excluding the United Kingdom), the United Kingdom, North America, Japan and other regions. Total revenues are attributed to geographic areas based on location of customers.

This data is presented in accordance with SFAS 131 "Disclosures about Segments of an Enterprise and Related Information", which the Company has retroactively adopted for all periods presented.

The following table presents total revenues classified according to geographical destination for the years ended December 31, 1997, 1998 and 1999:

	Year ended December 31,		
	1997	**1998**	**1999**
		(in thousands)	
Israel	$ 4,101	$ 3,726	$ 5,192
Europe (excluding United Kingdom)	14,794	17,310	21,205
United Kingdom	6,024	7,320	6,041
North America	5,945	6,289	7,605
Japan	3,743	1,550	13,134
Other	2,825	2,565	10,815
	$ 37,432	$ 38,760	$ 63,992

The Company's long-lived assets that consist of fixed assets and severance pay funds are as follows:

	December 31,		
	1997	**1998**	**1999**
		(in thousands)	
Israel	$ 5,785	$ 5,333	$ 7,874
Europe (excluding United Kingdom)	319	364	997
United Kingdom	244	175	173
North America	317	189	161
Japan	-	-	205
Other	-	35	746
	$ 6,665	$ 6,096	$ 10,156

B. Data on major distributors, percentage of total revenues (Note 1D):

	Year ended December 31,		
	1997	**1998**	**1999**
		(in thousands)	
Wacom	10%	4%	-

NOTE 13 - SELECTED STATEMENTS OF OPERATIONS DATA (cont.):

C. Research and development costs:

	Year ended December 31,		
	1997	1998	1999
		(in thousands)	
Total costs	$ 6,758	$ 4,080	4,287
Less - royalty-bearing grants	(285)	-	-
Less - capitalization of software costs	(3,125)	(1,283)	(1,334)
Research and development, net	$ 3,348	$ 2,797	$ 2,953

D. Provision for doubtful accounts:

	Year ended December 31,	
	1998	1999
	(in thousands)	
Balance at beginning of period	$ 670	$ 990
Charges to general and administrative expenses	1,118	246
Less - accounts written-off	(798)	(124)
Balance at end of period	$ 990	$ 1,112

E. Financial income (expenses), net:

	Year ended December 31,		
	1997	1998	1999
		(in thousands)	
Interest and bank charges	$ (240)	$ (268)	48
Gain (loss) arising from foreign currency transactions	(248)	(54)	127
	$ (488)	$ (322)	$ 175

NOTE 14 - RELATED PARTIES TRANSACTIONS:

A. In 1995, the Company signed an agreement with Mashov whereby the Company agreed to lease part of a building owned by Mashov. The annual lease expense is $150 thousand.

B. In 1995, the Company signed an agreement with Mashov to lease a part of another building. The annual lease expenses is $36 thousand.

C. In July 1999, the Company acquired from Mashov all of its rights in a building for a consideration of $2,000 thousand. Mashov agreed to reimburse the Company for the rental paid by the Company for the period January 1, 1999 until July 19, 1999, the date of the agreement. The Company entered into an agreement with Mashov effective January 1, 1999, pursuant to which Mashov leased a part of the building owned by it for an annual lease income of $37 thousand.

NOTE 14 - RELATED PARTIES TRANSACTIONS (cont.):

D. Transactions with related parties:

	Year ended December 31,		
	1997	1998	1999
		(in thousands)	
General and administrative expenses (1)	$ 798	$ 542	$ 974
Financial expenses, net	$ 473	$ 51	$ 27
Purchase of property (see C. above)	$ -	$ -	$ 2,000

(1) Including rent expenses paid to Mashov and management fees paid to a principal shareholder.

E. Balances of accounts with related parties are in part linked to foreign currency and bear no interest.

NOTE 15 - COMMITMENTS AND CONTINGENT LIABILITIES:

A. Lease commitments:

Future minimum lease commitments under non-cancelable operating leases as of December 31, 1999 are as follows:

	$ thousands
2000	994
2001	307
2002	204
2003	61
2004	60
	$ 1,626

Rent expenses for the years ended December 31, 1997, 1998 and 1999, were approximately $915 thousand, $738 thousand and $1,448 thousand, respectively.

B. Guarantees:

The Company has given guarantees to several banks amounting to $500 thousand in favor of its affiliates.

C. Charges:

As collateral for the Company's liabilities, a floating charge on all of the Company's assets were recorded in favor of a bank.

NOTE 15 - COMMITMENTS AND CONTINGENT LIABILITIES (cont.):

D. Legal proceedings:

The Company is a party to an arbitration proceeding initiated against it and Mashov Computers its parent company, by M.N.S Micronova Systems Ltd. and two its principal shareholders. The plaintiffs claim that pursuant to an agreement among the plaintiffs, the Company and Mashov Computers, the plaintiffs were granted, beginning in April 1993 and until January 1999, exclusive rights to distribute applications developed based on Magic technology worldwide. The plaintiffs claim that the Company and Mashov Computers breached the agreement, and a non-compete provision contained in the agreement. The plaintiffs have not specified the amount of damages sought by them, but have asked for an accounting by the Company and Mashov Computers to allow them to determine the amount of their damages. The Company and Mashov Computers maintain that the rights granted to the plaintiffs under the agreement were limited in scope and that the Company did not breach the non- compete provision contained in the agreement. The arbitration is currently in the hearing state. Based on legal advice, the Company believes that it is unlikely that it will be required to pay a material amount of compensation to the plaintiffs.

NOTE 16 - EARNINGS (LOSS) PER SHARE:

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Year ended December 31,		
	1997	1998	1999
	(in thousands except per share data)		
Net income (loss)	$ (10,454)	$ (6,459)	$ 10,907
Numerator for basic and diluted earnings (loss) per share - income available to shareholders	$ (10,454)	$ (6,459)	$ 10,907
Denominator for basic earnings (loss) per share - weighted average shares	14,559	17,610	24,281
Effect of dilutive securities	-	-	1,110
Denominator for diluted earnings (loss) per share - adjusted weighted average shares and assumed conversions	14,559	17,610	25,391
Basic earnings (loss) per share	$ (0.72)	$ (0.37)	$ 0.45
Diluted earnings (loss) per share	$ (0.72)	$ (0.37)	$ 0.43

NOTE 17 - SUBSEQUENT EVENTS:

A. In January 2000, the Company converted a capital note in the amount of $250 thousand issued in August 1999 by Sintec Call Centers Ltd, ("Sintec") (formerly known as Manov Ltd.), a Magic solutions provider and an affiliate of Formula, a related party (see Note 1b), into shares representing a 19.9% interest in Sintec.. The Company was granted an option to increase its interest in Sintec to 34.4% for an additional investment of $ 440 thousand. The option was exercised during February 2000. In February 2000 the Company acquired an additional 16.24% interest in Sintec for the amount of $800 thousand. The parties to this transaction further agreed that holders of 9.5% of the shares of Sintec will be entitled to appoint one director to the board of directors of Sintec.

B. On February 25, 2000, the Company completed a follow-on offering of 3,500,000 ordinary shares. The total net amount raised was approximately $80.6 million.

MAGIC SOFTWARE ENTERPRISES LTD.

APPENDIX A - DETAILS OF SUBSIDIARIES

Details of the percentage of control of the share capital and vote of subsidiaries as of December 31, 1999:

Name of subsidiary	Percentage of ownership and control %	Placement 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.
Criterion Design and Programming Ltd.	100	Canada
Magic Software Enterprises Netherlands B.V.	100	Netherlands
Magic Software Enterprises France	100	France
Magic Beheer B.V.	100	Netherlands
Magic Software Enterprises GMBH	90	Germany
Magic Software Enterprises Italy S.r.i.	81	Italy
Magic Rental Technologies International Rentpro Ltd.	75	Israel
Nextstep Infotech Prt. Ltd.	51	India
Magic Software (Thailand)	70	Thailand
Magic Software Enterprises Australia Pvt. Ltd.	51	Australia
Magic Software Enterprises India Pvt. Ltd.	51	India
Access Data Corporation	51	U.S.A.
ONYX Szoftverhaz Korlatolf Felelossegu Tarsasag	51	Hungary

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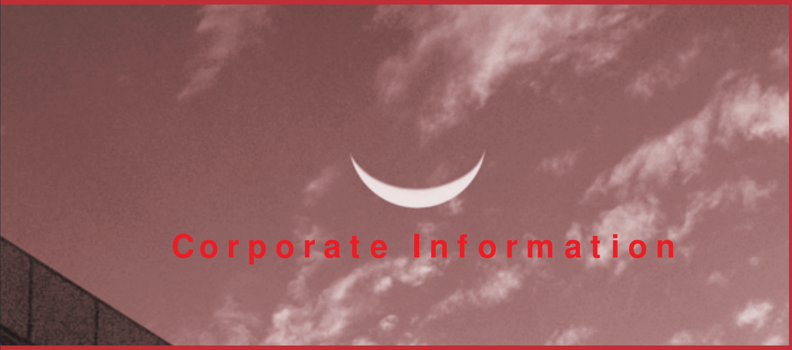

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Jack Dunietz
Co-Chairman & CEO

Israel Teiblum
President & CFO

Danny Goldstein
Director

Yigal Berman
Director

Gad Ariav
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Gad Goldstein
Director

Guy Bernstein
Vice President Finance

Benny Rosenbaum
Vice President
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Managing Director
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Form 20-F

Copies of MSE's Annual Report on Form 20-F as filed with the Securities and Exchange Commission may be obtained by shareholders without charge upon request.

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