

SAPIENS INTERNATIONAL CORP N V  
Form 20-F  
June 25, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 20-F**

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

**For the fiscal year ended December 31, 2007**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Date of event requiring this shell company report. . . . .

Commission file number 000-20181

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**SAPIENS INTERNATIONAL CORPORATION N.V.**

*(Exact name of Registrant as specified in its charter)*

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*(Translation of Registrant's name into English)*

NETHERLANDS ANTILLES

*(Jurisdiction of incorporation or organization)*

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P.O. Box 837  
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*(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)*

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

**Title of Class:**

**Name of each exchange on which registered:**

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Common Shares, par value 0.01 per share

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NASDAQ Capital Market

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

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

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

**As of December 31, 2007 the issuer had 21,541,088 Common Shares, par value 0.01 per share outstanding.**

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

Yes  No

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

Yes  No

Indicate by checkmark 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 proceeding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

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

If  Other has been checked in response to the previous question, indicate by checkmark which financial statement item the registrant has elected to follow:

Item 17  Item 18

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

Yes  No

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**INTRODUCTION**

*Definitions*

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In this annual report, unless the context otherwise requires:

References to Sapiens, the Company, us, we and our refer to Sapiens International Corporation N.V. (the Registrant), a Netherlands Antilles company, and its consolidated subsidiaries.

References to our shares, Common Shares and similar expressions refer to the Registrant's Common Shares, par value 0.01 per share.

References to dollars, US dollar or \$ are to United States Dollars.

References to NIS are to New Israel Shekels, the Israeli currency.

## **Cautionary Statement Regarding Forward-Looking Statements**

Certain matters discussed in this annual report are forward-looking statements that are based on our beliefs and assumptions as well as information currently available to us. Such forward-looking statements may be identified by the use of the words anticipate, believe, estimate, expect, may, will, plan and similar expressions. Such statements reflect our current views with respect to future events and are subject to certain risks and uncertainties. While we believe such forward-looking statements are based on reasonable assumptions, should one or more of the underlying assumptions prove incorrect, or these risks or uncertainties materialize, our actual results may differ materially from those described herein. Please read the risks discussed in Item 3 Key Information under the caption Risk Factors and cautionary statements appearing elsewhere in this annual report in order to review conditions that we believe could cause actual results to differ materially from those contemplated by the forward-looking statements.

We undertake no obligation publicly to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report might not occur.

## **PART I**

### **ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

### **ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

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### **ITEM 3. KEY INFORMATION**

#### **A. Selected Financial Data**

The following tables summarize certain selected consolidated financial data for the periods and as of the dates indicated. We derived the statement of operations financial data for the years ended December 31, 2005, 2006 and 2007 and the balance sheet data as at December 31, 2006 and 2007 from our consolidated financial statements included elsewhere in this annual report. The selected consolidated statement of operations financial data for the years ended December 31, 2003 and 2004 and the balance sheet data as of December 31, 2003, 2004 and 2005 are derived from our audited financial statements not included in this annual report. Certain financial data for previous years set forth below were reclassified to conform to later years' presentation. You should read the selected consolidated financial data together with our consolidated financial statements included elsewhere in this annual report and with Item 5, Operating and Financial Review and Prospects. Our consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( U.S. GAAP ).

#### **Selected Financial Data:**

	<b>Year Ended December 31,</b>				
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>

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	(In thousands, except per share data)				
<b>Revenues:</b>					
Products	\$ 32,580	\$ 26,781	\$ 13,295	\$ 10,423	\$ 5,632
Consulting and other services	19,738	21,023	26,109	33,888	36,763
Total revenues	52,318	47,804	39,404	44,311	42,395
<b>Cost of revenues:</b>					
Cost of products	16,628	15,274	8,809	6,302	3,277
Cost of consulting and other services	11,979	11,490	16,037	22,499	22,306
Impairment of capitalized software development costs	-	901	-	-	-
Total cost of revenues	28,607	27,665	24,846	28,801	25,583
Gross profit	23,711	20,139	14,558	15,510	16,812
<b>Operating Expenses:</b>					
Research and development, net	3,656	2,531	2,723	2,451	3,502
Selling, marketing, general and administrative	21,539	19,260	16,245	13,558	12,513
Restructuring Costs	-	-	1,113	758	-
Total operating expenses	25,195	21,791	20,081	16,767	16,015
Operating (loss) income	(1,484)	(1,652)	(5,523)	(1,257)	797
Financial expenses, net	958	2,410	1,788	2,230	2,798
Other expenses (income), net	(244)	552	(12)	-	109
Loss before taxes on income	2,198	4,614	7,299	3,487	2,110
Taxes on income (benefit)	(19)	217	1,798	325	338
Minority interests in earnings of a subsidiary and other	8	11	2	13	96
Net loss	2,187	4,842	9,099	3,825	2,544
Settlement of redeemable shares in a subsidiary	-	299	-	-	-
Net loss to shareholders of Common Shares	\$ 2,187	\$ 5,141	\$ 9,099	\$ 3,825	\$ 2,544
Basic and diluted net loss per share	\$ 0.20	\$ 0.46	\$ 0.76	\$ 0.29	\$ 0.14
Weighted average number of shares used in computing basic and diluted loss per share	10,693	11,273	11,982	13,395	18,218

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	At December 31, (in thousands)				
<b>Balance Sheet Data:</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Cash and cash equivalents	\$ 31,775	\$ 10,942	\$ 6,699	\$ 3,108	\$ 13,125
Working capital (deficit)	20,373	2,767	(10,636)	(12,616)	(567)
Total assets	76,723	68,734	51,866	45,619	52,532
Long-term debt and other long-term liabilities	24,783	23,281	15,603	13,235	7,560
Capital stock	105,908	108,635	110,645	113,683	132,310
Total shareholders equity	13,929	12,080	3,632	3,929	21,850

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

**D. Risk Factors**

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

**Risks Relating to Our Business and Our Industry**

*Implementing our strategy of focusing on the market for software solutions in the insurance industry has taken longer than anticipated, and we may not succeed in gaining acceptance in that market.*

Our goal is to rise to a position of global leadership in delivering strategic business software solutions to the insurance industry. Achieving this goal requires us, among other things, to design appropriate software solutions, maintain sufficient sales and marketing resources, recruit, train and hire sufficient professional services personnel and face intense competition. We have experienced delays in penetration of the insurance industry, and such delays have contributed to a decline in our results. We expect that additional time will be required to achieve our goal. Our future efforts to gain acceptance for our solutions may still not succeed which could have a material adverse affect on our results.

*We have a history of losses, and we anticipate that our revenues for the short to medium term will not significantly increase while our expenses may increase as a result of maintaining our research and development, sales and marketing efforts and increased interest costs.*

We incurred net losses of approximately \$3.8 million and \$2.5 million for the years ended December 31, 2006 and December 31, 2007, respectively. We cannot predict that our losses will continue to decrease, or if we may become profitable on a sustained basis. Due to the delay in the implementation of our strategy of offering solutions to the insurance industry and possible decline in orders from existing customers, we have no assurance that our revenues in the short to medium term will significantly increase, if at all. At the same time, expenses may increase in the foreseeable future as we maintain our research and development, sales and marketing activities. In addition, following our offering of approximately \$17.1 million principal amount of convertible debentures in December 2003, and an additional \$1.5 million of convertible debentures in March 2004, upon the exercise by non-affiliates of the Company of options that were offered together with the original convertible debentures in December 2003, we have the obligation to pay the debenture holders interest and to pay the principal amount when the debentures are due, which currently amounts to approximately NIS 38 million or \$9.9 million. Our research and development, marketing and sales efforts may prove more costly than we currently anticipate, and we may not succeed in the long term in increasing our revenues sufficiently to offset the expenses of those efforts and of paying back the principal and paying the interest on the debentures. If our revenues fail to increase at a greater rate than our expenses, we will not be able to achieve profitability.

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*Despite our financing activities in 2007 and our reported positive cash flow for 2007, we have a history of declining working capital and our working capital may once again decrease and we may need to raise capital again.*

Historically, our liquidity has reduced due to the drop in our cash reserves available. In 2007, we raised gross capital of \$20 million (excluding finders fees and out of pocket expenses), and at December 31, 2007, we had negative working capital of \$0.6 million. In the past, we have needed to raise capital in order to continue financing our business activities, to pay back the principal and the interest on the debentures and to continue meeting our other obligations. Despite our recent capital raise in 2007, there is no assurance that our past trend of diminishing working capital will not continue. There is no assurance that we will be able to obtain additional financing, or if we do, that it will be on favorable terms. In addition, if we issue capital stock to investors, in order to raise cash, our existing shareholders will experience dilution.

*Changes in exchange rates between the US dollar and other currencies may negatively impact our costs.*

Exchange rate fluctuations between the US dollar and other currencies which we and our subsidiaries use, especially the NIS may negatively affect our earnings. A significant portion of our expenses, including research and development, personnel and facilities-related expenses, are incurred in Israel, in NIS. In addition, our debentures are linked to the US dollar only if the exchange rate between the NIS and the US Dollar is greater than NIS 4.394 per 1 US Dollar. (On June 17, 2008, the exchange rate between the NIS and the US Dollar was NIS 3.340 per 1 US Dollar.) Consequently, we are exposed to the risk of appreciation of the NIS vis-à-vis the US dollar. This appreciation would cause, and in 2007 did cause, an increase in our expenses as recorded in our US dollar denominated financial statements even though the expenses denominated in local currencies will remain unchanged.

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Due to the appreciation of the NIS vis-a-vis the US dollar in 2007, our foreign currency transaction differences, net, increased to approximately \$0.7 million in 2007, from \$0.1 million in 2006. See Note 15.b of our consolidated financial statements. Such increase is after we take into account hedging transactions we performed during 2007, which diminished the adverse effect of the appreciation of the NIS in relation to the dollar. This appreciation may continue in 2008. Since December 31, 2007, the US dollar has continued its devaluation vis-a-vis the NIS. On June 2, 2008, the representative exchange rate between the NIS and the US dollar as published by the Bank of Israel was NIS 3.26 to \$1, as opposed to NIS 3.846 to \$1 as of December 31, 2007.

We cannot predict any future trends in the rate of devaluation of the US dollar against the NIS. We cannot assure you that we will not be materially affected in the future from currency exchange rate fluctuations. If the value of the NIS continues to rise in value relative to the US dollar, our business and financial condition could continue to be negatively impacted. See Item 11. Quantitative and Qualitative Disclosures about Market Risk - Foreign Currency Risk.

***As a result of an offering of convertible debentures, we have significant debt and the amount of the debt could hinder our activities and affect the flexibility needed for such activities.***

In December 2003, we completed an offering of convertible debentures on the Tel Aviv Stock Exchange ( TASE ). The offering resulted in gross proceeds to us of approximately \$17.1 million. The debentures were offered in units which included options to purchase additional debentures and warrants to purchase our Common Shares. Options which were exercised by non-affiliates of the Company before their expiry date resulted in additional gross proceeds of approximately \$1.5 million to the Company in the first quarter of 2004. None of the warrants were exercised and they expired on November 21, 2007. As a result of our purchase of NIS 15,000,000 nominal value of debentures, representing approximately \$3.5 million, in 2007 and our purchase of NIS 7,600,000 nominal value of debentures, representing approximately \$2.1 million, in 2008, the amounts that we must re-pay, of the principal and the interest have been reduced. In December 2008, we must re-pay approximately NIS 14.9 million or \$3.9 million (using the December 31, 2007 exchange rate of NIS 3.846 per \$1), which reflects approximately NIS 13.9 million or \$3.6 million for the third of the four annual re-payments of the principal of the debentures, and approximately NIS 1.0 million or \$0.3 million for the semi-annual interest payment. In the past, we did not create sufficient positive cash flow from operations to make such payment.

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In August 2006, a majority of the debenture holders approved changes to the amount and the timing of the first installment payment of the principal of the debentures, such that the payment of 50% of the first payment amount was deferred to December 5, 2009, and we were given the opportunity to either pay back the other 50% of the first payment amount, or to convert such amount into our Common Shares. On November 30, 2006, we announced our decision to pay the approximately \$2.4 million in cash, and on December 5, 2006, we made the payment. There can be no guarantee that the debenture holders will agree to any changes to the terms of the debentures in the future. In June 2007, we entered into a private placement transaction for an aggregate gross amount of \$20 million (excluding finders fees and out of pocket expenses). Following the private placement transaction, in June 2007, we purchased an aggregate amount of NIS 15,000,000 nominal value of debentures, representing approximately, \$3.5 million of the outstanding debentures. In January and February 2008, we purchased an aggregate amount of NIS 7,600,000 nominal value of debentures, representing approximately, \$2.1 million of the outstanding debentures. Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation. As a result, the amount of the semi-annual interest payment that we paid in June 2008 was reduced to approximately NIS 1.0 million or \$0.3 million. Similarly, the total amount that we must pay in December 2008 was reduced to approximately NIS 14.9 million or \$3.9 million (using the December 31, 2007 exchange rate of NIS 3.846 per \$1). We currently have enough funds to make the December 2008 payments. However, if we use those funds for other purposes in the future, we may not have enough funds to make the future principal and interest payments. We cannot be certain that our credit lines will be renewed in the future, and if they are, that they will be on favorable terms. If we are unable to obtain through other means the funds needed to make such payments, we could breach the terms of the debentures and of the Trust Deed which we entered into in connection with the offering. Even if we are able to make the payments required by the debentures, the amount of the debt could have a material adverse effect on our results of operations and financial position. For example, the debt could restrict our ability to obtain additional financing, restrict our flexibility in planning or in reacting to changes in the business, place us in a position inferior to that of competitors with lower debts or make us more vulnerable if there is a downturn in our revenues or in the economy in general. The amount of the debt could require us to dedicate a material part of our cash flow to payment of interest and repayment of principal and in addition reducing our ability to use the cash for other purposes such as working capital.

***The failure of our new solutions to achieve market acceptance or continued delays in our current or future efforts to develop software solutions could erode our competitive position.***

The failure to successfully develop, enhance or modify our software solutions, or the failure to do so on a timely basis, could limit our revenue growth and competitive position. We may need to rapidly develop and introduce additional software and enhancements to our existing solutions to satisfy our current customers and maintain our competitive position in the marketplace. We may also need to modify our software so that it can operate with new or enhanced software that may be introduced by other software vendors. The failure to introduce new, enhanced or modified software on a timely basis could prevent our solutions from achieving market acceptance. We have experienced in the past, and

anticipate experiencing in the future, delays in the timing of the introduction of new solutions and market acceptance of those solutions. To support our software development, enhancement or modification, we may find it necessary to license or acquire new technologies, which may not be available to us on acceptable terms, if at all.

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

The market for our solutions is characterized by rapidly changing business conditions and customer requirements. The introduction of solutions embodying new technology and the emergence of new customer requirements can render existing technology obsolete and unmarketable. Our ability to anticipate changes in technology and customer requirements and to successfully develop and introduce new and enhanced solutions on a timely basis will be significant factors in our ability to grow and to remain competitive. Substantial expenditures are required for research and development and the introduction of new products. There can be no assurance that we will have sufficient resources to make such investments, or that these investments will bring the full advantages or any advantage as planned. We have in the past experienced delays in introducing our technology and enhancements, and there can be no assurance that we will not encounter technical or other difficulties that could delay introduction of new technologies or enhancements in the future. There can be no assurance that we will be successful in developing and marketing enhancements that incorporate new technology on a timely basis, or that its new solutions will adequately address the changing needs of the marketplace. Our failure, for technological or other reasons, to timely develop and market products incorporating new technologies could have a material adverse effect on our results of operations, financial condition and cash flows.

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***The software solutions market we address is expected to evolve rapidly, and if we are not able to accurately predict and respond to market developments or customer needs, our competitive position will be impaired.***

The market for the solutions we provide is expected to evolve rapidly. However, estimates of our market's expected growth are inherently uncertain and are subject to many risks and assumptions. Moreover, many of our customers operate in markets characterized by rapidly changing technologies and business plans. Rapid changes in the needs of these customers and changing technologies make it difficult for us to predict their demands. We are particularly susceptible to those changes since our software is used in a wide array of operating environments, which are constantly evolving. As a result, we may not be able to develop, on a timely basis or at all, solutions that meet our customers' needs or desires. In addition, various sectors of our market are served by competitors who may respond more effectively to market developments and customer needs. There can be no assurance that the market for our solutions will grow or that we will be able to respond to changes in the market, evolving customer needs or our competition. If the market for our solutions does not develop as we expect or if we fail to respond to market and competitive developments, our business prospects and competitive position might be impaired.

***If existing customers do not make subsequent purchases from us or if our relationships with our largest customers are impaired, our revenue could be negatively affected.***

Our existing customers are a key asset of Sapiens, and we depend on repeat product and service revenues from our base of customers. Specifically, revenues from sales to Menora Mivtachim Insurance Ltd. ( Menora ) and Liverpool Victoria Friendly Services ( Liverpool Victoria ) constituted 20.0% and 6.3%, respectively, of our consolidated revenues in 2007. There can be no assurance that our existing customers will enter into new project contracts with Sapiens or that they will continue using our enabling technologies. If our revenue stream from existing customers were to decline significantly, it would have a material adverse impact on our operating results. Indeed, during 2007, one of our customers, Synergy Insurance Services Holdings Limited ( Synergy ) in the UK decided to change their business model and their requirements for the project. As a result, we mutually agreed to terminate the project and reached a settlement of all amounts due.

The relationships with two large customers of our U.S. subsidiary Texas Farm Bureau Insurance Companies, and Occidental Fire & Casualty; two large customers of our subsidiary in the United Kingdom EDS Credit Services and Liverpool Victoria; and a large customer of our subsidiary in Israel Menora Mivtachim, are the sources of a large portion of the revenues of each of those three subsidiaries. During 2007, revenues from sales to the American customers specified above constituted 37.5% of the total revenues of the U.S. subsidiary (9.4% of our consolidated revenues); revenues from sales to the British customers specified above constituted 35.4% of the total revenues of the U.K. subsidiary (11.2% of our consolidated revenues); and revenues from sales to the Israeli customer specified above constituted 63.5% of the total revenues of the Israeli subsidiary (20.0% of our consolidated revenues). In previous years, our sales to Liverpool Victoria, EDS Credit Services and Occidental Fire & Casualty have declined, which negatively impacted our revenue stream. While sales remained basically the same in 2007, we cannot guarantee that sales will not decrease again in the future, to these or to other customers. If we experience further reductions in sales to these or other customers, our revenue stream will be further negatively affected.

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



The market for software solutions and related services, and for business solutions for the insurance industry, in particular, is highly competitive. Our principal competitors generally have significantly greater resources than we do. Our customers or potential customers could prefer suppliers that are larger than us and that have not experienced losses such as ours. There is no guarantee that our customers, present and future, will be confident in our financial stability going forward. Price reductions or declines in demand for our solutions and services, whether as a result of competition, technological change, changes in the level of application development, reengineering or maintenance performed internally by our customers or potential customers would have a material adverse effect on our results of operations, financial position and cash flows.

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***Our business involves long-term, large projects, some of which are fixed-price projects that involve uncertainties, such as estimated project costs and profit margins.***

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

Some of our solutions are sold as fixed-price projects with delivery requirements spanning more than one year. If our actual cost-to-completion of these projects differs significantly from the estimated costs, there could be a material adverse effect on our results of operations and financial position. Similarly, delays in executing client contracts may affect our revenue and cause our operating results to vary widely. Some of our solutions may be priced in excess of \$1.0 million and are delivered over periods of time ranging from several months to a few years. Payment terms are generally based on periodic payments or on the achievement of milestones. Any delays in payment or in the achievement of milestones may have a material adverse impact on our results of operations, financial position or cash flows. The sales cycle for our solutions is long and variable, typically ranging between nine months to eighteen months from initial contact with the potential client to the signing of a contract. Occasionally, sales require substantially more time. This variability may adversely affect our operating results in any particular quarter.

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

Our products focus on organizations' business-critical applications including those related to core business solutions for the insurance industry and we provide re-engineering and re-development services for customers' specialized needs. Since our customers rely on our software to operate, monitor and improve the performance of their critical software applications, they are sensitive to potential disruptions that may be caused by the use of, or any defects in, our software. As a result, we may be subject to claims for damages related to software errors in the future. Liability claims could require us to spend significant time and money in litigation or to pay significant damages. Regardless of whether we prevail, diversion of key employees' time and attention from the business, incurrence of substantial expenses and potential damage to our reputation might result. While the terms of our sales contracts typically limit our exposure to potential liability claims, and we carry errors and omissions insurance against such claims, there can be no assurance that such insurance will continue to be available on acceptable terms, if at all, or that such insurance will provide us with adequate protection against any such claims. A significant liability claim against us could have a material adverse effect on our results of operations and financial position.

***Defects in our technology would harm our business and divert resources.***

The quality of our products, enhancements and new versions is critical to our success. Since our software solutions are complex, they may contain errors that can be detected at any point in their life cycle. Any errors or defects in our technology could result in:

- delayed or lost revenue;
- failure to attract new customers or achieve market acceptance;
- claims against us;
- diversion of development resources;
- increased service, warranty and insurance costs; and
- negative publicity resulting in damage to our reputation.

While we continually test our products for errors and work with customers to identify and correct them, errors in our technology may be found in the future. Testing for errors is complicated because it is difficult to simulate the breadth of operating systems, user applications and computing environments that our customers use and because our software is becoming increasingly complex itself. The costs we may incur in addressing technology errors could be substantial and could impair our results of operations.

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

In accordance with industry practice, since we have no registered patents, we rely on a combination of contractual provisions and intellectual property law to protect our proprietary technology. We believe that due to the dynamic nature of the computer and software industries, copyright protection is less significant than factors such as the knowledge and experience of our management and personnel, the frequency of product enhancements and the timeliness and quality of our support services. We seek to protect the source code of our products as trade secret information and as an unpublished copyright work. We also rely on security and copy protection features in our proprietary software. We distribute our products under software license agreements that grant customers a personal, non-transferable license to use our products and contain terms and conditions prohibiting the unauthorized reproduction or transfer of our products. In addition, we attempt to protect trade secrets and other proprietary information through non-disclosure agreements with employees, consultants and distributors. Although we intend to protect our rights vigorously, there can be no assurance that these measures will be successful. Our failure to protect our rights, and the improper use of our products by others without licensing them from us, could have a material adverse effect on our results of operations and financial condition.

***Our Sapiens eMerge solution is proprietary to us and if we need to hire programmers, maintenance and professional services providers, we would incur training costs and delays due to training.***

Our Sapiens eMerge solution was designed by us and its use requires special knowledge and training. If our current employees leave the Company or if a new project is undertaken by the Company and we need to hire new programmers or people to provide maintenance and professional services to our customers, we would have to train the new employees and consultants in Sapiens eMerge. As a result, we would incur training costs and would have to delay implementation of projects and services until such individuals were adequately trained. In addition, once these individuals are initially trained, they would still be inexperienced with Sapiens eMerge and would take additional time to develop efficiency and proficiency with Sapiens eMerge. As a result of these costs and delays, there could be a negative impact on our results of operations, our financial condition, our cash flows and our relationships with our customers.

***Some of our potential customers are reluctant to purchase proprietary solutions.***

Some customers of information technology solutions are reluctant to purchase solutions that are not off-the-shelf or widely used by a broad customer base. Since our Sapiens eMerge solution and our Sapiens INSIGHT suite of solutions are proprietary to us and require special knowledge and training, we have faced reluctance by potential customers to purchase our proprietary solutions. Such reluctance could have a negative impact on our results of operations and our financial condition.

***As part of our business strategy, we may make acquisitions that could disrupt our business and harm our results of operations and financial condition.***

As part of our growth strategy, we may consider acquiring complementary technologies, products and businesses. If we use capital stock in connection with such acquisitions, our existing shareholders may experience dilution. If we use cash or debt financing, our financial liquidity will be reduced, the holders of our debt would have claims on our assets ahead of holders of our Common Shares and our business operations may be restricted by the terms of any debt. An acquisition may involve nonrecurring charges or amortization of significant amounts of intangible assets, which would adversely affect our ability to achieve and maintain profitability. Attempted acquisitions may divert management, operational and financial resources from the conduct of our core business, and we may not complete any attempted acquisition.

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

Our loan and credit line agreements contain a number of conditions and limitations on the ways in which we can operate our business, including limitations on our ability to raise debt, sell or acquire assets and pay dividends. Our loan and credit line agreements also contain various covenants which require us to maintain certain financial performance milestones related to shareholders' equity and operating results. These

limitations and covenants may force us to pursue less than optimal business strategies or forego business arrangements which could have been financially advantageous to us or our shareholders. There can be no assurance that we will fulfill these covenants or, if we do not fulfill one or more of these covenants, that we will receive from our lender banks waivers of the necessity of fulfilling such covenants.

Our failure to comply with the covenants and restrictions contained in our loan and credit line agreements could lead to a default under the terms of these agreements. If a default occurs and we are unable to renegotiate the terms of the debt, the lenders could declare all amounts borrowed and all amounts due to them under the agreements due and payable. If we are unable to repay the debt, the lenders could foreclose on our assets that are subject to liens and sell our assets to satisfy the debt. As part of our loan agreements, the assets of our subsidiary in the United States are subject to a security interest and the assets of our subsidiaries in Israel and the United Kingdom are subject to a floating lien. Foreclosure on these assets could have a material adverse effect on our results of operations and financial condition.

***Our future results could be adversely affected by an impairment of the value of certain intangible assets.***

The assets listed in our consolidated balance sheet include, among other things, goodwill valued at approximately \$8.6 million, capitalized software development costs, net, valued at approximately \$15.0 million, long-term deferred income taxes valued at approximately \$2.6 million, short-term deferred income taxes valued at approximately \$953,000 and purchased technologies, net, valued at \$271,000. The applicable accounting standards require that (a) goodwill be tested for impairment at least annually, and written down when impaired; (b) capitalized software costs be assessed for recoverability on a regular basis, to determine whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold, in accordance with Statement of Financial Accounting Standard No. 86 ( Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed ); (c) certain identifiable intangible assets such as deferred taxes be reviewed for impairment in certain circumstances; and (d) purchased technologies be assessed for recoverability on a regular basis, to determine whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from such asset. If our goodwill, capitalized software development costs, deferred tax assets, or purchased technologies were deemed to be impaired in whole or in part due to the Company not achieving its goals, we could be required to reduce or write off such assets, thus having to recognize additional expense in our statements of operations and to reduce our shareholders equity.

***Our quarterly results may be impacted by multiple short-term factors.***

Our revenue and operating results could vary widely from quarter to quarter as a result of several different factors, such as the budgeting and purchasing practices of our customers, the length of the customer product evaluation process, the timing of our customers system conversions, the timing and cost of new product introductions and product enhancements, and the timing of any acquisitions and associated costs. Employee hiring and the rate of utilization of such employees may also affect our revenues and results of operations.

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

Most of our revenues are derived from international operations that are conducted in local currencies as well as dollars. Changes in the value of such local currencies or the dollar relative to such local currencies may affect our financial position and results of operations. Gains and losses on translations to dollars of assets and liabilities may contribute to fluctuations in our financial position and results of operations. In certain locations, we engage in currency-hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on our financial position and results of operations. However, there can be no assurance that any such hedging transaction, if entered into, will materially reduce the effect of fluctuation in foreign currency exchange rates on such results. In addition, if for any reason exchange or price controls or other restrictions on the conversion of foreign currencies were imposed, our financial position and results of operations could be adversely affected.

Other potential risks that may impact our international business activities include longer accounts receivable payment cycles, the burdens of complying with a wide variety of foreign laws and changes in regulatory requirements, although such factors have not had a material adverse effect on our financial position or results of operations to date.

***Formula Systems (1985) Ltd. and its parent company Emblaze Ltd., may exercise control and influence corporate actions that are potentially in conflict with our other public shareholders.***

Formula Systems (1985) Ltd. ( Formula ), whose ADRs trade on NASDAQ (under the trading symbol: FORTY) and whose shares trade on the TASE (under the trading symbol: FORT), directly owned (as of June 11, 2008) 12,496,090, or approximately 58%, of our currently outstanding Common Shares.

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In November 2006, Emblaze Ltd. ( Emblaze ), whose ordinary shares are traded on the London Stock Exchange (under the trading symbol: BLZ.L), purchased the controlling interest of Formula, and as a result, control of us. As of June 2, 2008, Emblaze owned 50.1% of the outstanding share capital of Formula and, therefore, has an indirect controlling influence over us.

Emblaze, through Formula, is and may continue to be in a position to exercise control over most matters requiring shareholder approval. Formula may use its share ownership or representation on our Board of Directors to substantially influence corporate actions that conflict with the interests of our other public shareholders including, without limitation, changing the size and composition of the Board of Directors and committees of our Board of Directors, causing the issuance of further securities, amending our governing documents or otherwise controlling the outcome of shareholder votes. Further, actions by Formula with respect to the disposition of the Common Shares it beneficially owns, or the perception that such actions may occur, may adversely affect the trading price of our Common Shares.

Eli Reifman, Guy Bernstein and Hadas Gazit Kaiser, all from Emblaze, and Naamit Salomon of Formula, are members of our Board of Directors. Eli Reifman serves as Chairman of our Board of Directors.

***We may be classified as a passive foreign investment company and, as a result, our U.S. shareholders may suffer adverse tax consequences.***

Generally, if for any taxable year, after applying certain look-through rules, 75% or more of our gross income is passive income, or at least 50% of the value of our assets are held for the production of, or produce, passive income, we may be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. This characterization could result in adverse U.S. tax consequences to our shareholders who are U.S. taxpayers, including gain realized on the sale of our Common Shares being treated as ordinary income rather than capital gain income and could result in punitive interest charges being applied to such sales proceeds. Rules similar to those applicable to distributions apply to amounts treated as excess distributions.

We believe we were not a PFIC in 2007, just as we believe we were not a PFIC for at least the past 5 years. We currently expect that we will not be a PFIC in 2008. However, PFIC status is determined as of the end of the taxable year and is dependent on a number of factors. Therefore, there can be no assurance that we will not become a PFIC for the year ending December 31, 2008 or in a future year. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our Common Shares. For a discussion of how we might be characterized as a PFIC and related tax consequences, please see Item 10.E, Additional Information Taxation - U.S. Federal Income Tax Considerations - Tax Consequences if We Are a Passive Foreign Investment Company.

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### **Risks Relating to Conducting Business in Israel**

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

Our corporate headquarters and research and development facilities are located in the State of Israel. Political, economic and military conditions in Israel directly affect our operations. We could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel. In addition, several countries still restrict business with Israel and with companies doing business in Israel. We do not believe that the political and security situation has had any material impact on our business to date; however, we can give no assurance that security and political conditions will have no such effect in the future.

Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. These developments have adversely affected the regional peace process, placed the Israeli economy under significant stress, and have negatively influenced Israel's relationship with several Arab countries. The establishment in 2006 of a government in the Palestinian Authority by representatives of the Hamas militant group resulted in an escalation in violence among Israel, the Palestinian Authority and other groups and has created additional unrest and uncertainty in the region. Further, during the summer of 2006, Israel was engaged in a war with Hezbollah, a Lebanese Islamist Shiite militia group, which involved rockets being fired from Lebanon up to 50 miles into Israel and disrupted most day-to-day civilian activity in northern Israel. Any future armed conflict, political instability or violence in the region, including acts of terrorism, may have a negative effect on our business condition, harm our results of operations and adversely affect our share price.

Some of our executive officers and employees in Israel are obligated to perform military reserve duty, currently consisting of approximately 30 days of service annually (or more for reserves officers or citizens with certain occupations). Additionally, they are subject to being called to active duty at any time upon the outbreak of hostilities. While we have operated effectively under these requirements since the establishment of Sapiens, no assessment can be made as to the full impact of such requirements on our business or work force and no prediction can be made as to the effect on us of any expansion of such obligations.

**Risks Related to the Market for our Common Shares**

*If we fail to meet the standards for continued listing of our shares on Nasdaq, the shares could be de-listed from the Nasdaq Capital Market.*

A company must continue to comply with several requirements in order to remain listed on Nasdaq. One of the requirements is that a company maintain a \$1.00 minimum bid price (the Minimum Bid Price Requirement). Under the Nasdaq Marketplace Rules, a failure to meet the continued listing requirement for minimum bid price on The Nasdaq Capital Market shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days.

For eight days in May 2008, the closing price of our common shares on the Nasdaq Capital Market was below \$1.00. The closing price of our common shares on the Nasdaq Capital Market, on June 18, 2008, was \$1.87 per share.

If we fail to maintain such compliance, our Common Shares could be de-listed from the Nasdaq Capital Market, which could have a material adverse effect on our share prices and our standing with current and future investors. In addition, if we are de-listed from the Nasdaq Capital Market, we may no longer be eligible for certain benefits granted by the Israel Securities Law to companies that are dual listed on the Tel Aviv Stock Exchange and a foreign (non-Israeli) securities exchange. The removal of such benefits would require us to incur additional costs relating to periodic reporting in Israel and would have a material impact on our results of operations.

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There can be no assurance that we will continue to meet all the requirements for continued Nasdaq listing. Failure to meet one of Nasdaq's continued listing standards could result in the delisting of our Common Shares from Nasdaq.

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

Our Common Shares are traded on the NASDAQ Capital Market and the TASE. Trading in our Common Shares on these markets will be made in different currencies (US dollars on the NASDAQ Capital Market and NIS on the TASE), and at different times (resulting from different time zones, different trading days and different public holidays in the U.S. and Israel). The trading prices of our Common Shares on these two markets may differ due to these and other factors. Any decrease in the trading price of our Common Shares on one of these markets could cause a decrease in the trading price of our Common Shares on the other market.

*There is very little trading volume of our Common Shares, which causes the stock price to be volatile and which may lead to losses by investors.*

There is very little trading volume of our Common Shares, both on the NASDAQ Capital Market and the TASE. As a result, our Common Shares have experienced significant market price volatility in the past and may experience significant market price and volume fluctuations in the future, in response to factors such as announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results and general conditions in the industry in which we compete.

On June 24, 2007, we received a letter from the TASE informing us that as of August 12, 2007, our Common Shares and warrants (Series 1) that are traded on the TASE, but not our debentures (Series A), would be included in a newly created list of Illiquid Securities. Inclusion in such list would mean that trades on the TASE of our Common Shares and warrants (Series 1) would only be executed twice a day, in the morning upon the commencement of trading, and at the end of day, at the end of trading. On August 8, 2007, we entered into an agreement with Clal Finance Batucha Investment Management Ltd. (Clal Finance) pursuant to which Clal Finance acts as a market maker for our Common Shares traded on the TASE. As a result of our entering into a market making agreement, we were not included on the TASE's list of Illiquid Securities.

**ITEM 4. INFORMATION ON THE COMPANY**

**A. History and Development of the Company**  
*Corporate Details*

Our legal and commercial name is Sapiens International Corporation N.V., and we were incorporated and registered in the Netherlands Antilles on April 6, 1990. We are a public limited liability company and operate under the provisions of the Netherlands Antilles Commercial Code. Our registered office is located at Landhuis Joonchi, Kaya Richard J. Beaujon z/n, Curaçao, Netherlands Antilles and our telephone number in Curaçao is + 5999-736-6277. United International Trust N.V. is the Company's agent in Curaçao and serves as a member of our Board of

Directors. Our World Wide Web address is [www.sapiens.com](http://www.sapiens.com). The information contained on the web site is not a part of this annual report. We did not have any material business developments since January 1, 2007.

***Capital Expenditures and Divestitures since January 1, 2005***

Our principal capital expenditures during the last three years related mainly to the purchase of computer equipment and software for use by our subsidiaries. These capital expenditures totaled \$366,000 in 2005, \$276,000 in 2006 and \$ 190,000 in 2007.

In 2008, we purchased computer equipment in the amount of approximately \$300,000. This purchase was financed through a capital lease agreement.

**B. Business Overview**

We are a global provider of information technology ( IT ) solutions that modernize business processes to enable insurance and other leading companies to quickly adapt to change. Our solutions, sold as customizable software modules, align IT with business demands for speed, flexibility and efficiency. Our solutions are supplemented by our technology, methodology and consulting services, which address the complex issues related to the life-cycle of enterprise business applications. Our solutions include scalable insurance applications we have developed for leading organizations such as AXA, Norwich Union, Liverpool Victoria, IAT Group, ING, OneBeacon, Principal Financial Group, the Surplus Line Association of California, Allianz Group, Texas Farm Bureau Insurance Companies, Menora Mivtachim Insurance and Santam. Our service offerings include a standard consulting offering that helps customers make better use of IT in order to achieve its business objectives.

Our core technology, Sapiens eMerge , is a rules-based application development suite which enables rapid solution development for complex mission-critical enterprises to deliver new functionality, achieve legacy modernization and enterprise application integration. We believe that our understanding of the insurance marketplace and broad experience in mainframe-based legacy systems, backed by the high return on investment made possible by Sapiens eMerge , help our customers gain a competitive edge in the rapidly changing business world while maximizing the value of their investments in existing IT systems.

Our primary goal is to rise to a position of global leadership in delivering strategic business software solutions to the insurance industry, selling Sapiens INSIGHT , our suite of modular business software solutions. Our mission is to drive customer profitability in the global insurance industry through thought leadership and the proven delivery methodology of our innovative solutions. We plan to achieve this objective by combining our insurance expertise and extensive experience in implementing feature-rich, robust, high volume solutions in order to deliver to our clients customizable software products for life insurance, pensions and annuities, general insurance, reinsurance and specialized underwriting. The primary building block of our Sapiens INSIGHT solution remains Sapiens eMerge , our business rules engine that has evolved and matured over the course of thousands of man-years of research and development efforts. Sapiens eMerge , which serves over 100 of our clients worldwide, reduces the cost of business software development and maintenance.

We market our solutions globally through our direct sales force and through marketing alliances with global IT providers, such as IBM Corporation and Electronic Data Systems Corporation. We have cooperated with IBM Corporation for over 10 years at what IBM refers to as a Premier Business Partner level. Currently, we work with IBM on solutions, joint development, testing, validation and marketing. Through this and other business alliances, we have developed extensive knowledge in mainframe and mid-range systems, including CICS, DB2, MQ and the WebSphere e-business platform. We are also a member of IBM s Insurance Application Architecture (IAA) group and the ISV Advantage Program for the Small and Medium Business insurance market segment. These alliances enable us to reach a broader base of customers while complementing our partners offerings.

***Industry Background***

The global insurance industry is highly competitive, constantly facing new regulations, multiple sales channels and demanding customers.

Insurance organizations are required to meet heightened needs of intermediaries and customers that have grown to expect information and answers immediately on request.

While insurance companies current systems may not be appropriate for current challenges and may be outdated, they are still an important part of an organization because of the vast investment of business know-how and rules, as well as the amounts of information they contain. Replacing them could cause a significant loss of business productivity.

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Businesses try to address these challenges in a variety of ways. Certain companies choose to dedicate significant in-house IT resources to address these issues. In many cases, however, organizations lack the requisite internal resources and know-how. As a result, many of these organizations rely on the expertise of external IT service providers.

### ***Our Business Solutions for the Insurance Industry***

Our management has focused the Company's resources on delivering solutions to help the insurance industry become more agile in the face of the new and rapidly changing business environment described above, while simultaneously reducing IT costs.

By creating cross-functional teams and working with leading insurance companies, we have formulated Sapiens INSIGHT, a suite of modular business software solutions that make use of existing assets to quickly and cost-effectively modernize business processes that are the key to survival in the current, challenging insurance landscape. Our Sapiens INSIGHT insurance solutions suite is already helping enterprises adapt to the marketplace's time and cost pressures.

We collaborate with our customers to tailor the Sapiens INSIGHT solutions to achieve the unique operational performance goals of each organization. In addition, we have executed independent projects for the insurance market, providing enhanced information access and visibility to empower the sales, agent and broker community, thus accelerating transaction processing for improved customer service and business efficiency. Our insurance solutions, which include the Sapiens INSIGHT family, are based on Sapiens eMerge, our rules-based rapid application development (RAD) suite, which enables rapid solution development and maintenance. The Sapiens INSIGHT modules therefore allow the codifying of carriers' implicit business rules into explicit, executable technical rules. The transition to a rules-based system allows for rapid interactive development by technical and business personnel, allowing business users to make changes using everyday language rules rather than application code. Our insurance solutions are compatible with a variety of platforms including IBM System z, IBM System i and HP UNIX at the host-side and Intel-based Web servers. They are also compatible with open architecture standards such as .NET, Java EE, XML, Web Services and application server platforms such as IBM's WebSphere.

Sapiens INSIGHT is designed for the general (property and casualty) and life insurance markets. These solutions can be customized to match specific legacy systems and business requirements, while providing pre-configured functionality. These solutions can be used independently or together as follows:

#### **\* Sapiens INSIGHT for Property & Casualty**

INSIGHT for Property & Casualty (formerly known as Policy INSIGHT) is a general insurance policy administration solution that makes it easier for brokers and agents to do business with carriers. By automating the process, this web-enabled solution reduces the cost of doing business and optimizes risk selection through the use of rules based underwriting. Sapiens INSIGHT for Property & Casualty is designed to improve internal efficiencies and simplify and accelerate the cycle of new business, and property and casualty policy processing and administration, by automating policy lifecycle processes and by allowing business analysts to quickly respond to changing rate and regulation issues. The solution also provides functionality supporting the rapid development and launch of new products to keep pace with competitive pressures and market opportunities. Sapiens INSIGHT for Property & Casualty is available as a complete package, or in individual modules.

#### **\* Sapiens INSIGHT for Life & Pensions (INSIGHT for Life & Health)**

Sapiens INSIGHT for Life & Pensions, known in the United States as Sapiens INSIGHT for Life & Health, is a powerful and comprehensive framework-based life and pensions solution that serves companies administering life insurance, pension funds, health insurance and saving plans.

Sapiens INSIGHT for Life & Pensions is dynamic, highly customizable and can be easily accommodated to administer changes in processes. It is fully web-enabled, prepared to utilize the advantages of the Internet and intranets.

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Sapiens INSIGHT for Life & Pensions consists of the following independent modules that can be implemented together or only individually:

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Processes Management - An efficient processes management module, very easy to build and maintain

Products Management - Set of tools that enables minimum time-to-market

Dossier Administration

Surrender Value and Paid-Up policies processes

Billing and Collection

Funds Revaluation

Investment Gateway

### \* Sapiens INSIGHT for Underwriting

Sapiens INSIGHT for Underwriting (formerly MediRisk INSIGHT ) is an underwriting solution for life, health and disability insurance. It reduces a customer's costs by automating a larger portion of the process of evaluating the risks of new business and by streamlining the procedures for handling new business. By using this solution, an insurance company can make underwriting assessments on new cases earlier in the business cycle and achieve greater consistency in its decision-making. We market Sapiens INSIGHT for Underwriting on the basis of licensing and distribution agreements with MediRisk Solutions Ltd. which developed and holds the intellectual property rights to the solution. Sapiens holds a minority interest (approximately 10%) in MediRisk Solutions Ltd.

### \* Sapiens INSIGHT for Reinsurance

Sapiens INSIGHT for Reinsurance is a functional-rich solution for the insurance market, designed to support insurance carriers and reinsurers in the management of all types of reinsurance for the general (property and casualty) insurance market, according to the rapidly changing requirements of the international reinsurance market. This state-of-the-art, web-enabled solution streamlines and reduces the cost of handling all reinsurance functions through automation, is based on ACORD standards and B2B XML technology, and is designed for a multi- language, multi- currency, multi- company environment.

### \* Sapiens INSIGHT for Claims

Sapiens INSIGHT for Claims is a solution that effectively manages and streamlines the information flow of claim handling across an insurance provider's entire organization. The claims handled include disability and maturity claims (annuities, pensions), death claims and health claims. This solution uses highly accessible business rules and messaging standards and allows the use of a company's existing information assets. Thus, the solution improves operational efficiency and enables better and more versatile customer service capabilities, with the goal of providing faster return on investment by reducing the total claims payout.

### \* Sapiens INSIGHT for Closed Books

Sapiens INSIGHT for Closed Books, also known as LifeLite, is a solution for life insurance companies and pension funds seeking ways to reduce the cost of maintaining long-term closed books of business, that is, lines of business that are no longer current. We provide customizable solutions that enable companies to efficiently and more effectively administer policies and claims relating to closed books. Lower ongoing cost of ownership is achieved by replacing old systems (which reflect out-dated business models and working practices with long processing cycles and limited on-line functionality) with modern technology and a Web browser user interface. In September 2004, we purchased the technologies underlying the Sapiens INSIGHT for Closed Books solution from Liverpool Victoria Friendly Society Limited.

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### Our Core Technology- Sapiens eMerge

Our solutions are built on Sapiens eMerge . Sapiens eMerge is a data-driven, rules-based, enterprise-scale transaction engine that facilitates business process integrity, application scalability and high performance. Its foundation is a rules-based development tool and repository that imposes easily-coded business rules, lending unconventional speed, visibility, agility and cost-effectiveness to the business software lifecycle. The use of Sapiens eMerge reduces the complexity of programming so that new applications and modifications of existing ones can be produced in a much shorter time frame than through conventional programming.



Another key advantage of Sapiens eMerge is the ability to extend the productive life of older computer systems, while at the same time providing the basis for using new generation Internet and service-oriented technologies. The use of rapid application development allows enterprise-specific enhancements to be made in a shorter time and with a greatly reduced maintenance burden when compared to other technologies.

Sapiens eMerge is based on a multi-level architecture and operates in multi-platform environments, encompassing many hardware vendors, operating system environments and databases. Host-side platforms supported include IBM's System z (zSeries), System i (iSeries), HP-UNIX and Linux. Sapiens eMerge supports databases such as DB2, VSAM, IMS, DB2/400 and Oracle. Since Sapiens eMerge exemplifies open systems and cross-platform capabilities, solutions developed with it can be seamlessly migrated from platform to platform and from database to database.

Development, deployment, integration and administration of applications are all accomplished through the technology components of Sapiens eMerge, providing customers with flexible, scalable and feature-rich systems.

### *Services*

Outsourcing of Application Maintenance. Our outsourcing services developed from our strong, long-term relationships with our customers. We are currently servicing multi-year outsourcing contracts with blue-chip customers involving mission-critical systems. The outsourcing projects are performed either on or off the customers' premises.

IT Services. We provide customers with specialized IT services in many areas, including project management and technical assistance. Our personnel work with the customer for the duration of the entire project, collectively undertaking design, development and deployment tasks, coupled with hands-on-training, to achieve a rapid software solution that matches the customer's business and IT goals.

### *Key Benefits of our Technology to our Customers*

Fast Time to Market and High Return on Investment. Our combination of a Rapid Application Development (RAD) methodology, rules-based development tools and experienced consultants has resulted in significant productivity increases at customer sites. Declarative development with business rules replaces traditional programming methods, addressing the full application life cycle, meaning that no programming code development is required. Sapiens eMerge also employs a positive inference engine that streamlines application development by requiring only the definition of standard situations, while automatically generating the logic required to handle the non-standard ones. This represents a reduction in logic specification and application maintenance and greatly enhances the quality of the delivered application compared to conventional development environments where most bugs arise in the non-standard logic.

Strong Technical Competence. Our solutions enable organizations to capitalize on their existing large-scale applications and data by non-intrusively integrating them with modern applications and technologies. Our solutions not only extend the productive life of older computer systems but simultaneously provide a migration path to next-generation technologies. Our solutions are designed for an extensive list of computing platforms and technologies including IBM zSeries and iSeries, HP-Unix at the host server-side and Windows 2000 / XP Web Servers. Due to the separation between business logic, data access logic and presentation logic, applications developed for a particular computing platform and database are seamlessly portable to other supported computing platforms and databases. The platform-independent nature of our solutions allows them to be scaled according to the needs of the organization. Sapiens eMerge has proven to be extremely scalable, allowing the daily execution of hundreds of millions of business rules for tens of thousands of concurrent users.

### *Customers*

Sapiens INISGHT

We market our Sapiens INISGHT suite of solutions to insurance carriers in four main categories: Property & Casualty (known as General Insurance in Europe); Life and Pensions (known as Life and Health in the United States), Reinsurance and Medical Underwriting. Our customers and target markets have direct written premiums in the range of \$80 million to \$5 billion per year. However, given the flexibility and modularity of the Sapiens INISGHT suite of solutions, our offerings can accommodate most situations and budgets.

Sapiens eMerge

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We market Sapiens eMerge primarily to corporate clients and government entities with large information technology budgets and ongoing maintenance and development needs. Our corporate customers include, among others, insurance companies, banks and other companies offering financial services, as well as companies in the manufacturing and transportation sectors.

The principal markets in which we compete are located in North America, Europe, Israel and Japan. As of December 31, 2007, we had approximately 135 customers in all the geographical areas in which we operate. Of these, the primary customers were Menora Mivtachim Insurance, the Israeli Ministry of Labor, Synergy Insurance Services Holdings Limited (which was terminated in 2007), EDS Credit Services Limited, Texas Farm Bureau Insurance Companies, Liverpool Victoria Friendly Society Limited, Santam, OneBeacon Insurance Company, Occidental Fire and Casualty Company of North Carolina and AXA Corporation, accounting for approximately 56% of our gross revenues during 2007.

### **Competition**

The market for enterprise software solutions is highly competitive and characterized by rapidly changing technology, evolving industry standards and customer requirements, and frequent innovations. On the operational level, insurance companies are focusing their business in an attempt to reduce costs and maximize efficiency, and to respond to frequent changes in regulations. Insurance companies need a solution that provides flexible management of business processes, support for rapid changes in regulations and fast time to market. The INSIGHT suite of solutions was designed to answer those challenges.

The following is a breakdown of the competition that we face in each of our primary markets:

#### **Sapiens INSIGHT - Insurance**

Our competitors in the market for solutions offered to the insurance industry fall into several categories: vendors of complete systems, vendors of insurance software products, large multinational integrators and local integrators in the various territories in which we operate. Examples of these competitors are:

In the United States:	CSC, Camilion, SOLCORP, Fineos, SAP, SunGard, Navisys, Fiserv, OneShield, Ascendant One, Insurity, IDP, The Innovation Group, Duck Creek and AQS;
In the United Kingdom:	Unisys, SunGard, FIS Software and RebusIs;
In Europe:	Falmeyer (FJA) and COR AG Insurance Technologies, mainly in German speaking countries, and IDIT I.D.I. Technologies.

Examples of large integrators in the insurance field are Electronic Data Systems and CSC (companies that also have customer or alliance relationships with Sapiens in other fields). An example of a competitor that is a local integrator is Ness Technologies in Israel.

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In addition, we face competition from our customers and our potential customers internal IT departments, who often prefer to develop solutions in-house.

We differentiate ourselves from our competition with a few key factors:

- (i) Sapiens INSIGHT is innovative and modern, rich in functionality and Internet compatible.
- (ii) As a result of the Sapiens INSIGHT architecture, customers may implement the full solution or parts of it, and readily integrate it into existing legacy systems.
- (iii) Sapiens INSIGHT is agile and flexible to use, based on its product configurator and its business rule technology.

#### **Sapiens eMerge - Business Rules Engines**

There has been an infusion of new vendors and new features into the business rules engine and management marketplace. Our competitors in the business rules engines and management marketplace include, among others, Fair Isaac (Blaze), Pegasystems, ILOG, Computer Associates, Haley, Corticon, Versata, RuleBurst and ESI.

We differentiate ourselves from our competition with a few key factors:

- (i) Our ability, utilizing Sapiens eMerge technology, to deliver a comprehensive IT solution, including an automatically generated Web presentation layer and interfaces with various databases, legacy systems and third party software. Most competing business rules engines are characterized by delivery of specialized, decision support capabilities that must be later framed into an enterprise's overall architecture at additional investment costs.
- (ii) Sapiens eMerge is highly optimized for performance of data-intensive tasks that characterize many enterprises' transactional environments.

#### **Sapiens eMerge - IT Solution Delivery**

By leveraging our differentiating characteristics mentioned above, we compete in the much larger IT solution delivery market, carving out for ourselves a niche attractive to mid-size enterprises seeking rapid and cost-effective custom software solutions. Our competitors in this domain include, among others: IBM, EDS, CSC, Accenture, Unisys, and India-based system integrators such as Tata, Infosys, and WiPro.

#### **International Advisory Board**

In May 2007, we disbanded our International Advisory Board that was created during 2004, as part of our emphasis on efficiency and efforts to increase returns on investments. Previously, we disbanded our Americas Advisory Board and our UK Vision Board.

#### ***Sales and Marketing***

To reach the broadest potential customer base, we use multiple distribution channels, including a direct sales force and relationships with system integrators and, in certain geographic areas, distributors.

We have marketing and sales personnel located at our offices in the United States, the United Kingdom, Japan and Israel. The direct sales force focuses on large organizations within select industries. It also coordinates sales activities with system integrators such as EDS and IBM. These partnerships allow us to further expand our own solutions and to gain access to specific types of businesses.

We employ a variety of business development and marketing techniques to communicate directly with current and prospective clients. These techniques include exhibiting at trade shows and industry conferences, disseminating product brochures and other literature, direct-mail marketing, authoring articles, and hosting business forums for customers and prospective customers on technology and industry issues.

As part of our efficiency measures, in 2007 we reduced our sales and marketing activities, from \$10,236 in 2006 to \$8,815 in 2007.

#### ***Customer Maintenance and Support***

We believe that a high level of post-contract customer support is important to the successful marketing and sale of our solutions. We employ a team of technical specialists who provide a full range of maintenance and support services to our customers. The typical direct sale to a client includes initial maintenance, training and consulting services. In addition, substantially all of our clients for which we have developed applications elect to enter into an ongoing maintenance and support contract with us. The term of such a contract is usually twelve months. A maintenance contract entitles the customer to technology upgrades, when made generally available, and technical support. In addition, we offer introductory and advanced classes and training programs available at our offices and at customer sites.

We also work with a limited few distributors and system integrators who provide customers with training, product support and consulting services. Each of our software distributors is capable of providing training in its respective country.

#### ***Geographical Distribution of Revenues***

The following is a breakdown of our revenues by geographical areas based on our geographic markets, both in thousands of dollars and as a percentage of total revenues for the years indicated:

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	2005		2006		2007	
United Kingdom	\$ 12,604	32.0%	\$ 13,805	31.2%	\$ 13,417	31.6%
North America	10,046	25.5	9,895	22.3	10,061	23.7
France	1,131	2.9	902	2.0	389	0.9
Germany	1,414	3.6	837	1.9	475	1.1
Israel	9,147	23.2	12,072	27.2	13,824	32.6
Japan	3,902	9.9	4,491	10.1	4,071	9.6
Other	1,160	2.9	2,309	5.3	158	0.5
Total	\$ 39,404	100.0%	\$ 44,311	100.0%	\$ 42,395	100.0%

For details of revenues by category of activity, see the table entitled Selected Financial Data under Item 3, Key Information.

**Seasonality**

Even if not reflected in our 2006 or 2007 results, traditionally, the first and third quarters of the fiscal year have tended to be slower quarters for us and the industries that we target. The first quarter usually reflects a lull following an active fourth quarter as companies rush to complete deals and utilize budgets before the end of the fiscal year. The slowdown in the third quarter reflects the summer months, which usually have reduced activities in many of the regions where our customers are located.

**Intellectual Property**

In accordance with industry practice, we rely on a combination of contractual provisions and intellectual property law to protect our proprietary technology. We believe that due to the dynamic nature of the computer and software industries, copyright protection is less significant than factors such as the knowledge and experience of our management and personnel, the frequency of product enhancements and the timeliness and quality of our support services. We seek to protect the source code of our products as trade secret information and as an unpublished copyright work. We also rely on security and copy protection features in our proprietary software. We distribute our products under software license agreements which grant customers a personal, non-transferable license to use our products and contain terms and conditions prohibiting the unauthorized reproduction or transfer of our products. In addition, we attempt to protect trade secrets and other proprietary information through agreements with employees, consultants and distributors. We do not believe that patent laws are a significant source of protection for our products and we do not hold any patents.

Our trademark rights include rights associated with our use of our trademarks, and rights obtained by registration of our trademarks. Our use and registration of our trademarks do not ensure that we have superior rights to others that may have registered or used identical or related marks on related goods or services. We have registrations for the mark Sapiens in the United States, Israel, Brazil and a number of countries in Europe. The initial terms of the registration of our trademarks range from 10 to 20 years and are renewable thereafter.

Our Sapiens INSIGHT group of solutions include our proprietary technology as well as technology licensed by customers (such as Liverpool Victoria, OneBeacon Insurance Company, Allianz Suisse and Menora) or strategic partners (MediRisk Solutions).

**C. Organizational Structure**

Sapiens International Corporation N.V. is the parent company of the Sapiens group of companies. We have a number of subsidiaries in Israel and throughout the world. The significant subsidiaries are as follows:

Sapiens International Corporation B.V. ( Sapiens B.V. ): incorporated in The Netherlands and 100% owned by Sapiens. Unless otherwise indicated, the other subsidiaries of Sapiens listed below are all 100% owned by Sapiens B.V.:

Sapiens Israel Software Systems Ltd.: incorporated in Israel  
 Sapiens Technologies (1982) Ltd.: incorporated in Israel

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Sapiens Americas Corporation: incorporated in New York  
Sapiens (UK) Limited: incorporated in England  
Sapiens France S.A.S.: incorporated in France  
Sapiens Deutschland GmbH: incorporated in Germany  
Sapiens Japan Co.: incorporated in Japan and 90% held by Sapiens B.V.  
In May 2007, Sapiens (Schweiz) AG was liquidated by the Commercial Register in Zug, Switzerland.

We are a member of the Formula Systems (1985) Ltd. Group (NASDAQ: FORTY and TASE: FORT). Formula is a holding and managing company of publicly traded companies and their subsidiaries. Formula companies provide IT solutions worldwide, developing and implementing innovative, proprietary software, services and solutions, turnkey projects and outsourcing services as well as software distribution and support. As of June 11, 2008, Formula beneficially owned approximately 58% of our outstanding Common Shares.

In November 2006, Emblaze purchased the controlling interest in Formula, and as a result, controls us. As of June 2, 2008, Emblaze beneficially owned 50.1% of the outstanding share capital of Formula.

Based on Formula's beneficial holding of over 50% of the outstanding Common Shares of the Company, and based on Emblaze's beneficial holding of over 50% of the outstanding share capital of Formula, both Formula and Emblaze may be considered to control us.

### **D. Description of Property**

We lease office space in Israel, the United States, Japan and the United Kingdom. The lease terms are generally five to ten years. In Israel, we lease approximately 45,000 square feet of office space; in the United States, approximately 4,700 square feet; in the United Kingdom, approximately 13,800 square feet, and in Japan, approximately 3,750 square feet. In the United Kingdom, we sub-lease to others approximately 7,364 square feet. In 2007, we terminated our lease in Germany and we sold premises that we owned in France, for approximately \$350,000. In 2007, our rent costs totaled \$1.82 million in the aggregate for all of our leased offices. Our corporate headquarters are located in Israel and our core research and development activities are performed at our offices in Israel. Our sales, marketing and general and administrative activities are performed in each of our offices. We believe that our existing facilities are adequate for our current needs.

### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not Applicable.

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### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following management's discussion and analysis of financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes thereto.

#### **Overview**

#### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and result of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of our financial statements required us to make estimations and judgments, in accordance with U.S. GAAP, that affect the reporting amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, bad debts, goodwill and other intangible assets, foreign currency fluctuation, capitalized software development costs, deferred taxes, income taxes, restructurings and legal contingencies. We based our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about the values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. More detailed descriptions of these policies are provided in Note 2 to the consolidated financial statements.

We believe the following critical accounting policies affect the estimates and judgments that we made in preparing our consolidated financial statements.

#### ***Revenue Recognition***

Our revenue recognition approach for software licensing requires that, in accordance with Statement of Position No. 97-2 Software Revenue Recognition (as amended), four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) is based on management's judgments regarding the fixed nature of the fee charged for services rendered and products delivered, and the collectibility of those fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

Revenues under multiple-element arrangements, which may include software licenses, support and maintenance, and training and consulting services, are allocated to each element under the residual method when Vendors Specific Objective Evidence (VSOE) of fair value exists for all undelivered elements and VSOE does not exist for all of the delivered elements. Under the residual method, we defer revenues related to the undelivered elements based on their vendor-specific objective evidence of fair value and recognize the remaining arrangement fee for the delivered elements. When vendor-specific objective evidence of fair value for undelivered elements does not exist, revenues from the entire arrangement are recognized over the term of the agreement.

We recognize revenue from consulting services ratably over the contractual period or as the services are performed. We recognize revenue from support and maintenance agreements ratably over the term of the agreement, which is typically one year. We recognize revenues from training arrangements as the services are performed.

We generally do not grant a right of return to our customers. When we do grant a right of return, we defer the recognition of revenue until the right of return expires, provided that all other revenue recognition criteria are met.

Amounts collected or billed prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Deferred revenue represents deferred maintenance revenue, and to a lesser extent, deferred software license revenues.

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Our project business derives a significant portion of its revenue from fixed price contracts. Revenues from fixed-price contracts are recognized based on Statement of Position No. 81-1 Accounting for Performance of Construction Type and Certain Production Type Contracts, which requires the accurate estimation of the cost, scope and duration for each project. Revenue and related cost for these projects are recognized on percentage of completion, using the input measure to assess the percent completed when enforceable right to services performed between milestones during the project exists, with revisions to estimates reflected in the period in which changes become known. If we do not accurately estimate the resources required or the scope of work to be performed, or do not manage the project properly within the projected periods of time or satisfy our obligations under the contract, project margins may be significantly and negatively affected, which may result in losses on existing contracts. Any such resulting reductions in margins or contract losses in a large, fixed-price contract may have a material adverse impact on our results of operations.

#### ***Bad Debt***

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers was to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required.

#### ***Goodwill and other identifiable intangible assets***

SFAS No. 142, Goodwill and Other Intangible Assets requires that goodwill be tested for impairment on adoption and at least annually thereafter. Goodwill is required to be written down when impaired, rather than amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is generally determined using market capitalization.

We selected December 31st as the date on which we will perform our annual goodwill and intangible assets with an indefinite life impairment tests. Through December 31, 2007, no impairment was required.

In accordance with SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, our long-lived assets are reviewed for impairment annually and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. In measuring the recoverability of assets, we are required to make estimates and judgments in assessing our forecast and cash flows and compare that with the carrying amount of the assets. Additional

significant estimates used by management in the methodologies used to assess the recoverability of our long-lived assets include estimates of future cash-flows, future short-term and long-term growth rates, market acceptance of products and services, and other judgmental assumptions, which are also affected by factors detailed in our Risk Factors section in this Annual Report (*see Item 3, Key Information Risk Factors*). If these estimates or the related assumptions change in the future, we may be required to record impairment charges for our long-lived assets.

### ***Share-Based Payments***

Effective January 1, 2006, we adopted Statement of Financial Accounting Statement No. 123 (revised 2004), Share-Based Payment (SFAS 123 (R)), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation (SFAS 123) which requires the measurement and recognition of compensation expense based on estimated fair values for all shared based payments awards made to employees and directors. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123 (R). We have applied the provisions of SAB 107 in our adoption of SFAS 123 (R).

SFAS 123 (R) requires us to estimate the fair value equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the awards that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statement of operations. Prior to the adoption of SFAS 123 (R), we accounted for equity based awards using the intrinsic-value method of accounting set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25).

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We adopted SFAS 123 (R) using the Modified Prospective Method. Under that transition method, compensation cost recognized in the year ended December 31, 2006 included compensation cost for all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of the SFAS 123 (R). In December 2005, primarily as a result of the issuance of SFAS No. 123 (R), we accelerated the vesting of all unvested stock options held by employees and directors.

Beginning on the date of adoption of SFAS 123 (R), we estimate forfeitures based on historical experience and other factors; previously, we recorded forfeitures as they occurred.

### ***Foreign Currency Fluctuation***

We expect that, in addition to the US dollar, a significant portion of our revenues will continue to be denominated in the British pound (the GBP) and in the NIS and a smaller portion will be denominated in the Euro and Japanese yen. As a result, changes in the exchange rates between the US dollar and the GBP, the US dollar and the NIS, and to a lesser extent the US dollar and the Euro and the US dollar and the Japanese yen, could have a material adverse impact on our revenues and results of operations within Europe, Israel and Japan. We regularly assess our currency exchange exposures and determine whether to adjust or hedge our position. We may use derivative instruments to hedge or adjust our exposures. As a matter of policy we do not enter into transactions of a speculative or trading nature. Foreign exchange exposures are monitored by tracking actual and projected commitments and through the use of sensitivity analysis.

### ***Capitalized Software Development Costs***

Our policy on capitalized software costs determines the timing of our recognition of certain development costs. Software development costs incurred from the point of reaching technological feasibility until the time of general product release should be capitalized. We define technological feasibility as the completion of a detailed program design. The determination of technological feasibility requires the exercise of judgment by our management. Since we sell our products in a market that is subject to rapid technological changes, new product development and changing customer needs, changes in circumstances and estimations may significantly affect the timing and the amounts of software development costs capitalized and thus our financial condition and results of operations.

Capitalized software costs are amortized by the greater of the amount computed using: (i) the ratio that current gross revenues from sales of the software bear to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method between three to five years, which is the estimated useful life of the software product. We assess the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold.

### ***Deferred Taxes***

Management judgment is required in determining our future taxable income for purposes of assessing our ability to realize any future benefits from our deferred tax assets. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. If actual results differ from these estimates or we adjust these estimates in future periods, our operating results and financial position

could be materially affected. If we determine that we will be able to realize the deferred tax assets in the future in excess of their net recorded amount, an adjustment to the deferred tax asset would increase income in the period in which such determination is made. On the other hand, should we determine that we will not be able to realize all or part of the net deferred tax assets in the future, an adjustment to the deferred tax assets will be charged to expenses in the period in which such determination is made. In 2007, we decreased our deferred income tax assets resulting from loss carry-forwards and other tax credits by \$2.2 million and decreased the related valuation allowance by \$2.1 million.

### ***Income Taxes***

Through our operating subsidiaries, we operate within multiple tax jurisdictions and may be subject to tax audits in these jurisdictions. These tax audits can involve complex issues, which may require an extended period of time to resolve. In management's opinion, adequate provisions for income taxes have been made for all years. However, though our income tax reserves are based on our best knowledge, we may be subject to unexpected audits by tax authorities in the various countries where we have subsidiaries, which may result in material adjustments to the reserves established in our consolidated financial statements and have a material adverse effect on our results of operations.

### ***Accounting for Income Taxes***

On January 1, 2007, we adopted FIN 48, *Accounting for Uncertainty in Income Taxes*, which contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with Statement 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. Prior to January 1, 2007, we estimated our uncertain income tax obligations in accordance with SFAS No. 109, *Accounting for Income Taxes* and SFAS No. 5 *Accounting for Contingencies*. A provision of \$300,000 was recorded as a result of the adoption of FIN 48 at January 1, 2007, that was reduced by \$150,000 during the year ended December 31, 2007.

### ***Legal Contingencies***

We are currently involved in certain legal proceedings and claims that arose in the ordinary course of business, as discussed in Note 10 of our consolidated financial statements. As of December 31, 2007, we have accrued our estimate of the probable costs for the resolution of those claims where we believe it is probable that we will incur a loss. This estimate has been developed in consultation with outside counsel handling our defense in these matters and is based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. We do not expect these claims and/or proceedings to have a material adverse effect on our consolidated financial position. It is possible, however, that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by changes in our assumptions related to these claims and proceedings.

### ***Restructurings***

In 2007, there were no restructurings. In February 2006, we implemented a restructuring plan for the purpose of reducing costs and restoring profitability. The restructuring plan includes the termination of the employment of approximately 25 employees. The Company's restructuring plan in 2006 resulted in costs of \$758,000.

### **Recent Accounting Pronouncements**

#### ***SFAS 157 Fair Value Measurements***

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS 123(R) and related interpretations. The statement does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.



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*SFAS 157-2 Effective Date of SFAS 157*

On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (the FSP). The FSP amends to delay the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). For items within its scope, the FSP defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact that this pronouncement may have on its consolidated financial statements.

*SFAS 159 - Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The adoption of the provisions of SFAS 159 will not have an impact on the Company's consolidated financial position and results of operations.

*SAB 110*

On December 21, 2007 the SEC staff issued Staff Accounting Bulletin No. 110 (SAB 110), which, effective January 1, 2008, amends and replaces SAB 107. SAB 110 expresses the views of the SEC staff regarding the use of simplified method in developing an estimate of expected term of plain vanilla share options in accordance with SFAS 123 (R). Under the simplified method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option.

The use of the simplified method, which was first described in SAB 107, was scheduled to expire on December 31, 2007. SAB 110 extends the use of the simplified method for plain vanilla awards in certain situations. The SEC staff does not expect the simplified method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. We are currently assessing the potential impact that the adoption of SAB 110 could have on our financial statements.

*SFAS 141(R) Business Combinations*

In December 2007, the FASB issued SFAS 141(R), Business Combinations (SFAS 141 (R)). This Statement replaces SFAS 141, Business Combinations, and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contractual contingencies, any contingent consideration, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. SFAS 141(R) also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141(R)). In addition, SFAS 141(R)'s requirement to measure the noncontrolling interest in the acquiree at fair value will result in recognizing the goodwill attributable to the noncontrolling interest in addition to that attributable to the acquirer. SFAS 141(R) amends SFAS No. 109, Accounting for Income Taxes, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. It also amends SFAS 142, Goodwill and Other Intangible Assets, to, among other things, provide guidance on the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently assessing the potential impact that the adoption of SFAS 141(R) could have on our financial statements.

*SFAS 160 - Noncontrolling Interests in Consolidated Financial Statements*

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 160 amends Accounting Research Bulletin 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss

in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. We believe that SFAS 160 will not have a material effect on our consolidated financial statements.

## A. Operating Results

### Years ended December 31, 2006 and 2007

**Revenues.** Revenues from the sale of products are comprised of sales of Sapiens eMerge licenses, license upgrades, license for Sapiens INSIGHT suite of solutions for the insurance industry, and fixed price projects. Revenues from services include mainly consulting on a time and materials basis, maintenance and support.

Total revenues in 2007 decreased 4.3% to \$42.4 million from \$44.3 million in 2006. Product revenues in 2007 decreased 46.2% to \$5.6 million in 2007 from \$10.4 million in 2006. Consulting and other service revenues in 2007 increased 8.6% to \$36.8 million from \$33.9 million in 2006.

Our product revenues for the year 2007 decreased and our consulting and other service revenues increased mainly due to a planned shift from fixed price projects to time and material based projects, and the completion of certain fixed price projects during the year.

**Cost of Revenues and Gross Profit.** Cost of revenues decreased 11.1% to \$25.6 million in 2007 from \$28.8 million in 2006. Cost of revenues relating to products is comprised of salaries and other personnel-related expenses of software consultants and engineers (\$1.0 million, or 30.3% of our total costs of products in 2007, and \$4.0 million, or 63.5% of our total costs of products in 2006), amortization of capitalized software development costs (\$1.0 million or 30.3% of our total costs of products in 2007 and \$1.1 million or 17.5% of our total costs of products in 2006), royalties to the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor of Israel ( OCS ) (\$0.6 million or 18.2% of our total costs of products in 2007, and \$0.5 million or 7.9% of our total costs of products in 2006) and other costs (\$0.7 million or 21.2% of our total costs of products in 2007, and \$0.7 million or 11.1% of our total costs of products in 2006). Cost of revenues relating to consulting and other services is comprised of salaries and other personnel-related expenses, and amortization of capitalized software development costs. Salaries and other personnel-related expenses amounted to \$20.3 million or 91% of our total costs of consulting and other services in 2007, and \$19.0 million or 84.4% of our total costs of consulting and other services in 2006. Amortization of capitalized software development costs amounted to \$2.0 million or 9.0% of our cost of revenues related to consulting in 2007, and \$3.5 million or 15.6% of our cost of revenues related to consulting in 2006. The decrease of the amortization is mainly due to completion of the amortization period of certain of our capitalized software development costs related to older products during 2007, offset by the commencement of the amortization of new capitalized software development costs amortized over a higher average useful life than in the prior years.

Our gross profit in 2007 increased 8.4% to \$16.8 million from \$15.5 million in 2006. The gross profit margin increased by 14.3% to 40.0 % from 35.0% in 2006. Gross margin increased mainly as a result of the completion of the amortization period of certain of our capitalized software development costs related to older products during 2007, offset by the commencement of the amortization of new capitalized software development costs amortized over a higher average useful life than in the prior years.

Gross profit from product revenues decreased 43.9% in 2007 to \$2.3 million from \$4.1 million in 2006. Gross margin from product revenues was 41.1% in 2007, an increase of 4.3% from 39.4% in 2006. Gross profit from consulting, maintenance and other services increased 27.2% to \$14.5 million in 2007 from \$11.4 million in 2006. Gross margin from consulting, maintenance and other services increased 17.3% in 2007 to 39.4% from 33.6% in 2006.

Amortization of capitalized software development costs decreased 34.8% to \$3.0 million in 2007 from \$4.6 million in 2006. The decrease is due to the completion of the amortization period of certain of our capitalized software development costs related to older products during 2007, offset by the commencement of the amortization of new capitalized software development costs amortized over a higher average useful life than in the prior years.

**Research and Development, net.** Research and development ( R&D ) costs are mainly comprised of labor costs and depreciation of property and equipment, reduced by grants from the OCS and capitalization of software development costs. Net R&D expenses increased 40.0% in 2007 to \$3.5 million from \$2.5 million in 2006. The increase in spending on R&D recorded in 2007, as compared with the previous year, resulted from

the reduction of capitalized software development costs.

Capitalized software development costs decreased 34.0% to \$3.1 million in 2007 compared with \$4.7 million in 2006 while direct labor costs remained constant: \$4.1 million in 2007 and \$4.1 million in 2006.

**Selling, Marketing, General and Administrative expenses, net.** Selling, marketing, general and administrative, net expenses ( SG&A expenses ) decreased 8.1% in 2007 to \$12.5 million from \$13.6 million in 2006. SG&A expenses consist primarily of salaries and other personnel-related expenses, which in 2007 amounted to \$6.8 million, or 54.4% of total SG&A expenses, and in 2006 to \$8.1 million or 59.6% of total SG&A expenses, as well as other costs associated with our sales and marketing efforts and our general and administrative activities such as rent which amounted to \$1.8 million in 2007, accounting, legal and other public company expenses in the amount of \$0.8 million, depreciation costs of \$0.3 million, and marketing costs, including tradeshow and design, in the amount of \$0.2 million. General and administrative expenses include management salaries, offices and office maintenance, communications, external consultants and other expenses. The decrease in SG&A expenses in 2007 was the result of a reduction in headcount and consistent efficiency measures implemented by our management, which resulted in reduced expenses.

**Restructuring Costs.** In 2007, there were no restructuring costs. Restructuring costs in 2006 were \$0.76 million as a result of the restructuring we implemented in February 2006, which resulted in the termination of approximately 25 employees.

**Financial expenses, net.** Our financial expenses, net, increased 27.3% to \$2.8 million in 2007 from \$2.2 million in 2006. The increase is mainly due to the devaluation of the US dollar against the NIS. Since we are obligated to pay the principal and the interest of our debentures in NIS, but we record the expenses in our financial statements in US dollars, the devaluation of the US dollar results in an increase in our financial expenses. During 2007, we paid \$0.98 million as interest to our debenture holders, and \$4.4 million for the second installment payment of the principal of the debentures.

**Taxes on Income.** Our net tax expenses in 2007 were \$0.34 million compared with \$0.33 million in 2006.

Our provision for taxes on income relates to operations in jurisdictions other than the Netherlands Antilles. The effective income tax rate varies from period to period as a result of the various jurisdictions in which we operate and where each one has its own system of taxation (not only with respect to the nominal rate, but also with respect to the allowance of deductions, credits and other benefits). We record a valuation allowance if we believe that it is more likely than not that the deferred income taxes regarding the loss carry forwards and other temporary differences, on which a valuation allowance has been provided, will not be realized in the foreseeable future. We did not recognize a majority of the deferred tax assets relating to the net operating losses of our subsidiaries worldwide due to the uncertainty of the realization of such tax benefits in the foreseeable future.

**Net Loss.** Net loss to shareholders of Common Shares for 2007 was \$2.5 million, a decrease of 34.2% compared with a net loss to shareholders of \$3.8 million in 2006. The decrease in net loss to shareholders in 2007 was due to the shift to operational profit of \$0.8 million, compared with an operating loss of \$1.3 million in 2006. The decrease in net loss was offset by an increase in Financial expenses, net and other expenses, which were \$2.9 million in 2007, compared to \$2.2 million in 2006.

**Years ended December 31, 2005 and 2006**

**Revenues.** Total revenues in 2006 increased 12.4% to \$44.3 million from \$39.4 million in 2005. Product revenues in 2006 decreased 21.8% to \$10.4 million in 2006 from \$13.3 million in 2005. Consulting and other service revenues in 2006 increased 29.9% to \$33.9 million from \$26.1 million in 2005.

Our product revenues for the year 2006 decreased mainly due to changes in the contract terms with our major customer Menora. As a result of these contractual changes, we changed certain revenue classifications from product to consulting. The increase in consulting and other service revenues came as a result of the change to the Menora contract mentioned above. In addition, we started consulting projects with two new customers (PZU in Central Europe and Synergy in the United Kingdom, for a total of \$6.9 million).

**Cost of Revenues and Gross Profit.** Cost of revenues increased 16.1% to \$28.8 million in 2006 from \$24.8 million in 2005. Cost of revenues relating to products is comprised of salaries and other personnel-related expenses of software consultants and engineers (\$4.0 million, or 63.5% of our total costs of products in 2006, and \$5.7 million, or 64.8% in 2005), amortization of capitalized software development costs (\$1.1 million or 17.5% in 2006 and \$1.3 million or 14.8% in 2005), royalties to the OCS (\$534,000 or 7.9% in 2006, and \$1.1 million or 12.5% in 2005) and other costs (\$677,000 or 11.1% in 2006, and \$726,000 or 8.0% in 2005). Cost of revenues relating to consulting and other services is comprised of salaries and other personnel-related expenses, and amortization of capitalized software development costs. Salaries and other

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personnel-related expenses amounted to \$19.0 million in 2006, an increase of 40.7% from \$13.5 million in 2005, mainly because of the new projects. Amortization of capitalized software development costs amounted to \$3.5 million or 15.6% of our cost of revenues related to consulting in 2006 and \$2.5 million or 15.6% in 2005.

Our gross profit in 2006 increased 6.2% to \$15.5 million from \$14.6 million in 2005. The gross profit margin decreased by 5.2% to 35.0% from 36.9% in 2005. Gross margin decreased as a result of the \$1.4 million decrease in revenue from license sales, which reflected 58% of the 5.2% decrease in our gross margin.

Gross profit from product revenues decreased 8.9% in 2006 to \$4.1 million from \$4.5 million in 2005. Gross margin from product revenues was 39.5% in 2006, an increase of 17.2% from 33.7% in 2005. The increase in product gross margin was due to projects with higher margins.

Gross profit from consulting, maintenance and other services increased 12.9% to \$11.4 million in 2006 from \$10.1 million in 2005. Gross margin from consulting, maintenance and other services decreased 13.0% in 2006 to 33.6% from 38.6% in 2005. The decrease in the gross margin from consulting, maintenance and other services is due to the change in the nature of our relationship with certain customers (including Menora) in 2006 and the transfer of certain revenues from product to consulting, which had smaller gross margins.

Amortization of capitalized software development costs increased 21.1% to \$4.6 million in 2006 from \$3.8 million in 2005. The increase is due to the release for sale of a new Sapiens eMerge version at the beginning of 2006.

**Research and Development, net.** R&D costs are mainly comprised of labor costs and depreciation of property and equipment, reduced by grants from the OCS and capitalization of software development costs. Net R&D expenses decreased 7.4% in 2006 to \$2.5 million from \$2.7 million in 2005. The decrease in spending on R&D recorded in 2006, as compared with the previous year, resulted from the reduction in the number of R&D employees.

A portion of our R&D expenditures is funded by the OCS in accordance with programs entitling the government of Israel to receive royalties on sales of products and services developed as a result of R&D projects so funded. In 2006 we had no R&D expenditure that benefited from OCS funding. In 2005 our net R&D expenditure that benefited from OCS funding was \$520,000.

Capitalized software development costs increased 9.3% to \$4.7 million in 2006 compared with \$4.3 million in 2005. This increase reflected our development efforts on Sapiens INSIGHT products.

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**Selling, Marketing, General and Administrative expenses, net.** SG&A expenses decreased 16% in 2006 to \$13.6 million from \$16.2 million in 2005. SG&A expenses consist primarily of salaries and other personnel-related expenses, which in 2006 amounted to \$8.1 million, or 59.6% of total SG&A expenses, and in 2005 to \$10.3 million or 63.6% of total SG&A expenses as well as other costs associated with our sales and marketing efforts and our general and administrative activities such as rent which amounted to \$2.4 million in 2006, accounting, legal and other public company expenses in the amount of \$0.7 million, depreciation costs of \$0.3 million, marketing costs, including tradeshows and design, in the amount of \$0.4 million and other miscellaneous costs amounting to \$1.6 million. General and administrative expenses include offices and office maintenance, communications, external consultants and other expenses. The decrease in SG&A expenses in 2006 was the result of planned and consistent efficiency measures implemented by our management, which resulted in reduced expenses, particularly reduced salary as a result of the February 2006 restructuring, which resulted in a reduction of annual direct labor costs of \$2.6 million. In addition, in the third quarter of 2006, the Company wrote-off \$360,000 due to bad debts.

**Restructuring Costs.** Restructuring costs in 2006 were \$758,000 as a result of the restructuring we implemented in February 2006, which resulted in the termination of approximately 25 employees. Restructuring costs in 2005 were \$1.1 million, as a result of the restructuring we implemented in February 2005, which resulted in the termination of approximately 40 employees. There are no restructuring costs from the 2006 terminations that have not been recorded in our consolidated financial statements.

**Financial expenses, net.** Our financial expenses, net, increased 22.2% to \$2.2 million in 2006 from \$1.8 million in 2005. The increase is due to the sale of our marketable securities which resulted in a decrease of \$187,000 in financial income and the net effect of currency fluctuations in the amount of \$235,000.

**Taxes on Income.** Our net tax expenses in 2006 were \$325,000 compared with \$1.8 million in 2005, due to the fact that in 2005 our deferred tax asset and tax advances were reduced by a total of \$1.6 million as compared to 2006 when they were reduced by \$160,000. In addition, in 2006 we incurred current tax expenses of \$165,000, of which \$104,000 were in Japan.

**Net Loss.** Net loss to shareholders of Common Shares for 2006 was \$3.8 million, a decrease of 58% compared with a net loss to shareholders of \$9.1 million in 2005. The decrease in net loss to shareholders in 2006 was primarily the result of planned and consistent efficiency measures implemented by our management, which resulted in a reduction of \$4.3 million in our operating losses, and the reduction in our tax expenses in the amount of \$1.5 million.

#### **B. Liquidity and Capital Resources**

Cash, cash equivalents, marketable securities and short-term deposits at the end of 2007 were \$13.1 million, compared with \$3.1 million at the end of 2006. The increase was due to the June 2007 private placement of \$20 million (excluding finders' fees and out of pocket expenses) and improved collection and positive cash flow from operating activities. The increase was offset by the payment of \$1 million to the investors in eZoneX, Inc. (our US subsidiary whose activities ceased in 2001), the re-payment of the \$2.5 million loan from Bank Leumi Le-Israel, the repurchase of the outstanding debentures in the amount of NIS 15,000,000 in June 2007, or approximately \$3.5 million, and the December 2007 payment of the second installment of the principal of debentures in the amount of approximately NIS 17,000,000, or approximately \$4.4 million.

Net cash provided by operating activities was \$7.1 million in 2007, compared with net cash used in operating activities in 2006 of \$0.9 million. This change reflects the decrease in net loss for 2007 of \$2.5 million and the decrease in trade receivables of \$4.1 million as a result of improved collection activities. These were offset by a decrease in trade payables of \$1.0 million.

Net cash used in investing activities was \$3.3 million in 2007, compared with net cash provided by investing activities in 2006 of \$0.2 million. In 2007, we had investments in software development of \$3.2 million and purchase of property and equipment of \$0.2 million.

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Net cash provided by financing activities totaled \$6.1 million in 2007, compared with \$3.4 million used in financing activities in 2006. In 2007, we received net proceeds of \$19.4 million from the issuance of common shares, decreased our short term bank credits in the amount of \$4.6 million, purchased as well as repaid the principal of our convertible debentures in the amount of \$7.8 million, and paid the principal of a long term loan in the amount of \$1.0 million.

#### **Credit Lines**

We have a revolving credit line facility for borrowings of up to \$9.2 million, available until June 30, 2008. We are currently negotiating the extension of the credit facility for another year. We cannot be certain that an agreement will be signed, though we expect that an agreement will be signed that extends the current credit line, on substantially similar terms, for an additional year.

As a condition for receiving the current credit lines from our lender banks, we undertook, among other things, (a) not to charge or sell our assets to any entity whatever without the advance written consent of the banks, (b) that the total of our debts and obligations to the banks will not at any time exceed \$9.2 million, and (c) that the total of our accounts receivable from customers will not be less than \$6.0 million. In addition, we undertook that our quarterly earnings before income tax, depreciation and amortization will be positive through June 30, 2008 and that our aggregate earnings before income tax, depreciation and amortization for the year ended December 31, 2007, and the six-month period ended June 30, 2008, will not be less than \$1.0 million. We also undertook that our shareholders' equity will not be less than \$3.0 million. In addition, we undertook, on behalf of each of our subsidiaries, to provide the banks with cross guarantees from each subsidiary to secure our performance and fulfillment of any of our or our subsidiaries' obligations under the facilities. Among themselves, the banks are entitled to repayment of our debts in proportion to our debts to each bank. As a result of negotiations regarding the extension of our loan agreements, the assets of our subsidiary in the United States will be subject to a UCC-1 security interest and the assets of our subsidiaries in Israel and the United Kingdom will be subject to floating liens.

Under the credit lines, borrowings in US dollars bear interest at rates ranging between LIBOR plus 1.7% to plus 2.2% and borrowings in NIS bear interest at the prime rate of interest in Israel plus 0.7%

In December 2006, we entered into loan agreement with Bank Leumi Le-Israel whereby we borrowed an aggregate amount of approximately \$2.5 million. The proceeds of the loan enabled us to make the December 2006 principal and interest payment on our debentures. The loan was secured by a pledged deposit of Formula. The loan bears an annual interest rate equal to the prime rate of interest in Israel plus 0.5% (for a total of 6.5%) and the principal and interest were due on August 30, 2007. In July 2007, we paid the principal and interest amounts, and the loan agreement has been terminated.

In 2007, we met all the conditions for receiving the current credit lines. There can be no assurance that we will continue to fulfill the covenants we undertook or, if we do not fulfill one or more of the covenants that we will receive from our lender banks waivers of the necessity of fulfilling such covenants.

In August 2006, we entered into an agreement with F.I.D. Holdings Ltd. and Israel Discount Bank Ltd., regarding the conversion of the \$1.0 million payment that was due to them on April 1, 2006 into 781,250 Common Shares, at a conversion price per share of \$1.28, which was the average closing price for the 10 day period prior to July 17, 2006, and the delay until August 1, 2007 of the \$1.0 million payment that was then due on August 1, 2006. The final installment of \$1.0 million was paid in August 2007.

In June 2007, we entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20 million (excluding finders' fees and out of pocket expenses), \$6.5 million of which was by Formula. We issued to the investors an aggregate of 6,666,667 Common Shares (of which 2,166,666 Common Shares were issued to Formula), at a price per share of \$3.00 which reflected a premium of approximately 25% above the trading price of our Common Shares (as of the date our Board of Directors approved the investment).

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In June 2007, we purchased an aggregate amount of NIS 15,000,000 nominal value, representing approximately \$3.5 million of the outstanding debentures. Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation.

In January and February 2008, we purchased an aggregate amount of NIS 7,600,000 nominal value, representing approximately \$2.1 million of the outstanding debentures. Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation. As a result, the amount of the semi-annual interest payment that we paid in June 2008 was reduced to approximately NIS 1.0 million or \$0.3 million. Similarly, the total amount that we must pay in December 2008 was reduced to approximately NIS 14.9 million or \$3.9 million (using the December 31, 2007 exchange rate of NIS 3.846 per \$1), approximately NIS 13.9 million or \$3.6 million for the third of the four annual re-payments of the principal of the debentures, and approximately NIS 1.0 million or \$0.3 million for the semi-annual interest payment.

*(For further details on certain of these transactions, see Item 10, Additional Information - Material Contracts. )*

In 2007 we generated positive cash flow on an annual basis, and in the first quarter of 2008 we also generated positive cash flow.

Management believes that the proceeds of the June 2007 \$20 million private placement investment will be sufficient for our present requirements, and at least until December 31, 2008, to support our operating and financing requirements. However, future operating requirements may necessitate the need for us to issue additional equity securities in connection with capital raising which could dilute the ownership interest of our existing shareholders.

#### **C. Research and Development**

See section A. Operating Results above.

#### **D. Trend Information**

The global insurance industry is constantly changing as a result of regulatory changes. Insurance companies must comply with regulations such as the Sarbanes-Oxley Act in the United States, Solvency II in Europe and other directives regarding transparency. In addition, many individual countries have increased supervision over local insurance companies.

Globally, the insurance industry has witnessed cross-border mergers and acquisitions, and the entry of international insurance companies into new emerging markets.

In Europe, regulators and insurers have been very active and creative, motivated by past financial crises and the need for pension restructuring. Distribution of policies is being optimized with the increasing use of Bank Assurance (selling of insurance through a bank's established distribution channels), supermarkets and kiosks (insurance stands). Nevertheless, European insurers, and to some extent North American insurers, are cautiously approaching spending increases and most companies have not decided to change their software.

Finally, in recent years there has been constant significant growth in income from annual premiums.

We believe that the insurance market is changing and the reasons that contributed to the delays we experienced in penetration of the insurance industry are gradually fading away.

However, we expect that additional time will be required to fully implement our strategy of focusing on the insurance industry, and that our results of operations and financial condition could continue to be adversely affected. We are addressing the challenges posed by the market environment by focusing our marketing and selling efforts and by further reducing the expenses of our operation.

#### E. Off-Balance Sheet Arrangements

In 2007, we performed hedging transactions, by purchasing a put option in the amount of \$2.5 million, to protect against the devaluation of the US dollar, in the range of NIS 4.00 - 4.25 per Dollar.

As of December 31, 2007, we had no off-balance sheet concentration of credit risk such as foreign exchange contracts, options contracts or other foreign hedging arrangement.

In 2008, we performed hedging transactions, by purchasing a put option in the amount of \$4.5 million, to protect against the devaluation of the US Dollar, in the range of NIS 3.60 - 3.30 per Dollar.

#### F. Contractual Obligations

The following table sets forth information on our short-term and long-term contractual obligations as at December 31, 2007 (in thousands of dollars):

	<u>Total</u>	<u>Less than 1 year</u>	<u>1 to 3 years</u>	<u>3 to 5 years</u>	<u>Over 5 years</u>
Convertible debentures	\$ 9,952	\$ 3,524	\$ 6,428	\$ --	\$ --
Short-term bank credit	1,058	1,058	--	--	--
Short-term bank loans	3,900	3,900	--	--	--
Long-term loan	270	--	--	270	--
Long-term liability-third party	974	974	--	--	--
Accrued severance pay	769	--	--	--	769
Provision for tax exposures	150	150	--	--	--
Operating leasing	7,021	2,689	3,578	456	298
<b>Total</b>	<b>\$ 24,094</b>	<b>\$ 12,295</b>	<b>\$ 10,006</b>	<b>\$ 726</b>	<b>\$ 1,067</b>

#### G. Safe Harbor

The safe harbor provided in Section 27A of the Securities Act of 1933, as amended (the Securities Act ) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ) shall apply to forward-looking information provided in Items 5.E and F.

### ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

#### A. Directors and Senior Management

The following table sets forth certain information regarding the current executive officers and directors of the Company.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Eli Reifman	38	Chairman of the Board of Directors
Ron Al Dor	47	President, Chief Executive Officer and Director
Roni Giladi	37	Chief Financial Officer
Rami Doron	50	Chief Operating Officer
Naamit Salomon (1)	44	Director
Yacov Elinav (2)	63	Director
Uzi Netanel (2)	72	Director
Ido Schechter (1) (2)	47	Director
Guy Bernstein (1)	40	Director
Hadas Gazit Kaiser	32	Director
United International Trust N.V. (3)		Director

(1) Member of Compensation Committee

(2) Member of Audit Committee

(3) United International Trust N.V. is a corporate body organized under the laws of the Netherlands Antilles. The Articles of Incorporation of the Company provide that a corporate body may be a member of the Board of Directors.

*Eli Reifman* has served as Chairman of the Board of Directors since January 1, 2007. Mr. Reifman is a Co-founder and President of Emblaze. Prior to his appointment as President of Emblaze in December 2006, Mr. Reifman served as Chief Executive Officer of Emblaze from 2000 to 2006. Emblaze was established as GEO Interactive Ltd. ( GEO ), which was co-founded by Mr. Reifman in 1994. Prior to founding GEO, Mr. Reifman was the head of the Technical Development Department and acting head of all production in the Training Development Center of the Israeli Defense Forces, where he was responsible for producing high-end military simulators.

*Ron Al Dor* joined the Company as President and Chief Executive Officer in November 2005 and has served as a director of the Company since November 2005. Prior to joining the Company, from August 1996 until 2004, Mr. Al Dor served as President of TTI Team Telecom International Ltd. ( TTI ), a global supplier of operations support systems to communications service providers. Prior to that, Mr. Al Dor served as TTI's Co-President from November 1995 until August 1996 and its Vice President from September 1992 to November 1995. During his service in the Israeli Air Force, Mr. Al Dor worked on projects relating to computerization in aircrafts. Mr. Al Dor is a graduate of the military computer college of the Israeli Air Force, studied computer science and management at Bar Ilan University and attended the Israel Management Center for Business Administration.

*Roni Giladi* joined the Company as Chief Financial Officer in July 2007. Prior to joining the Company, Mr. Giladi served as the Director of Finance at Emblaze since January 2007. Prior to joining Emblaze, Mr. Giladi served as Chief Financial Officer of RichFX, from August 2003 until November 2006, after serving as Corporate Controller since June 2002. Prior to RichFX, Mr. Giladi worked at Ernst & Young Israel, from 1997-2002, as a manager in the high-tech practice group. Since July 2007, Mr. Giladi has served as a director of MediRisk Solutions Ltd., as the nominee of the Company. Mr. Giladi is Certified Licensed Public Accountant and holds a BA in Business Management and Accounting from the College of Management in Israel.

*Rami Doron* joined the Company as Chief Operating Officer in February 2007. Prior to joining the Company, Mr. Doron led a business unit at Comverse Ltd. from January 2006 until February 2007. Prior to that, Mr. Doron was one of the founders of TTI where he led the professional services, R&D and existing customers sales units from December 1993 until May 2005. At TTI, Mr. Doron was involved in defining and building support systems, and was responsible for delivering, maintaining and enlarging the business with worldwide customers. Prior to founding TTI, Mr. Doron led the software division at TEAM Computers Ltd. ( TEAM ) from October 1985 until December 1993, where he was responsible for supporting a large customer base in Israel with TEAM's R&D and system support. Mr. Doron also has a software development background, having served as a database expert for several years. During his service in the Israeli Air Force, Mr. Doron was an electronics officer for six years. Mr. Doron is a graduate of Hadassah College with a degree in Software Engineering and he studied management at Bar-Ilan University. *Naamit Salomon* has served as a director of the Company since September 2003. She has held the position of Chief Financial Officer of Formula since August 1997. Ms. Salomon also serves as a director of Magic Software Enterprises ( Magic ) (NASDAQ: MGIC). From 1990 through August 1997, Ms. Salomon was a controller of two large, privately held companies in the Formula Group. Ms. Salomon holds a BA in economics and business administration from Ben Gurion University and an LL.M. from the Bar-Ilan University.



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*Yacov Elinav* has served as a director of the Company since March 2005. For over 30 years, Mr. Elinav served in various positions at Bank Hapoalim B.M., which is listed on the London and Tel Aviv Stock Exchanges, including over 10 years as a member of the Board of Management, responsible for subsidiary and related companies. From 1992 through 2006, Mr. Elinav served as Chairman of the Board of Directors of Diur B.P. Ltd., the real estate subsidiary of Bank Hapoalim. Since August 2004, Mr. Elinav has served as Chairman of the Boards of Directors of DS Securities and Investments, Ltd. and DS Provident Funds Ltd. Mr. Elinav also serves on the Board of Directors of several other public and private companies.

*Uzi Netanel* has served as a director of the Company since March 2005. He has served as Chairman of the Board of Directors of Maccabi Group Holdings Ltd. since 2005. From 2004 through 2007, Mr. Netanel served as Chairman of the Board of Directors of MLL Software & Computers Industries Ltd. and as Chairman of the Executive Committee of Carmel Olephines. From 2001 through 2003, Mr. Netanel served as a partner in the FIMI Opportunity Fund. From 1993 through 2001, he served as Active Chairman of Israel Discount Capital Markets and Investments Ltd. From 1997 to 1999, Mr. Netanel served as Chairman of Poliziv Plastics Company (1998) Ltd. Mr. Netanel also serves on the Board of Directors of Israel Oil Refineries, Carmel Olephines, Gaon Real Estate, The Maman Group, Acme Trading and Harel-PIA funds.

*Ido Schechter* has served as a director of the Company since June 2006. He has served as the Chief Executive Officer of Top Image Systems Ltd. ( TIS ) since January 2002 and has been a director of TIS since December 2004. Until he became CEO, Dr. Schechter served as TIS's Vice President of Sales and Marketing from August 1996. From January 1995 until August 1996, Dr. Schechter served as General Manager of Super Image, a former affiliate of TIS, which operated a form processing service bureau. From August 1993 to December 1994, Dr. Schechter oversaw the start-up of automatic form processing services at Israel Credit Cards, Ltd. From 1991 to 1993, Dr. Schechter was a research scientist at the Horticultural Research Institute of Ontario, Canada. Dr. Schechter received his Ph.D. and M.Sc. in Plant Physiology from the University of Guelph in Ontario, Canada and his BS from the Hebrew University in Israel.

*Guy Bernstein* has served as a director of the Company since January 1, 2007. Mr. Bernstein joined the Emblaze Group as Chief Financial Officer and member of the Board of Directors in April 2004 and was appointed Group Chief Executive Officer in December 2006. Prior to joining Emblaze, Mr. Bernstein served as Chief Financial and Operations Officer of Magic Software Enterprises ( Magic ) (NASDAQ: MGIC), a position he held since 1999. He also acted as the Interim CEO for Magic's subsidiaries: MSE Israel Ltd. and Coretech Consulting Group. Mr. Bernstein joined Magic from Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, where he acted as senior manager from 1994 to 1997. Mr. Bernstein also serves as Chief Executive Officer of Formula, Chairman of the Board of Magic and Chairman of the Board of Matrix IT Ltd. Mr. Bernstein is a Certified Licensed Public Accountant and holds a BA in Accounting and Economics from Tel Aviv University.

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*Hadas Gazit Kaiser* has served as a director of the Company since July 2007. She has served as the Chief Financial Officer and Finance Director of Emblaze since December 2006. From August 2005 until she became CFO, Ms. Gazit Kaiser served as the Vice President-Finance of Emblaze and the Chief Financial Officer of Emblaze Mobile. From August 2003 to August 2005, Ms. Gazit Kaiser served as the Budget Control Manager of TTI. From August 2000 to August 2003, Ms. Gazit Kaiser acted as a manager at Kost, Forer Gabbay & Kasierer. Ms. Gazit Kaiser holds a BA in Economics and Accounting and an MBA degree in Finance, both from Tel Aviv University, and is a Certified Public Accountant in Israel.

*United International Trust N.V.* ( UIT ) is a corporate body organized and existing under the laws of the Netherlands Antilles. It, or one of its predecessor entities, has provided the Company with corporate-related services since April 1990, including serving as the Company's transfer agent and register, maintaining the corporate-related records of the Company, and filing various corporate documents and the annual corporate tax return with the governmental authorities in the Netherlands Antilles. UIT was established by former shareholders of Intertrust (Curaçao) N.V., which subsequently operated under the names of MeesPierson Intertrust (Curaçao) N.V. and Fortis Intertrust (Curaçao) N.V.

In June 2007, Mr. Gadi Goldstein stepped down from the Board of Directors, following upon Mr. Goldstein's stepping down as Chief Executive Officer of Formula.

The Board of Directors must have a minimum of three, and a maximum of 24, directors. Directors of the Company are appointed by the General Meeting of Shareholders and hold office until the expiration of the term of their appointment by the General Meeting of Shareholders, or until they resign or are suspended or dismissed by the General Meeting of Shareholders. The Board of Directors may appoint up to four directors in addition to the directors elected by the General Meeting of Shareholders, subject to the maximum number of directors permitted, and any such appointment shall be effective until the next General Meeting of Shareholders. The Board of Directors may fill any vacancies on the Board of Directors, whether as a result of the resignation or dismissal of a director, or as a result of a decision of the Board of Directors to expand the Board of Directors.

Our executive officers are appointed by, and serve at the discretion of, the Board of Directors of the Company.

We had several changes in management positions during 2007. In February, Rami Doron was appointed as our new Chief Operating Officer. In July, Roni Giladi was appointed as our new Chief Financial Officer and Sagi Schliesser was appointed as our VP R&D.

There are no family relationships among the executive officers or directors of the Company.

#### **B. Compensation of Directors and Officers**

The aggregate amount of compensation paid by the Company, or accrued by the Company, during the fiscal year ended December 31, 2007 with respect to such year, to all directors and executive officers as a group for services in all capacities was \$965,000. This amount does not include amounts expended by the Company for automobiles made available to its officers or expenses (including business travel and professional and business association dues) reimbursed to such officers. The aggregate amount set aside or accrued by the Company during its fiscal year ended December 31, 2007, to provide pension, retirement severance and similar benefits for directors and executive officers of the Company was \$70,000. The foregoing amounts also exclude stock option grants to the Company's directors and officers pursuant to the Company's 1992 Stock Option and Incentive Plan, the Company's 2003 Share Option Plan and the Company's 2005 Special Incentive Share Option Plan, which are described below.

The Company has employment agreements with its officers. The Company, in the ordinary course of its business, enters into confidentiality agreements with its personnel and has entered into non-competition and confidentiality agreements with its officers and high-level technical personnel. The Company does not maintain key person life insurance on any of its executive officers.

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#### ***Board Fees and Expenses***

The Company reimburses all Board of Directors members for reasonable out-of-pocket expenses incurred in connection with their attendance at Board of Directors or committee meetings.

The Company grants to each of its independent directors a fee for attending or participating in Board of Directors meetings and committee meetings, and participating in unanimous written consents.

In the past, the Company granted to each of its independent directors options to purchase 4,000 Common Shares annually. The options were granted at an exercise price equal to the fair market value of the Company's Common Shares on the date of grant. The term of the options is 10 years and the options become exercisable in four equal, annual installments, beginning with the first anniversary of the grant date. Since 2005, the Company did not grant any options to its independent directors.

In 2008, the Company increased the fees paid to its independent directors, to reflect the increase in payments paid to outside directors under the Israeli Companies Law 5759-1999, even though the Company is not an Israeli company or subject to the Israeli Companies Law.

#### ***Stock Option and Incentive Plan***

In 1992, our Board of Directors and shareholders approved the 1992 Stock Option and Incentive Plan (the "1992 Stock Plan") pursuant to which our officers, directors and employees are eligible to receive awards of stock options and restricted stock. In February 2003, the Board of Directors authorized the extension of the 1992 Stock Plan until April 2012 and our shareholders approved that extension. In 2003, our Board of Directors and shareholders approved the 2003 Share Option Plan (the "2003 Option Plan"), pursuant to which our officers, directors, employees, consultants and contractors are eligible to receive awards of stock options. In the following description, the 1992 Stock Plan and 2003 Option Plan will be referred to together as the "Incentive Plans" and may be referred to individually as an "Incentive Plan."

Options granted under the 1992 Stock Plan may be incentive stock options ("ISOs"), within the meaning of section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or non-qualified stock options ("non-Qualified Stock Options"). Restricted stock may be granted in addition to or in lieu of any other award granted under the 1992 Stock Plan. Option grants under the 2003 Option Plan are intended to comply with, and benefit from, applicable tax laws and regulations in Israel.

Each of the Incentive Plans is administered by the compensation committee (the "Committee") established by the Board of Directors. Subject to the provisions of each Incentive Plan, the Committee determines the type of award, when and to whom awards will be granted and the number of shares covered by each award. The Committee also determines the terms, provisions, and kind of consideration payable (if any), with respect to awards. The Committee has discretionary authority to interpret the Incentive Plans and to adopt rules and regulations related thereto. In determining the persons to whom awards shall be granted and the number of shares covered by each award, the Committee takes into account

the contribution to the management, growth and/or profitability of the business of the Company by the respective persons and such factors as the Committee shall deem relevant, including the length of employment of the respective persons, the nature of their responsibilities to the Company, and their flexibility with regard to location of their employment and other employment-related factors.

An option may be granted on such terms and conditions as the Committee may approve, and generally may be exercised for a period of up to 10 years from the date of grant. In 2008, certain grants were limited to an exercise period of 6 years. Options granted under the Incentive Plans become exercisable in four equal, annual installments, beginning with the first anniversary of the date of the grant, or pursuant to such other schedule as the Committee may provide in the option agreement. The exercise price of such options generally will be not less than 100% of the fair market value per share of the Common Shares at the date of the grant. In the case of ISOs, certain limitations will apply with respect to the aggregate value of option shares which can become exercisable for the first time during any one calendar year, and certain additional limitations will apply to Ten Percent Stockholders (as defined in the 1992 Stock Plan). The Committee may provide for the payment of the option price in cash, by delivery of other Common Shares having a fair market value equal to such option exercise price, by a combination thereof or by any method in accordance with the terms of the option agreements. The Incentive Plans contain special rules governing the time of exercise of options in the case of death, disability, or other termination of employment. Options are not transferable except by will or pursuant to applicable laws of descent and distribution upon death of the employee.

The 1992 Stock Plan also provides for the granting of restricted stock awards, which are awards of Common Shares that may not be disposed of, except by will or the laws of descent and distribution, for such period as the Committee determines (the restricted period). The Committee may also impose such other conditions and restrictions on the shares as it deems appropriate, including the satisfaction of performance criteria. The Committee may provide that such restrictions will lapse with respect to specified percentages of the awarded shares on successive anniversaries of the date of the award. During the restricted period, the grantee is entitled to receive dividends with respect to, and to vote the shares awarded to him or her. If, during the restricted period, the grantee's continuous employment with the Company terminates for any reason, any shares remaining subject to restrictions will be forfeited. The Committee has the authority to cancel any or all outstanding restrictions prior to the end of the restricted period, including cancellation of restrictions in connection with certain types of termination of employment.

As of December 31, 2007, we had 896,267 Common Shares available for future issuance of awards under the Incentive Plans. As of December 31, 2007, options to purchase 2,825,900 Common Shares, 1,848,000 of which were held by officers and directors, were outstanding. As of that date, there were 22,280 shares of restricted stock that the Company had granted to employees and other eligible grantees (none of which were held by current and former officers and directors), and all of which had vested (prior to 1998) under the restricted stock awards.

In 2005, the Company's Board of Directors authorized a new Incentive Stock Option Plan (the Special Plan) and our shareholders approved the Special Plan in 2006. The number of Common Shares available for grants pursuant to the Special Plan was set at 2,000,000 shares. The Special Plan is intended to be used solely to attract or retain senior management and/or members of the Board of Directors. Unless otherwise determined by the Committee, options granted pursuant to the Special Plan will have an exercise price of \$3.00 per share, shares issued upon exercise will be locked for up to five years following the grant date, and the right to obtain shares will be contingent upon the optionee providing services to the Company throughout the entire five year period. In the event of a change of control of the Company, any unvested options will be accelerated.

The Special Plan is administered by the Committee. Subject to the provisions of the Special Plan, the Committee determines the type of award, when and to whom awards will be granted and the number of shares covered by each award. The Committee also determines the terms and provisions with respect to awards. The Committee has discretionary authority to interpret the Special Plan and to adopt rules and regulations related thereto.

Pursuant to the Special Plan, in November 2005 the Company's President and Chief Executive Officer was granted options to purchase 1,000,000 Common Shares. In December 2005, as a result of the issuance of SFAS No. 123(R), we accelerated the vesting of all 1,000,000 options. In 2007, the Company's Chief Operating Officer was granted options to purchase 250,000 Common Shares, pursuant to the Special Plan.

### **C. Board Practices**

Members of the Company's Board of Directors are elected by a vote at the annual general meeting of shareholders and serve for a term of one year. Directors may serve multiple terms and are elected by a majority of the votes cast at the meeting. The Chief Executive Officer serves until his removal by the Board of Directors or resignation from office. Non-employee directors do not have agreements with the Company for benefits upon termination of their service as directors.

***Audit Committee***

The Audit Committee of the Board of Directors is comprised of three independent directors, nominated by the Board of Directors: Yacov Elinav, Uzi Netanel and Dr. Ido Schechter. The Board of Directors has determined that Mr. Elinav meets the definition of an audit committee financial expert. The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing financial information, internal controls and the audit process. In addition, the Committee is responsible for oversight of the work of our independent auditors. The Committee is governed by a Charter and meets at regularly scheduled quarterly meetings.

***Compensation Committee***

The Compensation Committee of the Board of Directors is comprised of three directors, nominated by the Board of Directors: Naamit Salomon, Guy Bernstein and Ido Schechter. Dr. Schechter is an independent director. On March 11, 2008, Ms. Naamit Salomon replaced Mr. Gad Goldstein as a member of the Compensation Committee. The primary function of the Compensation Committee is to manage the Company's Stock Option Plan and review and approve all matters relating to the compensation of the Company's officers and directors. The Committee is governed by a Charter and meets at regularly scheduled quarterly meetings.

***NASDAQ Exemptions for a Controlled Company***

We are a controlled company within the meaning of NASDAQ Marketplace Rule 4350(c)(5), or Rule 4350(c)(5), since Formula holds more than 50% of our voting power.

Under Rule 4350(c)(5), a controlled company is exempt from the following requirements of NASDAQ Marketplace Rule 4350(c) as of July 31, 2005:

The majority of the company's board of directors must qualify as independent directors, as defined under NASDAQ Marketplace Rules; and

The compensation of the chief executive officer and all other executive officers must be determined, or recommended to the board of directors for determination, either by (i) a majority of the independent directors or (ii) a compensation committee comprised solely of independent directors (subject to limited exceptions). Director nominees must either be selected or recommended for the board of directors' selection, either by (a) a majority of independent directors or (b) a nominations committee comprised solely of independent directors (subject to limited exceptions).

The company must certify that it has adopted a formal written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under US federal securities laws.

***NASDAQ Exemption for a Foreign Private Issuer***

We are a foreign private issuer within the meaning of NASDAQ Marketplace Rule 4350(a), since we are incorporated in the Netherlands Antilles.

Pursuant to NASDAQ Marketplace Rule 4350(a), a foreign private issuer may follow a home country practice in lieu of certain provisions of Rule 4350.

We have elected to follow our home country practice in lieu of the requirements set forth in NASDAQ Marketplace Rule 4350(b)(1)(A) which requires a company to distribute to its shareholders copies of an annual report containing its audited financial statements. Instead of distributing copies of our annual report by mail, we have made our annual report available to shareholders on our website (<http://www.sapiens.com/AnnualReports/>).

We have also submitted to NASDAQ a written statement from our independent Netherlands Antilles counsel which certified that our practice of not mailing the annual report, but rather making it available on our website, was not prohibited by Netherlands Antilles law.

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As of December 31, 2007, we had a total of 302 employees, a 5.3% decrease from the end of 2006.

In February 2006, we began to implement a restructuring plan for the purpose of reducing costs and restoring profitability. The restructuring plan included the termination of the employment of approximately 25 employees during 2006.

The following table sets forth the number of employees in (1) research and development, (2) consulting, delivery and technical support and (3) SG&A at the end of each of the past three years, as well as their geographic area of employment:

	<u>Total Employees</u>	<u>Research &amp; Development</u>	<u>Consulting, Delivery &amp; Technical Support</u>	<u>SG&amp;A</u>
2007	302	48	207	47
2006	319	53	217	49
2005	364	52	235	77
	<u>2007</u>	<u>2006</u>	<u>2005</u>	
Israel	199	198	218	
United States	36	43	50	
United Kingdom	37	49	52	
Japan	23	23	24	
France	5	4	15	
Germany	1	1	5	
Switzerland	1	1	-	
Total Employees	302	319	364	

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### E. Share Ownership

	<u>Shares Beneficially Owned</u>	
	<u>Number</u>	<u>Percent (1)</u>
Eli Reifman (2)	12,556,692	58.1
Roni Al Dor (3)	240,000	*
All directors and executive officers as a group (11 persons) (4)	12,842,192	58.7

\* less than 1.0%

- (1) Unless otherwise indicated below, the persons in the above table have sole voting and investment power with respect to all shares shown as beneficially owned by them. The percentages shown are based on 21,541,088 Common Shares outstanding as of June 2, 2008 plus such number of Common Shares as the indicated person or group had the right to receive upon the conversion of our debentures and upon the exercise of options which are exercisable within 60 days of June 23, 2008.
- (2) Includes 12,503,451 Common Shares and NIS 1,437,500 par value of our debentures (convertible into 53,241 Common Shares) held by Formula. Emblaze beneficially owns 50.1% of the outstanding share capital of Formula. Messrs. Naftali Shani and Eli Reifman, directors of Emblaze, hold 13.9% and 15.4% of the outstanding share capital of Emblaze, respectively. Eli Reifman is a director and President of Emblaze and may be deemed to share with Emblaze the power to vote and dispose of our Common Shares beneficially owned by Formula. Eli Reifman disclaims beneficial ownership of the Common Shares beneficially owned by Formula. See Item 7, Major Shareholders and Related Party Transactions Major Shareholders.
- (3)

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Includes options to purchase 240,000 Common Shares at an exercise price of \$1.74 per share which expire in November 2015. Does not include the option to purchase 1,000,000 Common Shares granted pursuant to the Special Plan, which expire in November 2015. See Item 6, Directors, Senior Management and Employees - Compensation of Directors and Officers.

- (4) Each of the directors and executive officers not separately identified in the above table beneficially own less than 1% of our outstanding Common Shares (including options held by each such party and which are vested or will become vested within 60 days of June 23, 2008) and have therefore not been separately disclosed. The options held by the directors and executive officers not separately identified in the above table have exercise prices ranging from \$1.50 to \$3.00 per share, and none of which expire before 2015.

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### ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

#### A. Major Shareholders

The following table sets forth, as of June 2, 2008, certain information with respect to the beneficial ownership of the Company's Common Shares by each person known by the Company to own beneficially more than 5% of the outstanding Common Shares, based on information provided to us by the holders or disclosed in public filings with the Securities and Exchange Commission.

Name and Address	Shares Beneficially Owned	
	Number	Percent (1)
Formula Systems (1985) Ltd. (2) 3 Abba Eban Boulevard Herzlia 46725, Israel	12,556,692	58.1
Highbridge International LLC c/o Harmonic Fund Services The Cayman Corporate Centre, 4th Floor 27 Hospital Road Grand Cayman Cayman Islands, British West Indies	2,166,667	10.1
F.I.D. Holdings Ltd. Rubinstein House, Floor 29 37 Petach Tikva Road Tel Aviv - Yafo 67137, Israel	1,531,250	7.1

- (1) The percentages shown are based on 21,541,088 Common Shares outstanding as of June 2, 2008 plus such number of Common Shares as the indicated person or group had the right to receive upon the exercise of options which are exercisable within 60 days of June 23, 2008.
- (2) Includes 12,503,451 Common Shares and NIS 1,437,500 par value of our debentures (convertible into 53,241 Common Shares). Emblaze beneficially owns 50.1% of the outstanding share capital of Formula. Messrs. Naftali Shani and Eli Reifman, directors of Emblaze, hold 13.9% and 15.4% of the outstanding share capital of Emblaze, respectively. Guy Bernstein is a director and President of Formula but holds no outstanding shares of Formula. Messrs. Naftali Shani and Eli Reifman may be deemed to share with Formula the power to vote and dispose of our Common Shares beneficially owned by Formula. Messrs. Naftali Shani and Eli Reifman disclaim beneficial ownership of the Common Shares beneficially owned by Formula.

#### *Significant changes in holdings of major shareholders*

##### 1. Formula

In June 2005, we entered into a share purchase agreement with Formula, whereby Formula invested \$2.0 million in the Company and we issued 1,041,667 Common Shares to Formula at a purchase price per share of \$1.92, which was the average closing price for the 10 day period prior to the execution of the agreement. As a result of the \$2.0 million investment in June 2005, Formula became the holder of approximately 58% of our outstanding Common Shares at that time.

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In August 2006, we entered into a share issuance agreement with Formula whereby Formula invested \$2.0 million in the Company, and we issued 1,562,500 Common Shares to Formula, at a purchase price per share of \$1.28, which was the average closing price for the 10 day period prior to July 17, 2006, and which was the same as the conversion price approved by the debentures holders at the August 2006 meeting. As a result of the \$2.0 million investment in August 2006, Formula became the holder of approximately 60% of our outstanding Common Shares at that time.

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In June 2007, we entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20 million (excluding finders' fees and out of pocket expenses), \$6.5 million of which was by Formula. As a result, we issued to Formula 2,166,666 Common Shares, at a price per share of \$3.00 which reflected a premium of approximately 25% above the trading price of our Common Shares (as of the date our Board of Directors approved the investment).

From time to time, Formula has increased its beneficial shareholding in the Company through market purchases of additional Common Shares. From October 2007 through June 2008, Formula increased its holding of our Common Shares by approximately 914,858 Common Shares through purchases on the public market. See the Schedule 13DA filed by Formula with the SEC on June 12, 2008 with respect to such purchases.

As of June 18, 2008, Formula was the holder of approximately 58% of our outstanding Common Shares.

*(For further details about the transactions with Formula, see Item 10, Additional Information - Material Contracts. )*

### 2. FID and Israel Discount Bank

As a result of the agreement entered into as of March 16, 2004 among the Company and the F.I.D. Holdings Ltd. ( FID ) and Israel Discount Bank Ltd., the investors in eZone (the Investors ), FID became the beneficial holder of approximately 9.1% of the Company's share capital.

In May 2005, we entered into an agreement with the Investors, regarding the payment of the remaining \$4.0 million due to the Investors, pursuant to the March 2004 agreement between us and the Investors. We agreed to pay \$2.0 million on May 2, 2005, \$1.0 million by April 1, 2006 and \$1.0 million by August 1, 2006. The first installment of \$2.0 million was paid as required at the beginning of May 2005.

In August 2006, we entered into an agreement with the Investors whereby the Investors converted the \$1.0 million payment that was due on April 1, 2006 into 781,250 Common Shares and the \$1.0 million payment that was due on August 1, 2006 was delayed to August 1, 2007. The Investors had the option, at their sole discretion, to convert all or any portion of the \$1.0 million payment payable on August 1, 2007 into our Common Shares, at a conversion price per each share of \$3.20. The final installment of \$1.0 million was paid at the beginning of August 2007 and there was no conversion into our Common Shares.

As of June 11, 2008, FID was the holder of approximately 7% of our outstanding Common Shares.

*(For further details about the transactions with the Investors, see Item 10, Additional Information - Material Contracts - Agreements with FID and Israel Discount Bank Ltd. )*

### 3. Highbridge International LLC

In June 2007, we entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20 million (excluding finders' fees and out of pocket expenses). Pursuant to such private placement investment, Highbridge International LLC invested \$6.5 million in the Company in return for the issuance of 2,166,667 Common Shares, which equaled 10.5% of our outstanding Common Shares, at the time. As of June 11, 2008, Highbridge International LLC was the holder of approximately 10.1% of our outstanding Common Shares.

The major shareholders disclosed above do not have different voting rights from other shareholders.

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*Holders of Record*

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As of June 2, 2008, there were 137 holders of record of the Company's Common Shares, including 95 holders of record with addresses in the United States. The number of record holders in the United States is not representative of the number of beneficial holders, nor is it representative of where such beneficial holders are resident because many of these Common Shares were held of record by brokers or other nominees.

Based on Formula's beneficial holding of over 50% of the outstanding Common Shares of the Company, and based on Emblaze's beneficial holding of over 50% of the outstanding share capital of Formula, both Formula and Emblaze may be considered to control the Company.

### **B. Related Party Transactions**

#### FID and Israel Discount Bank

As a result of the agreement entered into as of March 16, 2004 among the Company and F.I.D. Holdings Ltd. ( FID ) and Israel Discount Bank Ltd., the investors in eZone (the Investors ), FID became the beneficial holder of approximately 9.1% of the Company's share capital.

In May 2005, we entered into an agreement with the Investors regarding the payment of the remaining \$4.0 million due to the Investors, pursuant to the March 2004 agreement between us and the Investors. We agreed to pay \$2.0 million on May 2, 2005, \$1.0 million by April 1, 2006 and \$1.0 million by August 1, 2006. The first installment of \$2.0 million was paid as required at the beginning of May 2005.

In August 2006, we entered into an agreement with the Investors whereby the Investors converted the \$1.0 million payment that was due on April 1, 2006 into 781,250 Common Shares and the \$1.0 million payment that was due on August 1, 2006 was delayed to August 1, 2007. The Investors had the option, at their sole discretion, to convert all or any portion of the \$1.0 million payment payable on August 1, 2007 into Common Shares, at a conversion price per each share of \$3.20. The final installment of \$1.0 million was paid at the beginning of August 2007 and there was no conversion into our Common Shares.

*(For further details about the transactions with the Investors, see Item 10, Additional Information - Material Contracts - Agreements with FID and Israel Discount Bank Ltd. )*

#### Formula

In June 2007, we entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20 million (excluding finders' fees and out of pocket expenses), \$6.5 million of which was by Formula. As a result, we issued to Formula an aggregate of 2,166,666 Common Shares, at a price per share of \$3.00. Following the closing of the \$20 million investment, Formula's holdings were reduced to approximately 53% of our outstanding Common Shares.

*(For further details about the transactions with Formula, see Item 10, Additional Information - Material Contracts. )*

### **C. Interests of Experts and Counsel**

Not applicable.

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## **ITEM 8. FINANCIAL INFORMATION**

### **A. Consolidated Statements and Other Financial Information**

#### *Financial Statements*

See the Consolidated Financial Statements and related notes in Item 18.

#### *Export Sales*

In 2007, 68.6% of our revenues were from customers located outside of Israel. For information on our revenues breakdown by geographic market for the past three years, see Item 4, Information on the Company - Business Overview - Geographical Distribution of Revenues.



**Dividend Policy**

We have never declared or paid any cash dividends on our Common Shares and we do not anticipate paying cash dividends in the foreseeable future. It is the present intention of our Board of Directors to retain all earnings in the Company in order to support the future growth of its business. Any determination in the future to pay dividends will be dependent upon our consolidated results of operations, financial condition, cash requirements, future prospects and other factors. For more information about distribution of dividends and various tax implications, see Item 10, Additional Information - Memorandum and Articles of Association; Item 10, Additional Information Exchange Controls, and Item 10, Additional Information Taxation.

**Legal Proceedings**

The Company is subject to certain legal and governmental proceedings and claims that arise in the conduct of its business. In the opinion of management, the amount of liability, if any, as a result of these claims and proceedings is not likely to have a material effect on the financial condition or results of operations of the Company.

**B. Significant Changes**

The following significant changes have occurred since the date of our annual consolidated financial statements:

On January 7, 2008, the Company received notification from Ubank Trust Company Limited (formerly Investec Trust Company (Israel) Ltd.), the trustee for the Company's debentures (Ubank) regarding its resignation from its position as trustee for the holders of the Debentures, in accordance with Section 35(14)(b) of the Israeli Securities Law, 5728-1968. The reason for the resignation, as provided by Ubank, is that since Ubank is a subsidiary of the First International Bank of Israel Ltd., there is concern that Ubank will find itself in a conflict of interest, as such term is defined in the Guidelines of the Israeli Securities Authority, as a result of actions that are not in its control. The Trustee also notified the Company that, at the same time, the Trustee resigned from its position as trustee for the holders of debentures of tens of other companies. The Company has notified the public that a special meeting of the debentures holders will be held on June 30, 2008, to approve the appointment of Hermetic Trust (1975) Ltd. in place of Ubank.

Hermetic Trust (1975) Ltd. (Hermetic) has expressed its willingness to serve as trustee for the debentures. Hermetic is a private company whose main purpose is to provide trust services. Hermetic has notified the Company that it serves as trustee for debentures of other public companies.

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In January and February 2008, we purchased an aggregate amount of NIS 7,600,000 nominal value of debentures, representing approximately, \$2.1 million of the outstanding debentures. Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation. As a result, the total amount that we must pay in December 2008 was reduced to approximately NIS 14.9 million or \$3.9 million (using the December 31, 2007 exchange rate of NIS 3.846 per \$1), approximately NIS 13.9 million or \$3.6 million for the third of the four annual re-payments of the principal of the debentures, and approximately NIS 1.0 million or \$0.3 million for the semi-annual interest payment.

In July 2007, we entered into agreements for a new revolving credit line facility for borrowings of up to \$9.2 million, until June 30, 2008. We are currently negotiating the extension of the credit facility for another year. We cannot be certain that an agreement will be signed, though we expect that an agreement will be signed that extends the current credit line, on substantially similar terms, for an additional year.

(See also Item 5, *Operating and Financial Review and Prospects - Liquidity and Capital Resources - Credit Lines.*)

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**ITEM 9. THE OFFER AND LISTING**

**A. Offer and Listing Details**

The Company's Common Shares are quoted on the NASDAQ Capital Market and on the TASE under the symbol SPNS.

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### NASDAQ:

The table below sets forth the high and low market prices for our Common Shares on the NASDAQ National Market (now known as the NASDAQ Global Market) until September 27, 2005 and the NASDAQ Capital Market thereafter on an annual basis for the years 2003 through 2007 and on a quarterly basis for the years 2006 and 2007, and the first quarter of 2008. On June 16, 2003, the Company carried out the Reverse Stock Split (see Note under Item 3.A Selected Consolidated Financial Data ). All share prices have been adjusted to reflect the Reverse Stock Split by multiplying historical prices by five.

	HIGH	LOW
2003 (Annual)	\$ 6.01	\$ 3.30
2004 (Annual)	5.25	1.48
2005 (Annual)	2.89	1.00
2006 (Annual)	2.10	1.02
2007 (Annual)	3.66	1.35
2008 (Annual) (through June 18, 2008)	1.88	0.82

### **2006**

First Quarter	\$ 1.60	\$ 1.14
Second Quarter	1.54	1.06
Third Quarter	2.10	1.09
Fourth Quarter	1.57	1.02

### **2007**

First Quarter	\$ 2.00	\$ 1.35
Second Quarter	3.66	1.51
Third Quarter	3.19	1.74
Fourth Quarter	1.99	1.20

### **2008**

First Quarter	\$ 1.50	\$ 1.01
Second Quarter (through June 18, 2008)	1.88	0.82

The table below sets forth the high and low market prices for our Common Shares on the NASDAQ Capital Market during the most recent six-month period:

	HIGH	LOW
December 2007	\$ 1.70	\$ 1.20
January 2008	1.50	1.21
February 2008	1.37	1.08
March 2008	1.34	1.01
April 2008	1.27	1.04
May 2008	1.27	0.82
June 2008 (through June 18, 2008)	1.88	1.10

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Set forth below are the closing prices of our Common Shares on the NASDAQ Capital Market on the first trading day of each of the following months:

January 2008	\$ 1.50
February 2008	1.22
March 2008	1.17
April 2008	1.10
May 2008	1.10

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June 2008

1.29

The closing price of our Common Shares on the NASDAQ Capital Market on June 18, 2008, being the last practicable date prior to publication of this annual report, was \$1.87.

### TASE:

Our Common Shares began trading on the TASE effective March 6, 2003. Under current Israeli law, the Company will satisfy its reporting obligations in Israel by furnishing to the applicable Israeli regulators only those reports the Company is required to file in the United States. The table below sets forth the high and low market prices for our Common Shares on TASE on an annual basis for the years 2003 through 2007 and on a quarterly basis for the years 2006 and 2007, and the first quarter of 2008. The conversion from NIS into US dollars for the following two tables is based on the average monthly representative rate of exchange published by the Bank of Israel then in effect for the month in which such high or low was recorded, except for the month of June 2008 where the conversion is based on the representative rate of exchange as published by the Bank of Israel for the specific date recorded.

	HIGH	LOW
2003 (Annual from March 6)	\$ 6.01	\$ 3.56
2004 (Annual)	5.29	1.75
2005 (Annual)	2.74	1.19
2006 (Annual)	1.57	1.14
2007 (Annual)	3.82	1.42
2008 (Annual) (through June 18, 2008)	2.09	0.93
<b><u>2006</u></b>		
First Quarter	\$ 1.57	\$ 1.24
Second Quarter	1.42	1.23
Third Quarter	1.37	1.14
Fourth Quarter	1.48	1.19
<b><u>2007</u></b>		
First Quarter	\$ 1.83	\$ 1.42
Second Quarter	3.83	1.50
Third Quarter	3.02	1.91
Fourth Quarter	2.19	1.03
<b><u>2008</u></b>		
First Quarter	\$ 1.41	\$ 1.11
Second Quarter (through June 18, 2008)	2.09	0.93

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The table below sets forth the high and low market prices for our Common Shares on TASE during the most recent six-month period:

	HIGH	LOW
December 2007	\$ 1.74	\$ 1.03
January 2008	1.41	1.33
February 2008	1.36	1.28
March 2008	1.32	1.11
April 2008	1.15	1.07
May 2008	1.15	0.93
June 2008 (through June 18, 2008)	2.09	1.23

Set forth below are the closing prices of our Common Shares on the TASE on the first trading day of each of the following months:

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January 2008	\$	1.34
February 2008		1.36
March 2008		1.29
April 2008		1.18
May 2008		1.15
June 2008		1.31

The closing price of our Common Shares on the TASE on June 18, 2008, being the last practicable date prior to publication of this annual report, was \$1.74.

We implemented a 1-for-5 reverse stock split of our Common Shares on June 16, 2003 to meet the listing requirements of the NASDAQ National Market (now known as the NASDAQ Global Market) ( NASDAQ ). On January 15, 2003, NASDAQ informed us that our Common Shares would be delisted from NASDAQ due to our failure to maintain compliance with the \$1.00 minimum bid price requirement for continued listing on NASDAQ (the Minimum Bid Price Requirement ). We requested and were granted a hearing before a NASDAQ Listing Qualifications Panel in order to present a definitive plan to regain compliance with the Minimum Bid Price Requirement, and thereby avoid the delisting of the Common Shares from NASDAQ.

On February 18, 2003, our Board of Directors approved a definitive plan to regain compliance with the Minimum Bid Price Requirement by implementing a 1-for-5 reverse stock split of the Common Shares. We presented this plan to implement a reverse stock split to the NASDAQ Listing Qualifications Panel at a hearing on February 27, 2003. On March 25, 2003, NASDAQ notified us that it approved of our plan to implement the reverse stock split and that our Common Shares would continue to be traded on NASDAQ provided that we regained compliance with the Minimum Bid Price Requirement by June 16, 2003 and maintained compliance for at least ten consecutive days thereafter.

On June 11, 2003, at a Special General Meeting, our shareholders approved the implementation of the reverse stock split and amendments to our Articles of Association that were required to affect the reverse stock split. As a result of the reverse stock split, our authorized capital of 48,300,000 became divided into 20 million Common Shares (instead of 100 million) and the par value of the Common Shares was changed to 2.30 (instead of 0.46). On June 16, 2003, we achieved compliance with the Minimum Bid Price Requirement and we have maintained such compliance through the date of this annual report.

Although we maintained compliance with the Minimum Bid Requirement, at the end of the second quarter of 2005, our shareholders' equity was below \$10,000,000 which is the required minimum shareholders' equity for continued listing on NASDAQ. As a result of a notice we received from NASDAQ, we applied to transfer the listing of our Common Shares from NASDAQ, and on September 28, 2005, our Common Shares began to trade on the NASDAQ Capital Market (formerly known as the NASDAQ SmallCap Market).

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At the end of the first quarter of 2006, our shareholders' equity was \$2.2 million. On June 5, 2006, we received a letter from NASDAQ indicating that we failed to comply with the minimum stockholders' equity requirement for continued listing on the NASDAQ Capital Market. On June 27, 2006, we submitted to NASDAQ a plan to achieve and sustain compliance with the minimum stockholders' equity requirement for continued listing on the NASDAQ Capital Market. On August 17, 2006, we received a letter from NASDAQ indicating that we had re-gained compliance with the minimum stockholders' equity requirement for continued listing.

All historical share amounts and per share data in this annual report have been retroactively restated to reflect the reverse stock split.

### **B. Plan of Distribution**

Not applicable.

### **C. Markets**

The Company's Common Shares are quoted on the NASDAQ Capital Market and on the TASE under the symbol SPNS .

### **D. Selling Shareholders**

Not applicable.

### **E. Dilution**

Not applicable.

**F. Expenses of the Issue**

Not applicable.

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**ITEM 10. ADDITIONAL INFORMATION**

**A. Share Capital**

Not applicable.

**B. Memorandum and Articles of Association (the Articles )**

1. **Registration and Purposes.** The Company is organized and existing under the laws of the Netherlands Antilles. Its registered number is 53368.

The objects and purposes of the Company, which are itemized in Article II of the Articles, may be summarized as follows:

to establish, participate in or have any other interest in business enterprises concerned with the development and commercial operation of software;

to finance directly or indirectly the activities of the Company, its subsidiaries and affiliates;

to borrow and to lend moneys;

to engage in the purchase and sale of securities, futures, real estate, business debts, commodities and intellectual property;

to undertake, conduct and promote research and development;

to guarantee, pledge, mortgage or otherwise encumber assets as security for the obligations of the Company or third parties; and

to do all that may be useful or necessary for the attainment of the above purposes.

2. **Board of Directors.** A member of the Board of Directors may vote on a proposal or transaction in which he/she has a material interest if the material facts as to the director's self-interest are disclosed to the Board of Directors. Neither the Articles nor Netherlands Antilles law requires a majority of the disinterested directors to authorize the proposal or transaction. Members of the Board of Directors have the power to vote compensation to themselves, even if they lack an independent quorum.

The Articles do not grant borrowing powers to directors; nor do they require directors to resign at a certain age or to purchase a certain number of shares of the Company's common stock.

3. **Rights and Preferences.** The Company has only one class of shares of common stock, the Common Shares, currently outstanding. All previous issuances of preferred shares have been converted into Common Shares. The rights and preferences of the holders of Common Shares are summarized below. The Articles authorize a class of undefined preferred shares (the Blank Preferred Shares ). There are no rights associated with the Blank Preferred Shares and none have been issued.

**(a) Common Shares**

Holders of the Common Shares are entitled to one vote for each whole share on all matters to be voted upon by shareholders, including the election of directors. Holders of the Common Shares do not have cumulative voting rights in

the election of directors. All Common Shares are equal to each other with respect to liquidation and dividend rights. Holders of the Common Shares are entitled to receive dividends, subject to shareholder approval, out of funds legally available under Netherlands Antilles law. See *Dividend Policy* below. In the event of the liquidation of the Company, all assets available for distribution to the holders of the Common Shares are distributable among them according to their respective holdings, subject to the preferences of any shares having a preference upon liquidation that may be then outstanding. Holders of the Common Shares have no preemptive rights to purchase any additional, unissued Common Shares. The foregoing summary of the Common Shares does not purport to be complete and is subject to, and qualified in its entirety by, the provisions of the Articles.

**(b) Dividend Policy**

The Company has never declared or paid any cash dividends on its Common Shares and does not anticipate paying cash dividends in the foreseeable future. It is the present intention of the Company's Board of Directors to retain all earnings in the Company in order to support the future growth of its business. Any determination in the future to pay dividends will be dependent upon the Company's consolidated results of operations, financial condition, cash requirements, future prospects and other factors. In addition, the ability of the Company to pay dividends is subject to the limitations of the Corporate Law of the Netherlands Antilles, which provides, among other things, that dividends, while permitted to be paid periodically during a fiscal year, are subject to being proposed by the Board of Directors of the Company and approved thereafter at the General Meeting of Shareholders. The Corporate Law of the Netherlands Antilles also provides that a distribution of dividends can only occur if, at the moment of distribution, the equity of the Company equals at least the nominal capital of the Company and, as a result of the distribution, will not fall below the nominal capital. Nominal capital is the sum of the par values of all of the issued shares in the Company's capital stock at any moment in time.

**(c) The Blank Preferred Shares**

There are no preferences or any rights whatsoever associated with the Blank Preferred Shares. These shares are unissued and are not owned by any of the current shareholders of the Company. Any issuance of these preferred shares is solely within the discretion of the Company's Board of Directors. The Company has undertaken toward the TASE that so long as shares of its Common Stock are listed for trading on the TASE, the Company shall not issue or grant any shares of a different class of shares than those that are listed for trading on the TASE. This undertaking does not apply to Preferred Shares as defined in Section 46B(b) of the Israel Securities Law, on the condition that such Preferred Shares are issued in accordance with the conditions set forth in Section 46A(1) therein.

4. ***Changing the Rights of the Shareholders.*** The general meeting of shareholders decides upon any change in the Articles. A resolution to amend the Articles requires the approval of the absolute majority of all shares outstanding and entitled to vote.
5. ***General Meetings.*** At least one general meeting of shareholders must be held each year. General meetings must be held in Curaçao. Special general meetings of shareholders may be called at any time by the Chairman of the Board or by the Board of Directors upon no less than 10 nor more than 60 days' written notice to the Company's shareholders. Every shareholder has the right to attend any meeting of shareholders in person or by proxy and to address the meeting. No action may be taken at any meeting of shareholders unless a quorum consisting of holders of at least one-half of the shares outstanding and entitled to vote are present at the meeting in person or by proxy.
6. ***Limitations to Own Securities.*** The Articles contain no limits on the right to own securities.
7. ***Change of Control.*** The Articles contain no provisions that would prevent or delay a change of control of the Company.
8. ***Disclosure of Ownership.*** By-laws do not exist under Netherlands Antilles law. The Articles contain no provisions requiring a shareholder to disclose his or her interest at a certain time; however holders of our shares are subject to the reporting provisions of the Securities and Exchange Commission.

**C. Material Contracts**

1. Convertible Debentures and Trust Deed

On December 11, 2003, we completed an offering of securities in Israel, resulting in gross proceeds of approximately \$17.1 million. We sold 100,000 units of securities, each unit consisting of 800 debentures (Series A), two options (Series A) exercisable into debentures (Series A) and six warrants (Series 1) exercisable into Common Shares of the Company.

The debentures are linked to the US dollar only if the exchange rate between the NIS and the US Dollar is greater than NIS 4.394 per 1 US Dollar. (On June 17, 2008, the exchange rate between the NIS and the US Dollar was NIS 3.340 per 1 US Dollar.) The debentures bear annual interest at the rate of 6.0%, payable on the 5th of June and the 5th of December each year commencing on June 5, 2004 and ending on December 5, 2009. Principal is payable in four installments on the 5th of December of the years 2006-2009. During the period beginning 45 days after the registration of the debentures (Series A) for trading on the TASE and ending November 21, 2009, the debentures (Series A) are convertible in Common Shares at a conversion rate of one Common Share per each NIS 27 (approximately \$7.02, using the December 31, 2007 exchange rate of NIS 3.846 per \$1) amount of the debentures. The conversion rate is subject to certain adjustments. The debentures (Series A) are unsecured.

Options (Series A) which were exercised by non-affiliates of the Company before their expiry date resulted in additional gross proceeds of approximately \$1.6 million to the Company in the first quarter of 2004.

Each warrant (Series 1) was exercisable into one Common Share of the Company until November 21, 2007 for an exercise price of approximately \$7.02. None of the 600,000 warrants (Series 1) were exercised and they expired on November 21, 2007.

In accordance with chapter E1 of the Israel Securities Law, we offered the debentures after nominating a trustee for the debenture holders. The trustee is Ubank Trust Company Ltd. (formerly Investec Trust Company (Israel) Ltd.) ( Ubank ) and the date of the Trust Deed is December 2, 2003. The Trust Deed includes, among other things, the duties of the trustee, the circumstances in which the trustee can demand immediate repayment of the outstanding debentures, the circumstances in which the trustee or the Company can call meetings of debenture holders and the procedures for such meetings.

On January 7, 2008, the Company received notification from Ubank regarding its resignation from its position as trustee for the holders of the Debentures, in accordance with Section 35(14)(b) of the Israeli Securities Law, 5728-1968. The reason for the resignation, as provided by Ubank, is that since Ubank is a subsidiary of the First International Bank of Israel Ltd., there is concern that Ubank will find itself in a conflict of interest, as such term is defined in the Guidelines of the Israeli Securities Authority, as a result of actions that are not in its control. The Trustee also notified the Company that, at the same time, the Trustee resigned from its position as trustee for the holders of debentures of tens of other companies. The Company has notified the public that a special meeting of the debentures holders will be held on June 30, 2008, to approve the appointment of Hermetic Trust (1975) Ltd. in place of Ubank.

Hermetic Trust (1975) Ltd. ( Hermetic ) has expressed its willingness to serve as trustee for the debentures. Hermetic is a private company whose main purpose is to provide trust services. Hermetic has notified the Company that it serves as trustee for debentures of other public companies.

In August 2006 we convened a general meeting of the debenture holders, where a special resolution was adopted concerning the amount and the timing of the first installment payment of the principal of the debentures. A majority of the debenture holders approved that (a) 50% of the first payment amount, approximately \$2.4 million, will be deferred to December 5, 2009 (the last date of payment of the principal on the debentures), and (b) with respect to the other 50% of the first payment amount, the Company could choose from the following alternatives, in its sole discretion: (1) to convert such amount on December 5, 2006 into our Common Shares, at a conversion price per share of \$1.28, which reflects the average closing price for the 10 day period prior to July 17, 2006, or (2) to pay the approximately \$2.4 million amount to the debenture holders, in cash. In December 2006, we made the payments, in cash.

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Following the \$20 million private placement investment in June 2007, we purchased an aggregate amount of NIS 15,000,000 nominal value, representing approximately \$3.5 million of the outstanding debentures. Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation.

In January and February 2008, we purchased an aggregate amount of NIS 7,600,000 nominal value of debentures, representing approximately, \$2.1 million of the outstanding debentures. Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation. As a result, the total amount that we must pay in December 2008 was reduced to approximately NIS 14.9 million or \$3.9 million (using the December 31, 2007 exchange rate of NIS 3.846 per \$1) approximately NIS 13.9 million or \$3.6 million for the third of the four annual re-payments of the principal of the debentures, and approximately NIS 1.0 million or \$0.3 million for the semi-annual interest payment.

2. Agreements with FID and Israel Discount Bank Ltd.

In April 2000, the Investors invested \$15 million in eZone, a subsidiary of the Company. The private placement to the Investors was accompanied by a Put/Call Agreement, according to which the Investors were granted the right to require us to repurchase their shares in eZone beginning May 2004 in exchange for both cash and our Common Shares. In February 2001, management decided to discontinue the operations of eZone. During the same period, we agreed to a partial exercise of the Investors' put option, resulting in a payment to them of \$4.5 million.

On March 16, 2004, we entered into a new agreement with the Investors which replaced the Put/Call Agreement and which restructured the remaining portion of the put option. We agreed to issue the Investors, in a private placement, 750,000 Common Shares and warrants to purchase 350,000 additional Common Shares that were exercisable through December 31, 2007. The Investors did not exercise the warrants and therefore the warrants expired on December 31, 2007. In addition, we agreed to pay the Investors in two annual installments a total of \$8.6 million plus interest at 7.5% a year by May 1, 2005. The first installment of \$4.6 million was paid as required at the beginning of May 2004.

In May 2005, we entered into an agreement with the Investors regarding the payment of the remaining \$4.0 million due to the Investors, pursuant to the March 2004 agreement between us and the Investors. We agreed to pay \$2.0 million on May 2, 2005, \$1.0 million by April 1, 2006 and \$1.0 million by August 1, 2006. In addition the interest to be paid on the outstanding principal amount was changed to LIBOR plus 2.5%. The first installment of \$2.0 million was paid as required at the beginning of May 2005.

In August 2006, we entered into an agreement with the Investors whereby the Investors converted the \$1.0 million payment that was due on April 1, 2006 into 781,250 Common Shares and the \$1.0 million payment that was due on August 1, 2006 was delayed to August 1, 2007. The Investors may, at their sole discretion, convert all or any portion of the \$1.0 million payment now payable on August 1, 2007 into Common Shares, at a conversion price per each share of \$3.20. The final installment of \$1.0 million was paid as required at the beginning of August 2007.

3. Agreements with Formula

In August 2006, we entered into a share issuance agreement with Formula whereby Formula invested \$2.0 million in the Company, and we issued 1,562,500 Common Shares to Formula, at a purchase price per share of \$1.28, which was the average closing price for the 10 day period prior to July 17, 2006, and which was the same as the conversion price approved by the debentures holders at the August 2006 meeting.

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4. Loan Agreement

In December 2006, we entered into loan agreement with Bank Leumi Le-Israel whereby we borrowed an aggregate amount of approximately \$2.5 million. The proceeds of the loan enabled us to make the December 2006 principal and interest payment on the debentures. The loan was secured by a pledged deposit of Formula. The loan bears an annual interest rate equal to the prime rate of interest in Israel plus 0.5% (for a total of 6.5%) and the principal and interest are due on August 30, 2007. In July 2007, we paid the principal and interest amounts, and the loan agreement has been terminated.

**D. Exchange Controls**

Although there are Netherlands Antilles laws which may impose foreign exchange controls on the Company and may affect the payment of dividends, interest or other payments to non-resident holders of the Company's securities, including the Common Shares, the Company has been granted an exemption from such foreign exchange control regulations by the Central Bank of the Netherlands Antilles. Other jurisdictions in which the Company conducts operations may have various currency or exchange controls. In addition, the Company is subject to the risk of changes in political conditions or economic policies which could result in new or additional currency or exchange controls or other restrictions being imposed on the operations of the Company. As to the Company's securities, Netherlands Antilles law and the Articles impose no limitations on the right of non-resident or foreign owners to hold or vote such securities.

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**E. Taxation**

See Item 5, Operating and Financial Review and Prospects - Operating Results - Taxes on Income for disclosure regarding the reduction of our deferred tax assets and tax advances balances, in 2007.



*Israeli Tax Considerations and Government Programs*

**General**

The following is a general discussion only and is not exhaustive of all possible tax considerations. It is not intended, and should not be construed, as legal or professional tax advice and should not be relied upon for tax planning purposes. In addition, this discussion does not address all of the tax consequences that may be relevant to purchasers of our Common Shares in light of their particular circumstances, or certain types of purchasers of our Common Shares subject to special tax treatment. Examples of this kind of investor include residents of Israel and traders in securities who are subject to special tax regimes not covered in this discussion. Each individual/entity should consult its own tax or legal advisor as to the Israeli tax consequences of the purchase, ownership and disposition of our Common Shares.

To the extent that part of the discussion is based on new tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities or the courts will accept the views expressed in this section.

The following summary describes the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli tax consequences to holders of our Common Shares.

**Taxation of Companies**

*General Corporate Tax Structure*

Generally, Israeli companies are subject to corporate tax at the rate of 29% on taxable income for the year 2007 and are subject to capital gains tax at a rate of 25% on capital gains (other than gains derived from the sale of listed securities that are taxed at the prevailing corporate tax rates) derived after January 1, 2003. However, the effective tax rate payable by a company that derives income from an approved enterprise (as discussed below) may be considerably lower. Depending on the relevant tax treaties at issue, dividends or interest received by an Israeli company from foreign subsidiaries are generally subject to tax regardless of the company's status as an approved enterprise. Under recently adopted legislation, taxes paid by Israeli companies will be gradually reduced to a rate of 27% for the 2008 tax year, 26% for the 2009 tax year and 25% for the 2010 tax year and thereafter.

*Law for the Encouragement of Industry (Taxes), 1969.*

According to the Law for the Encouragement of Industry (Taxes), 1969 ( *Industry Encouragement Law* ), industrial companies are entitled to the following tax benefits, among others:

deduction of purchases of know-how and patents over an eight-year period for tax purposes;

expenses involved with the issuance and listing of shares on the TASE or on a recognized stock market outside of Israel, are deductible over a three-year period;

the right to elect, under specified conditions, to file a consolidated tax return with other related Israeli industrial companies; and

accelerated depreciation rates on equipment and buildings.

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According to the law, an *industrial company* is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency (exclusive of income from 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. Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

We believe that our subsidiary, Sapiens Technologies (1982) Ltd, currently qualifies as an industrial company within the definition under the Industry Encouragement Law. However, we cannot give any assurance that we will continue to qualify as an *industrial company* or that the benefits described above will be available in the future.

*Law for the Encouragement of Capital Investments, 1959.*

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The Law for the Encouragement of Capital Investments, 1959, as amended (the Investments Law ), provides that a capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry, Trade and Labor 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 the financial scope of the investment and by the physical characteristics of the facility or the asset. An approved enterprise is entitled to benefits including Israeli government cash grants and tax benefits in specified development areas. The extent of the tax benefits available under the Investments Law and the period for which tax benefits are available are determined by the geographic location of the enterprise. The benefits are dependent upon the fulfillment of conditions stipulated in the Investments Law and its regulations, including the criteria set forth in the specific certificate of approval. The tax benefits from any certificate of approval relate only to taxable profits attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its enterprise is approved, its effective tax rate is the result of a weighted average of the applicable rates (such weighted average is calculated in accordance with the guidelines of the Investment Law).

Tax benefits given under the Investment Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated in the course of the approved enterprise's ordinary course of business.

Each application to the Investment Center is reviewed separately and a decision as to whether or not to approve such application is based, among other things, on the then-prevailing criteria set forth in the law, the specific objectives of the applicant company set forth in such application and certain financial criteria of the applicant company. Accordingly, there can be no assurance that any future application will be approved. In addition, as described above, the benefits available to an approved enterprise are dependent upon the fulfillment of certain conditions stipulated in the Investments Law and its regulations and the criteria set forth in the specific certificate of approval. In the event that these conditions are violated, in whole or in part, we would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage adjustment and interest.

Our subsidiary, Sapiens Technologies (1982) Ltd., which is incorporated in Israel, was granted approved enterprise status by the Investment Center for six investment programs in 1984, 1991, 1993, 1995, 1998 and 2000 under the Investments Law.

We believe our approved enterprise operates in substantial compliance with all such conditions and criteria.

On April 1, 2005, a comprehensive amendment to the Investments Law came into effect. As the amended Investments Law does not retroactively apply to investment programs having an approved enterprise approval certificate issued by the Investment Center prior to December 31, 2004, our current tax benefits are subject to the provisions of the Investments Law prior to its revision. Our approved plans subsequent to 2005 and others that may be received in the future will be subject to the provisions of the Investments Law, as amended. Accordingly, the following description includes a summary of the Investments Law prior to its amendment as well as the relevant changes contained in the Investments Law.

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Under the terms of our approved enterprise, once we begin generating taxable net income, we will be entitled to a tax exemption with respect to the income derived from our approved enterprise program for two years and will be subject to a reduced company tax rate of between 10% and 25% for the following five to eight years, depending on the extent of foreign (non-Israeli) investment in our company during the relevant year. The tax rate will be 20% if the foreign investment level is more than 49% but less than 74%, 15% if the foreign investment level is more than 74% but less than 90%, and 10% if the foreign investment level is 90% or more. The lowest level of foreign investment during a particular year will be used to determine the relevant tax rate for that year. The period in which we receive these tax benefits is limited to 12 years from the year in which operations or production by the enterprise commenced or 14 years from the year in which approval was granted, whichever is the earlier. Dividends distributed from tax-exempt income would be taxed according to the company tax rate that would have been applicable had the company not been exempt from taxation that year. This rate is generally 10% to 25% depending on the extent of foreign investment in the company.

Dividends paid out of income generated by an approved enterprise (or out of dividends received from a company whose income is generated by an approved enterprise) are generally subject to withholding tax at the rate applicable to dividends from approved enterprises (15%), unless a different rate is provided according to a treaty between Israel and the shareholder's country of residence (if the dividend is distributed out of income derived during the tax exemption period or within 12 years thereafter). The company must withhold this tax at source.

The Investments Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program. We have not utilized this benefit.

Pursuant to the amendment to the Investments Law, effective as of April 1, 2005, the basic condition for receiving the benefits (both under the grant and the tax benefits programs) is the enterprise's contribution to the economic independence of the State of Israel and its contribution to the

gross domestic product. In order to fulfill these conditions, the enterprise is required to be categorized as an industrial enterprise which complies with any of the following:

its major activity is in the field of biotechnology or nano-technology;

its revenues during the applicable tax year from any single market (i.e. country or a separate customs territory) do not exceed 75% of the privileged enterprise's aggregate revenues during such year; or

25% or more of its revenues during the applicable tax year are generated from sales into a single market (i.e. country or a separate customs territory) with a population of at least 12 million residents.

It should be noted that the amendment to the Investments Law further addresses benefits that are being granted to enterprises and the length of the benefits period.

We cannot assure you that we will comply with the above conditions in the future, or that we will be entitled to any additional benefits under the amended Investments Law.

According to the amendment to the Investments Law, only approved enterprises receiving cash grants require the approval of the Investment Center. Approved enterprises, which do not receive benefits in the form of governmental cash grants, such as benefits in the form of tax benefits, are no longer required to obtain this approval (such enterprises are referred to as privileged enterprises). In order to be eligible for the tax benefits, privileged enterprises are required to comply with certain requirements and make certain investments as specified in the amended Investments Law. The privileged enterprises are subject to the responsibility of the Israeli Tax Authority and may, at their discretion, in order to provide greater certainty, elect to apply for a pre-ruling from the Israeli tax authorities confirming that they are in compliance with the provisions of the amended Investments Law and therefore are entitled to receive the benefits provided under the amended Investments Law. The amended Investments Law also specifies which income of the privileged enterprise is entitled to tax benefits (for example income generated from the sale of products that were manufactured by the privileged enterprise, income generated from usage right with respect to know-how developed by the privileged enterprise, etc.).

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We cannot assure you that we will comply with the conditions required for privileged enterprises under the amended Investments Law in the future or that we will be entitled to any additional benefits under the amended Investments Law.

In addition, the amended Investments Law changed the definition of foreign investment according to the Investments Law so that the definition, instead of a foreign currency investment, now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder (secondary market purchase), provided that the company's outstanding and paid-up share capital exceed NIS 5 million. Such changes to the aforementioned definition will take effect retroactively from 2003.

#### *Special Provisions Relating to Taxation Under Inflationary Conditions*

Under the Income Tax (Inflationary Adjustments) Law, of 1985, or the Adjustments Law, results for tax purposes are measured in real terms, in accordance with the changes in the Israeli Consumer Price Index (Israeli CPI). Accordingly, until 2004, results for tax purposes were measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. Commencing in taxable year 2005, our subsidiaries in Israel elected to measure their taxable income and file their tax returns under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986. Such an election obligates our Israeli subsidiaries for three years. Accordingly, commencing taxable year 2005, results for tax purposes are measured in terms of earnings in dollar. We have submitted a request to the Israeli tax authorities to extend the effect of the above regulations on our company for 2008.

The Israeli Tax Ordinance and regulations promulgated thereunder allow Foreign-Invested Companies, (as defined in the Investments Law) that maintain their accounts in US dollars in compliance with regulations published by the Israeli Minister of Finance, to base their tax returns on their operating results as reflected in their US dollar financial statements or to adjust their tax returns based on exchange rate changes rather than changes in the Israeli consumer price index, in lieu of the principles set forth by the Inflationary Adjustments Law. For these purposes, a Foreign-Invested Company is a company (1) more than 25% of whose share capital, in terms of rights to profits, voting and appointment of directors are held by persons who are not residents of Israel, and (2) more than 25% of whose combined share and loan capital is held by persons who are not residents of Israel. A company that elects to measure its results for tax purposes based on the US dollar exchange rate cannot change such election for a period of three years following the election. Our Israeli subsidiaries have elected to measure our results for tax purposes

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based on the US dollar exchange rate as of January 1, 2005.

### *Tax Benefits for Research and Development*

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, for the year in which they are incurred. These expenses must relate to scientific research and development projects and must be approved by the relevant Israeli government ministry, determined by the field of research. Furthermore, the research and development must be for the promotion of the company's business and carried out by or on behalf of the company seeking such tax deduction. However, the amount of such deductible expenses is reduced by the sum of funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period.

### *Transfer Pricing*

As part of the Israeli 2003 tax reform, the Israeli Tax Ordinance was amended to include section 85A, dealing with international transactions transfer pricing. Section 85A provides that regardless of the actual conditions of an international transaction between related parties, the transaction shall be reported and taxed, based on the arm's length standard, *i.e.*, based on market conditions in similar transactions between unrelated parties. On October 30, 2006, the Income Tax Regulations (Determination of Market Conditions), hereinafter referred to as the Regulations, which provide instructions for the implementation of section 85A, came into effect.

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In accordance with the Regulations, a transaction shall be considered an international transaction if one of the parties is a foreign resident as defined thereunder or if the income generated from such transaction, in all or in part, is taxed both in and outside of Israel. The Regulations establish acceptable methods for comparison between transactions, and methods for calculating the price range against which the transaction is measured.

Taxpayers are required to include in their yearly income tax returns a report regarding their international transactions at arm's length prices.

### *Taxation of Investments*

The following discussion is a summary of certain anticipated tax consequences of an investment in the Common Shares under US federal income tax laws, Netherlands Antilles tax laws and Israeli laws. The discussion does not deal with all possible tax consequences relating to an investment in the Common Shares. In particular, the discussion does not address the tax consequences under state, local and other (e.g., non-US, non-Netherlands Antilles, non-Israel) tax laws. Accordingly, each prospective investor should consult its tax advisor regarding the tax consequences of an investment in the Common Shares. The discussion is based upon laws and relevant interpretations thereof in effect as of the date of this annual report on Form 20-F, all of which are subject to change.

### *Netherlands Antilles Taxation*

Under the laws of the Netherlands Antilles as currently in effect, a holder of Common Shares who is not resident of, and during the taxable year has not engaged in trade or business through a permanent establishment in, the Netherlands Antilles will not be subject to Netherlands Antilles income tax on dividends paid with respect to the Common Shares or on gains realized during that year on sale or disposal of such shares; the Netherlands Antilles does not impose a withholding tax on dividends paid by the Company. Under Netherlands Antilles law, no gift or inheritance taxes are levied if, at the time of such gift or at the time of death, the relevant holder of Common Shares was not domiciled in the Netherlands Antilles.

### *U.S. Federal Income Tax Considerations*

Subject to the limitations described herein, this discussion summarizes certain U.S. federal income tax consequences of the purchase, ownership and disposition of our Common Shares to a U.S. holder. A U.S. holder is a holder of our Common Shares who is:

an individual who is a citizen or resident of the U.S. for U.S. federal income tax purposes;

a corporation (or another entity taxable as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States, any political subdivision thereof, or the District of Columbia;

an estate, the income of which may be included in gross income for U.S. federal income tax purposes regardless of its source; or

a trust (i) if, in general, a U.S. court is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or (ii) that has in effect a valid election under applicable U.S. Treasury Regulations to be treated as a U.S. person.

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Unless otherwise specifically indicated, this discussion does not consider the U.S. tax consequences to a person that is not a U.S. holder (a non-U.S. holder ) and considers only U.S. holders that will own the Common Shares as capital assets (generally, for investment).

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the Code ), current and proposed Treasury Regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with a retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder's particular circumstances. In particular, this discussion does not address the U.S. federal income tax consequences to U.S. holders who are broker-dealers or who own, directly, indirectly or constructively, 10% or more of our outstanding voting shares, U.S. holders holding the Common Shares as part of a hedging, straddle or conversion transaction, U.S. holders whose functional currency is not the U.S. dollar, U.S. holders that acquired our Common Shares upon the exercise of employee stock options or otherwise as compensation, insurance companies, real estate investment trusts, regulated investment companies, grantor trusts, individual retirement and tax-deferred accounts, certain former citizens or long-term residents of the U.S., tax-exempt organizations, financial institutions, financial service entities and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, the tax treatment of persons who are, or hold the Common Shares through a partnership or other pass-through entity is not considered, nor is the possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws.

**You are advised to consult your tax advisor with respect to the specific U.S. federal, state, local and foreign income tax consequences to you of purchasing, holding or disposing of our Common Shares.**

#### *Taxation of Distributions on Common Shares*

Subject to the discussion below under Tax Consequences if We Are a Passive Foreign Investment Company, a distribution paid by us with respect to the Common Shares to a U.S. holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Dividends that are received by U.S. holders that are individuals, estates or trusts will be taxed at the rate applicable to long-term capital gains (currently a maximum rate of 15% through taxable years beginning on or before December 31, 2010), provided that such dividends meet the requirements of qualified dividend income. For this purpose, qualified dividend income generally includes dividends paid by a foreign corporation if certain holding period and other requirements are met and either (a) the stock of the foreign corporation with respect to which the dividends are paid is readily tradable on an established securities market in the U.S. (e.g., the NASDAQ Capital Market) or (b) the foreign corporation is eligible for benefits of a comprehensive income tax treaty with the U.S. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The United States Internal Revenue Service ( IRS ) has determined that the U.S.-Netherlands Antilles income tax treaty is not a comprehensive income tax treaty for this purpose. Dividends that fail to meet such requirements and dividends received by corporate U.S. holders are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend (i) if the U.S. holder held the Common Share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code Section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made (and not closed) a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such Common Share (or substantially identical securities); or (ii) to the extent that the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the Common Share with respect to which the dividend is paid. If we were to be a passive foreign investment company (as such term is defined in the Code), or PFIC, for any taxable year, dividends paid on our Common Shares in such year or in the following taxable year would not be qualified dividends. See the discussion below regarding our PFIC status under Tax Consequences if We Are a Passive Foreign Investment Company. In addition, a non-corporate U.S. holder will be able to take qualified dividend income into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend income will be taxed at ordinary income rates.

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The amount of any distribution which exceeds the amount treated as a dividend will be treated first as a non-taxable return of capital, reducing the U.S. holder's tax basis in its Common Shares to the extent thereof, and then as capital gain from the deemed disposition of the Common Shares. Corporate holders will not be allowed a deduction for dividends received in respect of the Common Shares.

Distributions of current or accumulated earnings and profits paid in foreign currency to a U.S. holder will be includible in the income of a U.S. holder in a U.S. dollar amount calculated by reference to the exchange rate on the day the distribution is received. A U.S. holder that receives a foreign currency distribution and converts the foreign currency into U.S. dollars subsequent to receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the U.S. dollar, which will generally be U.S. source ordinary income or loss.

#### *Taxation of the Disposition of Common Shares*

Subject to the discussion below under *Tax Consequences if We Are a Passive Foreign Investment Company*, upon the sale, exchange or other disposition of our Common Shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder's tax basis in the Common Shares. The gain or loss recognized on the disposition of the Common Shares will be long-term capital gain or loss if the U.S. holder held the Common Shares for more than one year at the time of the disposition and is eligible for a reduced rate of taxation for individuals (currently a maximum rate of 15% for taxable years beginning on or before December 31, 2010). Capital gain from the sale, exchange or other disposition of Common Shares held for one year or less is short-term capital gain and taxed as ordinary income. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of Common Shares generally will be treated as U.S. source income or loss. The deductibility of capital losses is subject to certain limitations.

A U.S. holder that uses the cash method of accounting calculates the dollar value of the proceeds received on the sale as of the date that the sale settles. However, a U.S. holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A U.S. holder that uses the accrual method may avoid realizing foreign currency gain or loss by electing to use the settlement date to determine the proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a U.S. holder that receives foreign currency upon disposition of Common Shares and converts the foreign currency into dollars after the settlement date or trade date (whichever date the U.S. holder is required to use to calculate the value of the proceeds of sale) may have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the dollar, which will generally be U.S. source ordinary income or loss.

#### *Tax Consequences if We Are a Passive Foreign Investment Company*

We would be a passive foreign investment company (a PFIC) if (taking into account certain look-through rules with respect to the income and assets of our corporate subsidiaries) either (i) 75% or more of our gross income for the taxable year was passive income, or (ii) the average percentage (by value) of our assets that are passive assets during the taxable year was at least 50%. As discussed below, we believe that we were not a PFIC for 2007.

If we were a PFIC, each U.S. holder would (unless it made one of the elections discussed below on a timely basis) be taxable on gain recognized from the disposition of our Common Shares (including gain deemed recognized if our Common Shares are used as security for a loan) and upon receipt of certain excess distributions (generally, distributions that exceed 125% of the average amount of distributions in respect to such shares received during the preceding three taxable years or, if shorter, during the U.S. holder's holding period prior to the distribution year) with respect to our Common Shares as if such income had been recognized ratably over the U.S. holder's holding period for the shares. The U.S. holder's income for the current taxable year would include (as ordinary income) amounts allocated to the current taxable year and to any taxable year prior to the first day of the first taxable year for which we were a PFIC. Tax would also be computed at the highest ordinary income tax rate in effect for each other taxable year to which income is allocated, and an interest charge on the tax as so computed would also apply. The tax liability with respect to the amount allocated to the taxable year prior to the taxable year of the distribution or disposition cannot be offset by any net operating losses. Additionally, if we were a PFIC, U.S. holders who acquire our Common Shares from decedents (other than nonresident aliens) dying before 2010 would be denied the normally-available step-up in basis for such shares to fair market value at the date of death and, instead, would have a tax basis in such shares equal to the decedent's basis, if lower.

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As an alternative to the tax treatment described above, a U.S. holder could elect to treat us as a qualified electing fund (a QEF), in which case the U.S. holder would be taxed, for each taxable year that we are a PFIC, on its pro rata share of our ordinary earnings and net capital gain (subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge). Special rules apply if a U.S. holder makes a QEF election after the first taxable year in its holding period in which we are a PFIC. We have agreed to supply U.S. holders with the information needed to report income and gain under a QEF election if we were a PFIC. Amounts includable in income as a result of a QEF election will be determined without regard to our prior year losses or the amount of cash distributions, if any, received from us. A U.S. holder's basis in its Common Shares will increase by any amount included in income and decrease by any amounts not included in income when distributed because such amounts were previously taxed under the QEF rules. So long as a U.S. holder's QEF election is in effect with respect to the entire holding period for its Common Shares, any gain or loss realized by such holder on the disposition of its Common Shares held as a capital asset generally will be capital gain or loss. Such capital gain or loss ordinarily would be long-term if such U.S. holder had held such Common Shares for more than one year at the time of the disposition. For non-corporate U.S. holders, long-term capital gain is generally subject to a maximum federal

income tax rate of 15% for taxable years beginning on or before December 31, 2010. The QEF election is made on a shareholder-by-shareholder basis, applies to all Common Shares held or subsequently acquired by an electing U.S. holder and can be revoked only with the consent of the IRS.

As an alternative to making a QEF election, a U.S. holder of PFIC stock that is marketable stock (e.g., regularly traded on the NASDAQ Capital Market) may, in certain circumstances, avoid certain of the tax consequences generally applicable to holders of stock in a PFIC by electing to mark the stock to market as of the beginning of such U.S. holder's holding period for our Common Shares. Special rules apply if a U.S. holder makes a mark-to-market election after the first year in its holding period in which we are a PFIC. As a result of such an election, in any taxable year that we are a PFIC, a U.S. holder would generally be required to report gain or loss to the extent of the difference between the fair market value of the Common Shares at the end of the taxable year and such U.S. holder's tax basis in such shares at that time. Any gain under this computation, and any gain on an actual disposition of our Common Shares, would be treated as ordinary income. Any loss under this computation, and any loss on an actual disposition of our Common Shares, generally would be treated as ordinary loss to the extent of the cumulative net-mark-to-market gain previously included. Any remaining loss from marking Common Shares to market will not be allowed, and any remaining loss from an actual disposition of Common Shares generally would be capital loss. A U.S. holder's tax basis in its Common Shares is adjusted annually for any gain or loss recognized under the mark-to-market election. There can be no assurances that there will be sufficient trading volume with respect to our Common Shares for the Common Shares to be considered regularly traded or that our Common Shares will continue to trade on the NASDAQ Capital Market. Accordingly, there are no assurances that our Common Shares will be marketable stock for these purposes. As with a QEF election, a mark-to-market election is made on a shareholder-by-shareholder basis, applies to all Common Shares held or subsequently acquired by an electing U.S. holder and can only be revoked with consent of the IRS (except to the extent our Common Shares no longer constitute marketable stock).

Based on an analysis of our assets and income, we believe that we were not a PFIC for 2007 or 2006. We currently expect that we will not be a PFIC in 2008. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC. U.S. holders who hold Common Shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC, subject to certain exceptions for U.S. holders who made QEF, mark-to-market or certain other special elections. U.S. holders are urged to consult their tax advisors about the PFIC rules, including the consequences to them of making a mark-to-market or QEF election with respect to our Common Shares in the event that we qualify as a PFIC.

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### ***Non-U.S. holders of Common Shares***

Except as provided below, a non-U.S. holder of Common Shares will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, or the proceeds from the disposition of, our Common Shares, unless, in the case of U.S. federal income taxes, that item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, such item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized on the disposition of our Common Shares by an individual non-U.S. holder will be subject to tax in the United States if the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

### ***Information Reporting and Backup Withholding***

A U.S. holder generally is subject to information reporting and may be subject to backup withholding at a rate of up to 28% (through 2010) with respect to dividend payments on, or receipt of the proceeds from the disposition of, our Common Shares. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations and tax-exempt organizations, or if a U.S. holder provides a correct taxpayer identification number, certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Non-U.S. holders are not subject to information reporting or backup withholding with respect to dividend payments on, or receipt of the proceeds from the disposition of, our Common Shares in the U.S., or by a U.S. payor or U.S. middleman, provided that such non-U.S. holder provides a taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a holder, or alternatively, the holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the IRS.

### **Israeli Tax Considerations**

#### **Israeli Holders**

#### ***Capital Gains From the Sale of Shares***

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Under Section 91 of the Israeli Income Tax Ordinance (New Version), 5721-1961, or Israeli Tax Ordinance, real capital gains from the sale of securities by an individual Israeli resident are subject to tax at the applicable marginal tax rates for such an individual. However, under Section 91 of the Israeli Tax Ordinance, such rates will not exceed 20% and the capital gain will be treated as the highest level on the scale of taxable income. The aforesaid will not apply to the sale of securities by an individual who is classified as a significant shareholder in the company - i.e. one who holds, directly or indirectly, alone or together with another, at least 10% in one or more of the means of control in the company - either at the time of sale of the securities or at any time during the 12 months that preceded the above stated sale, in which case the rate of tax in respect of the real capital gains will not exceed 25%. Together with another is defined in the Israeli Tax Ordinance as together with a relative and together with an entity that is not a relative, with which cooperation exists in the regular course of business according to a material agreement in respect of a corporate entity, directly or indirectly.

Furthermore, until the determination of the directives and conditions for the deduction of real interest expenses under Section 101A(A)(9) of the Israeli Tax Ordinance, an individual who claims real interest and linkage differential expenses with respect to securities will owe tax at a rate of 25% on real capital gains from the sale of such securities. The aforesaid reduced tax rates will not apply to an individual for whom the income from the sale of the securities is classified as business income under Section 2(1) of the Israeli Tax Ordinance and therefore will be subject to tax according to the applicable marginal tax rate set forth in Section 121 of the Israeli Tax Ordinance.

An association of individuals (including a company) will be taxed on real capital gains from the sale of securities at the corporate tax rate that is scheduled to decrease gradually to a rate of 25% by 2010.

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However, an association of individuals that prior to August 10, 2005 was not subject to Section 6 of the Income Tax Law (Inflationary Adjustments), 1985, or Section 130A of the Israeli Tax Ordinance, is taxed at a rate of 25% on real capital gains as of January 1, 2006.

An exempt mutual fund and entities subject to the exemption stated in Section 9(2) of the Israeli Tax Ordinance will be exempt from capital gains tax from sale of securities. A taxable mutual fund will be subject to tax at the rate of 20% on the real capital gain from sale of securities.

In accordance with the Income Tax Regulations (Deduction from Proceeds, from Payment or from Capital Gain from Sale of Securities or from a Future Transaction), 2002, or Deduction Regulations, the payer to an individual seller of consideration for sale of securities will withhold tax at source at the rate of 20% from the real capital gain subject to tax. The payer to a corporate entity of consideration for sale of securities will withhold tax at source at the rate of 25% from the real capital gain. Such payment to a foreign resident will be exempt from withholding tax at source, as stated, subject to fulfillment of certain conditions stated in the Deduction Regulations.

### *Rate of Tax Applicable to Income from Dividends on Shares*

In general, those individuals who are residents of Israel will owe tax at a rate of 20% on dividends received in connection with our shares of common stock. Yet, individuals who are significant shareholders (see above) at the time of receiving the dividend, or at any time during the 12-month period preceding the receipt of dividend, will be subject to a tax rate of 25%. The tax rate in respect of dividends received by Israeli companies is, in general, 0%, but dividends that are derived from sources outside of Israel or that are generated or produced outside of Israel will be taxed at a rate of 25%. Dividends received by a taxable mutual fund will be subject to the 20% tax rate of an Israeli resident individual (for whom the income is not classified as business income). Generally, exempt mutual funds, pension funds and other entities that are exempt from tax under Section 9(2) of the Israeli Tax Ordinance are exempt from tax on such dividends. A taxable mutual fund is defined in the Israeli Tax Ordinance as a mutual fund whose agreement or prospectus irrevocably states that the fund is a mutual fund subject to tax. An exempt mutual fund is defined as a mutual fund whose agreement or prospectus irrevocably states that the fund is a mutual fund exempt from tax.

In accordance with the Income Tax Regulations (Deduction From Interest, Dividends and Certain Income), 2005, tax will be withheld at the source upon the distribution of dividends. Distribution by a company of a dividend to an individual will be subject to tax at the rate of 20% (or 25% if such individual is a significant shareholder) as of the date of the dividend distribution.

### **Non- Israeli Holders**

Generally, Israeli income tax will not apply to income, including capital gains dividends, which is realized by a non-Israeli resident who has purchased securities from a non-Israeli resident corporation, provided that (i) the non-Israeli resident corporation is not deemed an Israeli resident corporation for tax purposes; (ii) the securities are not deemed as a right to assets in Israel (i.e., the consolidated assets of the corporation are substantially located in Israel); and (iii) the income is not derived from a permanent establishment of the non-Israeli resident purchaser in Israel.



Although we are not registered and/or incorporated in Israel, the Israeli Tax Authority may contend that the control and management of our business is exercised in Israel and, therefore, we are considered a resident of Israel for tax purposes. In general, the test of control and management seeks to determine where the company's policy is set and where its strategic resolutions are accepted. Accordingly, what is examined is the place in which the ability to direct and determine the business policy of the company is realized and the place in which the resolutions allowing the business of the company to be carried-out are accepted. The test of control and management is determined every tax year. Furthermore, since a substantial portion of our assets are located in Israel, our shares may be deemed by the Israeli Tax Authority as a right to assets in Israel. It should be noted that Israeli tax law does not provide clear guidelines regarding the manner in which the Israeli and non-Israeli assets of a non-Israeli company should be measured for purposes of determining whether the assets of such company are substantially located in Israel and whether its shares are deemed a right to assets in Israel. Therefore, it is uncertain whether our shares would be considered a right to assets in Israel.

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In the event that we are classified as an Israeli resident corporation or our shares are deemed a right to assets in Israel, the following tax consequences would be applicable to non-Israeli residents who purchased our securities.

#### *Capital Gains From the Sale of Shares*

Non-Israeli residents, including U.S. resident purchasers, are generally exempt from Israeli capital gains tax on any gains derived from the sale of securities publicly traded on Nasdaq, whether such sold securities are of an Israeli resident corporation or of a non-Israeli resident corporation, provided such gains are not derived from a permanent establishment of such shareholders in Israel. However, non-Israeli corporations selling such securities, including U.S. resident corporations, will not be entitled to such an exemption if an Israeli resident (i) has a controlling interest of 25% or more in the non-Israeli corporation, or (ii) if the beneficiary is directly or indirectly entitled to 25% or more of the revenues or profits of the non-Israeli corporation.

In addition, pursuant to certain treaties to which the Government of Israel is a party, the sale, exchange or disposition of common shares may not be subject to Israeli capital gains tax, in according with the terms of such treaties.

For example, pursuant to the Convention between the Government of the United States of America and the Government of Israel with respect to Taxes on Income, or U.S.-Israel Tax Treaty, the sale, exchange or disposition of common shares by a person who qualifies as a resident of the United States within its meaning under 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, which person is referred to for purposes of this tax discussion as Treaty U.S. Resident, generally will not be subject to Israeli capital gains tax unless such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of the voting power during any part of the 12-month period preceding such sale, exchange or disposition. Moreover, subject to particular conditions, the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment of such Treaty U.S. Resident in Israel. In such cases, subject to the limitations of U.S. laws applicable to foreign tax credits, the Treaty U.S. Resident would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition.

Therefore, the exemption under the Israeli Tax Ordinance may be the only exemption from Israeli tax available to non-Israeli shareholders. Accordingly, non-Israeli resident purchasers who, in light of the existence or lack of existence of certain conditions, are unable to benefit from a treaty, may wish to utilize a recently introduced special exemption on capital gains arising from the sale of shares in an Israeli company (including companies which are deemed an Israeli resident corporation for tax purposes) between July 1, 2005 and December 31, 2008. In order for this exemption to apply, the following conditions must be met:

- (a) an application is to be submitted to the Israeli Tax Authority at the same time as the reporting of the sale and capital gain;
- (b) the capital gain does not derive from a permanent establishment of the seller in Israel;
- (c) the seller is an individual and has been a resident of a country with which Israel has a tax treaty (e.g., the U.S.) during the ten continuous years prior to the acquisition or is an entity where at least 75% of the means of control of the entity are ultimately held, directly or indirectly, by individual shareholders who are residents of a country with which Israel has a tax treaty (e.g., the U.S.) during the ten continuous years prior to the acquisition. Unless it can be proved otherwise, where the entity is listed on a non-Israel stock exchange, this condition is deemed to be met automatically in respect of non-material shareholders. Material is defined as a 10% or more holding, directly or indirectly, of any means of control, together with related parties;

- (d) the shares were not purchased from a related party (as defined in the Israeli Tax Ordinance) and Chapter E-2 of the Israeli Tax Ordinance did not apply to such purchase of shares;
  - (e) the sale was reported to the tax authority in the country of the seller's residence; and
  - (f) within 30 days of the acquisition, the transaction was disclosed in full to the Israeli Tax Authority.
- Shareholders who wish to benefit from this additional exemption would therefore be advised to approach the Israeli Tax Authority within 30 days of the purchase of shares in the Company.

In the event that the exceptions to the capital gains tax do not apply to a non-Israeli resident purchaser, upon the realization of gain from the sale of our shares, such non-Israeli resident purchaser will be subject to the tax rates described above under Israeli Holders - Capital Gains From the Sale of Shares.

***Rate of Tax Applicable to Income from Dividends on 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 on shares of an Israeli resident corporation.

Under Israeli tax law, distributions of dividends are generally subject to withholding tax at the rates indicated above under Israeli Holders - Rate of Tax Applicable to Income from Dividends on Shares. However, the tax rates in the event of a distribution of dividends to a foreign resident are subject to relevant provisions of the applicable treaty for the avoidance of double taxation between Israel and the country of residency of the foreign resident. For U.S. resident purchasers, who qualify as Treaty U.S. Residents under the U.S.-Israel Tax Treaty, the maximum rate of tax on dividends paid to a holder of common shares is 25%; however, the tax rate is generally reduced to 12.5% if the shareholder is a U.S. corporation and holds at least 10% of the issued voting power during the whole of its prior tax year, as well as during the part of the tax year that precedes the date of payment of the dividend, and not more than 25% of the gross income consists of interest or dividends.

**F. Dividends and Paying Agents**

Not applicable.

**G. Statement by Experts**

Not applicable.

**H. Documents on Display**

We are currently subject to the information and periodic reporting requirements of the Exchange Act that are applicable to foreign private issuers. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as United States companies, we generally do publicly announce our quarterly and year-end results promptly and file periodic information with the United States Securities and Exchange Commission under cover of Form 6-K. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act. Our SEC filings are filed electronically on the EDGAR reporting system and may be obtained through that medium. You may inspect without charge and copy at prescribed rates such filings, including any exhibits and schedules, at the public reference facilities maintained by the SEC, 100 F Street, N.E., Washington, D.C. 20549 and at the SEC's regional offices at 233 Broadway, New York, NY 10279 and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, IL 60661. You may also obtain copies of such materials from the SEC at prescribed rates. The SEC also maintains a web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of this web site is <http://www.sec.gov>. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. The Exchange Act file number for our Securities and Exchange Commission filings is 000-20181.

The Company's Common Shares are quoted on the NASDAQ Capital Market. You may inspect reports and other information concerning the Company at the offices of the National Association of Securities Dealers, Inc., 9513 Key West Avenue, Rockville, MD 20850.

Information about Sapiens is also available on its website at <http://www.sapiens.com>. Such information on our website is not part of this annual report.

**I. Subsidiary Information**

Not applicable.

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**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

Market risks relating to our operations result primarily from changes in exchange rates, interest rates or weak economic conditions in the markets in which we sell our products and services. We have been and we are actively monitoring these potential exposures. To manage the volatility relating to these exposures, we may enter into various forward contracts or other hedging instruments. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in foreign currency rates and interest rates.

**Foreign Currency Risk.** We conduct our business in various foreign currencies, primarily those of Israel and the UK, and to a lesser extent of Japan, Europe and Canada. A devaluation of the NIS, GBP, Euro and the Japanese Yen in relation to the US dollar has the effect of reducing the US dollar amount of any of our expenses or liabilities which are payable in those currencies (unless such expenses or payables are linked to the US dollar) and increasing the US Dollar amount of any of our revenues which are payable in those currencies.

In 2007 and 2008 the US dollar devalued significantly with respect to the NIS. We are obligated to pay the principal and the interest of our debentures in NIS, but we record the expenses in our financial statements in US dollars. Therefore, as a result of the devaluation of the US dollar, we had an increase in our finance expenses.

Because exchange rates between the NIS, GBP, Euro and the Japanese Yen and the US dollar fluctuate continuously, exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reflected as financial expenses in our consolidated financial statements.

We monitor our foreign currency exposure and, from time to time, may enter into currency forward contracts or put/call currency options to hedge balance sheet exposure. In 2007, we performed hedging transactions, by purchasing a put option in the amount of \$2.5 million, to protect against the devaluation of the US dollar, in the range of NIS 4.00 - 4.25 per US dollar. As of December 31, 2007, we had no foreign exchange contracts, options contracts or other foreign hedging arrangement.

In 2008, we performed hedging transactions, by purchasing a put option in the amount of \$4.5 million, to protect against the devaluation of the US dollar, in the range of NIS 3.60 - 3.30 per US dollar.

We may use such contracts to hedge exposure to changes in foreign currency exchange rates associated with balance sheet balances denominated in a foreign currency and anticipated costs to be incurred in a foreign currency.

**Market Risk.** We currently do not invest in, or otherwise hold, for trading or other purposes, any financial instruments subject to market risk.

**Interest Rate Risk.** We pay interest on our credit facilities, convertible notes and short-term loans based on LIBOR, for dollar-denominated loans, and the prime interest rate in Israel, for some of our NIS-denominated loans. As a result, changes in the general level of interest rates directly affect the amount of interest payable by us under these facilities. However, we expect our exposure to risk from changes in interest rates to be minimal and not material. Therefore, no quantitative tabular disclosures are required.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

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**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

None.

**ITEM 15T. CONTROLS AND PROCEDURES**

**A. Disclosure Controls and Procedures.** The President and Chief Executive Officer of the Company and the Chief Financial Officer of the Company have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this annual report (the Evaluation Date). Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that the Company files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and that such information is recorded, processed, summarized and reported within the periods specified by the SEC's rules and forms.

**B. Management's Annual Report on Internal Controls Over Financial Reporting.** Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based principally on the framework and criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as of the end of the period covered by this report. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2007. Notwithstanding the foregoing, there can be no assurance that the Company's internal control over financial reporting will detect or uncover all failures of persons within the Company to comply with these procedures.

**This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report.**

**C. Changes in Internal Control Over Financial Reporting.** There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Since the Evaluation Date, there have not been any significant changes in the Company's internal controls over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

All internal control systems and disclosure controls and procedures, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to the ability to detect or uncover all failures of persons within the Company to disclose material information required to be set forth in the Company's reports. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our Board of Directors determined that Mr. Yacov Elinav meets the definition of an audit committee financial expert, as defined under the applicable rules promulgated by the SEC. All members of the Audit Committee are independent directors.

**ITEM 16B. CODE OF ETHICS**

We have adopted a Code of Ethics that applies to our principal executive officer, principal financial officer and corporate controller, as well as to our directors and other employees. The Code of Ethics is publicly available on our website at [www.sapiens.com](http://www.sapiens.com). Written copies are available upon request. If we make any substantive amendments to the Code of Ethics or grant any waivers, including any implicit waiver, from a provision of this code to our chief executive officer, principal financial officer or corporate controller, we will disclose the nature of such amendment or waiver on our website.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES****Policies and Procedures**

Our Audit Committee has adopted a policy and procedures for the approval of audit and non-audit services rendered by our independent auditors, Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global. The policy generally requires the Audit Committee's approval of the scope of the engagement of our independent auditors or on an individual basis. The policy prohibits retention of the independent auditors to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act of 2002 or the rules of the SEC, and also considers whether proposed services are compatible with the independence of the public auditors. During 2006 and 2007, 100% of the fees for services rendered by the Company's independent auditors were approved by the Audit Committee, in accordance with these procedures.

**Fees Paid to Independent Auditors**

The following table sets forth, for each of the years indicated, the aggregate fees billed by our independent auditors for types of services indicated:

	Year ended December 31,	
	2006	2007
	(in thousands)	
Audit Fees (1)	\$ 163	\$ 132
Audit Related Fees (2)	-	-
Tax Fees (3)	73	57
All Other Fees (4)	-	21
<b>Total</b>	<b>\$ 236</b>	<b>\$ 210</b>

- (1) Audit Fees consist of fees billed for the annual audit and the quarterly reviews of the Company's consolidated financial statements and consist of services that would normally be provided in connection with statutory and regulatory filings or engagements, including services that generally only the independent auditors can reasonably provide.
- (2) Audit Related Fees consist of fees billed for assurance and related services that traditionally were only performed by the independent auditor, and include the review of documents filed with the SEC, accounting consultation and consultation concerning financial accounting and reporting standards.
- (3) Tax Fees relate to tax compliance, planning and advice.
- (4) All Other Fees consist of services related to stock options and value added tax (VAT) related matters.

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**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not applicable.

**ITEM 16E. PURCHASE OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

In May 2007, we foreclosed our lien on the 300,000 Common Shares owned by Red Coral, and we now hold such shares.

Following the \$20 million private placement investment in June 2007, we purchased an aggregate amount of NIS 15,000,000 nominal value, representing approximately \$3.5 million, of the outstanding debentures.

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In January and February 2008, we purchased an aggregate amount of NIS 7,600,000 nominal value, representing approximately \$2.1 million, of the outstanding debentures

Pursuant to the terms of the prospectus governing the debentures, the amount repurchased by us was retired and removed from circulation.

See Item 7, Major Shareholders and Related Party Transactions Major Shareholders for purchases of our Common Shares by Formula, our controlling shareholder.

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### PART III

#### ITEM 17. FINANCIAL STATEMENTS

See Item 18.

#### ITEM 18. FINANCIAL STATEMENTS

The Consolidated Financial Statements and related notes required by this item are contained on pages F-1 through F-44 hereof.

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#### ITEM 19. EXHIBITS

- 1.1 Articles of Association of Sapiens International Corporation N.V., as amended on March 17, 2005 incorporated by reference to registrant's Form 20-F, filed on June 29, 2005.
- 2.(b)1 Trust Deed between Sapiens International Corporation N.V. and Investec Trust Company (Israel) Ltd., dated December 2, 2003 incorporated by reference to registrant's Form 20-F, filed on June 10, 2004.
- 4.(a)1 Amendment to Share Purchase Agreement by and between Sapiens International Corporation and Formula Systems (1985) Ltd. incorporated by reference to registrant's Form 20-F, filed on July 3, 2001.
- 4.(a)2 Agreement among Sapiens International Corporation N.V., F.I.D. Holdings Ltd. and Israel Discount Bank Ltd., dated March 16, 2004 incorporated by reference to registrant's Form 20-F, filed on June 10, 2004.
- 4.(a)3 Agreement among Sapiens International Corporation N.V., F.I.D. Holdings Ltd. and Israel Discount Bank Ltd., dated May 2, 2005 - incorporated by reference to registrant's Form 20-F, filed on June 29, 2005.
- 4.(a)4 Share Purchase Agreement between Sapiens International Corporation N.V. and Formula Systems (1985) Ltd., dated June 27, 2005 - incorporated by reference to registrant's Form 20-F, filed on June 29, 2005.
- 4.(a)5 Agreement among Sapiens International Corporation N.V., F.I.D. Holdings Ltd. and Israel Discount Bank Ltd., dated August 10, 2006 - incorporated by reference to registrant's Form 20-F, filed on June 28, 2007.
- 4.(a)6 Share Issuance Agreement between Sapiens International Corporation N.V. and Formula Systems (1985) Ltd., dated August 10, 2006 - incorporated by reference to registrant's Form 20-F, filed on June 28, 2007.
- 4.(c)1

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Sapiens International Corporation N.V. 1992 Stock Option and Incentive Plan, as amended and restated incorporated by reference to registrant's Registration Statement of Form S-8 (No. 33-64208), filed on June 9, 1993, and to registrant's Registration Statement of Form S-8 (No. 333-10622), filed on July 22, 1999.

4(c)2 Sapiens International Corporation N.V. 2003 Share Option Plan - incorporated by reference to registrant's Registration Statement of Form S-8 (No. 333-144595), filed on July 16, 2007, and to registrant's Form 20-F, filed on June 28, 2007.

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4(c)3 Sapiens International Corporation N.V. 2005 Special Incentive Share Option Plan - incorporated by reference to registrant's Registration Statement of Form S-8 (No. 333-144595), filed on July 16, 2007, and to registrant's Form 20-F, filed on June 28, 2007.

8.1 List of Subsidiaries

10.1 Consent of Kost Forer Gabbay & Kasierer, Independent Registered Public Accounting Firm

12.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

12.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

13.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

13.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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### SAPIENS INTERNATIONAL CORPORATION N.V.

#### AND ITS SUBSIDIARIES

#### CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2007

IN U.S. DOLLARS

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**Kost Forer Gabbay & Kasierer**  
 3 Aminadav St.  
 Tel-Aviv 67067, Israel  
 Tel: 972 (3)6232525  
 Fax: 972 (3)5622555  
 www.ey.com/il

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**SAPIENS INTERNATIONAL CORPORATION N.V.**

We have audited the accompanying consolidated balance sheets of Sapiens International Corporation N.V. and its subsidiaries (the Company) as of December 31, 2006 and 2007 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sapiens International Corporation N.V. and its subsidiaries as of December 31, 2006 and 2007 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
 June 25, 2008

/s/ Kost Forer Gabbay & Kasierer  
**KOST FORER GABBAY & KASIERER**  
 A Member of Ernst & Young Global

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
 AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**U.S. dollars in thousands**

	December 31,	
	2006	2007
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 3,108	\$ 13,125
Marketable securities	32	-
Trade receivables (net of allowance for doubtful accounts of \$ 1,148 and \$1,460 at December 31, 2006 and 2007, respectively) (Note 3)	11,010	7,549



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	December 31,	
	2006	2007
Other receivables and prepaid expenses (Note 4)	1,689	1,881
<b>Total current assets</b>	<b>15,839</b>	<b>22,555</b>
PROPERTY AND EQUIPMENT, NET (Note 5)	1,495	1,219
<b>OTHER ASSETS:</b>		
Capitalized software development costs, net of accumulated amortization of \$ 38,648 and \$45,758 at December 31, 2006 and 2007, respectively (Note 6a)	13,467	14,957
Goodwill	8,621	8,621
Deferred income taxes (Note 12e)	2,747	2,598
Other, net (Note 6b)	3,450	2,582
<b>Total other assets</b>	<b>28,285</b>	<b>28,758</b>
<b>Total assets</b>	<b>\$ 45,619</b>	<b>\$ 52,532</b>

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

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

	December 31,	
	2006	2007
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short-term bank credit (Note 8a)	\$ 9,298	\$ 4,958
Current maturities of long-term liabilities and convertible debt (Notes 8 and 9)	6,305	4,498
Trade payables	2,019	1,088
Deferred revenues	3,463	4,203
Other liabilities and accrued expenses (Note 7)	7,370	8,375
<b>Total current liabilities</b>	<b>28,455</b>	<b>23,122</b>
<b>LONG-TERM LIABILITIES:</b>		
Convertible debt and related warrants (Note 8b)	11,796	6,428

	December 31,	
	2006	2007
Other long-term liabilities (Note 9)	1,439	1,132
	13,235	7,560
<b>COMMITMENTS AND CONTINGENT LIABILITIES (Note 10)</b>		
<b>SHAREHOLDERS' EQUITY (Note 13):</b>		
Share capital:		
Preferred shares: Authorized - 1,000,000 of(euro)0.01 par value at December 31, 2006 and 2007; Issued and outstanding: None at December 31, 2006 and 2007	-	-
Common shares: Authorized - 30,000,000 of(euro)0.01 par value at December 31, 2006 and 2007; Issued - 15,195,646 and 21,891,882 shares at December 31, 2006 and 2007, respectively; Outstanding: 15,144,852 and 21,541,088 shares at December 31, 2006 and 2007, respectively	185	275
Additional paid-in capital	113,498	132,035
Treasury shares	(2,423)	(2,423)
Note receivable from a related party shareholder	(975)	-
Accumulated other comprehensive loss	(2,817)	(1,654)
Accumulated deficit	(103,539)	(106,383)
<b>Total shareholders' equity</b>	<b>3,929</b>	<b>21,850</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 45,619</b>	<b>\$ 52,532</b>

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

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

	Year ended December 31,		
	2005	2006	2007
<b>Revenues:</b>			
Products	\$ 13,295	\$ 10,423	\$ 5,632
Consulting and other services	26,109	33,888	36,763
<b>Total revenues</b>	<b>39,404</b>	<b>44,311</b>	<b>42,395</b>
<b>Cost of revenues:</b>			

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	Year ended December 31,		
	2019	2018	2017
Products	8,809	6,302	3,277
Consulting and other services	16,037	22,499	22,306
<u>Total</u> cost of revenues	24,846	28,801	25,583
Gross profit	14,558	15,510	16,812
Operating expenses:			
Research and development, net (Note 15a)	2,723	2,451	3,502
Selling, marketing, general and administrative	16,245	13,558	12,513
Restructuring costs	1,113	758	-
<u>Total</u> operating expenses	20,081	16,767	16,015
Operating Profit (loss)	(5,523)	(1,257)	797
Financial expenses, net (Note 15b)	1,788	2,230	2,798
Other expenses (income), net	(12)	-	109
Loss before taxes on income	7,299	3,487	2,110
Taxes on income (Note 12)	1,798	325	338
Minority interest in earnings of a subsidiary and other	2	13	96
Net loss	9,099	3,825	2,544
Basic and diluted net loss per share (Note 2t)	\$ 0.76	\$ 0.29	\$ 0.14
Weighted-average number of shares used in computing basic and diluted net loss per share	11,982	13,395	18,218

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

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

Common shares	Additional paid-in	Treasury shares	Note receivable	Accumulated other	Accumulated deficit	Total shareholders'
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SAPIENS INTERNATIONAL CORPORATION N.V.

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	<u>capital</u>		<u>from a</u>		<u>comprehensive</u>		<u>equity</u>	
	<u>Shares</u>	<u>Amount</u>		<u>shareholder</u>	<u>loss</u>			
Balance as of January 1, 2005	11,739,935	142	108,493	(2,423)	(975)	(2,542)	(90,615)	12,080
Net loss	-	-	-	-	-	-	(9,099)	(9,099)
Other comprehensive income:								
Unrealized gains on available-for-sale marketable securities, net	-	-	-	-	-	117	-	117
Foreign currency translation adjustments	-	-	-	-	-	(1,476)	-	(1,476)
Other comprehensive loss								(1,359)
Stock-based compensation related to warrants issued consultants	-	-	10	-	-	-	-	10
Employee stock options exercised	19,500	*) -	*) -	-	-	-	-	-
Shares issued to Formula Systems (1985) Ltd	1,041,667	13	1,987	-	-	-	-	2,000
Balance as of December 31, 2005	12,801,102	155	110,490	(2,423)	(975)	(3,901)	(99,714)	3,632
Accumulated unrealized gains from available- for-sale marketable securities						\$ 42		
Accumulated foreign currency translation adjustments						(3,943)		
Accumulated other comprehensive loss						\$ (3,901)		

\*) Less than \$ 1.

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

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

	<u>Common shares</u>		<u>Additional</u>	<u>Treasury</u>	<u>Note</u>	<u>Accumulated</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>paid-in</u>	<u>shares</u>	<u>receivable</u>	<u>other</u>	<u>deficit</u>	<u>shareholders'</u>
			<u>capital</u>		<u>from a</u>	<u>comprehensive</u>		<u>equity</u>
					<u>shareholder</u>	<u>loss</u>		
Balance as of January 1, 2006	12,801,102	\$ 155	\$ 110,490	\$ (2,423)	\$ (975)	\$ (3,901)	\$ (99,714)	\$ 3,632
Net loss	-	-	-	-	-	-	(3,825)	(3,825)

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	Common shares		Additional paid-in capital	Treasury shares	Note receivable from a shareholder	Accumulated other comprehensive loss	Accumulated deficit	Total shareholders' equity
Other comprehensive income:								
Unrealized losses on available-for-sale marketable securities, net	-	-	-	-	-	(22)	-	(22)
Foreign currency translation adjustments	-	-	-	-	-	1,106	-	1,106
Other comprehensive income								1,084
Stock-based compensation	-	-	38	-	-	-	-	38
Shares issued	2,343,750	30	2,970	-	-	-	-	3,000
Balance as of December 31, 2006	15,144,852	\$ 185	\$ 113,498	\$ (2,423)	\$ (975)	(2,817)	\$ (103,539)	\$ 3,929
Accumulated unrealized gains from available-for-sale marketable securities						\$ 20		
Accumulated foreign currency translation adjustments						(2,837)		
Accumulated other comprehensive loss						\$ (2,817)		

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

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Common shares		Additional paid-in capital	Treasury shares	Note receivable from a shareholder	Accumulated other comprehensive loss	Accumulated deficit	Total shareholders' equity
	Shares	Amount						
Balance as of January 1, 2007	15,144,852	\$ 185	\$ 113,498	\$ (2,423)	\$ (975)	\$ (2,817)	\$ (103,539)	\$ 3,929
Net loss	-	-	-	-	-	-	(2,544)	(2,544)
Other comprehensive income:								
Unrealized losses on available-for-sale marketable securities, net	-	-	-	-	-	(20)	-	(20)
Foreign currency translation adjustments	-	-	-	-	-	1,183	-	1,183
Other comprehensive income	-	-	-	-	-		-	1,163

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	Common shares		Additional paid-in capital	Treasury shares	Note receivable from a shareholder	Accumulated other comprehensive loss	Accumulated deficit	Total shareholders' equity
Cumulative impact of change in accounting for uncertainties in income taxes (FIN 48)	-	-	-	-	-	-	(300)	(300)
Exercise of options	29,569	(*)	69	-	-	-	-	69
Stock-based compensation	-	-	118	-	-	-	-	118
Loan settlement Red Coral	(300,000)	(*)	(975)	-	975	-	-	-
Shares issued, net (**)	6,666,667	90	19,325	-	-	-	-	19,415
Balance as of December 31, 2007	21,541,088	\$ 275	\$ 132,035	\$ (2,423)	\$ -	\$ (1,654)	\$ (106,383)	\$ 21,850

Accumulated foreign currency translation adjustments

\$ (1,654)

Accumulated other comprehensive loss

\$ (1,654)

\*) Less than \$ 1.

\*\*) Net of issuance expenses of \$585

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

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2005	2006	2007
<b>Cash flows from operating activities:</b>			
Net loss	\$ (9,099)	\$ (3,825)	\$ (2,544)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	5,226	5,807	4,037
Revaluation of Warrants (Series 1)	(79)	(46)	(71)
Amortization of convertible debt issuance expenses	42	230	228
Amortization of convertible debt discount and changes in embedded derivative	338	220	911
Exchange rate differences on convertible debt	-	-	742
Loss on repurchase of convertible debt	-	-	109
Gain on disposal of property and equipment	(1)	(75)	-
Stock-based compensation	10	38	118
Decrease (increase) in trade receivables	885	(2,154)	4,090
Decrease in other receivables and prepaid expenses	2,420	664	259
Decrease in deferred income taxes and reserves	814	160	103
Decrease in trade payables	(583)	(41)	(1,038)

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	Year ended December 31,		
Increase (decrease) in deferred revenues	1,965	(1,900)	493
Increase (decrease) in other liabilities and accrued expenses	(1,710)	76	(385)
Loss (gain) on marketable securities and bonds	71	(20)	(29)
Minority interests in earnings of a subsidiary and other	2	13	96
	<u>301</u>	<u>(853)</u>	<u>7,119</u>
<b>Net cash provided by (used in) operating activities</b>			
<b>Cash flows from investing activities:</b>			
Purchase of property and equipment	(366)	(276)	(190)
Increase in capitalized software development costs	(4,323)	(4,699)	(3,169)
Purchase of marketable securities and short-term deposits	(4,683)	(16)	-
Proceeds from sales of marketable securities and short-term deposits	10,318	5,319	41
Proceeds from sale of property and equipment	14	2	-
Investment in equity method investee	-	(168)	-
Other investment	(17)	-	-
	<u>943</u>	<u>162</u>	<u>(3,318)</u>
<b>Net cash provided by (used in) investing activities</b>			

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

	Year ended December 31,		
	2005	2006	2007
<b>Cash flows from financing activities:</b>			
Increase (decrease) in short-term bank credit, net	2,822	(2,962)	(4,610)
Proceeds from employee stock options exercised	-	-	69
Proceeds from issuance of Common shares, net	2,000	2,000	19,415
Principal payments and repurchase of convertible debt	-	(2,411)	(7,818)
Principal payments of long-term loans	(9,678)	-	(1,000)
	<u>(4,856)</u>	<u>(3,373)</u>	<u>6,056</u>
<b>Net cash provided by (used in) financing activities</b>			
Effect of exchange rate changes on cash and cash equivalents	(631)	473	160

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	Year ended December 31,		
Increase (decrease) in cash and cash equivalents	(4,243)	(3,591)	10,017
Cash and cash equivalents at the beginning of year	10,942	6,699	3,108
Cash and cash equivalents at the end of year	<u>\$ 6,699</u>	<u>\$ 3,108</u>	<u>\$ 13,125</u>
<u>Supplemental cash flow activities:</u>			
<u>Cash paid during the year for:</u>			
Interest	<u>\$ 2,281</u>	<u>\$ 2,132</u>	<u>\$ 1,992</u>
Income taxes	<u>\$ 144</u>	<u>\$ 221</u>	<u>\$ 120</u>
<u>Non-cash investing and financing activities:</u>			
Conversion of loan to shares	<u>\$ -</u>	<u>\$ 1,000</u>	<u>\$ -</u>

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1: GENERAL**

a. General:

The Company is a global provider of information technology ("IT") solutions that modernize business processes to enable insurance and other leading companies to quickly adapt to change. The Company's solutions, sold as customizable software modules, align IT with business demands for speed, flexibility and efficiency. The Company's solutions are supplemented by the Company's technology, methodology and consulting services, which address the complex issues related to the life-cycle of enterprise business applications. The Company's Sapiens INSIGHT(TM)suite of solutions includes scalable insurance applications the Company has developed for leading insurance organizations. The Company's service offerings include a standard consulting offering that helps customers make better use of IT in order to achieve its business objectives.

The Company's core technology, Sapiens eMerge , is a rules-based application development suite which enables rapid solution development for complex mission-critical enterprises to deliver new functionality, achieve legacy modernization and enterprise application integration.

Revenues from a major customer accounted for 11%, 17% and 20% of total revenues in the years ended December 31, 2005, 2006 and 2007, respectively.

b. Debentures:



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Subsequent to balance sheet date, in January and February 2008, the Company re-purchased an aggregate amount of NIS 7,600,000 nominal value, representing approximately \$2,100 of the outstanding debentures that were retired and removed from circulation on the Tel-Aviv Stock Exchange ("TASE").

c. Investment in eZoneXchange:

In April 2000, the Company completed a private placement of 600,000 shares of Common stock ("investors' shares") in its wholly-owned subsidiary, eZoneXchange.com, Inc. ("eZoneXchange"), for \$15,000. The investors also received a warrant to purchase an additional 2.25% of the Common stock of eZoneXchange at the same private placement share price of \$25 per share. As part of the transaction, the Company entered into a Put/Call Agreement pursuant to which the investors were granted the right (exercisable in whole or in part) to cause the Company during the put option exercise period (May 4, 2004 through May 3, 2005) to repurchase the investors' shares at the principal amount of the investors' investment plus 5% annual interest accrued thereon from May 4, 2000.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1: GENERAL (Cont.)**

On March 16, 2004, the Company and the investors signed an agreement according to which, among other terms specified in the agreement, the Company would redeem the remaining eZoneXchange Common shares and eZoneXchange warrants held by the investors by three means: (i) issuance of 750,000 of the Company's Common shares (valued at approximately \$2,700), (ii) issuance of a loan payable in the amount of \$8,600, bearing annual interest of 7.5% compounded annually on the outstanding principal from January 1, 2004, to be paid semi-annually, with principal payments of \$4,600 by no later than May 1, 2004, and \$4,000 by no later than May 1, 2005, and (iii) issuance of warrants to purchase 350,000 Common shares at an exercise price of \$4.00 per Common share of the Company, exercisable at any time and from time to time during the period from issuance to December 31, 2007. The warrants expired on December 31, 2007, without being exercised by the investors.

The difference between the fair value of the three components, equal to \$11,868, and the carrying amount of the liability before the modification of \$11,569, in the amount of \$299, was recorded as a Settlement of Redeemable Shares in a Subsidiary deemed dividend in the 2004 consolidated statement of operations.

On May 29, 2005, the Company entered into an agreement with the investors regarding the payment of the remaining \$4,000 originally due on May 1, 2005. It was agreed that the Company would pay \$2,000 on May 1, 2005, \$1,000 on April 1, 2006 and \$1,000 on August 1, 2006. The investors had the option, at their sole discretion, to convert all or any portion of the \$1,000 payable on August 1, 2006 into the Company's Common shares, at a conversion price per each share of \$3.20. In addition, the interest due on the remaining amount was changed to Libor + 2.5% (7.8% as of December 31, 2006). The first installment of \$2,000 was paid as required at the beginning of May 2005.

In August 2006, the Company entered into an agreement with the investors, whereby the investors received 781,250 Common shares as a conversion of the \$1,000 payment that was due on April 1, 2006. In addition, the payment of the \$1,000 payment originally payable on August 1, 2006, was extended to August 1, 2007.

The modification of the loan terms was accounted for as debt extinguishment in accordance with EITF 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments", due to the addition of a conversion option to the debt instrument which was considered substantial. The difference between the fair value of the modified loan and the book value of the original loan was de minimis.

In August 2007, the Company repaid the remaining outstanding balance of \$1,000 due to the investors, per the agreement described above.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands (except share and per share data)****NOTE 2: SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP").

a. Use of estimates:

U.S. GAAP requires management to make certain estimates, judgments and assumptions. Management believes that the estimates, judgments and assumptions upon which it relies, are reasonable based upon information available at the time that these estimates, judgments and assumptions were made. To the extent that there are material differences between these estimates and actual results, the financial statements may be affected.

b. Financial statements in U.S. dollars:

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

Thus, the functional and reporting currency of the Company and these subsidiaries is the dollar.

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

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

Foreign currency translation differences included in financial expenses (income), net, amounted to approximately \$(139), \$96 and \$663 for the years ended December 31, 2005, 2006 and 2007, respectively. See Note 15b for finance expenses.

c. Principles of consolidation:

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

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash, with maturities of three months or less at the date of acquisition.

## e. Marketable securities:

Management determines the proper classification of investments in marketable debt at the time of purchase and reevaluates such designations as of each balance sheet date. All securities covered by Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"), were designated as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in a separate component of shareholders' equity, accumulated other comprehensive loss. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the consolidated statement of operations as financial expenses, net. As of December 31, 2007 there is no outstanding balance of marketable securities.

## f. Allowance for doubtful accounts:

The allowance is determined based on management's evaluation of receivables doubtful of collection on a specific basis.

## g. Property and equipment, net:

Property and equipment are stated at cost, net of accumulated depreciation using the straight-line method over the estimated useful lives of the assets as follows:

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

## h. Impairment of long-lived assets:

The Company's long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. During 2005, 2006 and 2007, no impairment losses have been identified.

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## i. Capitalized software development costs:

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

Statement of Financial Accounting Standard No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed (SFAS No. 86), 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.

Significant costs incurred by the Company and its subsidiaries between the establishment of technological feasibility and the point at which the product is ready for general release, have been capitalized, net of participation by the OCS.

As for finance expenses capitalization, see Note 6a.

Capitalized software costs are amortized by the greater of the amount computed using: (i) the ratio that current gross revenues from sales of the software bear to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method between three to five years, which is the estimated useful life of the software product. The Company assesses the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold.

As of December 31, 2007, 2006 and 2005, no impairment of capitalized software development costs exists.

j. Goodwill:

Goodwill represents excess of the costs over the net assets of businesses acquired. Under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142) goodwill acquired in a business combination should not be amortized. SFAS No. 142 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is allocated to one reporting unit and fair values are determined using market capitalization.

Through 2007, no impairment losses were identified.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

k. Intangible assets:

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

Prepaid royalties	15 years
Distribution rights	7 years
Technology, usage rights and other intangible assets	4-8 years

During 2005, 2006 and 2007, no impairment losses have been identified.

l. Revenue recognition:

Product revenues include software license sales and implementation and customization services.

The Company recognizes revenue from software license sales in accordance with Statement of Position ( SOP ) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. Under SOP 97-2, revenues from software product licenses are recognized upon delivery of the software provided there is persuasive evidence of an agreement, the fee is fixed or determinable, collection of the related receivable is probable and no further obligations exist. Revenues under multiple-element arrangements, which may include software licenses, support and maintenance, and training and consulting services, are allocated to each element under the residual method when Vendor Specific Objective Evidence ( VSOE ) of Fair Value exists for all undelivered elements and VSOE does not exist for all of the delivered elements. Under the residual method, the Company defers revenues related to the undelivered elements based on their vendor-specific objective evidence of fair value and recognizes the remaining arrangement fee for the delivered elements.

When vendor-specific objective evidence of fair value for undelivered elements does not exist, revenues from the entire arrangement are recognized over the term of the agreement.

Revenues from support and maintenance agreements are recognized ratably over the term of the agreement, which is typically one year. Revenues from training arrangements are recognized as the services are performed.

The Company generally does not grant a right of return to its customers. When a right of return exists, revenue is deferred until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria are met.

Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Deferred revenue represents deferred maintenance revenue, and to a lesser extent, deferred software license revenues.

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Under certain circumstances, license revenue consists of license fees received whereby under the terms of these license agreements the Company's software is modified to that customer's specific requirements. Each license is designed to meet the specific requirements of the particular customer. Fees are payable upon completion of agreed-upon milestones, such as delivery of specifications and technical documentation.

Revenues from license fees that involve implementation and customization of the Company's software to customer specific requirements are generated from fixed-price or time-and-materials contracts. Such revenues are recognized in accordance with Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. Fixed-price contracts revenues are recognized using contract accounting on a percentage-of-completion method, over the period from signing of the license through to customer acceptance, in accordance with the Input Method or Output Method. The amounts of revenues recognized are based on the total license fees under the license agreement and the percentage to completion achieved. According to the Input Method, the percentage to completion is measured by monitoring progress using records of actual time incurred to date in the project compared to the total estimated project requirement, which corresponds to the costs related to earned revenues. According to the Output Method, the percentage to completion is determined by using technological or time-based milestones methods. The Company uses the Input Method when it has an enforceable right to services performed between milestones during the project.

Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology, and are reviewed and updated regularly by management. After delivery, if uncertainty exists about customer acceptance of the software, license revenue is not recognized until acceptance. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire

contract. As of December 31, 2007, no estimated losses were identified. Under time-and-materials contracts, the Company is reimbursed for labor hours at fixed hourly billing rates.

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

The Company believes that the use of the percentage of completion method is appropriate as the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of termination for convenience. In all cases, the Company expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Consulting and other services revenues also include training and post-contract maintenance services. Revenues from consulting services are recognized ratably over the contractual period or as services are performed.

m. Equity method investments

The Company's investments in a company (generally, that is held to the extent of 20% or more) which it has the ability to exercise significant influence over operating and financial policies are accounted for under the equity method. The Company applies Emerging Issues Task Force 99-10, *Percentage Used to Determine the Amount of Equity Method Losses*. Accordingly, losses of investee are recognized based on the ownership level of the particular investee security or loans held by the investor.

n. Advertising expenses:

Advertising expenses are charged to the statement of operations as incurred.

o. Government grants:

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

p. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standard No. 109, *Accounting for Income Taxes* (SFAS 109).

This Statement prescribes the use of the asset and liability method, whereby deferred tax assets and liability account balances are determined based on the differences between the 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 and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands (except share and per share data)****NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

On January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes- an interpretation of FASB statement No. 109 ( FIN 48 ). FIN 48 clarifies the accounting for uncertainties in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of FIN 48, the Company must review all of its tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying issue. The impact of the Company's consolidated financial position and results of operations as a result of the adoption of the provisions of FIN 48 was \$300, which was recognized as an adjustment to opening accumulated deficit.

**q. Concentrations of credit risk:**

Financial instruments that potentially subject the Company and certain of its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, marketable securities and trade receivables.

The Company's cash and cash equivalents are invested in deposits with major international financial institutions. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. 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 generally derived from sales to large and solid organizations located mainly in Europe, North America and Israel. The Company performs ongoing credit evaluations of its customers and has established an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers and other information. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

No off-balance sheet concentrations of credit risk exist.

**r. Fair value of financial instruments:**

The estimated fair value of financial instruments has been determined by the Company using available market information and valuation methodologies. Considerable judgment is required in estimating fair values. Accordingly, the estimates may not be indicative of the amounts the Company could realize in a current market exchange. The carrying amounts of cash and cash equivalents, trade accounts receivable, short-term bank credit and trade accounts payable approximate their fair values due to the short-term maturity of such instruments. The fair value for marketable securities is based on quoted market prices and does not significantly differ from a carrying amount.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The fair value of the convertible debentures with a carrying value in the amount of \$10,987 as of December 31, 2007 according to the quoted price in the Tel-Aviv Stock Exchange ( TASE ) is \$10,306.

s. Derivatives and hedging:

The Company accounts for derivatives and hedging based on Financial Accounting Standards Board Statement No. 133, Accounting for Derivative Instruments and Hedging Activities as amended ( SFAS 133 ). SFAS 133 requires companies to recognize all of its derivative instruments on the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship.

The Company enters into forward exchange contracts to hedge certain transactions denominated in foreign currencies. The purpose of the Company's foreign currency hedging activities is to protect the Company from risk that the eventual dollar cash flows from international activities will be adversely affected by changes in the exchange rates. The Company's forward contracts did not qualify as hedging instruments under SFAS 133.

Changes in the fair value of forward contracts are reflected in the consolidated statements of operations as financial income or expense.

In 2004, 2005 and 2007, the Company entered into forward currency agreements in the amount of \$1,500, \$1,500 and \$2,500 respectively, that converted a portion of its floating currency liabilities to a fixed rate basis for a 3 month period thus reducing the impact of the currency changes on the Company's cash flow. The agreements were settled in 2005, 2006 and 2007, resulting in a total gain of \$67, \$20 and \$158, respectively, presented in the statements of operations as financial income.

t. Basic and diluted net loss per share:

Basic net loss per share is computed based on the weighted average number of Common shares outstanding during each year. Diluted net earnings per share is computed based on the weighted average number of Common shares outstanding during each year, plus dilutive potential Common shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, Earnings Per Share .

In 2005, 2006 and 2007, all outstanding stock options, convertible debt and warrants have been excluded from the calculation of the diluted net loss per Common share because all such securities were anti-dilutive for the periods presented.

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

u. Stock-based compensation:

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS 123 (R) ), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ) which requires the measurement and recognition of compensation expense based on estimated fair values for all shared based payments awards made to employees and directors. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ( SAB 107 ) relating to SFAS 123 (R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123 (R).



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SFAS 123 (R) requires companies to estimate the fair value equity-based payment awards on the date of grant using an option-pricing model.

The value of the portion of the awards that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statement of operations.

The Company adopted SFAS 123 (R) using the Modified Prospective Method. Under that transition method, compensation cost recognized in the year ended December 31, 2006, includes compensation cost for all shared-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS 123 (R). Results for prior periods have not been restated.

Upon the adoption of SFAS 123 (R), forfeitures are estimated based on historical experience and other factors; previously, forfeitures were recorded as they occurred.

On December 28, 2005, the Company's Compensation Committee of the board of directors approved an acceleration of the vesting of all unvested stock options held by current employees, including executive officers and directors. All of the options were considered out-of-the-money since the stated option exercise price was greater than the closing price of the Company's Common stock on the day the Compensation Committee approved the acceleration (\$1.50). Unvested options to purchase approximately 1.7 million shares became exercisable as a result of the vesting acceleration. The accelerated vesting was effective as of December 28, 2005. The Company's decision to accelerate the vesting of those options was based primarily upon the issuance of SFAS No. 123 (R). The Company believes that the acceleration of vesting of those options will enable the Company to avoid recognizing stock-based compensation expense associated with these options in future periods. An additional purpose of the acceleration was to make the options more attractive to the recipients.

The vesting acceleration did not result in the recognition of additional compensation expense in the year ended December 31, 2005.

In 2006 and 2007, the Company granted 20,000 and 691,000 stock options to employees, respectively.

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### SAPIENS INTERNATIONAL CORPORATION N.V. AND ITS SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company estimates the fair value of stock options on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Year ended December 31,		
	2005	2006	2007
Expected term	6.9 years	6.25 years	6.25 years
Dividend yield	0%	0%	0%
Expected volatility	83%	67%	89%
Risk-free interest rate	4.4%	6%	4.2%

The risk-free interest rate assumption is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term as of the Company's employee stock options. The dividend yield assumption is based on the Company's historical and expectation of future dividend payouts and may be subject to substantial change in the future. The expected term of the options represents the period of time that the options are expected to be outstanding and is based on the simplified method, as allowed under SAB 107,

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which is the midpoint between the vesting date and the end of the contractual term of the options. The Company used its historical volatility for calculating volatility in accordance with SFAS 123 (R).

Stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense on a straight-line basis over the requisite service period for each of the awards.

For options granted prior to January 1, 2006, the Company accounted for its stock-based employee compensation plans using the intrinsic-value method of accounting set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ), but disclosed the pro forma effects on net loss and net loss per share had the fair value of the options been expensed. In accordance with APB 25 and related interpretations, compensation expense for stock options is recognized in income based on the excess, if any, of the fair value of the share at the grant date of the award or other measurement date over the amount an employee must pay to acquire the share.

The pro-forma results presented in the table below include approximately \$1,900 of compensation expense for the year ended December 31, 2005 resulting from the vesting acceleration.

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### SAPIENS INTERNATIONAL CORPORATION N.V. AND ITS SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The pro-forma table below reflects the Company's stock-based compensation expense, net income and basic and diluted loss per share for the year ended December 31, 2005, had the Company applied the fair value recognition provisions of SFAS123, as follows:

	<u>Year ended December 31, 2005</u>
Net loss to shareholders of Common shares- as reported	\$ 9,099
Less - stock-based employee compensation - intrinsic value	-
Add - stock-based employee compensation -fair value	<u>2,587</u>
Pro forma net loss	<u>\$ 11,686</u>
Basic and diluted net loss per share - as reported	<u>\$ 0.76</u>
Pro forma basic and diluted net loss per share	<u>\$ 0.98</u>

The Company applied SFAS 123 and EITF No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, with respect to options and warrants issued to non-employees. SFAS 123 requires the use of option valuation models to measure the fair value of the options and warrants at the measurement date as defined in EITF No. 96-18. In 2006 and 2007, there were no options and warrants granted to non-employees.

- v. Accrued severance pay:

The liability of the Company's subsidiaries in Israel for severance pay is calculated pursuant to Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The liability for all of its employees in Israel is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's consolidated balance sheet.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expense for the years 2005, 2006 and 2007 amounted to approximately \$547, \$773 and \$502, respectively.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

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

Expense for contributions made to these plans was \$518, \$568 and \$502 for 2005, 2006 and 2007, respectively.

w. Recently issued Accounting Standards:

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS 123 (R) and related interpretations. The statement does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (the FSP ). The FSP amends to delay the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). For items within its scope, the FSP defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact that this pronouncement may have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The adoption of the provisions of SFAS 159 will not have an impact on the Company's consolidated financial position and results of operations.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

On December 21, 2007 the SEC staff issued Staff Accounting Bulletin No. 110 ( SAB 110 ), which, effective January 1, 2008, amends and replaces SAB 107. SAB 110 expresses the views of the SEC staff regarding the use of simplified method in developing an estimate of expected term of plain vanilla share options in accordance with SFAS 123 (R). Under the simplified method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option.

The use of the simplified method, which was first described in SAB 107, was scheduled to expire on December 31, 2007. SAB 110 extends the use of the simplified method for plain vanilla awards in certain situations. The SEC staff does not expect the simplified method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. We are currently assessing the potential impact that the adoption of SAB 110 could have on our financial statements.

In December 2007, the FASB issued SFAS 141(R), Business Combinations ( SFAS 141 (R) ). This Statement replaces SFAS 141, Business Combinations, and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contractual contingencies, any contingent consideration, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. SFAS 141(R) also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141(R)). In addition, SFAS 141(R)'s requirement to measure the noncontrolling interest in the acquiree at fair value will result in recognizing the goodwill attributable to the noncontrolling interest in addition to that attributable to the acquirer. SFAS 141(R) amends SFAS 109, Accounting for Income Taxes, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. It also amends SFAS 142, Goodwill and Other Intangible Assets, to, among other things, provide guidance on the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently assessing the potential impact that the adoption of SFAS 141(R) could have on our financial statements.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements ( SFAS 160 ). SFAS 160 amends Accounting Research Bulletin 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income

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attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. Management believes this Standard will not have a material effect on its consolidated financial statements.

### NOTE 3: TRADE RECEIVABLES

The Company's net trade receivables are composed of accounts receivable in the amounts of \$7,108 and \$5,475 as of December 31, 2006 and 2007, and unbilled receivables in the amounts of \$3,902 and \$2,074 as of December 31, 2006 and 2007, respectively.

Bad debt expense totaled \$213, \$562 and \$195 for the years ended December 31, 2005, 2006 and 2007, respectively.

### NOTE 4: OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31,	
	2006	2007
Sales and other taxes receivable	\$ 204	\$ 108
Prepaid expenses	435	328
Deferred income taxes	907	953
Government grants	62	-
Employees receivables	23	27
Other	58	465
	\$ 1,689	\$ 1,881

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## SAPIENS INTERNATIONAL CORPORATION N.V. AND ITS SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

### NOTE 5: PROPERTY AND EQUIPMENT, NET

	Cost		Accumulated depreciation	
	December 31,			
	2006	2007	2006	2007
	U.S. dollars in thousands			
Equipment and furniture	\$ 2,384	\$ 2,306	\$ 1,992	\$ 1,983
Computer equipment and software	11,895	12,888	11,323	12,474
Motor vehicles	151	89	126	67
Leasehold improvements	2,296	2,446	1,790	1,986

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	Cost		Accumulated depreciation	
	\$ 16,726	\$ 17,729	\$ 15,231	\$ 16,510

Depreciation expense totaled \$876, \$690 and \$583 for the years 2005, 2006 and 2007, respectively.

As for pledges see Note 11.

**NOTE 6: OTHER ASSETS**

- a. Amortization expense for capitalized software development costs for 2005, 2006 and 2007, was \$3,769, \$4,565 and \$3,035, respectively. Amortization expense is included in cost of revenues.

In 2006 and 2007, \$523 and \$408 respectively, of interest expense was capitalized to software development costs.

- b. Other assets, net, are comprised of the following:

	Cost		Accumulated amortization		Other assets, net	
	December 31,					
	2006	2007	2006	2007	2006	2007
Prepaid royalties	\$ 2,074	\$ 2,074	1,890	\$ 2,022	\$ 184	\$ 52
Technologies and usage rights (1)	1,586	1,682	947	1,411	639	271
Deferred debt issuance costs (2)	1,528	1,528	534	929	994	599
	<u>\$ 5,188</u>	<u>\$ 5,284</u>	<u>\$ 3,371</u>	<u>\$ 4,362</u>	<u>\$ 1,817</u>	<u>\$ 922</u>

In addition, other assets include:

Severance pay fund					1,099	1,235
Long-term deposits					275	315
Other					259	110
					<u>1,633</u>	<u>1,660</u>
					<u>\$ 3,450</u>	<u>\$ 2,582</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6: OTHER ASSETS (Cont.)

- (1) In September 2004, the Company purchased the technologies underlying the Sapiens INSIGHT for Closed Books solution, for a minimum amount of approximately \$1,600 to be paid in 4 annual installments, beginning December 31, 2005. Under certain conditions set forth in the agreement, the consideration may increase in the future, based on the number of policies administered by such solution. Subsequent to balance sheet date, the December 31, 2007 payment of \$487 was paid.

The technologies are amortized over a 4 year period, which is the estimated useful life of the technologies.

- (2) As to the issuance of Debentures, Options (Series A) and Warrants (Series 1) (see Note 8b).

Amortization of other assets charged to expenses was \$623, \$791 and \$647 for 2005, 2006 and 2007, respectively.

As for impairment of long-lived assets, see Note 2h.

- c. Estimated amortization expense of prepaid royalties, technologies and usage rights, distribution rights and other intangible assets for the years ending:

	December 31, 2007
2008	640
2009	282
	\$ 922

## NOTE 7: OTHER LIABILITIES AND ACCRUED EXPENSES

	December 31,	
	2006	2007
Employee and related payroll accruals	\$ 3,003	\$ 3,104
Sales and other taxes payable	733	760
Accrued royalties to the OCS (Note 10a)	1,685	2,618
Accrued expenses and other liabilities	1,949	1,893
	\$ 7,370	\$ 8,375

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

## NOTE 8: DEBT

## a. Short-term bank credit:

As of December 31, 2007, the Company and its subsidiaries have a revolving credit line facility for borrowings of up to a total of \$9,200, available until June 30, 2008. As of December 31, 2007, the Company has an unutilized credit line of \$3,180. Under the terms of these credit line agreements, the Company and several of its subsidiaries recorded floating charges in favor of the banks over all the assets of Sapiens Technologies (1982) Ltd. and Sapiens Israel Software Systems Ltd. The Company also issued cross guarantees in support of the credit line facilities. Additionally, the Company is required to maintain certain financial ratios and results. In 2007, the Company fulfilled the covenant contained in its loan agreements pertaining to maintenance of cumulative, quarterly earnings at certain levels.

The Company is currently negotiating the extension of the credit line facility for an additional year.

Linkage	Weighted average interest				
	December 31,		December 31,		
	2006	2007	2006	2007	
	%				
Credit lines	NIS *)	6.7	6.2	\$ 4,728	\$ 1,058
Short-term loans	U.S. dollar	7.3	7.2	4,570	3,900
				\$ 9,298	\$ 4,958

\*) New Israeli Shekel, including immaterial amounts linked to other currencies.

## b. Convertible Debentures, Warrants and Options:

During December 2003, the Company completed an offering of securities in the Tel-Aviv Stock Exchange ( TASE ) in Israel, resulting in gross proceeds of NIS 75.2 million (approximately \$17,100). The price per unit was NIS 752 (approximately \$171.14) with 100,000 units sold. Each of the units consists of 800 Debentures (Series A), two Options (Series A) exercisable into Debentures (Series A) and six Warrants (Series 1) exercisable into Common shares of the Company.

The Debentures (Series A) are linked to the U.S. dollar with a floor exchange rate of NIS 4.3941 to the dollar, and bear annual interest at the rate of 6.0%, payable on the 5th of June and the 5th of December each year commencing on June 5, 2004 and ending on December 5, 2009. According to the original terms, principal is payable in four installments on the 5th of December of the years 2006-2009. During the period beginning 45 days after the registration of the Debentures (Series A) for trading on TASE and ending November 21, 2009, the Debentures (Series A) are convertible into Common shares at a conversion rate of one Common share per each NIS 27 (approximately \$6.14) amount of the Debentures, linked to the NIS/dollar exchange rate, with a floor exchange rate of NIS 4.3941 to the dollar. The Debentures (Series A) are unsecured.



**U.S. dollars in thousands (except share and per share data)****NOTE 8: DEBT (Cont.)**

Each Option (Series A) was exercisable into 100 Debentures (Series A) no later than March 3, 2004 at an exercise price of NIS 96 (approximately \$21.85). Through March 3, 2004, 179,663 Options (Series A) were exercised into Debentures (Series A), with a total exercise price of approximately \$3,800. 105,225 of the Options (Series A), with a total exercise price of approximately \$2,300, were exercised by one of the Company's subsidiaries in Israel. The remaining balance expired.

Each Warrant (Series 1) was exercisable into one Common share of the Company during the period beginning 45 days after the registration of the Debentures (Series A) for trading on TASE and ending November 21, 2007 at an exercise price of NIS 27 (approximately \$6.14) linked to the U.S. dollar. None of the 600,000 Warrants (Series 1) were exercised and they expired on November 21, 2007.

The Debentures (Series A) are, and the Options (Series A) and Warrants (Series 1) were, traded on TASE only. Any Common shares issued upon conversion of the Debentures (Series A) will be traded on both TASE and NASDAQ. The offering was made to the public in Israel only in accordance with Israeli securities laws. It was not open to persons residing in the United States or to other U.S. persons (other than distributors). The securities offered have not been registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration under such Act or an applicable exemption from registration.

Pursuant to an evaluation of the terms of the agreement under the provisions of EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In a Company's Own Stock (EITF 00-19), the Company has classified all the above derivative financial instruments issued in connection with issuance of the Debentures (Series A), Warrants (Series 1) and Options (Series A) as liabilities.

The conversion feature and the floor rate to the dollar payments were evaluated under FAS 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), and EITF 00-19, and were determined under EITF 00-19 to have characteristics of liabilities and therefore derivative liabilities under FAS 133. Each reporting period, these derivatives liabilities are marked to fair value with the non-cash gain or loss recorded in the period. At December 31, 2007, the aggregate derivatives liabilities were \$1,143, classified on the balance sheet as Convertible debentures and related warrants. The valuation of the embedded derivatives is determined by the Black and Scholes model and the Lattice model.

Amounts allocated to the Options (Series A) and the Warrants (Series 1) are accounted for as liabilities, in accordance with EITF 00-19, and are marked to market, based on their fair values in the TASE at each reporting date, against financial income (expense).

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands (except share and per share data)****NOTE 8: DEBT (Cont.)**

In August, 2006 the Company modified the terms of the first payment of the Debentures (Series A) that was due in December, 2006 as follows: (a) 50% of the first payment amount, approximately \$2,400, was deferred to December 5, 2009 (the last day of payment of the principal on the Debentures), and (b) with respect to other 50% of the first payment amount, the Company could choose from the following alternatives, in its sole discretion: (1) to convert such amount on December 5, 2006 into Company's Common shares, at a conversion price per share of \$1.28, which reflects the average closing price for the 10 day period prior to July 17, 2006, or (2) to pay the \$2,400 amount to the debenture holders.

On December 5, 2006, an amount of \$2,400 was paid to the debenture holders.

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The modification of the terms of the first payment of the Debentures (Series A) was accounted for in accordance with FAS 15 Accounting by Debtors and Creditors for Troubled Debt Restructurings . Accordingly, the Company calculated the new effective borrowing rate of the debt, which affected the amortization rate of the unamortized discount and unamortized issuance expenses as of the date of the restructuring.

In June 2007, the Company re-purchased an aggregate amount of NIS 15 million nominal value, representing \$3,500 of the outstanding Debentures (Series A) that were retired and removed from circulation on the TASE.

On December 5, 2007, an amount of \$4,400 was paid to the debenture holders, representing the second payment of the principal of the Debentures (Series A).

As of December 31, 2006 and 2007, the long-term outstanding balance of the convertible debt and warrants are as follows:

	December 31,	
	2006	2007
<b>Debentures:</b>		
Par value	\$ 19,508	\$ 11,497
Embedded derivatives, net *)	**) 1,135	1,366
Deemed discount, net *)	**) (1,947)	(966)
	18,696	11,897
Less -debentures purchased by one of the Company's subsidiaries	(2,521)	(1,945)
Less - current maturities of debentures	(4,450)	(3,524)
Warrants (Series 1)	71	-
	\$ 11,796	\$ 6,428

\*) Amortization of the deemed discount and the changes in the fair value of embedded derivatives charged to expenses were \$254 and \$911 for 2006 and 2007, respectively.

\*\*) The amounts were reclassified to conform to the current year presentation.

The share issuance expenses, which are classified to other assets (Note 6b), and the deemed discount, are amortized over the term of the Debentures (Series A), using the effective interest rate method.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 9: OTHER LONG-TERM LIABILITIES

December 31,

	Linkage	Interest	Maturity	2006	2007
		%			
Loan payable eZoneXchange *)	U.S. Dollar	Libor+2.5	Through 8/2007	\$ 1,000	\$ -
Other long-term liability **)	GBP	-	Through 12/2008	1,291	974
Other long-term debt	Japanese Yen	2.175	2/2011	-	270
				2,291	1,244
Less - current maturities of long-term liabilities				(1,854)	(974)
				437	270
Accrued severance pay				924	769
Minority interest				78	93
				\$ 1,439	\$ 1,132

\*) See Note 1c.

\*\*\*) See Note 6(b)(1).

Interest expense in respect of the above liabilities was approximately \$800, \$300 and \$60 for 2005, 2006 and 2007, respectively.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 10: COMMITMENTS AND CONTINGENT LIABILITIES**

- a. Sapiens Technologies (1982) Ltd. ( Technologies ), a subsidiary incorporated in Israel, partially finances its research and development expenditures under programs sponsored by the OCS for the support of certain research and development activities conducted in Israel.

In exchange for participation in the programs by the OCS, the Company agreed to pay 3%-3.5% of total net consolidated license and maintenance revenue and 0.35% of the net consolidated consulting services revenue related to the software developed within the framework of these programs. The royalties will be paid up to a maximum amount equaling 100%-150% of the grants provided by the OCS, and for grants received after January 1, 1999, bear annual interest at a rate based on LIBOR. Repayment of such grants is not required in the event that there are no sales of products developed within the framework of such funded programs.

Royalties paid or accrued amounted to approximately \$1,100, \$500 and \$930 in 2005, 2006 and 2007, respectively, and are included in cost of revenues.

As of December 31, 2007, the Company had a contingent liability to pay royalties of approximately \$9,500.

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

	<u>Operating leases</u>
2008	\$ 2,689
2009	2,131
2010	1,447
2011	456
2012 and thereafter	298
	<hr/>
<u>Total</u> future minimum lease payments	\$ 7,021
	<hr/>

Rent expense for the years 2005, 2006 and 2007 was \$2,200, \$2,300 and \$1,820, respectively.

- c. In July 2006, the city council of Rehovot, Israel, notified the Company of (a) an increase in the annual property taxes payable by the Company and (b) a claim for \$895 for property taxes due for the years 2000 through 2006. In March 2007, the Company filed an appeal against the increase and the claim for taxes due for previous years. Based on the opinion of legal counsel, the Company believes that it is probable that the amount being claimed retroactively (for the period of 2000 through 2006) will be cancelled. The Company is currently negotiating a settlement of the claim, and has accrued approximately \$100 with respect to such claim.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 10: COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

Subsequent to the balance sheet date, a former employee filed a claim against the Company for the amount that such employee was required to pay to the Israel Tax Authorities as the result of his exercise of stock options. The Company believes that such claim lacks merit and the Company, based on the advice of its legal counsel, believes that it has a reasonable defense. The Company does not believe that the claim reflects a probable loss contingency, in accordance with Statement of the Financial Accounting Standard Board No. 5, Accounting for Contingencies .

The Company is a party to various other legal proceedings and claims that arise in the ordinary course of business. The total aggregate amount of exposure of such proceedings and claims, except for the above mentioned claims, is approximately \$300, of which an accrual in the amount of approximately \$100 was recorded in accordance with Statement of the Financial Accounting Standard Board No. 5, Accounting for Contingencies .

- d. As for tax assessments, see Note 12(c).
- e. See Note 6(b)(1) for a contingent liability related to a purchased technology.

**NOTE 11: SECURITY INTERESTS AND PLEDGES**

The Company and several of its subsidiaries granted floating charges to certain financial institutions and issued cross guarantees in support of the credit facilities described in Note 8a above.

The Company's leased assets are pledged to the finance companies that provided the lease financing and the banks providing credit lines. The pledges are for various terms depending on the asset leased.

The Company has provided bank guarantees in the amount of approximately \$343 as security for the rent to be paid for its leased offices in Israel. The lease is valid for approximately six years ending 2010. If the Company were to breach certain terms of its lease, the lessor could demand that the banks providing the guarantees pay amounts claimed to be due.

As of December 31, 2007 the Company has provided bank guarantees in the amount of approximately \$600 as security for the performance of various contracts with customers. If the Company were to breach certain terms of such contracts, the customers could demand that the banks providing the guarantees pay amounts claimed to be due.

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12: TAXES ON INCOME

a. Net operating losses carryforward:

At December 31, 2007, the Company's subsidiary in the U.S. had net operating loss carryforward for U.S. federal income tax purposes of approximately \$5,300.

Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the change in ownership provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitations may result in the expiration of net operating losses before utilization.

In addition, the Company had net operating losses carryforwards relating to non-U.S. subsidiaries totaling approximately \$51,500, which is available to offset future taxable income. Generally, a majority of such amounts have no expiration date.

b. Israeli income tax:

Sapiens Technologies, has been granted Approved Enterprise status for number of investment programs approved by the Israeli Government under the Law for Encouragement of Capital Investments, 1959 (the Capital Investments Law).

Undistributed Israeli income derived from the Approved Enterprise programs entitle Technologies to a tax exemption for a period of two to four years and to a reduced tax rate of 10% - 25% for an additional period of three to eight years (depending on the level of foreign-investment in Technologies). These tax benefits are subject to a limitation of the earlier of twelve years from commencement of operations, or fourteen years from receipt of the approval. This limitation does not apply for the years of tax exemption. The law also grants entitlement to claim accelerated depreciation on machinery and equipment used by the Approved Enterprise, during the first five years, which the Company claims.

Income from sources other than the Approved Enterprise during the benefit period is subject to tax at the regular corporate tax rate of 29% in 2007, 27% in 2008, 26% in 2009, and 25% in 2010 and thereafter.

The entitlement to the above benefits is conditional upon the Company fulfilling the conditions stipulated by the Capital Investments Law, regulations published thereunder and the Instruments of approval for the specific investments in Approved Enterprises.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 12: TAXES ON INCOME (Cont.)**

In the event of failure to comply with these conditions, the benefits may be cancelled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. In the event of a distribution of such tax-exempt income including, among other things, a cash dividend, the Company will be required to pay tax at the rate of 10%-25% on the gross amount distributed. In addition, these dividends will be subject to a 15% withholding tax.

On April 1, 2005, an amendment to the Capital Investments Law came into effect (the Amendment) and has significantly changed the provisions of the Capital Investments Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a Privileged Enterprise, such as provisions generally requiring that at least 25% of the Privileged Enterprise's income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Capital Investments Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Capital Investments Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore, the Company's existing Approved Enterprise will generally not be subject to the provisions of the Amendment.

As a result of the Amendment among others, tax-exempt income generated under the provisions of the new law, will subject the Company to taxes upon distribution or liquidation and the Company may be required to record deferred tax liability with respect to such tax-exempt income. As of December 31, 2007, the Company did not generate income under the Amendment.

Commencing 2005, the Company's Israeli subsidiaries have elected to file their tax returns under the Israeli Income Tax Regulations 1986 (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income). Such an election obligates the Company's Israeli subsidiaries for the first three years. Accordingly, commencing 2005, results for tax purposes are measured in terms of U.S. dollars.

c. Tax assessments

Technologies and some of the Company's group entities have final tax assessments through the year 2003.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 12: TAXES ON INCOME (Cont.)**

- d. The Company adopted the provisions of FIN 48 on January 1, 2007. As of January 1, 2007, the difference between the provisions of SFAS 109 and FIN 48 of \$300 was recorded as an adjustment to the accumulated deficit.

At December 31, 2007, the Company had a liability for unrecognized tax benefits of \$150. During 2007, the Company and its subsidiaries were subject to examination by various tax authorities in jurisdictions such as Japan and UK. As a result of the settlement of the tax matters, the Company recorded a reduction in Provision for income taxes of \$150 related to settlement of tax

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matters. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<u>Operating leases</u>
Balance as of January 1, 2007	\$ 300
Reductions related to settlement of tax matters	(150)
Balance at December 31, 2007	<u>\$ 150</u>

e. Deferred income taxes:

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

	<u>December 31, 2006</u>		<u>December 31, 2007</u>	
	<u>Current</u>	<u>Non- current</u>	<u>Current</u>	<u>Non- current</u>
Gross deferred tax assets	\$ 907	\$ 15,814	\$ 1,626	\$ 11,784
Less - valuation allowance	-	(13,067)	(673)	(9,186)
Net deferred tax asset	<u>\$ 907</u>	<u>\$ 2,747</u>	<u>\$ 953</u>	<u>\$ 2,598</u>

During the year ended December 31, 2007, the Company and its subsidiaries have decreased the deferred income taxes assets resulting from tax loss carryforwards and other tax credits by \$3,311 and the related valuation by \$3,208. Management currently believes that it is more likely than not that the deferred income taxes regarding the loss carryforwards and other temporary differences, on which a valuation allowance has been provided, will not be realized in the foreseeable future.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 12: TAXES ON INCOME (Cont.)**

Provisions for income tax expense are comprised of the following:

	<u>Year ended December 31,</u>		
	<u>2005</u>	<u>2006</u>	<u>2007</u>
Current (foreign)	\$ 198	\$ 165	\$ 235

	Year ended December 31,		
	2005	2006	2007
Deferred (foreign)	*) 1,600	160	103
	\$ 1,798	\$ 325	\$ 338

\*) Including the write-off of tax advances in the amount of \$783.

The Company's entire provision for taxes on income relates to operations in jurisdictions other than the Netherlands Antilles. The effective income tax rate varies from period to period because each jurisdiction in which the Company and its subsidiaries operate has its own system of taxation (not only with respect to the nominal rate, but also with respect to the allowance of deductions, credits and other benefits).

The main reconciling items from the statutory tax rate of the Company to the effective tax rate is the non-recognition of tax benefits from accumulated net operating losses carryforward among the various subsidiaries worldwide due to the uncertainty of the realization of such tax benefits and a write off of tax advances.

f. Loss before taxes on income is comprised as follows:

	Year ended December 31,		
	2005	2006	2007
Domestic	\$ 2,683	\$ 2,450	\$ 4,471
Foreign	4,616	1,037	(2,361)
	\$ 7,299	\$ 3,487	\$ 2,110

#### NOTE 13: SHAREHOLDERS EQUITY

- a. On June 27, 2005, the Company entered into a share purchase agreement with its controlling shareholder, Formula Systems (1985) Ltd. (Formula), whereby Formula invested \$2.0 million in the Company and the Company issued 1,041,667 Common shares to Formula, at a purchase price per share of \$1.92, which was the average closing price for the 10 day period prior to the execution of the agreement.
- b. In August 2006, the Company entered into an agreement with Formula, whereby Formula invested \$2,000 in the Company and the Company issued 1,562,500 Common shares to Formula, at a price per share of \$1.28 which was the average closing price over the 10 day period prior to July 17, 2006.

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 13: SHAREHOLDERS EQUITY (Cont.)



- c. In August 2006, the Company entered into an agreement with the investors in eZoneXchange, whereby the investors converted the \$1,000 payment that was due on April 1, 2006 into 781,250 Common shares at a conversion price per share of \$1.28, which was the average closing price over the 10 day period prior to July 17, 2006.
- d. In June 2007, the Company entered into a private placement investment transaction with several institutional investors, private investors, and Formula for an aggregate gross investment amount of \$19,415 (net of issuance expenses of \$585). The Company issued the investors an aggregate of 6,666,667 Common Shares, at a price per share of \$3.00.
- e. On April 4, 2001, the Company entered into a share purchase and loan agreement with Red Coral Holdings, Inc. ( Red Coral ), a company owned by the Company's former President and Chief Executive Officer. According to the terms of the share purchase agreement, Red Coral purchased 300,000 Common shares of the Company for a purchase price of \$975. As part of the loan agreement, the Company granted to Red Coral a loan in the amount of \$975 for the purpose of acquiring the Common shares. The term of the loan was six years, with accrued interest at a rate of 4%, which was payable on January 15<sup>th</sup> of each calendar year. The interest amount was fully-recourse and fixed. To secure payment of the loan, Red Coral granted to the Company a lien and security interest on the 300,000 Common shares of the Company that it owned. To secure fulfillment of the terms of the agreement, the Common shares were held in escrow by the General Counsel of the Company. The issuance of Common shares was recorded in shareholders' equity and the loan amount was deducted from the shareholders' equity as a Note receivable from a related party shareholder.

In accordance with EITF 95-16, "Accounting for Stock Compensation Arrangements with Employer Loan Features under APB Opinion No. 25", the transaction was accounted for as a fixed award.

On November 10, 2005, the Company's former President and Chief Executive Officer was replaced by its current President and Chief Executive Officer. Following the departure of the former President and Chief Executive Officer, the Company postponed the due date of the January 15, 2006 and 2007 interest payments, until the due date for repayment of the principal amount of the loan (April 4, 2007), and converted the final two interest payments from fully-recourse to non-recourse.

On April 4, 2007, the term of the loan expired. In May 2007, the Company foreclosed its lien on the 300,000 Common shares of the Company owned by Red Coral. As a result, the loan agreement was terminated and Red Coral has no further obligations to the Company. Accordingly, the note receivable was written off.

- f. Common shares confer upon their holders voting rights, the right to receive cash dividends and the right to share in excess assets upon liquidation of the Company.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 13: SHAREHOLDERS' EQUITY (Cont.)**

- g. Stock option plan:

Stock options granted under the Company's 1992 Stock Option and Incentive Plan (the 1992 Stock Plan) to employees, directors and service providers are exercisable at the fair market value of the Company's Common shares on the date of grant and, subject to termination of employment, expire ten years from the date of grant and are generally exercisable in four equal annual installments commencing one year from the date of grant, unless otherwise determined by the Compensation Committee of the Company's board of directors.

In 2003, the Company's Board of Directors and shareholders authorized the extension of the 1992 Stock Plan until April 2012. Also in 2003, the Company's Board of Directors and shareholders approved the 2003 Share Option Plan (the 2003 Option Plan), including the reservation of 500,000 Common Shares for grant pursuant to such plan. The 1992 Stock Plan and the 2003 Option Plan are referred together as the Plan.

In August 2004, the Company's shareholders approved an increase of the number of Common shares available for grant pursuant to the Plan by an additional 500,000 Shares.

In November 2005, the Company's Board of Directors approved a new Incentive Stock Option Plan (the Special Plan). The number of Common shares available for grants pursuant to the Special Plan was set at 2,000,000 shares. The Special Plan is intended to be used solely to attract or retain senior management and/or Board members. Options granted pursuant to the Special Plan will have an exercise price of \$3.00, will be locked for up to five years, and will be contingent upon the optionee providing services to the Company throughout the entire five year period. In the event of a change of control of the Company, the vesting of such options will be accelerated. The Special Plan was approved by the Company's shareholders, at the 2006 Annual General Meeting of Shareholders.

In November 2005, the Company's current President and Chief Executive Officer was granted options to purchase 240,000 shares pursuant to the 2003 Option Plan and additional options to purchase 1,000,000 shares pursuant to the Special Plan.

On December 28, 2005, the 240,000 options under the 2003 Option Plan and the 1,000,000 options under the Special Plan were accelerated and became fully exercisable. See Note 2u.

As of December 31, 2007, 896,267 options to Common shares of the Company are available for future grant. Any options, which are forfeited or cancelled before expiration, become available for future grant under the Plan.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 13: SHAREHOLDERS' EQUITY (Cont.)**

A summary of the stock options activities in 2007, is as follows:

		Year ended		
		December 31, 2007		
	Amount of options	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value
			(Years)	
Outstanding -beginning of year	*) 2,441,050	\$ 4.68	6.45	
Granted	691,000	\$ 2.39	9.50	
Exercised	(29,569)	\$ 2.35	-	
Expired, cancelled and forfeited	(276,581)	\$ 5.53	5.31	
Outstanding at end of year	*) 2,825,900	\$ 4.01	6.67	\$ 21,470

Vested and expected to vest

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	Year ended					
at end of year	2,721,650	\$	4.02	6.14	\$	21,043
Exercisable options at end of year	2,130,900	\$	4.58	5.50	\$	18,620

\*) Including 59,000 and 14,000 options repriced to zero in 2005, as of December 31, 2006 and 2007, respectively.

The aggregate intrinsic value is the difference between the Company's closing stock price on the last trading day of the fiscal year 2007 and the exercise price, multiplied by the number of in-the-money options that would have been received by the option holders had all option holders exercised their options on December 31, 2007. This aggregate intrinsic value changes based on the fair market value of the Company's shares.

The options outstanding as of December 31, 2007, have been classified by range of exercise price, as follows:

Exercise price	Options outstanding as of December 31, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2007	Weighted average exercise Price
\$ 0	14,000	0.83	\$ 0	14,000	\$ 0
\$ 1.14 - \$1.86	458,000	7.22	\$ 1.65	325,000	\$ 1.74
\$ 2.00 - \$ 2.63	540,450	8.05	\$ 2.31	228,450	\$ 2.31
\$ 3.00	1,250,000	8.17	\$ 3.00	1,000,000	\$ 3.00
\$ 3.28 - \$ 3.75	30,900	2.34	\$ 3.73	30,900	\$ 3.73
\$ 4.06 - \$ 5.15	332,950	2.53	\$ 4.24	332,950	\$ 4.24
\$ 5.25 - \$ 5.70	116,450	1.28	\$ 5.49	116,450	\$ 5.49
\$ 16.875 - \$ 34.375	46,550	1.31	\$ 31.75	46,550	\$ 31.75
\$ 43.13 - \$ 45.0	20,000	1.81	\$ 44.89	20,000	\$ 44.89
\$ 61.25 - \$ 69.375	16,600	1.92	\$ 67.71	16,600	\$ 67.71
	<b>2,825,900</b>		<b>\$ 4.01</b>	<b>2,130,900</b>	<b>\$ 4.58</b>

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SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13: SHAREHOLDERS EQUITY (Cont.)

The weighted average grant date fair values of the options granted during the years ended December 31, 2005, 2006 and 2007 were \$1.61, \$0.52 and \$1.38, respectively. The total intrinsic value of options exercised during the years ended December 31, 2005, 2006 and 2007 was \$30,821, \$0 and \$17,666, respectively. Compensation expense recognized amounted to \$0, \$32 and \$115 for the years ended December 31, 2005, 2006 and 2007, respectively.

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As of December 31, 2007, there was \$670 of total unrecognized compensation cost related to nonvested options granted under the Plan and the Special Plan, which is expected to be recognized over a period of up to four years.

Upon exercise of options by employees, the Company satisfies the requirements by issuing newly issued shares.

- h. During 2005 and 2006, the Company decided to extend the exercise period for certain former employees. The extensions were accounted for in accordance with FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25 and FAS 123 (R), by applying a new measurement date, which resulted in no additional compensation expenses. Total options extended during 2005 and 2006 were 313,250 and 86,800, respectively.
- i. Warrants:

In 2005, warrants were granted to advisory board members. As of December 31, 2007, warrants are outstanding as follows:

Warrants to Common shares	Weighted average exercise price per share	Warrants exercisable	Exercisable through
11,000	\$ 2.00	5,500	May 2015
17,000	2.24	8,500	February 2015
28,000	\$ 2.15	14,000	

These warrants were measured at fair value (according to Black Scholes option pricing model) with the following assumptions: Risk free rate of 3.5%, dividend yields of 0%, expected volatility of 80% and contractual life of the warrants of ten years. Total compensation expense amounted to \$25, of which \$6 and \$3 were recorded in 2006 and 2007, respectively.

- j. As for warrants granted to investors as part of the settlement of redeemable shares in a subsidiary, the investors did not exercise the warrants and therefore the warrants expired on December 31, 2007. See Note 1c.
- k. As for 600,000 Warrants (Series 1) offered to the public, none of the 600,000 Warrants (Series 1) were exercised and they expired on November 21, 2007. See Note 8b.

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 13: SHAREHOLDERS EQUITY (Cont.)

1. The total stock-based compensation expenses related to all of the Company's equity-based awards recognized for the years ended December 31, 2006 and 2007 was \$38 and \$118, respectively. The total stock-based compensation expenses were recorded as general and administrative expenses.

#### NOTE 14: GEOGRAPHIC INFORMATION

- a. The Company operates in a single segment as a provider of software solutions. See Note 1 for brief description of the Company's business. The data below is presented in accordance with Statement of Financial Accounting Standard No. 131, Disclosure about Segments of an Enterprise and Related Information.

## b. Geographic information:

The following is a summary of operations within geographic markets.

	Year ended December 31,		
	2005	2006	2007
<b>1. Revenues:</b>			
U.K.	\$ 12,604	\$ 13,805	\$ 13,417
North America	10,046	9,895	10,061
Israel	9,147	12,072	13,824
France	1,131	902	389
Germany	1,414	837	475
Japan	3,902	4,491	4,071
Switzerland	1,160	2,309	158
	<u>\$ 39,404</u>	<u>\$ 44,311</u>	<u>\$ 42,395</u>

	December 31,	
	2006	2007
<b>2. Long-lived assets:</b>		
Israel	\$ 15,025	\$ 15,570
France	496	518
Netherlands Antilles	184	52
Other	445	784
	<u>\$ 16,150</u>	<u>\$ 16,924</u>

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**SAPIENS INTERNATIONAL CORPORATION N.V.  
AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 15: SELECTED STATEMENTS OF OPERATIONS DATA**

a. Research and development expenses:

	Year ended December 31,		
	2005	2006	2007
Total costs	\$ 7,566	\$ 7,150	\$ 6,635

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	Year ended December 31,		
Less - capitalized software development costs, net of royalties bearing grants	(4,323)	(4,699)	(3,133)
Less - royalty-bearing grants	(520)	-	-
Research and development expenses, net	\$ 2,723	\$ 2,451	\$ 3,502

b. Financial expenses, net:

	Year ended December 31,		
	2005	2006	2007
<b>Financial income:</b>			
Interest	\$ 309	\$ 122	\$ 458
Re-evaluation of Warrants (Series 1) which are classified as liabilities	79	46	71
Foreign currency transaction differences	213	81	250
Income on sale of marketable securities and bonds	-	20	29
	601	269	808
<b>Financial expenses:</b>			
Interest *)	1,780	1,640	1,924
Foreign currency transaction differences	74	177	913
Bank charges and others	84	198	109
Loss on sale of marketable securities and bonds	71	-	-
Amortization of issuance expenses and discount on convertible notes	380	484	551
Loss on repurchase of convertible debentures	-	-	109
	2,389	2,499	3,606
Financial expenses, net	\$ 1,788	\$ 2,230	\$ 2,798

\*) For capitalization of interest expenses, see Note 6a.

**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and has duly caused and authorized the undersigned to sign this annual report on its behalf.

SAPIENS INTERNATIONAL CORPORATION N.V.

By: /s/ Ron Al Dor

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Ron Al Dor  
President & Chief Executive Officer

Date: June 25, 2008

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