

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Our business, operating results and financial condition could be seriously harmed due to any of the following risks. The trading price of our ordinary shares could decline due to any of these risks.

We may experience significant fluctuations in our annual and quarterly results, which makes it difficult for investors to make reliable period-to-period comparisons and may contribute to volatility in the market price for our ordinary shares and American Depositary Shares.

Our quarterly and annual revenues, gross profits and results of operations have fluctuated significantly in the past and we expect them to continue to fluctuate significantly in the future. The following events may cause fluctuations:

- acquisitions and dispositions of companies and consolidation of our subsidiaries;
- the size, time and recognition of revenue from significant contracts;
- timing of product releases;
- foreign currencies value and timing of contracts;
- delays in implementation;
- changes in the proportion of service and license revenues;
- price and product competition;
- increases in selling and marketing expenses, as well as other operating expenses;
- technological changes;
- adverse economic conditions and currency fluctuations;
- the global business slow-down and the the recent sharp decline in capital spending in the information technology sector; and
- consolidation of our customers.

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A substantial portion of our expenses, including most product development and selling and marketing expenses, must be incurred in advance of when revenue is generated. If our projected revenue does not meet our expectations, we are likely to experience an even larger shortfall in our operating profit relative to our expectations. The gross margins of our subsidiaries also will vary both among themselves and over time. As a result, changes in the revenue mix from these subsidiaries may affect quarterly operating results. In addition, we may derive a significant portion of our net income from transactions which involve equity issuances by our subsidiaries, the sale of equity securities of our subsidiaries or the sale of proprietary software technology. These events do not occur on a regular basis and their timing is difficult to predict. As a result, we believe that period-to-period comparisons of our historical results of operations are not necessarily meaningful and that you should not rely on them as an indication for future performance. Also, it is possible that our quarterly and annual results of operations may be below the expectations of public market analysts and investors. If this happens, the price of our ordinary shares will likely decrease.

We have been influenced by the recent global economic changes, and, in particular, the decline in information technology spending. If this trend continues, our business may be harmed.

We have been affected by global economic changes, in particular the recent sharp decline in capital spending in the information technology, or IT, sector and the overall business slow-down in North America and Europe, as well as in Israel. As a result of these global trends, in 2001, certain of our subsidiaries posted restructuring charges of approximately \$11 million, related primarily to severance costs for employees, relocation expenses and expenses related to closing of branches. In addition, in 2001, certain of our subsidiaries wrote off goodwill and certain investments of \$37 million in the aggregate, as a result of the effect of the global slow-down. We cannot assure you that this trend will not continue. Uncertainties in the North American and European market have influenced the purchasing patterns of leading software developers who delayed their planned orders and caused developers to reduce the amount of their planned license commitments. These changes in purchasing patterns in the IT industry directly affected the operating results of some of our subsidiaries which in turn affected our consolidated operating results. If this trend continues, our business could be seriously harmed.

If Formula Vision fails to repay its debt to us under the debentures, our business, financial condition and results of operations would be materially adversely affected.

One of our major assets is comprised of debentures issued to us by Formula Vision Technologies (F.V.T.) Ltd., or Formula Vision, in December 2001 and March 2002, in connection with the sale of private companies held by us to Formula Vision. The aggregate amount of the debentures, as of December 31, 2002 is \$76 million. We evaluate, periodically, the quality of the indebtedness, the financial strength of Formula Vision and its ability to meet the repayment schedule of the loan. However, in the event that Formula Vision fails to repay the loan under the terms of the debentures, our business, financial condition and results of operations would be materially adversely affected.

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Our success depends upon the development and maintenance of strategic alliances.

We established relationships with strategic partners to provide international marketing presence and name recognition, as well as the resources necessary to implement many of our IT services. We are dependent upon our strategic partners for the marketing and selling of certain of our proprietary software solutions. Recently, due to the global business slow-down, we have encountered difficulties in entering into new partnerships. If we cannot maintain our existing relationships with these partners or if we fail to establish effective, long-term relationships with additional partners, or if our partners enter into relationships with our competitors, our ability to market our proprietary software solutions in international markets may be limited. If this happens, our growth, if any, might be delayed or slowed-down. As a result our

business, financial condition, and results of operations could be seriously harmed.

If our products fail to compete successfully with those of our competitors, we may have to reduce the prices of our products, which in turn, may adversely affect our business.

We face competition, both in Israel and internationally, from a variety of companies, including companies with significantly greater resources than us who are likely to enjoy substantial competitive advantages, including:

- longer operating histories;
- greater financial, technical, marketing and other resources;
- greater name recognition;
- well-established relationships with our current and potential clients; and
- a broader range of products and services.

As a result, they may be able to respond more quickly to new or emerging technologies or changes in customer requirements. They may also benefit from greater purchasing economies, offer more aggressive product and service pricing or devote greater resources to the promotion of their products and services. In addition, in the future, we may face further competition from new market entrants and possible alliances between existing competitors. We also face additional competition as we continue to penetrate international markets. As a result, we cannot assure you that the products and solutions we offer will compete successfully with those of our competitors. Furthermore, several software development centers worldwide, like in India, offer software development services at much lower prices than we do. Due to the intense competition in the markets in which we operate, software products prices may fluctuate significantly. As a result, we may have to reduce the prices of our products, which in turn, may adversely affect our business.

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If we fail to compete for acquisitions and investments, we may be unable to grow.

As part of our strategy, we intend to pursue acquisitions of, and investments in, other companies. If and when acquisition or investment opportunities occur, we expect to compete for these opportunities with other established and well-capitalized entities. We cannot assure you that we will be able to locate potential acquisition or investment opportunities in Israel or internationally on terms which are favorable to us. If we fail to consummate further acquisitions or investments in the future our ability to grow may be harmed.

Any future acquisitions of companies or technologies and our restructuring process may distract our management and disrupt our business.

Our strategy includes selective acquisitions of, and investments in, companies offering products and services suitable for integration into our business. We may acquire or make investments in complementary businesses, technologies, services or products if appropriate opportunities arise. We may engage in discussions and negotiations with companies about our acquiring or investing in those companies' businesses, products, services or technologies. We cannot assure you that we will be able to identify future suitable acquisition or investment candidates, or if we do identify suitable candidates, that we will be able to make the acquisitions or investments on commercially acceptable terms or at all. In addition, we have begun in 1999, a restructuring process of the Formula Group. This process involved acquisitions of interest in certain of our subsidiaries and affiliates by other subsidiaries and integration of businesses of certain subsidiaries within the businesses of other subsidiaries. If we acquire or invest in another company, or if any of our subsidiaries acquires control in another subsidiary or affiliate, the acquirer could have difficulty assimilating that company's personnel, operations, technology or products and service offerings into its own. The key personnel of the acquired company may decide not to work for the acquirer. These difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and adversely affect our results of operations. We may incur indebtedness or issue equity securities to pay for any future acquisitions. The issuance of equity securities could be dilutive to our existing shareholders.

We intend to pursue acquisitions outside of Israel as part of our expansion strategy. These acquisitions, as well as any future acquisitions of companies located outside of Israel, would pose additional risks, including monitoring a management team from a great distance and integrating a potentially different business culture. Our failure to successfully integrate these new businesses could harm our business. In addition, the investigation of acquisition candidates outside of Israel involves higher costs than those associated with pursuing domestic acquisitions, and we cannot assure you that these investigations will result in transactions.

If we fail to raise capital for our subsidiaries, we may be required to borrow money on unfavorable terms.

Our business strategy involves raising capital for our subsidiaries through public or private offerings. Our ability to raise capital for our subsidiaries depends upon market and other conditions which are beyond our control. If we fail to raise capital for our subsidiaries, it may hinder their growth. We may therefore be required to seek alternative capital raising methods, including borrowing money on terms which are not favorable to us. Due to difficulties we encountered in 2002 in raising capital for our subsidiaries, we were required to borrow increased amounts from banks. Our short-term bank debt increased to \$87.8 million as of December 31, 2002 compared to \$53.3 million as of December 31, 2001. Difficulties in raising capital on favorable terms, may materially and adversely affect our business, operating results and financial condition.

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

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

A substantial portion of our assets is pledged to banks. 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.

Marketing our products and services in international markets may require increased expenses and greater exposure to risks

that we may not be able to successfully address.

We intend to continue to focus our efforts on selling proprietary software solutions in international markets. We expect to continue devoting significant resources to these efforts. If we are unable to continue achieving market acceptance for our solutions or otherwise continue to successfully penetrate international markets, our business will be harmed. In 2001 and 2002, we received approximately 43% and 45% of our total revenues from customers located outside of Israel. The expansion of our existing operations and entry into additional international markets will require significant management attention and financial resources. We are subject to a number of risks customary for international operations, including:

- changing product and service requirements in response to the formation of economic and marketing unions, including the European Economic Union;
- economic or political changes in international markets;
- greater difficulty in accounts receivable collection and longer collection periods;
- unexpected changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;

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- the uncertainty of protection for intellectual property rights in some countries;
- multiple and possibly overlapping tax structures; and
- currency and exchange rate fluctuations.

If we grow and fail to address the strain on our resources caused by our growth, we will be unable to effectively manage our business.

Our business has grown in complexity over the past few years. The growth of our business, as well as the corporate organizational changes, have placed and will continue to place a strain on our personnel and resources. Our ability to manage any future growth, if any, depends on our ability to continue to implement and improve our operational, financial and management information control and reporting systems on a timely basis and to expand, train, motivate and manage our work force. If we do not manage our growth, if any, effectively, our business, financial condition and results of operations could be materially adversely affected.

If we are unable to attract, train and retain qualified personnel, we may not be able to achieve our objectives and our business could be harmed.

In order to achieve our objectives, we may need to hire additional qualified software, administrative, operational, sales and technical support personnel. The process of attracting, training and successfully integrating qualified personnel into our operations can be lengthy and expensive. We may not be able to compete effectively for the personnel we need. Our future success depends on our ability to absorb and retain senior employees and to attract, motivate and retain highly qualified professional employees. We expect to recruit most of our software and systems personnel in Israel. In addition, our operations are dependent on the efforts of certain key management. Any loss of members of senior management or key technical personnel, or any failure to attract or retain highly qualified employees as needed, could materially adversely affect our business.

If we are unable to accurately predict and respond to market developments or demands, our business will be adversely affected.

The IT business is characterized by rapidly evolving technology and methodologies. This makes it difficult to predict demand and market acceptance for our services and products. In order to succeed, we need to adapt the products and services we offer to technological developments and changes in customer needs. We cannot guarantee that we will succeed in enhancing our products and services or developing or acquiring new products and services that adequately address changing technologies and customer requirements. We also cannot assure you that the products and services we offer will be accepted by customers. If our products and services are not accepted by customers, our future revenues and profitability will be adversely affected. Changes in technologies, industry standards, the regulatory environment, customer requirements and new product introductions by existing or future competitors could render our existing products and services obsolete and unmarketable, or require us to enhance our current products or develop new products. This may require us to expend significant amounts of money, time and other resources to meet the demand. This could strain our personnel and financial resources.

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If we are unable to retain control in our subsidiaries, we would cease to consolidate them and our operating results may fluctuate significantly.

We currently hold a controlling interest in our subsidiaries through our direct equity holdings. From time to time, if and when required, we enter into voting agreements with other shareholders of the companies, in order to retain control of our subsidiaries. As a result of our controlling interests in the subsidiaries, we consolidate their operating results with ours. If we are unable to maintain a controlling interest in our subsidiaries, as a result of equity issuances by subsidiaries, failure to reach voting agreements or otherwise, we would cease to consolidate the operating results of these subsidiaries. This may result in significant fluctuations of our consolidated operating results.

We are exposed to significant claims for damage caused to our customers' information systems.

Some of the products and services we provide involve key aspects of clients' information systems. These systems are frequently critical to our clients' operations. As a result, our clients have a greater sensitivity to failures in these systems than do clients of other software products generally. We have never been the subject of a material damages claim related to our products and services. However, if a client's system fails during or following the provision of products or services by us, or if we fail to provide customers with proper support for our software products, we are exposed to the risk of filing a claim for substantial damages against us, regardless of our responsibility for the failure. We have signed agreements with our customers for the provision of various software services. When possible, we limit our liability under our product and service contracts. We cannot guarantee that these limitations of liability, if any, would be sufficient to protect us against legal claims. We maintain general liability and professional liability insurance coverage. However, we cannot assure you that our insurance coverage will be sufficient to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. If we lose one or more, large claims against us that exceed available insurance

coverage, our business, operating results and financial condition may be materially adversely affected. In addition, the filing of legal claims against us in connection with contract liability may cause us negative publicity and damage to our reputation.

If third parties assert claims of infringement against us, we may suffer substantial costs and diversion of management's attention.

Substantial litigation over intellectual property rights exists in the software industry. We expect that software products may be increasingly subject to third-party infringement claims as the functionality of products in different industry segments overlaps. We believe that many industry participants have filed or intend to file patent and trademark applications covering aspects of their technology. Although our products and services have never been the subject of an infringement proceeding, we cannot predict whether third parties will assert claims of infringement against us. Any claims, with or without merit, could:

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- be expensive and time-consuming to defend;
- divert management's attention and resources; or
- require us to enter into royalty or licensing agreements to obtain the right to use a necessary product or component.

Royalty or licensing agreements, if required, may not be available on acceptable terms, if at all. A successful claim of product infringement against us and our failure or inability to license the infringed or similar technology could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to adequately protect our proprietary rights, which may limit our ability to compete effectively.

Our success and ability to compete are substantially dependent upon our internally developed technology. Substantially all of our intellectual property consists of proprietary or confidential information that is not subject to patent or similar protection. In general, we have relied on a combination of technical leadership, trade secret, copyright and trademark law and nondisclosure agreements to protect our proprietary know-how. Unauthorized third parties may attempt to copy or obtain and use the technology protected by those rights. Any infringement of our intellectual property could have a material adverse effect on our business, financial condition and results of operations. Policing unauthorized use of our products is difficult and costly, particularly in countries where the laws may not protect our proprietary rights as fully as in the United States. We have placed, and in the future may place, certain of our software in escrow. The software may, under specified circumstances, be made available to our customers. We have provided our software directly to customers. This may increase the likelihood of misappropriation or other misuse of our software.

Two shareholders control a significant portion of our ordinary shares and influence the outcome of matters that require shareholder approval.

Dan Goldstein, our chairman of the board, and his brother, Gad Goldstein, our president and a member of our board, own, in the aggregate, 23.3% of our outstanding ordinary shares. As a result, Dan Goldstein and Gad Goldstein are able to influence significantly the outcome of those matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. This share ownership may have the effect of delaying or preventing a change in control. In addition, potential conflicts of interest may arise in the event that we enter into agreements or transactions with these persons. Although Israeli law imposes certain procedures (including shareholder approval) for approval of certain related party transactions, we cannot assure you that these procedures will eliminate the possible detrimental effects of these conflicts of interest. If certain transactions are not approved in accordance with required procedures under applicable Israeli law, these transactions may be void or voidable.

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For information about a binding memorandum entered in February 2002, between Dan and Gad Goldstein and Iscal Holdings Ltd., see "Item 7. Major shareholders and Related Party Transactions."

The market price of our ordinary shares and American Depositary Shares may be volatile and you may not be able to resell your shares at or above the price you paid, or at all.

The stock market in general has recently experienced extreme price and volume fluctuations. The market prices of securities of technology companies have been extremely volatile, and have experienced fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market fluctuations could adversely affect the market price of our ordinary shares and American Depositary Shares, or ADSs. The market price of our ordinary shares, for example, fluctuated between NIS 151.30 and NIS 48.11 during 2001. In this period, the market price of our ADSs fluctuated between \$38.00 and \$11.25. In 2002, the market price of our ordinary shares fluctuated between NIS 75.80 and NIS 40.12. In this period, the market price of our ADSs fluctuated between \$16.92 and \$8.16. The market price of the ordinary shares and the ADSs may fluctuate substantially due to a variety of factors, including:

- any actual or anticipated fluctuations in our or our competitors' quarterly revenues and operating results;
- shortfalls in our operating results from levels forecast by securities analysts;
- public announcements concerning us or our competitors;
- the introduction or market acceptance of new service offerings by us or our competitors;
- changes in product pricing policies by us or our competitors;
- changes in security analysts' financial estimates;
- changes in accounting principles;
- sales of our shares by existing shareholders; and
- the loss of any of our key personnel.

In addition, economic, political and market conditions and military conflicts and in particular, those specifically related to the State of Israel, may affect the market price of our shares.

We may be adversely affected if the market prices of our publicly traded subsidiaries and affiliates decrease.

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A significant portion of our assets is comprised of equity securities of publicly and non-publicly traded companies. Our publicly traded subsidiaries are Crystal Systems Solutions Ltd., Magic Software Enterprises Ltd., Matrix IT Ltd. and Sapiens International Corporation N.V. The stock prices of these publicly traded companies have been extremely volatile, and have experienced fluctuations due to market conditions and other factors which are beyond our control. Fluctuations in the market price and valuations of our holdings in these companies may affect the value of our assets. In addition, the stock prices of many technology companies fluctuate significantly for reasons that may be unrelated to operating results. If the value of our assets decreases significantly as a result of the above, our business, operating results and financial condition, may be materially and adversely affected.

Future sales of our shares in the public market or issuances of additional securities could cause the market price for our ordinary shares and ADSs to fall.

As of June 1, 2003, we had 10,000,000 ordinary shares outstanding, of which 490,662 were represented by ADSs. Of the 10,000,000 shares outstanding, 2,330,534 shares are held by affiliates. In addition, we have reserved 564,500 ordinary shares for issuance under our option plans and options granted to Shandol Ltd. We intend to register for resale these reserved ordinary shares upon issuance. If a large number of our ordinary shares are sold in a short period, the price of our ordinary shares would likely decrease.

We do not intend to pay dividends.

In August 2001, Formula distributed to its shareholders a dividend in kind of Formula Vision's (formerly known as Mashov Computers Ltd.) shares held by Formula, which was distributed in the form of cash to holders of our ADRs. Other than this distribution, Formula has never declared or paid cash dividends on its ordinary shares. We currently intend to retain any future earnings to finance operations and to expand our business and, therefore, do not expect to pay any cash dividends in the foreseeable future.

Our United States investors could suffer adverse tax consequences if we are characterized as a passive foreign investment company.

Although we do not believe that we were a passive foreign investment company for U.S. federal income tax purposes during 2002, we cannot assure you that we will not be treated as a passive foreign investment company in 2003 or in future years. We would be a passive foreign investment company if 75% or more of our gross income in a taxable year is passive income. We would also be a passive foreign investment company if at least 50% of the average value, or possibly the adjusted bases of our assets in particular circumstances, of our assets in a taxable year produce, or are held for the production of, passive income. Passive income includes interest, dividends, royalties, rents and annuities. If we are or become a passive foreign investment company, many of you will be subject to adverse tax consequences, including:

- taxation at the highest ordinary income tax rates in effect during your holding period on some distributions on our ordinary shares or ADSs, and on gain from the sale or other disposition of our ordinary shares;

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- paying interest on taxes allocable to prior periods; and
- no increase in the tax basis of our ordinary shares to fair market value at the date of your death.

Our operating profit may decrease if the rate of inflation in Israel exceeds the rate of devaluation of the new Israeli shekel against the dollar.

Most of our revenues from sale of our products and services are in dollars or are linked to the dollar, while a substantial portion of our expenses, principally salaries and related personnel expenses, are in new Israeli shekels, or NIS. As a result, we are exposed to the risk that the rate of inflation in Israel exceeds the rate of devaluation of the NIS in relation to the dollar or that the timing of this devaluation lags behind inflation in Israel. This would have the effect of increasing the dollar cost of our operations and decreasing our operating profit. In recent years, the rate of devaluation of the NIS against the dollar has exceeded the rate of inflation, a reversal from prior years. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation of the NIS against the dollar. If the dollar cost of our operations in Israel increases, our operating profit will be adversely affected. To date, we have not engaged in significant hedging transactions. In the future, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of the dollar against the NIS. However, we cannot assure you that these measures will adequately protect us from adverse effects arising from the impact of inflation in Israel.

Risks Relating to Operations in Israel

Political, economic, and military conditions in Israel could negatively impact our business.

Our headquarters and principal research and development facilities are located in Israel. Although we generate approximately 45% of our revenues from international markets, we are, nonetheless, directly influenced by the political, economic and military conditions affecting Israel. Since September 2000, the violence between Israel and the Palestinians has intensified and a material escalation in the violence has occurred. The future of the peace efforts between Israel and its Arab neighbors is uncertain. Major hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our business, operating results and financial condition. Furthermore, several countries restrict business with Israeli companies. In addition, all nonexempt male adult citizens of Israel, including some of our officers and employees, are obligated to perform military reserve duty and are subject to being called for active duty under emergency circumstances. While we have operated effectively under these requirements since our incorporation, we cannot predict the full impact of such conditions on us in the future, particularly if emergency circumstances occur. If many of our employees are called for active duty, our operations in Israel and our business may be adversely affected.

The tax benefits available to us from government programs may be discontinued or reduced at any time, which would likely increase our taxes.

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