

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Our business prospects, operating results and financial condition could be seriously harmed due to any of the following risks. Additional risks and uncertainties that we are not aware of or that we currently believe are immaterial may also adversely affect our business prospects, financial condition, and results of operations. The trading prices of our ordinary shares and ADSs could decline due to any of these risks, and you may lose all or part of your investment.

Risks Related to Our Business and Our Industry

Rapid technological changes may adversely affect the market acceptance of our products and services, and our business, results of operations and financial condition could be adversely affected; adapting to evolving technologies can require substantial financial investments, distract management and adversely affect the demand for our existing products or services.

We compete in markets that are characterized by rapid technological changes. Other companies are also seeking to offer software solutions and other products and services in our markets, including enterprise mobility solutions, internet-related solutions, such as cloud computing and business solutions for the insurance and financial services industry, all to generate growth. These companies may develop technological or business model innovations in the markets that we seek to address that are, or are perceived to be, equivalent or superior to our products. Furthermore, many of our smaller competitors have been acquired by larger competitors, which provides such smaller competitors with greater resources and potentially a larger client base for which they can develop solutions. Our customers or potential customers may prefer suppliers that are larger than us, are better known in the market or that have a greater global reach.

In addition, our customers' business models may change in ways that we do not anticipate and these changes could reduce or eliminate our customers' needs for our products and services. Our operating results depend on our ability to adapt to market changes and develop and introduce new products and services into existing and emerging markets.

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

- Supporting existing and emerging hardware, software, databases and networking platforms; and
- Developing and introducing new and enhanced software development technology and applications that keep pace with such technological developments, emerging new product markets and changing customer requirements.

Adapting to evolving technologies can require substantial financial investments, distract management and adversely affect the demand for our existing products and services. In addition, if release dates of any future products or enhancements are delayed or if they fail to achieve market acceptance when released, our business, financial condition and results of operations could be adversely affected.

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

If our products and software services 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 ours who are likely to enjoy substantial competitive advantages, including:

- longer operating histories;
- closer proximity to future markets;
- greater financial, technical, marketing and other resources;
- cheaper costs, including labor cost;
- political leverage;
- greater name recognition;
- well-established relationships with our current and potential clients; and
- a broader range of products and services.

These competitors 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. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase such competitors' ability to successfully market their tools and services. We also expect that competition will increase as a result of continued consolidation within the industry. Our further penetration of international markets may likewise cause us to face additional competition. As a result, we cannot assure you that the products and solutions that we offer will compete successfully with those of our competitors.

We may be unable to differentiate our tools and services from those of our competitors or successfully develop and introduce new tools and services that are less costly than, or superior to, those of our competitors. This could have a material adverse effect on our ability to compete.

Furthermore, several software development centers worldwide offer software development services at lower prices than we do. Due to the intense competition in the markets in which we operate, software products and services prices may fluctuate significantly. As a result, we may have to reduce the prices of our products, which in turn, may adversely affect our revenues and the gross margins for our products.

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, and which can therefore adversely affect our results of operations.

Our business is characterized by certain 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, are relatively fixed. Therefore, a variation in the timing of the initiation, progress or completion of projects or engagements can cause significant variations in operating results from quarter to quarter.

This is particularly the case on fixed-price contracts. Some of our solutions and services are sold as fixed-price projects with delivery requirements spanning more than one year. As certain of our projects can be highly complex, we may not be able to accurately estimate our actual costs of completing a fixed-price project. If our actual cost-to-completion of these projects exceeds significantly the estimated costs, we could experience a loss on the related contracts, which would have a material adverse effect on our results of operations, financial position and cash flow.

Similarly, delays in executing client contracts (whether fixed price or not) may affect our revenue and cause our operating results to vary widely. Certain of our solutions 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 effect on our results of operations, financial position or cash flows.

Our development cycles are lengthy, we may not have the resources available to complete development of new, enhanced or modified, solutions and we may incur significant expenses before we generate revenues, if any, from our solutions.

Because development of a significant portion of our solutions is complex and requires rigorous testing, development cycles can be lengthy, taking us up to two years to develop and introduce new, enhanced or modified solutions. Moreover, development projects can be technically challenging and expensive. The nature of these development cycles may cause us to experience delays between the time we incur expenses associated with research and development and the time we generate revenues, if any, from such expenses. Furthermore, we may invest substantial resources in the development of solutions that do not achieve market acceptance or commercial success. We may also not have sufficient funds or other resources to make the required investments in product development. Even where we succeed in our sales efforts and obtain new orders from customers, the complexity involved in delivering certain of our solutions to such customers makes it more difficult for us to consummate delivery in a timely manner and to recognize revenue and maximize profitability. Failure to deliver our solutions in a timely manner could result in order cancellations, damage our reputation and require us to indemnify our customers. Any of these risks relating to our lengthy and expensive development cycle could have a material adverse effect on our business, financial conditions and results of operations.

Our sales cycle is variable, depends upon many factors outside our control, and could cause us to expend significant time and resources prior to earning associated revenues.

The typical sales cycle for certain of our solutions and services is lengthy and unpredictable, requires pre-purchase evaluation by a significant number of persons in our customers' organizations, and often involves a significant operational decision by our customers. Our sales efforts involve educating our customers and industry analysts about the use and benefits of our products and services, including the technical capabilities of our products and the potential cost savings achievable by organizations deploying our solutions or utilize our services. Customers typically undertake a significant evaluation process, which frequently involves not only our products, but also those of our competitors and can result in a lengthy sales cycle with little or no control over any delays encountered by us. We spend substantial time, effort and money in our sales efforts without any assurance that such efforts will produce any sales.

We may be liable to our clients for damages caused by a violation of intellectual property rights, the disclosure of other confidential information, including personally identifiable information, system failures, errors or unsatisfactory performance of services, and our insurance policies may not be sufficient to cover these damages.

We often have access to, and are required to collect and store, sensitive or confidential client information, including personally identifiable information. Some of our client agreements do not limit our potential liability for breaches of confidentiality, infringement indemnity and certain other matters. Furthermore, breaches of confidentiality may entitle the aggrieved party to equitable remedies, including injunctive relief. If any person, including any of our employees and subcontractors, penetrates our network security or misappropriates sensitive or confidential client information, including personally identifiable information, we could be subject to significant liability from our clients or from our clients' customers for breaching contractual confidentiality provisions or privacy laws. Despite measures we take to protect the intellectual property and other confidential information or personally identifiable information of our clients, unauthorized parties, including our employees and subcontractors, may attempt to misappropriate certain intellectual property rights that are proprietary to our clients or otherwise breach our clients' confidences. Unauthorized disclosure of sensitive or confidential client information, including personally identifiable information, or a violation of intellectual property rights, whether through employee misconduct, breach of our computer systems, systems failure or otherwise, may subject us to liabilities, damage our reputation and cause us to lose clients.

Many of our contracts involve projects that are critical to the operations of our clients' businesses and provide benefits to our clients that may be difficult to quantify. Any failure in a client's system or any breach of security could result in a claim for substantial damages against us, regardless of our responsibility for such failure. Furthermore, any errors by our employees in the performance of services for a client, or poor execution of such services, could result in a client terminating our engagement and seeking damages from us.

Although we attempt to limit our contractual liability for consequential damages in rendering our services, these limitations on liability may not apply in all circumstances, may be unenforceable in some cases, or may be insufficient to protect us from liability for damages. There may be instances when liabilities for damages are greater than the insurance coverage we hold and we will have to internalize those losses, damages and liabilities not covered by our insurance.

If we fail to locate, successfully compete for and consummate suitable acquisitions and investments, we may be unable to grow or maintain our market share.

As part of our strategy, we intend to pursue acquisitions of, and investments in, other businesses, particularly businesses offering products, technologies and services that are complementary to ours and are suitable for integration into our business. We cannot assure you that we will be able to locate suitable potential acquisition or investment opportunities in Israel or internationally, or if we do identify suitable candidates, that at the conclusion of related discussions and negotiations, we will be able to consummate the acquisitions or investments on terms which are favorable to us. If and when acquisition or investment opportunities arise, we expect to compete for these opportunities with other established and well-capitalized entities and we cannot guarantee that we will succeed in such competition on terms which remain favorable to us. If we fail to consummate further acquisitions or investments in the future, our ability to grow or to even maintain our market share may be harmed.

Any future acquisitions of, or investments in, companies or technologies, especially those located outside of Israel, may distract our management, disrupt our business and may be difficult to finance on favorable terms.

As described above, it is part of our strategy to pursue acquisitions of, and investments in, companies offering products, technologies and services in order to expand our product offerings or services or otherwise enhance our market position and strategic strengths. In the past three years we made a number of acquisitions, including:

In April 2014, Formula acquired InSync Staffing Solutions, Inc., a U.S. based full-service provider of consulting and staffing solutions for IT, engineering and other professional staff (i.e. accounting and finance, administrative, customer service, healthcare, human resources, manufacturing, marketing/sales, and operations). The total consideration paid by Formula was \$4.0 million.

In January 2012, our subsidiary Matrix acquired a 60% interest in Exzac Inc., a U.S. based company in the field of risk management for financial institutions that deals in commerce, and which specializes in application services for enterprise fraud management. In consideration for the shares, Matrix paid the sellers an amount of \$6.8 million with the addition of approximately \$0.2 million for Exzac Inc. equity (Moreover, the sellers were entitled to an additional consideration that is contingent on meeting certain targets based on the excess of operating income results over predetermined amount, but in any event not more than \$2.5 million). As part of the acquisition both Matrix and the sellers received mutual options for the purchase of the sellers' remaining shares in Exzac Inc. On December 19, 2012, the option was partially exercised and Matrix purchased from one of the sellers its shares in Exzac (20% of the Exzac Inc. shares, in consideration of \$5.0 million and with additional consideration that was to be calculated according to a formula based on the Exzac results in 2014), while the option for purchasing the remaining 20% in Exzac Inc., was exercised on January 5, 2014 (in consideration of \$5.0 million and with additional consideration that was to be calculated according to a predetermined formula based on the Exzac results in 2014). At the request of the sellers, in November 2014, Matrix agreed to an early settlement of the remaining contingent amount based on an estimated calculation of Exzac results in 2014. As of December 31, 2014 Matrix holds 100% in Exzac without any liability to any of the sellers.

In August 2014, our subsidiary Sapiens acquired Knowledge Partners International LLC, or KPI and the assets of The Decision Model Licensing LLC, or TDML. KPI is a leader in decision management consultancy, services and training and through TDML owns certain patents used as part of Sapiens' Decision solution. The total consideration was \$2.1 million in cash and 57,000 ordinary shares of Sapiens Software Solutions (Decision) Ltd., or Sapiens Decision, the subsidiary of Sapiens which holds all of the interests in KPI. In addition, one of the shareholders of KPI received 88,500 restricted shares of Sapiens Decision plus \$450,000 in cash, subject to certain performance criteria.

In February 2015, Magic Software entered into a definitive agreement to acquire a 70% stake, with an option to increase the holding to 100%, in a profitable Israeli-based company that specializes in software professional services for mainframes and complex large-scale environments.

In November 2013, Magic Software acquired the operations of Allstates Technical Services, LLC, a U.S. based full-service provider of consulting and staffing solutions for IT, Engineering and Telecom personnel, for a total consideration of \$11.0 million.

During the year ended December 31, 2014, Matrix completed three acquisitions for a total cash consideration of up to approximately \$4.7 million, of which \$ 3.1 million was attributed to goodwill and \$ 1.3 million to other identifiable intangible assets. These acquisitions generally enhance our group's technologies, product and services offerings.

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

- Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired businesses or enterprises;
- Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;
- Potential difficulties in completing projects associated with in-process research and development;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- Insufficient revenue to offset increased expenses associated with acquisitions; and
- The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

Furthermore, we may not be able to retain the key employees that may be necessary to operate the businesses we acquired and may acquire and we may not be able to timely attract new skilled employees and management to replace them. An acquisition may also involve accounting charges and/or amortization of significant amounts of intangible assets, which would adversely affect our ability to achieve and maintain profitability. These difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and adversely affect our results of operations.

Any acquisition or investment in a company located outside of Israel poses additional risks, including risks related to the monitoring of a management team from a great distance and the need to integrate a potentially different business culture. Our failure to successfully integrate such a newly acquired business or such an investment could harm our business.

We may furthermore need to raise capital in connection with any such acquisition or investment, which we would likely seek via public or private equity or debt offerings. The issuance of equity securities pursuant to any such financing could be dilutive to our existing shareholders. The issuance of equity securities by our any of our significant subsidiaries pursuant to any such financing could be dilutive to our existing interest in these subsidiaries. If we raise funds through debt offerings, we may be pressured in serving such debt. If we use cash or debt financing, our financial liquidity will be reduced, the holders of our debt may have claims on our assets ahead of holders of our ordinary shares and our business operations may be restricted by the terms of any debt. Our ability to raise capital in this manner also depends upon market and other conditions, many of which are beyond our control. Due to unfavorable conditions, we could be required to seek alternative financing methods, such as bank financings, which involve borrowing money on terms that are not favorable to us. Difficulties in raising equity capital or obtaining debt financing on favorable terms, or the unavailability of financing, including bank borrowings, may hinder our ability to implement our strategy for selective acquisitions and investments.

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

We have experienced rapid growth during the last five years, through both acquisitions and organic growth. The number of our employees increased from approximately 5,339 as of December 31, 2010 to approximately 10,108 as of December 31, 2014 (including our affiliate Magic Software) and may increase further as we aim to enhance our businesses. This increase may significantly strain our management and other operational and financial resources. In particular, continued headcount growth increases the integration challenges involved in:

- recruiting, training and retaining skilled technical, marketing and management personnel;
- maintaining high quality standards;
- preserving our corporate culture, values and entrepreneurial environment;
- developing and improving our internal administrative infrastructure, particularly our financial, operational, communications and other internal controls; and
- maintaining high levels of client satisfaction.

The rapid execution necessary to exploit the market for our business model requires an effective planning and management process. Our systems, procedures or controls may not be adequate to support the growth in our operations, and our management may not be able to achieve the rapid execution necessary to exploit the market for our business model. Our future operating results will also depend on our ability to expand our development, sales and marketing organizations. If we are unable to manage growth effectively, our profitability will likely decline.

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

We regularly review our long-lived assets, including identifiable intangible assets and goodwill, for impairment. Goodwill and indefinite life intangible assets are subject to impairment review at least annually. Other long-lived assets are reviewed when there is an indication that impairment may have occurred. The amount of goodwill and identifiable intangible assets on our consolidated balance sheet has increased significantly from \$199.6 million as of December 31, 2010 to \$267.1 million and \$449.3 million as of December 31, 2013 and 2014, respectively, as a result of our acquisitions, and may increase further following future acquisitions. Impairment testing under U.S. GAAP may lead to further impairment charges in the future. Any significant impairment charges could have a material adverse effect on our results of operations.

During the years ended December 31, 2012, 2013 and 2014, no impairment was required for any of our reporting units and no impairment losses were identified for these intangible assets and software products.

Our credit facility agreements with banks and other financial institutions contain a number of restrictive covenants which, if breached, could result in acceleration of our obligation to repay our debt.

In the context of our engagements with banks and other financial institutions for receiving various credit facilities we have undertaken to maintain a number of conditions and limitations on the manner in which we can operate our business, including limitations on our ability to incur debt and sell or acquire assets. These credit facilities agreements also contain various covenants which require us to maintain certain financial ratios related to shareholders' equity, total rate of debt and liabilities, minimum outstanding balance of total cash and short-term investments 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 and, by extension, to our shareholders. In addition, we have secured a credit facility with certain of the shares of each of Formula's publicly held subsidiaries Matrix and Sapiens and affiliate Magic Software. A breach of the restrictive covenants could result in the acceleration of our obligations to repay our 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 and services in international markets and to devote significant resources to these efforts to expand our international operations as part of our growth strategy. If we are unable to continue achieving market acceptance for our solutions or continue to successfully penetrate international markets, our business will be harmed. In 2013 and 2014, we received approximately 34% and 16.5% of our consolidated revenues, respectively, from customers located outside of Israel (including but not limited to the United States, Europe, Japan, Asia-Pacific, India and South Africa). The expansion of our existing operations and entry into additional international markets will require significant management attention and financial resources which could adversely affect our business. If we had continued to consolidate Magic's revenues in all of 2014, 28% of our revenues would have been generated from customers located outside of Israel.

Our international operation subjects us to many risks inherent to international business activities, including:

- limitations and disruptions resulting from the imposition of government controls;
- changes in regulatory requirements;
- export license requirements;
- economic or political instability;

- trade restrictions;
- changes in tariffs;
- currency fluctuations;
- difficulties in the collection of receivables;
- foreign tax consequences;
- compliance with the U.S. Foreign Corrupt Practices Act of 1977, as amended, or FCPA, particularly in emerging market countries;
- increased financial accounting and reporting burdens and complexities;
- greater difficulty in localizing certain of our products and licensing programs for international customers
- greater difficulty in safeguarding intellectual property; and
- difficulties in managing overseas subsidiaries and international operations.

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

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

During periods of slowing economic activity our customers may reduce their demand for our products, technology and software services, which would reduce our sales, and our business, operating results and financial condition may be adversely affected. Economies throughout the world currently face a number of challenges, including threatened sovereign defaults, credit downgrades, restricted credit for businesses and consumers and potentially falling demand for a variety of products and services. Notwithstanding the improving economic conditions in some of our markets, many companies are still cutting back expenditures or delaying plans to add additional personnel or systems. Any further worsening of global economic conditions could result in longer sales cycles, slower adoption of new technologies and increased price competition for our products and services. We could also be exposed to credit risk and payment delinquencies on our accounts receivable, which are not covered by collateral. Any of these events would likely harm our business, operating results and financial condition.

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

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

In addition, as a provider of software solutions that rely upon technological advancements and because part of our software solutions are considered highly complex and are generally used by our customers to perform critical business functions we rely heavily on our research and development activities to remain competitive. We consequently depend in large part on the ability to attract, train, motivate and retain heavily skilled information technology professionals for our research and development team, particularly individuals with knowledge and experience in niche vertical industries. These skilled technology professionals are often in high demand and short supply. If we are unable to hire or retain qualified research and development personnel and other technology professionals to develop, implement and modify our solutions, we may be unable to meet the needs of our customers. Even if we succeed in retaining the necessary skilled personnel and in our research and development efforts, our investments in our personnel and product development efforts increase our costs of operations and thereby reduce our profitability, unless accompanied by increased revenues. Given the highly competitive industry in which we operate, we may not succeed in increasing our revenues in line with our increasing investments in our personnel and research and development efforts.

Furthermore, if we seek to expand the marketing and offering of our products into new territories, that requires the retention of new, additional skilled personnel with knowledge of the particular market and applicable regulatory regime. Such skilled personnel may not be available at a reasonable cost relative to the additional revenues that we expect to recognize in those territories, or may not be available at all.

Errors or defects in our software solutions could inevitably arise and would harm our profitability and our reputation with customers, and could even give rise to liability claims against us.

The quality of our solutions, including new, modified or enhanced versions thereof, is critical to our success. Since certain of our software solutions are complex, they may contain errors that cannot be detected at any point in their testing phase. While we continually test all our software solutions for errors or defects and work with customers, our partners and end-users (who occasionally participate in our beta-testing of certain programs) to identify and correct them, errors in our technology may be found in the future. Testing for errors or defects is complicated because it is difficult to simulate the breadth of operating systems, user applications and computing environments that our customers use or in the applications developed with our technology. Errors or defects in our technology have resulted in terminated work orders and could result in delayed or lost revenue, diversion of development resources and increased services, termination of work orders, damage to our brand and warranty and insurance costs in the future. In addition, time-consuming implementations may also increase the number of services personnel we must allocate to each customer, thereby increasing our costs and adversely affecting our business, results of operations and financial condition.

In addition, since our customers rely on our solutions to operate, monitor and improve the performance of their business processes or to develop or integrate their business 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 our business, the incurrence of substantial expenses and potential damage to our reputation might result. While the terms of our standard 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 business, results of operations and financial position. Accordingly, the adverse consequences of, and expenses related to, failures, errors and defects could have a material adverse effect on our business, operating results, and financial condition.

Failure to meet customer expectations with respect to the implementation and use of our solutions or damage caused by our solutions to our customers' information systems could result in negative publicity, reduced sales and diversion of resources, may cause the cancellation of our contracts and may subject us to liability claims, all of which would harm our business, results of operations, financial condition and growth prospects.

We generally provide our customers with upfront estimates regarding the duration, budget and costs associated with the implementation of our products. Implementation of some of our solutions is complex and meeting the anticipated duration, budget and costs often depends on factors relating to our customers or their other vendors. We may not meet the upfront estimates and expectations of our customers for the implementation of products as a result of our products' capabilities or service engagements by us, our system integrator partners or our customers' IT employees. Consequently, if we fail to meet upfront estimates and the expectations of our customers for the implementation of our products, our reputation could be harmed, which could adversely affect our ability to attract new customers and sell additional products and services to existing customers.

In addition, some of the products and software services that we provide involve key aspects of customers' information systems and may be considered critical to the operations of our clients' businesses. As a result, our customers have a greater sensitivity to failures in these systems than do customers of other software products generally. In addition, our exposure to legal liability may be increased in the case of outsourcing contracts in which we become more involved in our clients' operations. If a customer'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 or do so in an untimely manner, we are exposed to the risks of cancellation of our contract with the customer and a legal claim for substantial damages being filed against us, regardless of whether or not we are responsible for the failure. While we typically strive to include provisions designed to limit our exposure to legal claims relating to our services and the solutions we develop, these provisions may not adequately protect us or may not be enforceable in all cases. The general liability insurance coverage that we maintain, including coverage for errors and omissions, is subject to important exclusions and limitations. We cannot be certain that this coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. A successful assertion of one or more large claims against us that exceeds our available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could adversely affect our profitability.

Incorrect or improper use of our products or our failure to properly train customers on how to implement or utilize our products could result in customer dissatisfaction and negatively affect our business, results of operations, financial condition and growth prospects.

Certain of our software solutions are complex and are deployed in a wide variety of network environments. The proper use of these solutions requires training of the customer. If these solutions are not used correctly or as intended, inadequate performance may result.

Additionally, our customers or third-party partners may incorrectly implement or use our solutions. Our solutions may also be intentionally misused or abused by customers or their employees or third parties who are able to access or use our solutions. Similarly, our solutions are sometimes installed or maintained by customers or third parties with smaller or less qualified IT departments, potentially resulting in sub-optimal installation and, consequently, performance that is less than the level anticipated by the customer. Because our customers rely on our software, services and maintenance support to manage a wide range of operations, the incorrect or improper use of our solutions, our failure to properly train customers on how to efficiently and effectively use our solutions, or our failure to properly provide implementation or maintenance services to our customers has resulted in terminated work orders and may result in termination of work orders, negative publicity or legal claims against us in the future. Also, as we continue to expand our customer base, any failure by us to properly provide these services will likely result in lost opportunities for follow-on sales of our software and services.

In addition, if there is substantial turnover of customer personnel responsible for implementation and use of our products, or if customer personnel are not well trained in the use of our products, customers may defer the deployment of our products, may deploy them in a more limited manner than originally anticipated or may not deploy them at all. Further, if there is substantial turnover of the customer personnel responsible for implementation and use of our products, our ability to make additional sales may be substantially limited.

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

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

If existing customers do not make subsequent purchases from us and continue using our solutions and services or if our relationships with our largest customers are impaired, our revenue and profitability could be negatively affected

The loss of any of our major customers or a decrease or delay in orders or anticipated spending by such customers could reduce our revenues and profitability, due to our reliance on such customers. Our customers could also engage in business combinations, which could increase their size, reduce their demand for our products and solutions as they recognize synergies or rationalize assets, and increase or decrease the portion of our total sales concentration with respect to any single customer.

For example, five customers of one of our four significant subsidiaries and affiliates—Sapiens— and its subsidiaries accounted for 30% and 31% of Sapiens’ consolidated revenues in 2013 and 2014, respectively (or 5% and 8% of our consolidated revenues, respectively). One significant customer of an affiliate—Magic Software— accounted for 13% and 10% of its consolidated revenues in 2013 and 2014, respectively (or 2% and 3% of our consolidated revenues, respectively). There can be no assurance that the existing customers of our significant subsidiaries and affiliates will enter into new project contracts with us or that they will continue using our technologies and IT services. A significant decline in our revenue stream from existing customers would have an adverse effect on our operating results.

Failure to manage our rapid growth effectively could harm our business.

Over the last 5 years we have experienced, and expect to continue to experience, rapid growth in our number of employees and in our international operations that has placed, and will continue to place, a significant strain on our operational and financial resources and our personnel. To manage our anticipated future growth effectively, we must continue to maintain and may need to enhance our information technology infrastructure, financial and accounting systems and controls and manage expanded operations and employees in geographically distributed locations. We also must attract, train and retain a significant number of additional qualified sales and marketing personnel, professional services personnel, software engineers, technical personnel and management personnel. Our failure to manage our rapid growth effectively could have a material adverse effect on our business, results of operations and financial condition. Our growth could require significant capital expenditures and may divert financial resources from other projects, such as the development of new services or product enhancements. For example, since it may take as long as six months to hire and train for the development and implementation of our proprietary software solutions certain new member of our professional services staff, we make decisions regarding the size of our professional services staff based upon our expectations with respect to customer demand for our products and services. If these expectations are incorrect, and we increase the size of our professional services organization without experiencing an increase in sales of our products and services, we will experience reductions in our gross and operating margins and net income. If we are unable to effectively manage our growth, our expenses may increase more than expected, our revenues could decline or grow more slowly than expected and we may be unable to implement our business strategy. We also intend to continue to expand into additional international markets which, if not technologically or commercially successful, could harm our financial condition and prospects.

There may be consolidation in the markets and industries in which we operate, which could reduce the use of our products and services and adversely affect our revenues.

Mergers or consolidations among our customers could reduce the number of our customers and potential customers. This could adversely affect our revenues even if these events do not reduce the aggregate number of customers or the activities of the consolidated entities. If our customers merge with or are acquired by other entities that are not our customers, or that use fewer of our products and services, they may discontinue or reduce their use of our products and services. Any of these developments could materially and adversely affect our results of operations and cash flows.

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

We provide services for a wide range of Israeli governmental agencies. Any reduction in total Israeli government spending for political or economic reasons, such as occurred during the Israeli recession ending in 2004 or the current worldwide recession, may reduce our revenues and profitability. In addition, the government of Israel has experienced significant delays in the approval of its annual budget in recent years and will experience such a delay also during the first half of 2015 with respect to the 2015 government budget, which allows government offices to utilize their monthly spending based on 1/12 of 2014 approved budget. Such delays in the future could negatively affect our cash flows by delaying receipt of payment from the government of Israel for services performed.

If our interest in our subsidiaries' outstanding equity interests becomes diluted below 50% or if we are unable to retain effective control over our subsidiaries and affiliated company, we would cease to consolidate them and our operating results may fluctuate significantly.

We currently hold a controlling interest in Matrix, Sapiens and InSync through our direct equity holdings. As a result of our controlling interests in those subsidiaries as of December 31, 2014, we consolidated their balance sheets with ours and, with respect to Sapiens, included its operating results beginning from December 31, 2014 and with respect to InSync, beginning from April 1, 2014, following our consummation of the acquisition of InSync.

As of January 1, 2012, Formula's interest in Sapiens outstanding common shares was 47.3%. On January 27, 2012, Formula consummated the purchase of Sapiens common shares in private transactions, resulting in an increase in Formula's interest in Sapiens' outstanding common shares from 47.3% to 52.1%, following which Formula regained control over Sapiens. As a result, a gain in an amount of \$ 3.4 million was recorded during 2012 and is presented in our income statement in the item "equity in gains of affiliated companies, net". Formula purchased additional Sapiens common shares in market and off-market transactions.

On November 19, 2013, Sapiens completed a follow-on public offering of its ordinary shares on the NASDAQ. Sapiens issued 6,497,400 shares at a price of \$ 6.25 per share before issuance expenses. Total net proceeds from the issuance amounted to approximately \$37.8 million. As a result of the offering, Formula's interest in Sapiens' outstanding common shares was diluted below 50% (from 56.8% to 48.6%). Our investment in Sapiens following the dilution was measured under the equity method of accounting. The gain recognized in relation to Formula's loss of control in Sapiens amounted to \$61.2 million and is presented in the income statement as equity in gains of affiliated companies, net.

During the period following the offering through December 23, 2014, Formula purchased additional Sapiens common shares, bringing its interest in Sapiens common shares to 50.2% of Sapiens common shares on December 23, 2014. As a result, Formula regained control over Sapiens as of such date and Sapiens' balance sheet is consolidated into Formula's balance sheet.

From August 21, 2011 until January 27, 2012, and from November 19, 2013 until December 23, 2014 Sapiens' results of operations were reflected in our results of operations using the equity method of accounting.

On March 5, 2014, following Magic Software's public offering of additional 6,900,000 of its ordinary shares our percentage interest in Magic Software outstanding ordinary shares decreased from 51.6% to 45.0% and Magic Software was no longer our subsidiary as of such date and thereafter its results of operations were reflected in our results of operations using the equity method of accounting.

Although it is our board of directors investment strategy to maintain effective control over our directly held subsidiaries, If we are unable to continue maintaining a controlling interest in Matrix and Sapiens, as a result of equity issuances to third parties that are unaffiliated with us or otherwise or we are unable to regain control over Magic Software, we would cease to consolidate the operating results of Matrix and Sapiens and not reconsolidate Magic Software, based on relevant accounting guidelines. This, in turn, could result in significant fluctuations of our consolidated operating results. In addition, should the share price of our traded subsidiaries and equity method investees fall significantly below the carrying amount of these investees for a long duration it may indicate that the carrying amount of these investees has been impaired and may require us to record impairment losses.

Risks Related to our Intellectual Property

Assertions by third parties of infringement or other violation by us of their intellectual property rights could result in significant costs and substantially harm our business and results of operations.

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

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

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

Although we apply measures to protect our intellectual property rights and our source code, there can be no assurance that the measures that we employ to do so will be successful.

Our success and ability to compete depend in large part upon our ability to protect our proprietary technology. Since we have no registered patents, we rely on a combination of trade secret and copyright laws and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. We believe that due to the dynamic nature of the computer and software industries, copyright protection is less significant than factors such as the knowledge and experience of our management and personnel, the frequency of product enhancements and the timeliness and quality of our support services. We seek to protect the source code of our products as trade secret information and as unpublished copyright works. 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, while we attempt to protect trade secrets and other proprietary information through non-disclosure agreements with employees, consultants and distributors, not all of our employees have signed invention assignment agreements. 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, or 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.

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

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

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

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

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

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

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

Some of our customers have the right to require the source code of certain of our products to be deposited into a source code escrow. Under certain circumstances, our source code could be released to our customers. The conditions triggering the release of our source code vary by customer. A release of our source code would give our customers access to our trade secrets and other proprietary and confidential information which could harm our business, results of operations and financial condition.

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

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

Maintaining the security of our products, computers and networks is a critical issue for us and our customers. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate computer and network security measures. In addition, hackers also develop and deploy viruses, worms and other malicious software programs, some of which may be specifically designed to attack our products, systems, computers or networks. Additionally, outside parties may attempt to fraudulently induce our employees or users of our products to disclose sensitive information in order to gain access to our data or our customers' data. These potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees or our customers, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability or fines for us, damage our brand and reputation or otherwise harm our business.

Risks Related to our Traded Securities

There is limited trading volume for our ADSs and ordinary shares, which reduces liquidity for our shareholders, and may furthermore cause the stock price to be volatile, all of which may lead to losses by investors.

There has historically been limited trading volume for our ADSs and ordinary shares, respectively, both on the NASDAQ Global Select Market and the TASE, such that still not reached the level that enables shareholders to freely sell their shares in substantial quantities on an ongoing basis and thereby readily achieve liquidity for their investment. As a further result of the limited volume, our ordinary shares have experienced significant market price volatility in the past and may experience significant market price and volume fluctuations in the future, in response to factors such as announcements of developments related to our subsidiaries' and affiliates' business, announcements by competitors of our subsidiaries and affiliates, quarterly fluctuations in our financial results and general conditions in the industry in which we through our subsidiary and affiliates compete.

The market price of our ordinary shares and ADSs 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 experienced during recent years 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 have affected and are expected to continue to affect the market price of our ordinary shares and ADSs.

The high and low closing market price of our ordinary shares traded on the Tel Aviv Stock Exchange, or the TASE, under the symbol "FORT," and the high and low closing market price of our ADSs traded on the NASDAQ Global Select Market (for periods from January 3, 2011) or the NASDAQ Global Market (for periods prior to January 3, 2011) under the symbol "FORTY," during each of the last five years, are summarized in the table below:

Year	NASDAQ		Tel Aviv Stock Exchange*			
	In US\$		In NIS		In US\$	
	High	Low	High	Low	High	Low
2014	33.79	21.02	114.10	83.70	32.83	21.52
2013	26.64	16.22	94.99	57.89	26.96	15.51
2012	17.88	13.55	69.21	54.41	17.83	13.59
2011	20.49	11.14	75.57	43.94	20.55	11.81
2010	18.92	10.82	68.98	40.21	18.21	10.77

* The U.S. dollar price of our ordinary shares on the Tel Aviv Stock Exchange was determined by dividing the price of an ordinary share in NIS by the representative exchange rate of the NIS against the U.S. dollar as reported by the Bank of Israel on the same date.

The market price of our ordinary shares and 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;
- industry trends and changes;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- public announcements concerning us or our competitors;
- results of integrating investments and acquisitions;
- the introduction or market acceptance of new service offerings by us or our competitors;
- changes in product pricing policies by us or our competitors;
- public announcements concerning distribution of dividends and payment of dividends;
- the public's response to our press releases, our other public announcements and our filings with the Securities and Exchange Commission and the Israeli Securities Authority;
- changes in accounting principles;
- sales of our shares by existing shareholders;
- the loss of any of our key personnel;
- other events or factors in any of the markets in which we operate, including those resulting from war, incidents of terrorism, natural disasters or responses to such events; and

- general trends of the stock markets.

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

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

Our quarterly and annual revenues, gross profit, net income 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:

- general global economic conditions;
- acquisitions and dispositions of, and consolidation of, our subsidiaries;
- the size, time and recognition of revenue from significant contracts;
- timing of product releases or enhancements;
- timing of contracts;
- timing of completion of specified milestones and delays in implementation;
- changes in the proportion of service and license revenues;
- price and product competition;
- market acceptance of our new products, applications and services;
- increases in selling and marketing expenses, as well as other operating expenses;
- currency fluctuations; and
- consolidation of our customers.

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 individual subsidiaries vary both among themselves and over time. As a result, changes in the revenue mix from these subsidiaries may affect our quarterly operating results. In addition, we may derive a significant portion of our net income from the sale of our investments or the sale of our 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 prices of our ordinary shares and ADSs will likely decrease.

The market prices of our ordinary share and ADSs may be adversely affected if the market prices of our publicly traded subsidiaries or affiliated company decrease.

A significant portion of our assets is comprised of equity securities of directly held publicly traded companies. Our publicly traded subsidiaries and affiliate are, as of the current time, Matrix, Sapiens and Magic Software. The share prices of these publicly traded companies have been extremely volatile, and have been subject to fluctuations due to market conditions and other factors which are often unrelated to operating results and which are beyond our control. Fluctuations in the market price and valuations of our holdings in these companies may affect the market's valuation of the price of our ordinary shares and ADSs and may also thereby impact our results of operations. If the value of our assets decreases significantly as a result of a decrease in the value of our interest in our publicly traded subsidiaries and affiliated company, our business, operating results and financial condition may be materially and adversely affected and the market price of our ordinary shares and ADSs may also fall as a result.

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

Our ordinary shares are traded on the TASE and our ADSs were traded on the NASDAQ Global Market until January 3, 2011, at which date the listing of our ADSs was transferred to the NASDAQ Global Select Market. Trading in our ordinary shares and ADSs on these markets takes place in different currencies (dollars on the NASDAQ Global Select Market and NIS on the TASE), and at different times (resulting from different time zones, different weekly trading days and different public holidays in the United States and Israel). The trading prices of our ordinary shares and ADSs on these two markets may differ due to these and other factors (see the risk factor titled "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" above for an example thereof). On the other hand, any decrease in the trading price of our ordinary shares or ADSs, as applicable, on one of these markets could likely affect— and cause a decrease in— the trading price on the other market.

Our largest shareholder, Asseco Poland S.A., can significantly influence the outcome of matters that require shareholder approval.

Asseco Poland S.A., or Asseco, owns approximately 48.7% of our outstanding ordinary shares (which excludes shares that we have repurchased that lack voting rights and shares subject to restrictions that are voted in proportion to the votes of our other shares). Therefore, Asseco can significantly influence the outcome of those matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. This voting power may have the effect of delaying or preventing a change in control which may otherwise be favorable to our minority shareholders. In addition, potential conflicts of interest may arise in the event that we or any of our subsidiaries or other affiliates enter into agreements or transactions with affiliates of Asseco. 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.

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

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

Risks Relating to Operations in Israel

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

We are incorporated under the laws of, and our headquarters and principal research and development facilities are located in, the State of Israel, and approximately 66% and 83.5% of our consolidated revenues in 2013 and 2014, respectively were generated from the Israeli market (had we consolidated Magic Software's revenues and Sapiens revenues for all of 2014, 63% of our revenues would have been generated from the Israeli market). As a result, we are directly influenced by the political, economic and military conditions affecting Israel. In addition, several countries still restrict business with Israel and with companies doing business in Israel. These political, economic and military conditions in Israel, and business restrictions, could have a material adverse effect on our business, financial condition, results of operations and future growth.

In recent years, there have been hostilities between Israel and Hezbollah in Lebanon and Hamas in the Gaza strip, both of which resulted in rockets being fired into Israel causing casualties and disruption of economic activities. Most recently, in July 2014, an armed conflict commenced between Israel and Hamas. In addition, Israel faces threats from more distant neighbors, in particular, Iran. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decline in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect our business, financial condition and results of operations in the future.

Some of our 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 non-officers with certain expertise). 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, 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.

The tax benefits that will be available to certain of our Israeli subsidiaries and affiliates will require us to continue to meet various conditions and may be terminated or reduced in the future, which could increase our costs and taxes.

Some of our Israeli subsidiaries and affiliates have been granted "Approved Enterprise" and "Beneficiary Enterprise" status, which provide certain benefits, including tax exemptions and reduced tax rates under the Israeli Law for the Encouragement of Capital Investments, 1959, referred to as the Investment Law. Income not eligible for Approved Enterprise and Beneficiary Enterprise benefits is taxed at regular rates (26.5% in 2014 and thereafter).

In the event of distribution of dividends in these subsidiaries from said tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved/ Beneficiary Enterprise's income. Tax-exempt income generated under the Approved/Beneficiary Enterprise program will be subject to taxes upon dividend distribution (which includes the repurchase of the Company's shares) or liquidation. The benefits period under the Investment Law has yet to commence.

The entitlement to the above benefits (once they commence) is conditional upon the fulfillment of the conditions stipulated by the Investment Law and applicable regulations. Should the Israeli subsidiaries fail to meet such requirements in the future, income attributable to the Approved Enterprise and Beneficiary Enterprise programs could be subject to the statutory Israeli corporate tax rate and they may be required to refund a portion of the tax benefits already received, with respect to such programs.

Fluctuations in foreign currency values may affect our business and results of operations.

Due to our extensive operations and sales in Israel, most of our revenues and expenses from our IT services are denominated in NIS. For financial reporting purposes, we translate all non-U.S. dollar denominated transactions into dollars in accordance with ASC 830. Therefore, we are exposed to the risk that a devaluation of the NIS relative to the dollar will reduce our revenue growth rate in dollar terms. On the other hand, a significant portion of our revenues from proprietary software products and related services is currently denominated in other currencies, particularly the Euro, Japanese Yen, British Pound and South African Rand, while a substantial portion of our expenses relating to the proprietary software products and related services, principally salaries and related personnel expenses, is denominated in NIS. As a result, the depreciation of the Euro, Japanese Yen, British Pound or South African Rand relative to the U.S. dollar reduces our dollar recorded revenues from sales of our proprietary software products and related services that are denominated in those currencies and thereby harms our results of operations. In addition, the appreciation of the NIS relative to the dollar increases the dollar recorded value of expenses that we incur in NIS in respect of such proprietary software products sales, and, therefore, could adversely affect our results of operations and harm our competitive position in the markets. The depreciation (appreciation) of the dollar in relation to the NIS (based on the change in the exchange rate reported by the Bank of Israel from the start to the conclusion of each year) amounted to 2.3%, 7.0% and (12.0)% for the years ended December 31, 2012, 2013 and 2014, respectively. Rises in the inflationary rate in Israel further increase the dollar cost of our NIS-based operating expenses and adversely impact the profits that we realize from our proprietary software products sales. The Israeli rate of inflation amounted to 1.6%, 1.8% and (-0.2)% for the years ended December 31, 2012, 2013 and 2014, respectively. We have engaged and may continue in the future to engage in certain hedging transactions, to decrease the risk of financial exposure from fluctuations in the exchange rate of the non-dollar currency forecasted cash flows. However, we cannot assure you that these measures will adequately protect us from the material adverse effects described above. For additional information relating to the exchange rates between different relevant currencies, see "Item 5. Operating and Financial Review and Prospects—Overview—Our Functional and Reporting Currency."

It may be difficult to serve process and enforce judgments against our directors and officers in the United States or in Israel.

We are organized under the laws of the State of Israel. All of our executive officers and directors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside of the United States. Therefore, it may be difficult to:

- effect service of process within the United States on us or any of our executive officers or directors;
- enforce court judgments obtained in the United States including those predicated upon the civil liability provisions of the United States federal securities laws, against us or against any of our executive officers or directors, in the United States or Israel; and
- bring an original action in an Israeli court against us or against any of our executive officers or directors to enforce liabilities based upon the United States federal securities laws.

Provisions of Israeli law may delay, prevent or make more difficult an acquisition of our company.

The Israeli Companies Law, 1999, referred to as the Companies Law, generally requires that a merger be approved by the board of directors and a majority of the shares voting on the proposed merger, of each of the merging companies. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if shares representing a majority of the voting power present at the shareholders meeting, and which are not held by the other party to the merger (or by any person who holds 25% or more of the shares or the right to appoint 25% or more of the directors of the other party or its general manager, or any of their relatives or corporations controlled by them) have voted against the merger. Upon the request of any creditor of a party to the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of the surviving company. In addition, the court may give instructions to secure creditors' rights. Finally, a merger may generally not be completed unless at least (i) 50 days have passed since the filing of a merger proposal signed by both parties with the Israeli Registrar of Companies; and (ii) 30 days have passed since the merger was approved by the shareholders of each of the parties to the merger. Also, in certain circumstances an acquisition of shares in a public company must be made by means of a tender offer. Lastly, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than U.S. tax laws. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or make more difficult an acquisition of or merger with us, which may adversely affect our ability to engage in a business combination and may also depress the price of our ordinary shares and ADSs.

Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

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

As a foreign private issuer whose ADSs are listed on the NASDAQ Global Select Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.

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

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

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. Passive income for these purposes generally includes, among other things, certain dividends, interest, royalties, rental and gains from commodities and securities transactions and from the sale or exchange of property that gives rise to passive income. This characterization could result in adverse U.S. tax consequences to our shareholders who are U.S. taxpayers, including having gain realized on the sale of our ordinary shares or ADSs 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 dispositions apply to amounts treated as "excess distributions."

We believe that we were not a PFIC in 2014 but may be classified as such in 2015. Since a PFIC status is only 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, 2015 or in a future taxable year. Rules similar to those applicable to gains derived from the disposition of our ordinary shares or ADSs also apply to certain "excess distributions." A decline in the value of our ordinary shares or ADSs could result in our company being classified as a PFIC. U.S. investors should consult with their own tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares or ADSs. For a discussion of how we might be characterized as a PFIC and related tax consequences, see "Item 10. Additional Information-Taxation-United States Federal Income Tax Considerations."

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Both our legal name and our commercial name is Formula Systems (1985) Ltd. We were incorporated in Israel on April 2, 1985. We maintain our principal executive offices at 5 Haplada Street, Or Yehuda 60218, Israel and our telephone number is 011-972-3-5389487. Our agent in the United States is Corporation Service Company and its address is 2711 Centerville Road, Suite 400, Wilmington, DE 19808. In 1991, we completed the initial public offering of our ordinary shares on the TASE. In October 1997, we completed the listing of our ADSs on the NASDAQ Global Market. As of January 3, 2011 our ADSs have been listed on the NASDAQ Global Select Market.

Since our inception, we have acquired effective controlling interests, and have invested, in companies which are engaged in the IT solutions and services business. We, together with our subsidiaries and affiliates, are known as the Formula Group.

In November 2010, Emblaze Ltd., our former controlling shareholder, sold its controlling stake in us to Asseco Poland SA, a Polish IT company listed on the Warsaw Stock Exchange. Asseco currently beneficially owns 48.7% of our issued and outstanding ordinary shares (which excludes shares that we have repurchased that lack voting rights and shares subject to restrictions that are voted in proportion to the votes of our other shares).

We have adopted a strategy of seeking opportunities to realize gains through the selective sale of investments and interests in our subsidiaries and affiliates to outside investors. We believe that this strategy provides us with capital to support the growth of our interest in our remaining subsidiaries, as well as provide us the opportunity to pursue new acquisitions of, and investments in, other businesses, particularly businesses offering products, technologies and services that are complementary to ours and are suitable for integration into our business therefore increasing value for our shareholders (and ADS holders). We expect to continue to develop and enhance the products, services and solutions of our subsidiaries and affiliates, and to continue to pursue additional acquisitions of, or investments in, companies that provide IT services and proprietary software solutions.

Capital Expenditures and Divestitures

Our principal investment and divestiture activities and related financing activities since the start of our 2012 fiscal year are described below. For additional information relating to our investment, divestiture and financing activities during 2013 and 2014, see "Item 5. Operating and Financial Review and Prospects- Liquidity and Capital Resources."

Changes in our percentage ownership of Sapiens. As of January 1, 2012, our percentage interest in our subsidiary Sapiens was 47.3%. We subsequently increased our investment in Sapiens, acquiring additional common shares of Sapiens in private transactions that raised our beneficial ownership to 56.6% of Sapiens' outstanding share capital as of December 31, 2012. We purchased additional shares in 2013 which resulted in our percentage interest increasing to 57.2% as of May 2013. In November 2013, Sapiens issued 6,497,400 of its common shares in a follow-on public offering. As a result, as of December 31, 2013, our percentage interest in Sapiens decreased to 48.6%. We purchased additional shares in 2014 which resulted in our percentage interest increasing to 50.2% as of December 31, 2014. Pursuant to our acquisitions of Sapiens common shares, we have invested an aggregate of \$11.7 million, \$2.7 million and \$11.9 million in 2012, 2013 and 2014, respectively. The source of such funds has been our working capital and loans from financial institutions.