

In January 2016, Formula declared a cash dividend to its shareholders, which was paid in February 2016, of \$0.34 per share. The aggregate amount distributed by Formula was approximately \$5.0 million.

In June 2015, Formula declared a cash dividend to its shareholders, which was paid in August 2015, of \$0.34 per share. The aggregate amount distributed by Formula was approximately \$5.0 million.

Cash dividends may be declared and paid in NIS or dollars. Dividends to the holders of Formula's American Depositary Shares, or ADSs, are paid by the depositary of the ADSs, for the benefit of owners of ADSs. If a dividend is declared and paid in NIS in Israel, the NIS amount is converted into, and paid out in, dollars by the depositary of the ADSs.

**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.**

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, digital transformation solutions, big data, advance analytics solutions, internet-related solutions, such as cloud computing and complementary services and business solutions for the insurance and financial services industry. These companies may develop technological or business model innovations or offer services in the markets that we seek to address that are, or are perceived to be, equivalent or superior to our products and services. Furthermore, many of our smaller competitors have been acquired and may be acquired in the future 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. For example, we and some of our competitors have developed systems to allow customers to outsource certain of their systems to external providers (known as BPO). We are seeking to partner with BPO providers, but there can be no assurance that such BPO providers will adopt our solutions rather than those of our competitors. Determinations by current and potential customers to use BPO providers that do not use our solutions may result in the loss of such customers and limit our ability to gain new customers.

The introduction of new technologies, devices and business models 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.**

Adapting to evolving technologies may require us to invest a significant amount of resources, time and attention into the development, integration, support and marketing of 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 which we have adapted into our products, packaged software solution 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 substantial investments 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 software solutions, system integrations and professional services related to these changing technologies. Even if we succeed in adapting to a new technology by developing attractive products and services and successfully bringing them to market, there is no assurance that the new product or service will have a positive impact on our financial performance and could even result in lower revenue, lower margins and higher costs and therefore could negatively impact our financial performance.

**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.

These developments, or the perception that any of them could occur, could have a material adverse effect on global economic conditions and the stability of global financial markets, and could significantly reduce global market liquidity and restrict the ability of key market participants to operate in certain financial markets. Asset valuations, currency exchange rates and credit ratings may be especially subject to increased market volatility.

In June 2016, a majority of voters in the United Kingdom elected to withdraw from the European Union in a national referendum (Brexit). The referendum was advisory, and the terms of any withdrawal are subject to a negotiation period that could continue for a few years after the government of the United Kingdom formally initiates a withdrawal process. Nevertheless, the referendum has created significant uncertainty about the future relationship between the United Kingdom and the European Union, and has given rise to calls for certain regions within the United Kingdom to preserve their place in the European Union by separating from the United Kingdom as well as for the governments of other EU member states to consider withdrawal.

In the United States, the new Trump Administration has called for substantial change to fiscal, tax and trade policies that may adversely affect our business. We cannot predict the impact, if any, of these changes to our business. However, it is possible that these changes could adversely affect our business.

If global economic and market conditions, or economic conditions in the United States, Europe or Asia or other key markets, remain uncertain or weaken further, our business, operating results and financial condition may be adversely affected.

**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 our solutions are complex and require 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.

**Investment in highly skilled research and development and customer support personnel is critical to our ability to develop and enhance our software solutions and support our customers, but an increase in such investment may reduce our profitability.**

As providers of software solutions that rely upon technological advancements, we rely heavily on our research and development activities to remain competitive. We consequently highly depend on the ability to attract, train, motivate and retain highly skilled information technology professionals for our research and development team, particularly individuals with knowledge and experience in the insurance, healthcare and defense industries. Because our software solutions are highly complex and are generally used by our customers to perform critical business functions, we also depend heavily on other skilled technology professionals to provide ongoing support to our customers. 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 software solutions, we may be unable to meet the needs of our customers. Even if we succeed in retaining the necessary skilled personnel in our research and development and customer support efforts, our investment in our personnel and product development might increase our costs of operations and thereby reduce our profitability, unless compensated through 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, it would require 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 generate in those territories, or may not be available at all.

If our products and services fail to compete successfully with those of our competitors, we may have to reduce the prices of our products and services, 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.

Both Matrix's and Magic Software's principal domestic competitors in the Israeli market are Israeli IT services companies and systems integrators, the largest of which are Hilan Ltd., Malam-Team, One-1, Taldor Computer Systems, (Aman, the Elad Group, Yael, SQLink, Emet, LogOn, HMS and OfficeSoft. Matrix's competitors in the United States market include many companies who provide similar services to those offered by Matrix, as well as providers of offshore services. In some cases, Matrix competes with IBM, Accenture and the Big-4 accounting firms. Matrix's international competitors in the Israeli market include Microsoft, IBM, HP, Oracle and CA. These international competitors often use local subcontractors to provide personnel for contracts performed in Israel. Most of these international entities are also business partners of Matrix. Competitors with respect to infrastructure solutions include HP, Lenovo and Dell. With respect to cloud services, competitors include All Cloud, DoIT, Google, Microsoft and Amazon Web Services. Matrix's competitors with respect to training are the training centers of the Technion, IITC, HackerU, Ness Technologies and Sela.

With respect to Magic Software's application development solutions, Magic Software competes in the application platform, SOA architecture and enterprise mobility markets. Among its current competitors are Kony, IBM, Microsoft, Adobe, Oracle, SAP Sybase, OutSystems and Pegasystems. With respect to Magic Software's integration solutions, Magic Software competes in the integration platform market. Among its current competitors are IBM, Informatica, TIBCO, MuleSoft, Jitterbit, Talend and Software AG.

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

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

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

Sapiens' competitors in the market for insurance solutions differ based on the size, geography and line of business in which it operates. Some of its competitors offer a full suite of services, while others only offer one module; some operate in specific (domestic) geographies, while others operate on a global basis. In addition, delivery models vary, with some competitors keeping delivery in-house, or using IT outsourcing (ITO) or business process outsourcing (BPO).

Examples of Sapiens' primary competitors are:

- Global software providers with their own IP;
- Local/domestic software vendors with their own IP, operating in a designated geographic market and/or within a designated segment of the insurance industry;
- BPO providers who offer end-to-end outsourcing of insurance carriers business, including core software administration (although BPO providers want to buy comprehensive software platforms to serve as part of the BPO proposition from vendors and may seek to purchase Sapiens' solutions for this purpose); and
- Internal IT departments, who often prefer to develop solutions in-house.

With respect to Sapiens DECISION, we believe that Sapiens is considered a pioneer in this disruptive market landscape. Since the introduction of Sapiens innovative approach to enterprise architecture to the market, Sapiens has identified only a small number of potential competitors.

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 in Israel and 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.

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

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

TSG, our jointly-controlled investee together with Israel Aerospace Industries Ltd. or IAI, derives most of its revenues directly or indirectly from government agencies, mainly the Israeli Ministry of Defense (IMOD) and authorities of various countries, pursuant to contracts awarded to it under defense and homeland security-related programs. The funding of these programs could be reduced or eliminated due to numerous factors, including geo-political events and macro-economic conditions that are beyond our control. Reduction or elimination of government spending under our contracts would cause a negative effect on TSG's revenues, results of operations, cash flow and financial condition. Furthermore, the Israeli government may reduce its expenditures for defense items or change its defense priorities in the coming years. In addition, the Israeli defense budget may be adversely affected if there is a reduction in U.S. foreign military assistance.

**We recently began preparing our consolidated financial statements in accordance with IFRS and, as a result, some of our financial data are not easily comparable from period to period.**

On January 1, 2016, we began preparing our consolidated financial statements in accordance with IFRS. Prior to the year ended December 31, 2016, we prepared our consolidated financial statements only in accordance with U.S. GAAP. Therefore, our financial data as of and for the years ended December 31, 2013, 2014 and 2015, which was presented in prior year's annual report on Form 20-F, was derived from our annual audited consolidated financial statements which were prepared in accordance with U.S. GAAP. Because IFRS differs in certain significant respects from U.S. GAAP, in particular with respect to the results of our subsidiaries, all of which are consolidated with our results under IFRS, the U.S. GAAP financial information presented in prior years is not directly comparable to our IFRS financial information in this annual report. The lack of comparability of our financial data may make it difficult to gain a full and accurate understanding of our operations and financial condition in periods prior to 2015. For further information, please see Note 21 to our consolidated financial statements included in Item 18 of this annual report.

**Our clients' complex regulatory requirements may increase our costs, which could negatively impact our profits.**

Some of our clients, particularly those in the financial services, life sciences, healthcare and defense verticals, are subject to complex and constantly changing regulatory requirements. On occasion, these regulatory requirements change unpredictably. These regulations may increase our potential liabilities if our services are found to contribute to a failure by our clients to comply with the requirements applicable to them and may increase compliance costs as regulatory requirements increase or change. These increased costs could negatively impact our profits.

**With respect to certain of our defense sector command and control software solutions which are developed and offered by our jointly controlled investee, TSG, we depend on governmental approval of our exports.**

Our international sales, as well as our international procurement of skilled human resources, technology and components, related to our command and control software solutions, depends largely on export license approvals from the governments of Israel, the U.S. and other countries. If we fail to obtain material approvals in the future, or if material approvals previously obtained are revoked or expire and are not renewed, our ability to sell our products and services to overseas customers and our ability to obtain goods and services essential to TSG's business could be interrupted, resulting in a material adverse effect on TSG's business, revenues, assets, liabilities and results of operations.

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

We depend heavily on repeat product and service revenues from our base of existing customers. For example, five of Sapiens' customers accounted for, in the aggregate, 32% and 34% of its revenues in the years ended December 31, 2015 and 2016, respectively. If our existing customers are not satisfied with our solutions and services, they may not enter into new project contracts with us or continue using our technologies. A significant decline in our revenue stream from existing customers would have a material adverse effect on our business, results of operations and financial condition.

**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.

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

Our software services customers typically retain us on a non-exclusive basis. Many of our customer contracts, including those that are on a fixed price and timeframe basis, can be terminated by the customer with or without cause upon 90 days' notice or less, and generally without termination-related penalties. Additionally, our contracts with customers are typically limited to discrete projects without any commitment to a specific volume of business or future work and may involve multiple stages. In addition, the increased breadth of our service offerings may result in larger and more complex projects for our customers that require us to devote resources to more thoroughly understand their operations. Despite these efforts, our customers may choose not to retain us for additional stages or may cancel or delay planned or existing engagements due to any number of factors, including:

- financial difficulties;
- a change in strategic priorities;
- demand for price reductions; and
- a decision to utilize in-house IT capacity or work with our competitors.

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

**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.

In addition, while we have taken steps to protect the confidential information that we have access to, including confidential information we may obtain through usage of our cloud-based services, our security measures may be breached. If a cyber-attack or other security incident were to result in unauthorized access to or modification of our customers' data or our own data or our IT systems or in disruption of the services we provide to our customers, or if our products or services are perceived as having security vulnerabilities, we could suffer significant damage to our business and reputation.

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.

**Changes in privacy regulations may impose additional costs and liabilities on us, limit our use of information, and adversely affect our business.**

Personal privacy has become a significant issue in the United States, Europe, and many other countries where we operate. Many government agencies and industry regulators continue to impose new restrictions and modify existing requirements about the collection, use, and disclosure of personal information. Changes to laws or regulations affecting privacy and security may impose additional liabilities and costs on us and may limit our use of such information in providing our services to customers. If we were required to change our business activities, revise or eliminate services or products, or implement burdensome compliance measures, our business and results of operations may be harmed. Additionally, we may be subject to regulatory enforcement actions resulting in fines, penalties, and potential litigation if we fail to comply with applicable privacy laws and regulations.

**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 we consider it as a significant part of our business strategy to pursue acquisitions and other initiatives in order to expand our product or services offerings or otherwise enhance our market position and strategic strengths, 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 a significant 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 May 2016, Formula and IAI each acquired 50% of TSG, which had been a subsidiary and the military arm of Ness Technologies, which is engaged in the fields of command and control systems, intelligence, homeland security and cyber-security. Each of Formula and IAI acquired 50% of TSG and each paid a purchase price of \$25.8 million (subject to certain adjustments). For further information, please see Note 4(i)(a) to our consolidated financial statements included in Item 18 of this annual report.

In January 2017, Formula acquired all of the share capital of Michpal, an Israeli-based company that develops, sells and supports a proprietary on-premise payroll software solution for processing traditional payroll stubs to Israeli enterprise and payroll service providers. Formula paid a purchase price of \$22.1 million. For further information, please see Note 20(i) to our consolidated financial statements included in Item 18 of this annual report..

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, reflecting 3% of the outstanding shares of Sapiens Decision. In addition, one of the shareholders of KPI received 88,500 restricted shares of Sapiens Decision (of which 29,500 vested during each of the years ended December 31, 2015 and 2016) plus \$450,000 in cash, subject to certain performance criteria. The agreements for the foregoing acquisitions included, among other things, certain put and call options relating to the Sapiens Decision shares issued upon consummation of the transaction and certain other benefits payable upon the occurrence of certain conditions. For further information, please see Note 4(ii)(b) to our consolidated financial statements included in Item 18 of this annual report.

In May 2015, Sapiens acquired IBEXI Solutions Private Limited, or IBEXI, an India-based provider of insurance solutions and services, which services 18 insurers in both the P&C and L&P markets throughout Southeast Asia. The total purchase price in this acquisition was approximately \$4.8 million, which was paid in cash by Sapiens at the closing, and which is subject to adjustment based on certain future criteria. For further information, please see Note 4(ii)(c) to our consolidated financial statements included in Item 18 of this annual report.

In August 2015, Sapiens acquired Insseco, a Poland-based software and services provider for the insurance market, from Asseco, the controlling shareholder of Formula, which helped Sapiens to establish a strong presence in the Polish insurance market. Sapiens paid approximately \$9.1 million in cash for Insseco, subject to upwards adjustment based on its achieving future revenue goals. For further information, please see Note 4(ii)(a) to our consolidated financial statements included in Item 18 of this annual report.

In the third quarter of 2016, Sapiens acquired Maximum Processing Inc., or MaxPro. MaxPro is the provider of the Stingray System, a P&C insurance administration suite targeted towards the tier 4-5 U.S. market, as well as managing general agents, or MGAs, third-party administrators, or TPAs, and insurance brokers. Sapiens paid \$4.3 million in cash for this acquisition (including \$1.5 million that Sapiens placed in escrow at the closing). The seller also has the right to receive performance based payments of up to \$3.1 million relating to achievements of revenue and profitability goals over three years (2016, 2017, 2018), which are also subject to continued employment. For further information, please see Note 4(ii)(d) to our consolidated financial statements included in Item 18 of this annual report.

In the third quarter of 2016, Sapiens acquired 4Sight Business Intelligence Inc., or 4Sight, a provider of business intelligence reports. 4Sight offers insurance-specific business intelligence, or BI, solutions, including 4SightBI, a P&C-specific, off-the-shelf business intelligence (BI) product. Sapiens paid \$330,000 in cash for this acquisition. In addition, the seller of 4Sight may receive additional performance-based payments of up to \$2.2 million relating to achievements of revenue and profitability goals over three years (2016, 2017, 2018), which are also subject to continued employment. For further information, please see Note 4(ii)(e) to our consolidated financial statements included in Item 18 of this annual report.

In the first quarter of 2017, Sapiens acquired StoneRiver, a provider of a wide range of technology solutions and services to insurance carriers, agents, and broker-dealers, whose product groups encompass front-office, policy, claim, rating, underwriting, billing, and reinsurance solutions for all major business lines. The acquisition is expected to enable Sapiens to expand the range of solutions and services that Sapiens offers in North America. Sapiens paid approximately \$100 million in cash, subject to certain adjustments based on working capital, transaction expenses, unpaid debt and certain litigation matters. For further information, please see Note 20(ii) to our consolidated financial statements included in Item 18 of this annual report.

In April 2015 Magic Software acquired a 70% interest in Comblack IT Ltd., an Israeli-based company that specializes in software professional and outsource management services for mainframes and complex large-scale environments, for a total consideration of \$1.8 million, of which \$ 1.5 million was paid upon closing and \$ 0.3 million was contingent upon the acquired business meeting certain operational targets in 2015. Magic Software and the seller hold mutual call and put options, respectively, for the remaining 30% interest in the Comblack. In March 2016, Magic Software paid the seller the remaining contingent payments for meeting 2015 operational targets. For further information, please see Note 4(iii)(b) to our consolidated financial statements included in Item 18 of this annual report.

In June 2015, Magic Software acquired a 70% interest in Infinigy Solutions LLC, a US-based services company focused on expanding the development and implementation of technical solutions throughout the telecommunications industry with offices over the US, providing nationwide coverage and support for wireless engineering, deployment services, surveying, environmental service and project management, for a total consideration of \$6.5 million, of which \$ 5.6 was paid upon closing and \$ 0.9 million is contingent upon the acquired business meeting certain operational targets in 2016 and 2017. In July 2016, Magic Software paid the seller \$ 0.5 million with respect to the acquired business meeting certain of its 2016 operational targets. Magic Software and the seller hold mutual Call and Put options respectively for the remaining 30% interest in the company. For further information, please see Note 4(iii)(c) to our consolidated financial statements included in Item 18 of this annual report.

In July 2016, Magic Software acquired a 60% equity interest in Roshtov Software Industries Ltd, the developer of the Clicks development platform, which is used in the design and management of patient-file oriented software solutions for managed care and large-scale healthcare providers. The aggregate purchase price for the 60% interest was approximately \$ 20.6 million in cash and Magic Software and the seller hold mutual call and put options, respectively, for the remaining 40% interest in Roshtov. For further information, please see Note 4(iii)(d) to our consolidated financial statements included in Item 18 of this annual report.

In October 2016, Magic Software acquired the entire share interests in Shavit Software (2009) Ltd., an Israeli-based company that specializes in software professional and outsourced management services, for a total consideration of \$ 6.8 million, of which \$ 4.7 was paid upon closing, \$ 1.6 million was allocated to a deferred payment which is due in 2018 and \$ 0.5 million is contingent upon the acquired business meeting certain operational targets in 2017, 2018 and 2019. For further information, please see Note 4(iii)(e) to our consolidated financial statements included in Item 18 of this annual report.

In January 2015, Matrix acquired 75% of the share capital of SeeV Solutions Ltd in total consideration of \$1.2 million. SeeV, an Israeli based company, specialized in permanent placement of employees in start-ups and high-tech companies. In addition, the purchaser and the seller hold mutual call and put options respectively for the remaining 25% interest in SeeV valued at \$ 0.4 million. For further information, please see Note 4(iv)(a) to our consolidated financial statements included in Item 18 of this annual report.

In April 2015, Xtivia Inc. (a wholly owned subsidiary of Matrix) completed the acquisition of all of the outstanding shares of Hydus Inc. in total consideration of \$ 2.5 million. Hydus Inc. is a U.S based consulting firm specializing in software services in the field of Enterprise Information Management, or EIM. In addition, the sellers may be eligible for future consideration, valued at \$ 1.7 million as of December 31, 2016, subject to obtaining accumulated operating income targets during three years (not exceeding Hydus operating income). For further information, please see Note 4(iv)(c) to our consolidated financial statements included in Item 18 of this annual report.

In May 2015, Matrix completed the acquisition of all of the outstanding shares of Ono Apps Ltd., an Israeli based service provider specializing in mobile applications development services, for total consideration of NIS 4.6 million (approximately \$ 1.2 million). In addition, the sellers may be eligible for future consideration, valued at \$ 0.3 million, subject to obtaining accumulated operating income targets during three years commencing on January 1, 2016, not exceeding NIS 5.0 million (approximately \$ 1.3 million). For further information, please see Note 4(iv)(d) to our consolidated financial statements included in Item 18 of this annual report.

In March 2016, Matrix acquired 60% of the share capital of Programa Logistics System Ltd., an Israeli provider of advisory services and design and development of solutions in supply chain, production and logistics. Matrix paid NIS 7.3 million (approximately \$ 1.9 million). In addition, the sellers may be eligible for future consideration, valued at \$ NIS 1.1 million (approximately \$ 0.3 million) as of December 31, 2016, subject to obtaining accumulated operating income targets over a three year period. Matrix and the seller hold mutual call and put options, respectively, for the remaining 40% interest in Programa. For further information, please see Note 4(iv)(e) to our consolidated financial statements included in Item 18 of this annual report.

In October 2016, Matrix acquired 60% of the share capital of Network Infrastructure Technologies Inc., a provider of IT help desk services for the healthcare industry. Matrix paid \$6.7 million. Matrix and the seller hold mutual call and put options, respectively, for the remainder of the shares. In addition, the seller is eligible for future consideration, valued at \$ 0.7 million, subject to obtaining accumulated operating income targets over a three year period. For further information, please see Note 4(iv)(f) to our consolidated financial statements included in Item 18 of this annual report.

In November 2016, Matrix acquired 55% of the share capital of Second to None Solutions Inc., a certified distributor of IBM products to U.S federal and enterprise customers. Matrix paid \$0.3 million. Matrix and the seller hold mutual call and put options, respectively, for the remainder of the shares. In addition, the seller is eligible for future consideration, valued at \$ 0.5 million as of December 31, 2016, subject to obtaining accumulated operating income targets over a three year period. For further information, please see Note 4(iv)(g) to our consolidated financial statements included in Item 18 of this annual report.

In December 2016, Matrix acquired 85% of the share capital of Aviv Management Engineering Systems Ltd., a company engaged in management and project consulting, focusing in four areas of expertise: environmental planning, project management, urban and physical planning and management consulting. Matrix paid NIS 19.7 million (approximately \$ 5.1 million). Matrix and the seller hold mutual call and put options, respectively, for the remainder of the shares. In addition, the seller is eligible for future consideration, valued at NIS 1.5 million (approximately \$ 0.4 million), subject to obtaining accumulated operating income targets over a three year period. For further information, please see Note 4(iv)(h) to our consolidated financial statements included in Item 18 of this annual report.

During the years ended December 31, 2015 and 2016, Formula and its subsidiaries and affiliates completed additional acquisitions for a total cash consideration of approximately \$ 1.9 million and \$8.9 million, respectively and increased during 2015 their share interest in two existing subsidiaries and one affiliate for total consideration of \$ 2.3 million. These acquisitions generally enhance our technologies, product and services offerings. Pro forma results of operations for these acquisitions have not been presented because they are not material to the consolidated results of operations, either individually or in the aggregate. For further information, please see Note 4(iii)(f) and Note 4(iv)(b) to our consolidated financial statements included in Item 18 of this annual report.

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. For example, we issued \$58.3 million (net of issuance expenses) of secured debentures, or Series A Secured Debentures, and convertible debentures, or Series B Convertible Debentures as part of a public offering in Israel in September 2015. In addition, in March 2014, Magic Software consummated a public offering in which it received net proceeds of \$ 54.7 million. Furthermore, Sapiens (via its wholly-owned subsidiary, Sapiens Americas Corporation, or the Borrower) entered into a \$40 million secured credit agreement with HSBC Bank USA, National Association in connection with, and as financing for, Sapiens' acquisition of Stone River. The issuance of equity securities pursuant to any such financing could be dilutive to our existing shareholders. The issuance of equity securities by any of our investees pursuant to any such financing could be dilutive to our existing interest in these investees. 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 acquisitions and organic growth. The number of our employees increased over the last five years from approximately 7,666 as of December 31, 2011 to approximately 13,572 as of December 31, 2016 (including our affiliated company TSG) 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 was \$534 million, \$545.7 million and \$627.6 million as of December 31, 2014, 2015 and 2016, respectively, as a result of our acquisitions, and may increase further following future acquisitions. Impairment testing under IFRS 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, 2015 and 2016, no impairment was required for any of our cash generating units and no impairment losses were identified for these intangible assets and software products.

**Our and our investees' credit facility agreements with banks and other financial institutions and our Series A Secured Debentures and Series B Convertible Debentures are subject to a number of restrictive covenants which, if breached, could result in acceleration of our obligation to repay our debt.**

In the context of our and our investees engagements with banks and other financial institutions for receiving various credit facilities and under the terms governing our Series A Secured Debentures and Series B Convertible Debentures, 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 distribute dividends, 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 and the risk that we may not be able to maintain in the future the rating level assigned to the Notes. 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 and our Series A Secured Debentures with certain of the shares of Formula's publicly held subsidiaries Matrix, Sapiens and Magic Software. With respect to our subsidiaries, Sapiens has a \$40 million secured credit agreement with HSBC Bank USA, National Association. A breach of the restrictive covenants could result in the acceleration of our obligations to repay our or our subsidiaries' 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 2015 and 2016, we received approximately 41% and 40% 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.

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

- Limitations and disruptions resulting from the imposition of government controls;
- Compliance with a wide variety of foreign regulatory standards;

- Compliance with the U.S. Foreign Corrupt Practices Act of 1977, as amended, or FCPA, particularly in emerging market countries;
- Import and export license requirements, tariffs, taxes and other trade barriers;
- Political, social and economic instability abroad, terrorist attacks and security concerns in general.;
- Trade restrictions;
- Changes in tariffs;
- Increased exposure to fluctuations in foreign currency exchange rates;
- Complexity in our tax planning, and increased exposure to changes in tax regulations in various jurisdictions in which we operate, which could adversely affect our operating results and limit our ability to conduct effective tax planning;
- Increased financial accounting and reporting requirements and complexities;
- Weaker protection of intellectual property rights in some countries;
- Greater difficulty in safeguarding intellectual property;
- Increased management, travel, infrastructure and legal compliance costs associated with having multiple international operations;
- Longer payment cycles and difficulties in enforcing contracts and collecting accounts receivable;
- The need to localize our products and licensing programs for international customers;

As we continue to expand our business globally, our success will depend, to a large extent, 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.

**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.

For example, subsequent to the balance sheet date, Sapiens received a letter from one of its significant customers, in which the customer alleged that Sapiens has materially breached a software development project agreement between them. After carefully examining the customer's allegations Sapiens informed the customer that it has not materially breached any of its obligations under the agreement and that the customer itself has materially breached the agreement. As a result of the foregoing work on the project has been halted and Sapiens currently does not expect to generate any further revenues from such customer in 2017. While Sapiens believes that this does not have an impact on its financial statements for the year ended December 31, 2016 it may have an adverse effect on Sapiens' results of operations in 2017.

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 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 Sapiens (together with its subsidiaries) accounted for, in the aggregate, 32% and 34% of Sapiens' consolidated revenues in 2015 and 2016, respectively (or 6% and 7%, of our consolidated revenues, in each of the respective years). In addition, Magic Software's (together with its subsidiaries) five largest customers accounted for, in the aggregate, 26% and 18% of its revenues in 2015 and 2016, respectively (or 5% and 3%, of our consolidated revenues, in each of the respective years). One significant customer of TSG accounted for approximately 40% of its revenues in 2015 and 2016 (or 2% of our consolidated revenues, in each of the respective years). One significant customer of InSync accounted for approximately 21% of its revenues in 2016 (or 1% of our consolidated revenues in 2016).

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.



**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. Furthermore, as the number of companies in the defense industry has decreased in recent years, the market share of some prime contractors has increased. Some of these companies are vertically integrated with in-house capabilities similar to ours in certain areas. Thus, at times we could be seeking business from certain of these prime contractors, while at other times we could be in competition with some of them. Failure to maintain good business relations with these major contractors could negatively impact TSG's business which focuses on the defense market.

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

Except for our joint control in TSG, we currently have effective control under IFRS 10 in each of our other investees, despite the lack of absolute majority of voting power in each of Magic Software and Sapiens. As a result of our effective control in these investees as of December 31, 2016, we consolidated their financial results with ours throughout the period covered by the financial statements included in Item 18 of this annual report. Prior to our transition to reporting under IFRS, we would consolidate investees in which we held an equity interest only if we held a controlling interest in those companies. Under IFRS 10, we may consolidate entities in which we have effective control. For further information, please see Note 2(2) to our consolidated financial statements included in Item 18 of this annual report

Although it is our board of directors' strategy to maintain effective control over our directly held investees, if we are unable to continue maintaining effective control over one or more of our public subsidiaries as a result of equity issuances to third parties that are unaffiliated with us or otherwise, we would cease to consolidate the operating results of those subsidiaries, based on relevant accounting guidelines. This, in turn, could result in significant fluctuations of our consolidated operating results.

#### ***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. In accordance with industry practice, since we have no registered patents on our software solutions technologies, we rely on a combination of trade secret and copyright and intellectual property 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 attacks, 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 trading has 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 investees businesses, announcements by competitors of our investees, quarterly fluctuations in our financial results and general conditions in the industry in which we through our investees 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 "FORTY," and the high and low closing market price of our ADSs traded on the NASDAQ Global Select Market 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
2016	42.17	23.55	162.70	93.79	42.18	23.61
2015	35.00	20.52	135.20	82.36	35.31	20.98
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

\* 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;
- 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 investees decrease.**

A significant portion of our assets is comprised of equity securities of directly held publicly traded companies. Our publicly traded investees are currently 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 investees, 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.**

Formula's ordinary shares are traded on the TASE and our ADSs are traded on 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 46.3% 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 investees enters into any 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, our management is required to assess and issue a report concerning our internal control over financial reporting and our independent registered public accounting firm must issue an attestation report on our internal control procedures. 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 control 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 59% and 60% of our consolidated revenues in 2015 and 2016, respectively were 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 our Israeli affiliate 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 investees have been granted “Approved Enterprise” and “Benefited 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 Benefited Enterprise benefits is taxed at the regular corporate tax rate (26.5% for 2015, 25% in 2016, and is currently set at 24% for 2017 and 23% for 2018 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 in respect of the amount of the distributed dividend (grossed-up to reflect the pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate which would have been applicable if such income had not been tax-exempted. Tax-exempt income generated under the Approved/Benefited Enterprise program will be subject to taxes upon dividend distribution (which includes the repurchase of the Company's shares) or liquidation.

The entitlement to the above benefits is conditional upon the continuous fulfillment of the conditions stipulated by the Investment Law and applicable regulations. Should the Israeli investees fail to meet such requirements in the future, income attributable to the Approved Enterprise and Benefited Enterprise programs would be subject to the statutory Israeli corporate tax rate and they will be required to refund a portion of the tax benefits already received, including interest and CPI linkage or other monetary penalty, with respect to such programs. As of December 31, 2016, we believe that certain of our Israeli investees are in compliance with all of the conditions required by the Investment Law.

#### **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 IFRS. 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 and British Pound, 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 and British Pound 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 (0.3)% and 1.5% for the years ended December 31, 2015 and 2016, respectively. Deflation in Israel further increases 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 deflation amounted to 1% and 0.2% for the years ended December 31, 2015 and 2016, 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.



Israeli courts may refuse to hear a claim based on an alleged violation of U.S. securities laws reasoning that Israel is not the most appropriate forum in which to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proven as a fact by expert witnesses, which can be a time consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel that addresses the matters described above. As a result of the difficulty associated with enforcing a judgment against us in Israel, an investor may not be able to collect any damages awarded by either a U.S. or foreign court.

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

The Israeli Companies Law, 1999 regulates that mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or complicating a merger with, or other acquisition of, us. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

***Curacao law makes it more difficult for Sapiens to enter into a change of control transaction in which its is acquired and Formula would be paid a premium on the shares that it holds in Sapiens.***

Sapiens' status as a Curacao company makes it more challenging (compared to Israel and various US states) to consummate a change of control transaction in which Sapiens is acquired and its shareholders benefit economically via the payment of a premium on their shares relative to the then-current market price. Under Curacao law, there is no legal basis for a reverse triangular merger, a commonly-utilized transaction structure for the acquisition of publicly traded companies such as Sapiens, in which shareholders receive cash. Curacao law allows for the acquisition of a publicly traded company such as Sapiens for cash through a tender offer, provided that the offeror acquires at least 95% of the company's issued and outstanding share capital (which 95% threshold may be reduced under certain circumstances to 90% or 80% in case of a pre-wired asset sale), following which the offeror can purchase the remaining shares subject to court approval and possibly the exercise of certain dissenters' rights. Since Curacao law does not permit a cash merger and due to the challenges in obtaining such level of acceptance of the tender offer, a potential buyer might need to use different structures to acquire Sapiens, e.g. migrating the company to another jurisdiction that allows for a cash merger as a means to acquire publicly traded companies; however, such process may be very time-consuming and could therefore prevent such a transaction from occurring. An additional option under Curacao law is a sale of assets, which is likely to be generally less efficient to Sapiens' shareholders from a tax perspective. Each of the foregoing limitations or disadvantages of effecting an acquisition of Sapiens or its assets in which shareholders realize a premium could furthermore adversely impact the market price of Sapiens shares and therefore our shares in an ongoing manner.

***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 officer 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.

***Sapiens was formed under the laws of Curaçao and the rights of shareholders under Curaçao law differ from those under U.S. law and Israeli law, therefore, you may have fewer protections as a shareholder.***

Sapiens' corporate affairs are governed by its articles of association, the Civil Code of Curaçao and the civil law of Curaçao. The rights of shareholders to take legal action against Sapiens' directors, actions by minority shareholders and the fiduciary responsibilities of our directors under Curaçao law are to a large extent governed by the Civil Code of Curaçao, the civil law of Curaçao and applicable case law. The rights of shareholders and the fiduciary responsibilities of Sapiens' directors under Curaçao law are not as clearly established as they would be under statutes or judicial precedents in some jurisdictions in the U.S. and in Israel. In particular, Curaçao has a less developed body of securities laws as compared to the U.S., and some states (such as Delaware) have more fully developed and judicially interpreted bodies of corporate law. In addition, Curaçao law does not generally distinguish between public and private companies, and some of the protections and safeguards (such as statutory pre-emption rights, except to the extent that they are expressly provided for in the Articles) that investors may expect to find in relation to a public company are not provided for under Curaçao law. As a result of all of the above, holders of Sapiens common shares, such as Formula, may have more difficulty in protecting their interests in the face of actions taken by Sapiens' management, directors or major shareholders than they would as shareholders of a U.S. or Israeli company.

***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 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



**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 2016 but may be classified as such in 2017. 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, 2017 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 investees, 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 46.3% 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 to create positive economic impact and long-term value for our investors and the companies we invest in. 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 investees, and to continue to pursue additional acquisitions of, or investments in, companies that provide IT services and proprietary software solutions.