*Reflects the change in the exchange rate from January 1 to December 31 of the relevant year, rather than the difference in the average exchange rate over the course of each year relative to the previous year.

Effective Corporate Tax Rates in Israel

Tax regulations have a material impact on our business, particularly in Israel where we have the headquarters or our subsidiary and affiliated companies. The following summary describes the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of government programs from which we, and some of our subsidiaries, benefit. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax authorities in question.

Corporate Tax

The Israeli corporate tax rate is 26.5% for 2014 and thereafter. The corporate tax rate was increased to 26.5% for 2014 and thereafter. However, the effective tax rate payable by a company that derives income from an Approved Enterprise, a Beneficiary Enterprise or Preferred Enterprise, as further discussed below, may be considerably less. In addition, Israeli companies are currently subject to regular corporate tax rate on their capital gains.

Besides being subject to the general corporate tax rules in Israel, certain of our Israeli subsidiaries have also, from time to time, applied for and received certain grants and tax benefits from, and participate in, programs sponsored by the Government of Israel, as described below.

Taxation of Non-Israeli Subsidiaries Held by an Israeli Parent Company

Non-Israeli subsidiaries of an Israeli parent company are generally subject to tax in their countries of residence under tax laws applicable to them in such countries. Such subsidiaries could also be subject to Israeli corporate tax on their income if they were to be managed and controlled from Israel. In such case, double taxation could ensue unless an applicable tax treaty provides applicable rules for relief from double taxation or such relief is available under internal law.

An Israeli parent company may also be required to include in its income on a current basis, as a deemed dividend, certain income derived by its subsidiaries under the Israeli Controlled Foreign Corporation rules, regardless of whether such income is distributed or not. Under these rules, a non-Israeli subsidiary is considered to be a controlled foreign corporation, if, among other things, a majority of the subsidiary’s means of control are held by Israeli residents, most of its revenues or income is passive (such as interest, dividends, royalties, rental income or income from capital gains) and such income is taxed at a rate that does not exceed 15%. An Israeli parent company that is subject to Israeli taxes on such deemed dividend income, may generally receive a credit for foreign taxes paid by its subsidiaries in their country of residence and for deemed foreign taxes to be withheld upon the actual distribution of such income.

Tax Benefits Under the Law for the Encouragement of Capital Investments, 5719-1959

The Law for the Encouragement of Capital Investments, 5719-1959 (the “**Investment Law**”), provides certain incentives for capital investments in a production facility (or other eligible assets). Generally, an investment program that is implemented in accordance with the provisions of the Investment Law, referred to as an Approved Enterprise, a Beneficiary Enterprise or a Preferred Enterprise, is entitled to benefits as discussed below. These benefits may include cash grants from the Israeli government and tax benefits, based upon, among other things, the location of the facility in which the investment is made or the election of the grantee. In order to qualify for these incentives, an Approved Enterprise, a Beneficiary Enterprise or a Preferred Enterprise is required to comply with the requirements of the Investment Law.

The Investment Law has been amended several times over the last years, with the two most significant changes effective as of April 1, 2005 (the “**2005 Amendment**”), and as of January 1, 2011 (the “**2011 Amendment**”). Pursuant to the 2005 Amendment, tax benefits granted in accordance with the provisions of the Investment Law prior to its revision by the 2005 Amendment remain in force but any benefits granted subsequently are subject to the provisions of the amended Investment Law. Similarly, the 2011 Amendment introduced new benefits instead of the benefits granted in accordance with the provisions of the Investment Law prior to the 2011 Amendment, yet companies entitled to benefits under the Investment Law as in effect up to January 1, 2011 were entitled to choose to continue to enjoy such benefits, provided that certain conditions are met, or elect instead irrevocably to forego such benefits and elect the benefits of the 2011 Amendment.

The following discussion is a summary of the Investment Law prior to its amendments as well as the relevant changes contained in the new legislation.

Tax Benefits for Income from Approved Enterprises Approved Before April 1, 2005

Under the Investment Law prior to the 2005 Amendment, a company that wished to receive benefits on its investment program that is implemented in accordance with the provisions of the Investment Law, or an Approved Enterprise, had to receive an approval from the Investment Center of the Israeli Ministry of Economy (formerly the Ministry of Industry, Trade and Labor) which we refer to as the Investment Center. Each certificate of approval for an Approved Enterprise relates to a specific investment program that is defined both by the financial scope of the investment, including sources of funds, and by the physical characteristics of the facility or other assets. The tax benefits available under any certificate of approval relate only to taxable income attributable to the specific program and are contingent upon meeting the criteria set out in the certificate of approval.

An Approved Enterprise may elect to forego any entitlement to the grants otherwise available under the Investment Law and, instead, participate in an alternative benefits program. Certain of our Israeli subsidiary and affiliated companies receive the benefits through the alternative benefits program. Under the alternative benefits program, a company’s undistributed income derived from an Approved Enterprise will be exempt from corporate tax for a period of between two and ten years from the first year of taxable income, depending upon the geographic location in Israel of the Approved Enterprise, and a reduced corporate tax rate of between 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in the company in each year, as detailed below. The benefits commence on the date in which that taxable income is first earned. The benefits period under Approved Enterprise status is limited to 12 years from the year the enterprise commences its operations, or 14 years from the year of the approval as an Approved Enterprise, whichever ends earlier. If a company has more than one Approved Enterprise program or if only a portion of its capital investments are approved, its effective tax rate is the result of a weighted combination of the applicable rates. The tax benefits from any certificate of approval relate only to taxable income attributable to the specific Approved Enterprise. Income derived from activity that is not integral to the activity of the Approved Enterprise will not enjoy tax benefits.

A company that has an Approved Enterprise program is eligible for further tax benefits, if it qualifies as a Foreign Investors’ Company, or FIC. An FIC eligible for benefits is essentially a company with a level of foreign investment, as defined in the Investment Law, of more than 25%. The level of foreign investment is measured as the percentage of rights in the company (in terms of shares, rights to profits, voting and appointment of directors), and of combined share and loan capital, that are owned, directly or indirectly, by persons who are not residents of Israel. The determination as to whether or not a company qualifies as an FIC is made on an annual basis. An FIC that has an Approved Enterprise program will be eligible for an extension of the period during which it is entitled to tax benefits under its Approved Enterprise status (so that the benefits period may be up to ten years) and for further tax benefits if the level of foreign investment exceeds 49%. If a company that has an Approved Enterprise program is a wholly owned subsidiary of another company, then the percentage of foreign investment is determined based on the percentage of foreign investment in the parent company.

The corporate tax rates and related levels of foreign investments with respect to an FIC that has an Approved Enterprise program are set forth in the following table:

Percentage of non-Israeli ownership	Corporate Tax Rate
Over 25% but less than 49%	25%
49% or more but less than 74%	20%
74% or more but less than 90%	15%
90% or more	10%

A company that has elected to participate in the alternative benefits program and that subsequently pays a dividend out of the income derived from the portion of its facilities that have been granted Approved Enterprise status during the tax exemption period will be subject to tax in respect of the amount of dividend distributed (grossed up to reflect such pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate that would have been otherwise applicable if such income had not been tax-exempted under the alternative benefits program. This rate generally ranges from 10% to 25%, depending on the extent to which non-Israeli shareholders hold such company’s shares.

In addition, dividends paid out of income attributed to an Approved Enterprise (or out of dividends received from a company whose income is attributed to an Approved Enterprise) are generally subject to withholding tax at the rate of 15%, or at a lower rate provided under an applicable tax treaty. The 15% tax rate is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. After this period, the withholding tax is applied at a rate of up to 30%, or at a lower rate under an applicable tax treaty. In the case of an FIC, the 12-year limitation on reduced withholding tax on dividends does not apply.

The Investment Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program. This benefit is an incentive granted by the Israeli government regardless of whether the alternative benefits program is elected.

The benefits available to an Approved Enterprise are subject to the fulfillment of conditions stipulated in the Investment Law and its regulations and the criteria in the specific certificate of approval with respect thereto, as described above. If a company does not meet these conditions, it would be required to refund the amount of tax benefits, adjusted to the Israeli consumer price index and interest.

In our case, subject to compliance with applicable requirements stipulated in the Investment Law and its regulations and in the specific certificate of approval, as described above, the portion of undistributed income derived from Approved Enterprise programs of certain of our Israeli subsidiary and affiliated companies will be exempt from corporate tax for a period of two to four years, followed by five to eight years with reduced tax rate of 25% on income derived from Approved Enterprise investment programs.

Tax benefits under the 2005 Amendment that became effective on April 1, 2005.

The 2005 Amendment applies to new investment programs and investment programs commencing after 2004, and does not apply to investment programs approved prior to April 1, 2005. The 2005 Amendment provides that terms and benefits included in any certificate of approval that was granted before the 2005 Amendment became effective (April 1, 2005) will remain subject to the provisions of the Investment Law as in effect on the date of such approval. Pursuant to the 2005 Amendment, the Investment Center will continue to grant Approved Enterprise status to qualifying investments. The 2005 Amendment, however, limits the scope of enterprises that may be approved by the Investment Center by setting criteria for the approval of a facility as an Approved Enterprise.

An enterprise that qualifies under the new provisions is referred to as a Beneficiary Enterprise, rather than Approved Enterprise. The 2005 Amendment provides that the approval of the Investment Center is required only for Approved Enterprises that receive cash grants. As a result, a company is no longer required to obtain the advance approval of the Investment Center in order to receive the tax benefits previously available under the alternative benefits program. Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set forth in the 2005 Amendment. A company that has a Beneficiary Enterprise may, at its discretion, approach the Israel Tax Authority for a pre-ruling confirming that it is in compliance with the provisions of the Investment Law.

Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export to specific markets with a population of at least 14 million in 2012 (such export criteria will further increase in the future by 1.4% per annum). In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment which meets certain conditions set forth in the amendment for tax benefits and which exceeds a minimum amount specified in the Investment Law. Such investment entitles a company to a Beneficiary Enterprise status with respect to the investment, and may be made over a period of no more than three years from the end of the year in which the company chose to have the tax benefits apply to the Beneficiary Enterprise. Where a company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered to be a Beneficiary Enterprise, and the company's effective tax rate will be the weighted average of the applicable rates. In such case, the minimum investment required in order to qualify as a Beneficiary Enterprise must exceed a certain percentage of the value of the company's production assets before the expansion.

The extent of the tax benefits available under the 2005 Amendment to qualifying income of a Beneficiary Enterprise depends on, among other things, the geographic location of the Beneficiary Enterprise. Such tax benefits include an exemption from corporate tax on undistributed income for a period of between two to ten years, depending on the geographic location of the Beneficiary Enterprise in Israel, and a reduced corporate tax rate of between 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in the company in each year, as explained above.

Dividends paid out of income attributed to a Beneficiary Enterprise (or out of dividends received from a company whose income is attributed to a Beneficiary Enterprise) are generally subject to withholding tax at the rate of 15% or such lower rate as may be provided in an applicable tax treaty. The reduced rate of 15% is limited to dividends and distributions out of income attributed to a Beneficiary Enterprise during the benefits period and actually paid at any time up to 12 years thereafter, except with respect to an FIC, in which case the 12-year limit does not apply. Furthermore, a company qualifying for tax benefits under the 2005 Amendment which pays a dividend out of income attributed to its Beneficiary Enterprise during the tax exemption period will be subject to tax in respect of the amount of the dividend distributed (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 that would have otherwise been applicable

The benefits available to a Beneficiary Enterprise are subject to the fulfillment of conditions stipulated in the Investment Law and its regulations. If a company does not meet these conditions, it would be required to refund the amount of tax benefits, adjusted to the consumer price index and interest, or other monetary penalty.

Income that is attributable to one of Sapiens' Israeli subsidiaries, will be exempt from income tax for a period of two years commencing 2014, under the 2005 Amendment.

Tax benefits under the 2011 Amendment that became effective on January 1, 2011.

The 2011 Amendment canceled the availability of the benefits granted in accordance with the provisions of the Investment Law prior to 2011 and, instead, introduced new benefits for income generated by a "Preferred Company" through its Preferred Enterprise (as such terms are defined in the Investment Law) as of January 1, 2011. A Preferred Company is defined as either (i) a company incorporated in Israel which is not wholly owned by a governmental entity or (ii) a limited partnership that (a) was registered under the Israeli Partnerships Ordinance and (b) all of its limited partners are companies incorporated in Israel, but not all of them are governmental entities; which has, among other things, Preferred Enterprise status and is controlled and managed from Israel. Pursuant to the 2011 Amendment, a Preferred Company was entitled to a reduced corporate tax rate of 15% with respect to its preferred income attributed to its Preferred Enterprise in 2012, unless the Preferred Enterprise was located in a certain development zone, in which case the rate was 10%. Such corporate tax rate was reduced to 12.5% and 7%, respectively, in 2013 and was increased to 16% and 9%, respectively, in 2014 and thereafter. Income derived by a Preferred Company from a 'Special Preferred Enterprise' (as such term is defined in the Investment Law) would be entitled, during a benefits period of 10 years, to further reduced tax rates of 8%, or to 5% if the Special Preferred Enterprise is located in a certain development zone.

Dividends paid out of income attributed to a Preferred Enterprise are generally subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty. However, if such dividends are paid to an Israeli company, no tax is required to be withheld (although, if such dividends are subsequently distributed to individuals or a non-Israeli company, withholding tax at a rate of 20% or such lower rate as may be provided in an applicable tax treaty will apply).

The 2011 Amendment also provided transitional provisions to address companies already enjoying current benefits under the Investment Law. These transitional provisions provide, among other things, that unless an irrevocable request is made to apply the provisions of the Investment Law as amended in 2011 with respect to income to be derived as of January 1, 2011: (i) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, which chose to receive grants, before the 2011 Amendment became effective, will remain subject to the provisions of the Investment Law as in effect on the date of such approval, and subject to certain conditions; (ii) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, that had participated in an alternative benefits program, before the 2011 Amendment became effective, will remain subject to the provisions of the Investment Law as in effect on the date of such approval, provided that certain conditions are met ; and (iii) a Beneficiary Enterprise can elect to continue to benefit from the benefits provided to it before the 2011 Amendment came into effect, provided that certain conditions are met.

As of December 31, 2014, none of our Israeli subsidiary and affiliated companies had filed a request to apply the new benefits under the 2011 Amendment.

Tax Benefits and Grants for Research and Development

Israeli tax law allows, under certain conditions, a tax deduction for research and development expenditures, including capital expenditures, for the year in which they are incurred. Such expenditures must relate to scientific research and development projects, and must be approved by the relevant Israeli government ministry, determined by the field of research, and the research and development must be for the promotion or development of the company. Furthermore, the research and development must be carried out by or on behalf of the company seeking such tax deduction. The amount of such deductible expenses is reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not approved by the relevant Israeli government ministry, but otherwise qualifying for deduction, are deductible over a three-year period. However, the amounts of any government grants made available are subtracted from the amount of the deductible expenses.

Law for the Encouragement of Industry (Taxes), 5729-1969

The Law for the Encouragement of Industry (Taxes), 5729-1969, or the Industry Encouragement Law, provides several tax benefits for an “Industrial Company”. Pursuant to the Industry Encouragement Law, a company qualifies as an Industrial Company if it is an Israeli resident company that was incorporated in Israel and at least 90% of its income in any tax year (other than income from certain government loans) is generated from an “Industrial Enterprise” that it owns and located in Israel. An “Industrial Enterprise” is defined as an enterprise whose major activity, in a given tax year, is industrial production.

An Industrial Company is entitled to certain tax benefits, including:

- Deduction of the cost of the purchases of patents, or the right to use a patent or know-how used for the development or promotion of the Industrial Enterprise, over an eight year period commencing on the year in which such rights were first exercised;
- Straight-line deduction of expenses related to a public offering in equal amounts over a three-year period commencing on the year of offering;
- The right to elect, under certain conditions, to file a consolidated tax return together with Israeli Industrial Companies controlled by it; and
- Accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

We believe that certain of our Israeli subsidiary and affiliated companies currently qualify as Industrial Companies within the definition under the Industry Encouragement Law. We cannot assure you that we will continue to qualify as Industrial Companies or that the benefits described above will be available in the future.

B. Liquidity and Capital Resources

Since inception, we have financed our growth and business primarily through cash provided by operations and through public debt and equity offerings, as well as through private and public debt and equity offerings of our subsidiaries. In addition, we finance our business operations through short-term and long-term loans and borrowings available under our credit facilities.

Current Outlook

We had cash and cash equivalents and short-term investments of $100.8 million and $129.7 million at December 31, 2013 and December 31, 2014, respectively. At December 31, 2013 and December 31, 2014, we had indebtedness to banks and others of $98.1 million and $150.0 million, respectively, of which $35.6 million and $41.8 million were current liabilities and $62.4 million and $108.2 million were long-term liabilities as of those respective dates.

In November 2011, we received a long-term bank credit in the amount of $12.0 million which is secured by a pledge over a certain portion of our investment in outstanding shares of Matrix and Sapiens. The loan is to be repaid in three equal installments on November 14, 2012, 2013 and 2014. We also have an option to repay any portion, or all, of the outstanding principal amount every six months, subject to the foregoing minimum repayment of one-third of the total principal amount during each of 2012, 2013 and 2014. As of December 31, 2013 the remaining balance was $4.0 million, to be repaid on November 14, 2014. On February 14, 2014, our board of directors determined to effect an early redemption of the outstanding principal balance of the loan. The early redemption payment was made in one installment, on the interest payment date on February 18, 2014.

In January 2014, Formula agreed to the terms of a NIS 200 million loan (approximately $57.6 million) that was extended to us by a leading Israeli institutional investor. The loan is secured by certain of the shares of each of our publicly held subsidiaries and affiliated company. The loan's average duration is approximately four years (paid over a period of 6 years) and carries a fixed annual interest rate of 5.5%.

Under the terms of the loan with the Israeli institutional investor, Formula has undertaken to maintain the following financial covenants, as they will be expressed in its financial statements, as described:

1. Our equity shall not be lower than $ 160 million at all times.

2. The ratio of our equity to total assets will not be less than 20%.

3. The ratio of our total financial debts less cash, short-term deposits and short-term marketable securities to the annual EBITDA will not exceed 3.5 to 1.

4. The ratio of our total financial debts less cash, short-term deposits and short-term marketable securities to the total assets will not exceed 30%.

5. Formula’s liabilities to banks and other financial institutions in its standalone balance sheet shall not be higher than NIS 450 million (approximately $ 115.7 million).

6. Formula will not create any pledge on all or part of its property and assets in favor of any third party and will not provide any guarantee to secure any third party's debts as they are today and as they will be without the financial institution's consent.

7. Formula will not sell and/or transfer all or part of its assets to others in any manner whatsoever without the financial institution’s advance written consent, unless it is done in the ordinary course of business.

From time to time, our subsidiaries also maintain credit facilities with banks and issue debt instruments such as debentures in accordance with their cash requirements. These credit facilities and debentures include, inter alia, certain covenants related to our subsidiaries' operations, such as the required maintenance of a minimum level of shareholders' equity and the achievement of certain operating results targets. Some of our subsidiaries' assets are pledged to the lender banks and debenture holders. If any of our subsidiaries does not meet the covenants specified in its credit agreement or indenture (or equivalent agreement with the debenture holders), and a waiver with respect to the fulfillment of such covenant has not been received from the lender bank or representative of the debenture holders, the lender bank or debenture holders (via the action of their representative) may foreclose on the pledged assets to satisfy a debt.

Currently, only Matrix and Formula have such material credit facilities outstanding. The long-term debt obligations of Matrix bear fixed interest at an average annual rate of 2.9%-5.9%. These credit facilities expire over a period of time that ranges from 1 to 7 years. The long-term debt obligation of Formula bears a fixed rate annual interest of 5.5%.

Until June 30, 2013, Matrix had its debentures (Series A) outstanding. The Series A debentures were originally issued in August 2007 in an original principal amount of NIS 250 million (approximately $69.9 million, based on the representative exchange rate of NIS 3.5781 per $1 reported by the Bank of Israel for the 2011 fiscal year). The principal amount of the debentures (following a partial redemption of approximately $12.8 million of the principal amount of the debentures in November 2008) was due to be repaid in four annual installments, on December 31, 2010, 2011, 2012 and 2013. The first payment (following the November 2008 redemption) in an approximate amount of $14.7 million was made on December 31, 2010. No payment was made on December 31, 2011, as the second and third payments were made in 2012 in an aggregate amount of approximately $33.0 million, respectively. On May 28, 2013, Matrix's board of directors decided on early redemption of the outstanding balance of the debentures (series A). The early redemption payment was made in one installment, at the interest payment date on June 30, 2013 (the "Early Redemption Date"). The amount of actual redemption was approximately NIS 60.8 million (approximately $16.8 million). After the early redemption, the debentures were written off for trading and from the TASE Clearing House. The amount per NIS 1 par value that Matrix redeemed equals to the value of the bonds` liability value, (i.e. principal plus interest and linkage differences to the actual date of early redemption).

As of December 31, 2014, Matrix had aggregate short-term obligations to banks and others of NIS 162.6 million (approximately $41.8 million) and aggregate long-term obligations to banks of NIS 220.8 million (approximately $56.8 million) under its credit facilities.

In November 2013, Magic Software received a loan from a US bank institution, in the amount of $3.0 million, to be paid monthly in equal payments, for a period of 36 months bearing interest of Libor+3.5%. The loan agreement contains various covenants which require Magic Software to maintain certain financial ratios. During 2014, Magic Software made an early redemption and repaid the entire amount.

On November 19, 2013, Sapiens completed a follow-on public offering of its common shares. Sapiens issued 6,497,400 shares at a price of $ 6.25 per share before issuance expenses. Total net proceeds from the issuance amounted to approximately $37.8 million. On March 5, 2014, Magic Software completed a follow-on public offering of its ordinary shares. Magic Software issued 6,900,000 shares at a price of $ 8.50 per share before issuance expenses. Total net proceeds from the issuance were approximately $ 54.7 million.

We believe that our current cash reserves, together with cash that may be distributed to us from the ongoing operations of our subsidiaries and any credit that we may choose to draw upon that is available under our (and our subsidiaries' and affiliated company's) existing credit facilities should be sufficient for our present working capital requirements for at least the next 12 months at our current level of operations. We will consider in the future additional equity issuances, debt issuances or borrowings from banks if necessary to meet cash needs for our growth, including if needed to consummate one or more acquisitions for consideration consisting of all or a substantial portion of our available cash. Should we require additional financing in the future, we cannot assure you that such financing will be available on favorable terms or at all.

Cash Provided by Operating Activities

Cash flow provided by our operating activities decreased from $ 68.6 million in 2013 to $ 16.7 million in 2014.

Net cash provided by operations in 2014 consisted primarily of the cash generated by our subsidiaries’ ongoing operating activities and of net income stemming therefrom, as adjusted for non-cash activity, including changes in operating assets and liabilities. The material upwards adjustments in cash flow reflecting non-cash activity included adjustments due to (i) depreciation and amortization of capitalized research and development assets and other intangible assets (mainly customer relations) in an aggregate amount of $ 9.0 million, (ii) stock-based compensation expenses, in an amount of $ 5.0 million, (iii) increase in deferred revenues in an amount of $ 7.3 million, (iv) changes in deferred taxes and in value of debentures in an aggregate amount of $ 20.2 million, (v) impairment of other investments in an amount of $ 1.3 million, and (vi) an increase in trade payables and in other accounts payable and employees and payroll accrual, in an aggregate amount of $ 6.2 million. Material downwards adjustments in cash flow for non-cash activity, including changes in operating assets and liabilities, consisted of adjustments of (i) an increase in trade receivables in an amount of $13.6 million, (ii) decrease in value of long term loans in an amount of $ 6.2 million, (iii) a decrease in inventory, in an amount of $0.2 million, reflecting our subsidiaries’ strategy to maintain adequate, but not excessive, levels of inventory based on their anticipation of future demand for proprietary software products and software services, (iv) change in liabilities in respect of business combinations in an amount of $ 3.3 million (v) increase in other current and long term account receivables in an amount of $ 5.7 million and (vi) gain derived from deconsolidation of Magic Software, consolidation of Sapiens and equity in gains of affiliated companies in an amount of $ 90.9 million.

Cash flow provided by operating activities in 2014 was primarily comprised of $ 23.1 million provided by Matrix offset by $ 7.0 million used by Formula.

Cash flow provided by our operating activities decreased from $ 73.1 million in 2012 to $ 68.6 million in 2013.

Net cash provided by operations in 2013 consisted primarily of the cash generated by our subsidiaries’ ongoing operating activities and of net income stemming therefrom, as adjusted for non-cash activity, including changes in operating assets and liabilities. The material upwards adjustments in cash flow reflecting non-cash activity included adjustments due to (i) depreciation and amortization of capitalized research and development assets and other intangible assets (mainly customer relations) in an aggregate amount of $ 24.3 million, (ii) stock-based compensation expenses, in an amount of $ 4.0 million, (iii) increase in deferred revenues in an amount of $ 5.0 million (iv) changes in deferred taxes and in value of debentures in an aggregate amount of $ 0.7 million and, (v) an increase in trade payables and in other accounts payable and employees and payroll accrual, in an aggregate amount of $ 5.8 million. Material downwards adjustments in cash flow for non-cash activity, including changes in operating assets and liabilities, consisted of adjustments of (i) an increase in trade receivables, in an amount of $ 5.7 million. (ii) a decrease in inventory, in an amount of $0.1 million, reflecting our subsidiaries’ strategy to maintain adequate, but not excessive, levels of inventory based on their anticipation of future demand for proprietary software products and software services, and (iii) gain derived from deconsolidation of Sapiens, in an amount of $61.2 million.

Cash flow provided by operating activities in 2013 was primarily comprised of $35.6 million provided by Matrix, $12.8 million provided by Sapiens (reflecting approximately 10.5 months of activity consolidated in our reports from January 1, 2013 until November 19, 2013) and $22.3 million provided by Magic Software, reflecting the $21.6 million, $9.9 million and $15.8 million, of net income generated by these subsidiaries, respectively, in 2013, as adjusted for non-cash operating line items and changes in non-cash operating assets and liabilities (as detailed above).

Cash Generated by (Used in) Financing Activities

Cash generated by financing activities of $ 31.6 in 2014 compared to cash used in financing activities of $38.4 million in 2013, mainly reflecting the cumulative effect of the following financing-related transactions that occurred over the course of those years:

Year Ended December 31, 2014

In April 2014, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $ 5.8 million, of which $ 2.9 million was paid to non-controlling interests in Matrix.

In June 2014, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $ 4.9 million, of which $ 2.4 million was paid to non-controlling interests in Matrix.

In July 2014, Formula distributed to its shareholders a cash dividend in an aggregate amount of approximately $7.1 million.

In September 2014, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $ 3.3 million, of which $ 1.6 million was paid to non-controlling interests in Matrix.

In December 2014, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $ 4.1 million, of which $ 2.0 million was paid to non-controlling interests in Matrix.

In December 2014, Formula distributed a cash dividend in an aggregate amount of approximately $7.9 million. The dividend was paid to Formula shareholders after the balance sheet date in February 2015.

In addition, net cash provided by financing activities in 2014 was attributable to (i) repayment of long term loans from banks and others in an amount of $ 25.1 million, and (ii) cash paid in conjunction with acquisition of activities in an amount of $14.8 million offset by (i) an increase in short term bank credit, net and proceeds from long term debt in the aggregate amount of $ 97.3 million, and (ii) purchase of non-controlling interests and redeemable non-controlling interests in an amount of $ 1.7 million.

Year Ended December 31, 2013

In February 2013, Sapiens distributed to its shareholders a cash dividend in an aggregate amount of approximately $5.8 million, of which $2.5 million was paid to non-controlling interests in Sapiens.

In March 2013, Magic Software distributed to its shareholders a cash dividend in an aggregate amount of approximately $4.4 million, of which $2.1 million was paid to non-controlling interests in Magic Software.

In April 2013, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $5.0 million, of which $2.5 million was paid to non-controlling interests in Matrix.

In June 2013, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $3.8 million, of which $1.9 million was paid to non-controlling interests in Matrix.

In July 2013, Formula distributed to its shareholders a cash dividend in an aggregate amount of approximately $5.4 million.

In September 2013, Magic Software distributed to its shareholders a cash dividend in an aggregate amount of approximately $3.3 million, of which $1.6 million was paid to non-controlling interests in Magic Software.

In September 2013, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $4.8 million, of which $2.4 million was paid to non-controlling interests in Matrix.

In December 2013, Matrix distributed to its shareholders a cash dividend in an aggregate amount of approximately $4.1 million, of which $2.1 million was paid to non-controlling interests in Matrix.

In December 2013, Formula distributed a cash dividend in an aggregate amount of approximately $4.6 million. The dividend was paid to Formula shareholders after the balance sheet date in February 2014.

In addition, net cash used in financing activities in 2013 was attributable to (i) repayment of long term loans from banks and others in an amount of $ 17.6 million (ii) cash paid in conjunction with acquisition of activities in an amount of $ 3.9 million, and, (iii) repayment of debentures in Matrix in an amount of $ 16.8 million, offset by (i) an increase in short term bank credit, net and proceeds from long term debt in the aggregate amount of $ 23.8 million, and, and (ii) purchase of non-controlling interests and redeemable non-controlling interests in an amount of $ 4.4 million.

Cash Used in Investing Activities

Net cash used in our investing activities was $ 19.8 million in 2014 compared to $63.3 million in 2013, mainly reflecting the cumulative effect of the following investment-related transactions that occurred over the course of those years:

Year Ended December 31, 2014

On March 5, 2014, Magic Software completed a follow-on public offering of its ordinary shares on the NASDAQ. Magic issued 6,900,000 shares at a price of $ 8.50 per share before issuance expenses. Total net proceeds from the issuance amounted to $ 54.7. As a result of the offering, Formula’s interest in Magic Software’s outstanding ordinary shares diluted from 51.6% to 45.0% and Formula's investment in Magic Software was measured under the equity method of accounting due to loss of control in Magic Software. We recorded a capital expenditure of $ 37.4 million in respect of losing control in Magic Software.

In April 2014, Formula acquired the VMS operations of InSync Staffing LLC, a U.S.-based full service provider of staffing solutions for IT, engineering and telecom. We recorded a capital expenditure of $ 4.0 million in respect of this acquisition.

In September 2014, Magic Software distributed to its shareholders a cash dividend in an aggregate amount of approximately $4.2 million, of which $1.9 million was paid to Formula.

On December 23, 2014, following the purchase by Formula of Sapiens common shares, bringing Formula interest in Sapiens common shares to 50.2% and as a result, regaining control over Sapiens, we recorded a net capital proceed of $ 42.4 million in respect of regaining control in Sapiens

In addition, net cash used in investing activities in 2014 was attributable to (i) purchase of property and equipment in an amount of $ 4.0 million (ii) investments in affiliated companies in an amount of $7.6 million, (iii) expenditure (net of cash acquired) with respect to business acquisitions in an amount of $ 4.4 million, and, (iv) net investment in short term deposits in an amount of $ 6.1 million.

Year Ended December 31, 2013

In February 2013, Magic Software purchased Pilat Europe Limited Ltd. and Pilat (North America) Inc. which provides custom human capital management solutions, for a total consideration of $ 1,233.

In November 2013, Magic Software acquired the enterprise division of Allstates Technical Services, LLC, a U.S.-based full-service provider of consulting and staffing solutions for IT, Engineering and Telecom personnel from KBR, Inc. (NYSE: KBR). With a 60-year history, this division, now known as Allstates Consulting Services LLC brings a strong reputation and an experienced growth-focused management team serving some of the world’s leading telecom and technology companies.

In May 2013, Magic Software's subsidiary, Comm-IT Technology Solutions Ltd., acquired Dario Solutions IT Ltd. and Valinor Ltd., both incorporated in Israel, for a total consideration of $5.3 million, of which $2.3 million is contingently payable upon the acquired business meeting certain operational targets in 2013, 2014 and 2015. Dario, a Microsoft Gold Level Partner, provides integration services especially with respect to Microsoft products for large and mid-range customers in Israel and specializes in virtualization and private cloud; server based computing, storage area networks, multiple users system management and mobile solutions. Valinor specializes in project and product consultation, installation and implementation of databases and employs a wide range of information system architects, including data base system architects, or DBAs, who have expertise in database management. Valinor assists its customers in finding creative and effective solutions, including development, conversion, upgrade and installation of complex database systems that handle large amounts of information. As a Microsoft Certified Partner and an Oracle Gold Level Partner, Valinor collaborates with both of these major software providers and is involved in different projects in Israel and internationally.

In December 2013, Matrix purchased 100% of the share capital of Strategic Sales Systems Inc. from its former shareholders in consideration of approximately NIS 1.4 million (approximately $0.4 million) in cash. Matrix may pay an additional consideration in the amount of approximately NIS 5.2 million ($1.5 million) subject to certain revenue and profit goals.

Company Commitments

In January 2014, Formula agreed to the terms of a NIS 200 million loan (approximately $57.6 million) that was extended to us by a leading Israeli institutional investor. The loan is secured by certain of the shares of each of our publicly held subsidiaries and affiliated company. The loan's average duration is approximately four years (paid over a period of 6 years) and carries a fixed annual interest rate of 5.5%.

In the context of Formula's engagements the above mentioned leading financial institution, Formula has undertaken to maintain the following financial covenants, as they will be expressed in its financial statements, as described:

1. Our equity shall not be lower than $ 160 million at all times.

2. The ratio of our equity to total assets will not be less than 20%.

3. The ratio of our total financial debts less cash, short-term deposits and short-term marketable securities to the annual EBITDA will not exceed 3.5 to 1.

4. The ratio of our total financial debts less cash, short-term deposits and short-term marketable securities to the total assets will not exceed 30%.

5. Formula's liabilities to banks and other financial institutions in its standalone balance sheet shall not be higher than NIS 450 million (approximately $ 115.7 million).

6. Formula will not create any pledge on all or part of its property and assets in favor of any third party and will not provide any guarantee to secure any third party's debts as they are today and as they will be without the financial institution's consent.

7. Formula will not sell and/or transfer all or part of its assets to others in any manner whatsoever without the financial institution's advance written consent, unless it is done in the ordinary course of business.

We do not have material commitments for capital expenditures by Formula as of December 31, 2014 or as of the date of this annual report

We have entered into an undertaking to indemnify our office holders in specified limited categories of events and in specified amounts, subject to certain limitations. For more information, see "Item 7. Major Shareholders and Related Party Transactions—Related Party Transactions—Indemnification of Office Holders."

Subsidiary Commitments

Our subsidiaries do not have any material commitments for capital expenditures as of December 31, 2014 or as of the date of this annual report.

As alluded to above (see “—Current Outlook”), the loan agreements and indentures to which we are party contain a number of conditions and limitations on the way in which we (mainly Matrix and Formula) can operate our businesses, including limitations on our ability to raise debt and sell or acquire assets not in normal business activity. For example, Matrix’s loan agreement includes a negative pledge with respect to Matrix’s assets, as well as limitations on Matrix’s ability to provide guarantees to third parties and sell or transfer its assets. Matrix’s loan agreements also contain various covenants which require it to maintain certain financial ratios related to shareholders’ equity and operating results that are customary for companies of comparable size.

Our subsidiaries as of December 31, 2014 have provided bank guarantees aggregating to approximately $ 14.0 million as security for the performance of various contracts with customers. If our subsidiaries were to breach certain terms of such contracts, the customers could demand that the banks providing the guarantees pay amounts claimed to be due.

Our subsidiaries as of December 31, 2014 have also provided additional bank guarantees aggregating to $ 5.2 million as security for rent to be paid for their offices. If our subsidiaries were to breach certain terms of their leases, the lessors could demand that the banks providing the guarantees pay amounts claimed to be due.

Pursuant to the credit agreement described above, a lien has been incurred over a certain portion of our investment in outstanding shares of Matrix, Sapiens and Magic Software.

C. Research and Development, Patents and Licenses, etc.

The net amounts that we spent on research and development activities in 2012, 2013 and 2014 totaled $ $12.3 million, $14.2 million and $0.8 million, respectively. For more information about our research and development activities, see “Item 4. Information on the Company—Business Overview— Software Development.”

For information concerning our intellectual property rights, see “Item 4. Information on the Company— Business Overview — Intellectual Property Rights.”

D. Trend Information

For information see discussion in Item 4. “Information on the Company-Business Overview-Industry Background and Trends” and Item 5. “Operating and Financial Review and Prospects - Results of Operations.”

E. Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our contractual obligations and commitments as of December 31, 2014.

	Payments due by period				
	Total	**Less than 1 year**	**1-3 years**	**3-5 Years**	**More than 5 years**
	(U.S. dollars, in thousands				
Long-term debt obligations (1)	134,329	26,127	59,904	36,634	11,664
Lease obligations	59,991	21,891	23,692	11,289	3,119
Liability in respect of the acquisition of operations	12,760	1,782	10,978	-	-
Liability to the OCS(4)	4,720	788	1,010	1,010	1,912
Uncertainties in income taxes (ASC 740) (2)	1,283	-	-	-	-
Accrued severance payments, net (3)	12,627	-	-	-	-
Total	**225,710**	**50,588**	**95,584**	**48,933**	**16,695**

(1) Does not include interest.

(2) Payment of uncertain tax benefits would result from settlements with taxation authorities. Due to the difficulty in determining the timing of settlements, this information is not included in the above table. We do not expect to make any significant payments for these uncertain tax positions within the next 12 months.

(3) Accrued severance payments, net relate to accrued severance obligations and notice obligations mainly to our Israeli employees as required under Israeli labor law or personal employment agreements. We are legally required to pay severance upon certain circumstances, primarily upon termination of employment by our company, retirement or death of the respective employee. Our liability for all of our Israeli employees is fully provided for by monthly deposits with insurance policies and by an accrual.

(4) Does not include additional contingent liabilities to the OCS of approximately $2.9 million as described in Note 13(f) to our consolidated financial statements contained elsewhere in this annual report.