Annual Report
2000

MAGIC
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Annual Report 2000

Integrating Tomorrow's Solutions Today

Annual Report
2000

Customer relationship management

Strategic alliances

Web development technology

Channel partnerships

eCommerce solutions

Professional services and support

MAGIC
Magic Software Enterprises

A Formula Group Company

Contents

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ABOUT THE COMPANY

Magic Software Enterprises (Nasdaq: MGIC) is a leading provider of application development technology and business solutions to corporations worldwide. With annual revenues of more than $90 million, its customers include thousands of solutions providers and enterprises in approximately 50 countries supported through Magic's global network of branches and distributors. Magic Software also provides related consulting and professional services, education, and technical support.

In 1986, Magic Software revolutionized the world of application development when it introduced what generally is considered the most productive development environment for creating customizable applications. The latest version of this product, Magic eDeveloper, provides a revolutionary framework for rapidly developing, customizing and deploying complex eBusiness and client/server solutions. It is this framework that makes Magic Software one of the only companies that can provide timely delivery of eBusiness solutions that extend from front-office customer relationship management to back-office applications to specific vertical solutions.

Magic eDeveloper enables solutions that are especially in demand when time-to-market is critical, integration with existing systems and business processes is required, or a high degree of maintenance is anticipated. Unlike competitors who force organizations to change to meet the needs of their software, Magic solutions allow companies to utilize their existing business processes and legacy investments, as well as rapidly customize solutions to meet specific enterprise needs.

In addition, applications developed in Magic eDeveloper provide the portability and scalability crucial for today's dynamic business environment, as well as the advantage of a uniform application paradigm regardless of architecture (Internet, Client/Server, LAN), platforms (Windows, Linux, UNIX, iSeries) or database (DB2, Oracle, Informix, SQLServer, Cache, etc).

Magic Software has also introduced applications based on the Magic eDeveloper technology, including Magic eMerchant™, Magic eService™, and Magic eContact™, for eBusiness and CRM.

- Magic eMerchant is a highly customizable eBusiness platform that offers enterprise-level processing power, security and rapid integration with existing back-end systems.
- Magic eService is a Web-based customer support management solution that allows companies to handle complex, iterative support and improve service profitability.
- Magic eContact is a comprehensive contact management solution for managing all aspects of sales and marketing, customer care and support.

In addition, Magic Software's Professional Services provides a wide range of consulting services to assist companies with application development and integration, e-commerce strategy and design, project management, and technology transformation and migration.

Magic eDeveloper is used by a wide variety of developers, including in-house corporate development teams as well as software houses or Magic Solution Partners, which range from large and medium system integrators that use Magic eDeveloper in large customized system projects - to companies developing industry specific vertical applications.

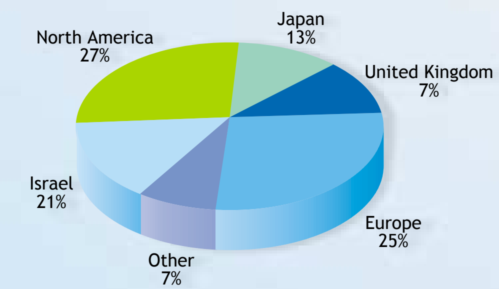
Magic Software subsidiaries develop, market and support vertical applications in the areas of long-term care, criminal justice and multi-facility car and truck rental management. In addition, the Magic community is significantly represented in such industries as finance, retail, media, telecommunications, manufacturing, tourism, and government agencies.

Among the tens of thousands of end-users running their business systems on Magic technology are the following organizations: **Bank of France, Fiat, Chase Manhattan Bank, Club Med, Financial Times, Gannet Media, Hitachi, Hutchison Telecom, Israel Discount Bank, Kodak, Matsushita, McKesson HBOC, Minolta, Nestle, Philip Morris, Steelcase, adidas-Salomon, State of Washington, John Menzies, Athlon Group, Marconi Mobile, Compass Group PLC and the United Nations.**

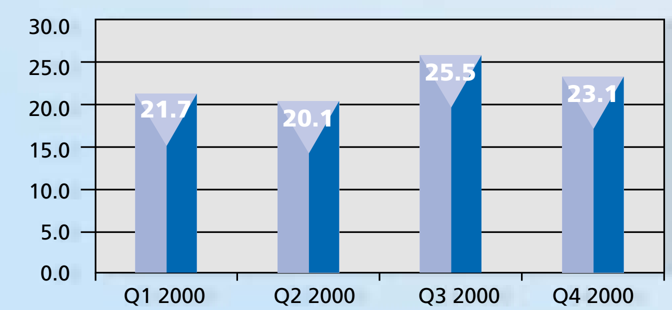
FINANCIAL HIGHLIGHTS

Country	%	Revenues (in millions)
Europe	24.5	22
United Kingdom	6.8	6
Japan	13.4	12
North America	27.4	25
Israel	20.5	19
Other	7.4	7

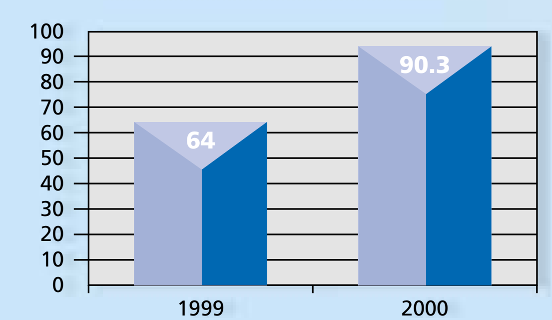
2000 Revenue by Region



Quartely Revenue Growth (in Millions USD)



Annual Revenue Growth (in Millions USD)



Financial Highlights

TO OUR SHAREHOLDERS:

The year 2000 was the dawn of a new era for Magic because it marked the true beginnings of our diversification into the solutions arena. It also was a period of uneven results. Several consecutive quarters of record-breaking performance were temporarily disrupted by a slowdown in the overall economy and the need to realign our organization to support our expanded direction and future growth. We were however, very encouraged by a number of positive developments that occurred during this year.

Early in the year, Magic delivered record-breaking results fueled by our decision to expand our offerings with packaged solutions targeted at several high growth areas. We also completed a secondary offering that provided us in excess of $80 million — a move that solidified Magic's cash position. The proceeds from the offering allowed us to invest in key capabilities and people, both through acquisitions and internal growth. The largest acquisition, that of CoreTech Consulting Group, Inc., adds considerable depth to Magic America's consulting and professional services capabilities - capabilities that we expect to be in great demand as we move further along the solutions continuum.

We were also able to step up our R&D efforts to add several new products to our portfolio of offerings. We rolled out our core application development technology for the rapidly emerging Linux platform, and we introduced Magic eService™, our packaged solution targeted at the growing customer relationship management (CRM) space. A second CRM product, Magic eContact™, also was released and quickly captured several industry awards.

In addition, we completed beta testing of Magic eDeveloper™, the latest version of our development environment that enables rapid development of interactive Web applications. This product was released early in 2001. We also witnessed growing acceptance for our Magic eMerchant™ product among major companies such as EDS, the Compass Group PLC (France), Marconi Mobile (UK) and Italy's Bonfiglioli Group, which won the prestigious Software Development Best Practice Award 2000 for its Magic eMerchant-based supply chain solution.

We believe these results confirm the wisdom of our decision to diversify our product line. We also believe that in today's dynamic economy, a diversified offering of innovative products and services, quickly developed, efficiently supported and rapidly deployed — Magic's key strengths — will be the defining elements in determining tomorrow's market leaders.

During 2000, we also made significant strides in realigning our organizational structure, introducing new management talent at many levels of the corporation. Dan Goldstein, Chairman of Formula Systems Ltd., Magic's majority shareholder, assumed the additional role of Chairman of Magic. And, in early 2001, I replaced Jack Dunietz as President and Chief Executive Officer of Magic. A veteran of the international software industry, I expect to use my experience to lead Magic to new levels of profitability — helping to ensure shareholder value is preserved.

In addition, we examined each of our branch operations, in many cases bringing in new talents more closely aligned with our expanded product line. Obviously, in any situation where new people are introduced into an organization, there is a painful learning curve that must take place, and profitability can suffer temporarily. However, we are close to completing this process and we expect to emerge from this effort as a much stronger company. Finally, 2000 was the year for building deeper, more strategic business relationships. A key development was receipt from IBM of its highest level of certification for e-business applications. This ranking identifies Magic as an approved AS/400 vendor deserving of special consideration for joint marketing with IBM.

Moving forward, our goal is to accelerate and complete the current restructuring, and to strengthen our strategic alliances and channel partnerships to produce superior long-term results.
We also plan to increase our emphasis on growing the Magic community by recruiting new channel partners - Magic Solutions Partners (MSPs), as well as on solidifying relationships with existing MSPs.

And we are placing increased emphasis on customer relationship management within our own organization —training our internal staff to be more responsive to the external pressures and dynamics of our customer base.

We view 2001 as a time for us to finish fixing our business, to continue introducing enhancements to our existing core technology and solutions, and to firmly establish the kinds of relationships that will enable us to take a more aggressive approach to successfully competing in today's e-business world. Clearly, we face a number of challenges. However, we have many strengths including world-class technology and a solid organization structure peopled with talented and highly qualified professionals — to fuel future growth.

In addition, the demand for increased productivity from faster, more robust technology should persist well into the foreseeable future — periodic economic and industry softness notwithstanding.

For these reasons, we believe the marketplace is rich with opportunities for a company with Magic's strengths, and we remain confident in ourselves and in our future. We remain dedicated to building a high-performance company capable of delivering consistent, sustainable, profitable growth that produces shareholder value.

Thank you to our shareholders, employees and partners for their continued loyalty and support.

Sincerely,

Menachem Hasfari
President and CEO

To Our Shareholders

Management Discussion and Analysis

The statements contained in this annual report that are not purely historical are forward-looking statements. Such forward-looking statements also include statements in Item 4 – "Information on the Company" and Item 5 – "Operating and Financial Review and Prospects." These statements involve risks and uncertainties and actual results could differ materially from such results discussed in these statements as a result of the risk factors set forth in this annual report. All forward-looking statements included in this annual report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements.

A. Operating Results

The following discussion and analysis is based and should be read in conjunction with our consolidated financial statements and notes thereto and the other financial information included elsewhere in this annual report.

Overview

We develop, market and support our Magic software development and deployment technology. Our Magic technology enables enterprises to accelerate the process of building and deploying software applications that can be rapidly customized and integrated with existing systems. During 1999, we expanded our business to include the sale of applications developed using Magic technology. These applications are designed for e-Business, CRM and other enterprise uses. Magic technology and Magic-based applications are used by over 2,500 software solution providers and thousands of enterprises in approximately 50 countries. We also provide maintenance and technical support as well as professional services to the Magic community.

We began operations in 1983 and completed an initial public offering of our ordinary shares in the United States in August 1991.

In the second quarter of 1998, we recorded a restructuring charge of $2.3 million ($0.13 per share) to cover the costs of a restructuring program approved in June 1998 by our board of directors. This charge relates to the termination of distribution agreements in Southeast Asia, Brazil and Israel in the total amount of $372,000 and severance and other costs relating to the termination of 41 employee positions in the total amount of $1.2 million. The restructuring charge also included a one time expense of approximately $512,000 relating to the write off of capitalized computer software development costs associated with a new line of products that has been terminated. In addition, we wrote off unused fixed assets designated for abandonment. The restructuring program was completed by the end of 1998.

During the second quarter of 1998, we also recognized other non-recurring charges of $350,000, principally due to our determination to cancel an agreement with the Israel-U.S. Binational Industrial Research and Development Foundation, or BIRD-F.

Beginning in the third quarter of 1998, we benefited from cost savings derived from the implementation of our restructuring plan and the lower cost structure of our operations in India, as well as increased revenues, which resulted in improved margins and a return to profitability in the second half of 1998. We also benefited from a sharp increase in revenues derived from maintenance and technical support and professional services. This increase was primarily due to an increase in maintenance fees derived from the release of a new version of our Magic technology and an increase in marketing efforts related to fee-based professional services. In late 1998 and 1999, we implemented our strategy of providing both Magic technology and applications through acquisitions of some of our distributors and Magic solution providers. Accordingly, in 1999 we acquired interests or increased our ownership interests in our distributors or Magic solution providers in Australia, Canada, Hungary, India, Japan, Thailand and the United States. Our Japanese subsidiary acquired the distribution rights for our products in Japan from our previous distributor, Wacom Co. Ltd.

As a result, we now consolidate all of the sales of our Japanese subsidiary, Magic Software Japan, in our revenues rather than as the royalty percentage we received in the past. In addition, our sales also increased as a result of our enhanced focus on the development and sale of applications. As a result, we generated record revenues and profits in each of the quarters of 1999.

In the first quarter of 2000, we completed a follow-on offering of 4,000,000 of our ordinary shares in the United States at $25.00 per share. Of these shares, 3,500,000 ordinary shares were offered by us and 500,000 ordinary shares were offered by our major shareholder, Formula Group (1985) Ltd. (Nasdaq:FORTY). Our net proceeds from the offering, after deducting the underwriting discount and expenses, were $80.6 million.

For a description of the acquisitions and dispositions of companies we made in 2000, please see Item 4A "History and Development of the Company".

Our consolidated financial statements are stated in U.S. dollars, the currency of our primary economic environment and our functional and reporting currency, and prepared in accordance with generally accepted accounting principles in the United States. Nevertheless, we conduct our operations in the local currencies of the countries in which many of our subsidiaries are located. Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transactions and balances in other currencies are remeasured into U.S. dollars in accordance with the principles set forth in Financial Accounting Standards Board Statement No. 52. Gains and losses arising from conversion are included in accumulated other comprehensive loss in shareholders' equity.
The following table presents our consolidated revenues according to the geographical regions to which such revenues are attributable for the periods indicated:

	Year ended December 31,					
	1998		1999		2000	
	Revenues	%	Revenues	%	Revenues	%
	(U.S. dollars in thousands)					
Europe (excluding the United Kingdom)	$ 17,310	44.7%	$ 21,205	33.1%	$ 22,129	24.5%
Japan	1,550	4.0	13,134	20.6	12,078	13.4
United Kingdom	7,320	18.9	6,041	9.4	6,094	6.8
North America	6,289	16.2	7,605	11.9	24,724	27.4
Israel	3,726	9.6	5,192	8.1	18,508	20.5
Other	2,565	6.6	10,815	16.9	6,723	7.4
	$ 38,760	100.0%	$ 63,992	100.0%	$ 90,256	100.0%

Revenues. Revenues are derived primarily from sales of software licenses and applications and fees from maintenance and technical support and professional services. Software sales are recognized pursuant to Statement of Position 97-2, as amended, upon delivery of the software if: collection is probable; all license payments are due within one year; the license fee is fixed or determinable; and persuasive evidence of an arrangement exists. Revenues from maintenance and technical support are recognized ratably over the contractual period. Revenues from professional services are recognized as project milestones are reached or pursuant to the contract.

Cost of Revenues. Cost of revenues for software sales consists primarily of software production costs and royalties and licenses payable to third parties, and amortization of capitalized software. Cost of revenues for maintenance and technical support and professional services consists primarily of personnel expenses and other related costs.

Research and Development Expenses, Net. Research and development costs consist primarily of salaries of employees engaged in on-going research and development activities and other related expenses. Grants for research and development and the capitalization of software development costs are applied as reductions to gross research and development costs to calculate net research and development expenses.

The following table sets forth the gross research and development costs, the amount of royalty-bearing grants received primarily from the Government of Israel, software development costs capitalized, and the net research and development expenses for the periods indicated:

	Year ended December 31		
	1998	1999	2000
	(U.S. dollars in thousands)		
Gross research and development costs	$4,080	$4287	$12,832
Less capitalization of software development costs	(1,283)	(1334)	(6,885)
Research and development expenses, net	$2,797	$2953	$5,947

Research and development expenses, net of government and other grants, are charged to income as incurred until technological feasibility is established. Technological feasibility is established upon completion of a detailed program design. Expenses incurred between the completion of the working model and the point at which the product is ready for general release are capitalized in accordance with Statement of Financial Accounting Standards No. 86. Capitalized software costs are amortized on a product-by-product basis. The annual amortization is the greater of the amount computed using the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or the straight-line method over the remaining estimated economic life of the product, including the period being reported on. Amortization begins when the product is available for general release to customers.

In the years 1998 through 2000, we did not submit any applications for grants to the Israeli Office of the Chief Scientist. We believe that the current policy of the Office of the Chief Scientist with respect to research and development grants is not beneficial to us and, therefore, have no intention to seek additional grants under the current policy. See Item 10E. "Taxation -- Grants under the Law for the Encouragement of Industrial Research and Development, 1984."

Selling and Marketing Expenses, Net. Selling and marketing expenses consist primarily of compensation and related expenses for sales and marketing personnel, sales commissions, marketing programs, web site related expenses, public relations, promotional materials, travel expenses and trade show exhibit expenses. Selling and marketing expenses are presented net of marketing grants received from the Government of Israel.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related expenses for executive, accounting, human resources and administrative personnel, professional fees, provisions for doubtful accounts, amortization of goodwill, and other general corporate expenses.

Financial Expenses, Net. Financial expenses consist of interest expense and currency translation expenses adjustments. Financial income consists of interest on cash and cash equivalent balances, and currency translation gains.

Taxes. Under Israeli tax law, Israeli companies are generally subject to income tax at the corporate tax rate of 36%. However, income recognized by us from our seven investment programs which have been granted "approved enterprise" status are tax exempt or taxed at a lower rate for a specified period commencing the date we begin to report taxable income and exhaust any net operating loss carry-forwards. These tax benefits are not available to us with respect to any income of our foreign subsidiaries.

Results of Operations

The following table presents selected consolidated statement of operations data for the periods indicated as a percentage of total revenues:

	Year ended December 31,		
	1998	1999	2000
Revenues:			
Software[1]	52.8%	51.0%	29.8%
Applications	-	6.9	16.0
Maintenance and technical support	14.9	14.4	12.6
Professional services	32.3	27.7	26.6
Total revenues	100.0%	100.0%	100.0%
Cost of revenues:			
Software[1]	7.7	6.2	4.0
Applications[1]			2.2
Maintenance and technical support	8.5	5.4	4.7
Professional services	23.4	17.8	27.3
Total cost of revenues	39.6	29.4	37.5
Gross profit	60.4	70.6	62.5
Operating expenses:			
Research and development, net	7.2	4.6	6.6
Selling and marketing, net	41.5	32.7	29.2
General and administrative	20.2	16.0	23.4
Restructuring and other non-recurring costs	6.9	-	2.7
Total operating expenses	75.8	53.3	61.9
Operating income (loss)	(15.4)	17.3	0.6
Capital loss	-	-	0.7
Financial income, net	(0.8)	(0.3)	(2.7)
Income (loss) before income taxes	(16.2)	17.6	2.6
Income taxes	(0.1)	-	(0.5)
Equity in earnings (losses) of affiliates	(0.4)	0.1	(0.1%)
Minority interest in (earnings) losses of consolidated subsidiarie	-	0.6	0.8
Net income (loss)	(16.7%)	17.0%	1.0%

(1) In the year 1998 revenues from software included applications revenues and cost of revenues for software included cost of revenues for applications.

Year Ended December 31, 2000 Compared With Year Ended December 31, 1999

Revenues. Total revenues increased 41.0% to $90.3 million in 2000 from $64.0 million in 1999. Software sales decreased 17.5% to $26.9 million in 2000 from $32.6 million in 1999. This decrease was principally attributable to the shift in our focus to sales of applications. Revenues from applications increased 227.0% to $14.4 million in 2000 from $4.4 million in 1999, as a result of our increased marketing efforts. Revenues from maintenance and technical support increased 22.8% to $11.3 million in 2000 from $9.2 million in 1999, mainly as a result of the increase in our software sales. Revenues from professional services increased 111.2% to $37.6 million in 2000 from $17.8 million in 1999. This growth reflects our transition towards sales of applications and the implementation of our acquisition strategy.

Cost of Revenues. Cost of revenues increased 80.3% to $33.9 million in 2000 from $18.8 million in 1999. Costs of revenues for software sales increased 12.5% to $3.6 million in 2000 from $3.2 million in 1999. Cost of revenues for applications increased 169.9% to $2.0 million in 2000 from $741,000 in 1999, in line with the increase in sales of applications.
Cost of revenues for maintenance and technical support increased 20.0% to $4.2 million in 2000 from $3.5 million in 1999, in line with the increase in revenues from maintenance and technical support. Cost of revenues for professional services increased 110.5% to $24.0 million in 2000 from $11.4 million in 1999 as a result of our transition towards sales of applications and the implementation of our acquisition strategy.

Gross Profit. Gross profit increased 24.8% to $56.4 million in 2000 from $45.2 million in 1999. Our gross margin, or gross profit as a percentage of total revenues, on software sales decreased to 86.5% in 2000 from 90.0% in 1999. Our gross margin on applications decreased to 86.1% in 2000 from 93.3% in 1999. Our gross margin on maintenance and technical support was 63.0% in 2000, the same as in 1999, and our gross margin on professional services decreased to 36.1% in 2000 from 36.0% in 1999.

Research and Development Expenses, Net. Gross research and development costs increased 298.0% to $13.0 million in 2000 from $4.3 million in 1999. Net research and development expenses increased 96.6% to $5.9 million in 2000 from $3.0 million in 1999. We did not receive any grants from the Israeli Office of the Chief Scientist in either 2000 or 1999, nor did we accrue any grants from BIRD-F. At December 31, 2000, we employed 141 persons in research and development, of which 38 persons were based in our research and development facility in India. Net research and development expenses as a percentage of revenues increased to 6.6% in 2000 from 4.6% in 1999. We expect that our gross research and development costs as a percentage of revenues will increase for the foreseeable future.

Selling and Marketing Expenses, Net. Selling and marketing expenses increased 26.3% to $26.4 million in 2000 from $20.9 million in 1999, mainly due to our transition towards applications' sales and the implementation of our acquisition strategy. Selling and marketing expenses as a percentage of revenues decreased to 29.2% in 2000 from 32.7% in 1999.

General and Administrative Expenses. General and administrative expenses increased 106.0% to $21.1 million in 2000 from $10.2 million in 1999. The increase was primarily attributable to acquisitions of companies we made in 2000. We expect that general and administrative expenses will increase in the future, but will decrease as a percentage of revenues as a result of the continued growth in our operations.

Restructuring and Other Non-Recurring Costs. We incurred restructuring or other non-recurring costs of $2.5 million in connection with employee termination expenses, management changes and the consolidation of certain job responsibilities worldwide in 2000. We did not incur any restructuring or other non-recurring costs in 1999.

Financial (Income) Expenses, Net. Our financial income increased to $2.4 million in 2000 from $175,000 in 1999, principally as a result of investment of the proceeds of our 2000 follow-on offering.

Income Taxes. We incurred income taxes of $523,000 in 2000 and $2,000 in 1999. These taxes are primarily attributable to taxes paid in Japan, Israel and India.

Equity in Earnings (Losses) of Affiliates. In 2000, we recognized a loss of $57,000 from our minority interests as compared to income of $52,000 in 1999.

Minority Interest in Profits of Consolidated Subsidiaries. Minority interest in the profits of our consolidated subsidiaries represents the minority shareholders' share of the profits of some of our majority owned subsidiaries. In 2000, we recognized minority interest of $825,000 from the income attributed to the minority shareholders of our subsidiaries as compared to $394,000 in 1999.

Net Income (Loss). As a result of the foregoing, we reported net income of $920,000 or $0.03 per share for the year ended December 31, 2000 as compared to net income of $10.9 million or $0.43 per share for the year ended December 31, 1999.

Year Ended December 31, 1999 Compared with Year Ended December 31, 1998

Revenues. Total revenues increased 65.0% to $64.0 million in 1999 from $38.8 million in 1998. Software sales increased 80.5% to $37.0 million in 1999 from 20.5 million in 1998. This increase was principally attributable to our consolidation of the revenues of Magic Software Japan in 1999 and to sales of applications of approximately $4.4 million. Revenues from maintenance and technical support increased 58.6% to $9.2 million in 1999 from $5.8 million in 1998, mainly as a result of our increased marketing efforts and regaining our customers' confidence in our maintenance and technical support as a result of the implementation of our strategic plan. Revenues from professional services increased 42.4% to $17.8 million in 1999 from $12.5 million in 1998. This growth reflects our increased efforts to expand our fee-based professional services including consulting to and training of external contractors mainly in Europe.

Cost of Revenues. Cost of revenues increased 22.9% to $18.8 million in 1999 from $15.3 million in the 1998. Costs of revenues for software sales increased 32.7% to $4.0 million in 1999 from $3.0 million in 1998, as a result of our consolidation of the revenues of Magic Software Japan in 1999. Cost of revenues for maintenance and technical support remained constant at approximately $3.5 million in both periods due to the relatively low cost structure of our operations in India. Cost of revenues for professional services increased 26.7% to $11.4 million in 1999 from $9.0 million in 1998 as a result of our efforts to expand our professional services.

Gross Profit. Gross profit increased 93.2% to $45.2 million in 1999 from $23.4 million in 1998. Our gross margin, or gross profit as a percentage of total revenues, on software sales increased to 90.1% in 1999 from 85.4% in 1998. Our gross margin on maintenance and technical support increased to 62.6% in 1999 from 42.8% in 1998, and our gross margin on professional services increased to 36.0% in 1999 from 27.6% in 1998.

Research and Development Expenses, Net. Gross research and development costs remained constant at $4.4 million in both periods. Net research and development expenses increased 7.1% to $3.0 million in 1999 from $2.8 million in 1998. We did not receive any grants from the Office of the Chief Scientist in either 1999 or 1998, nor did we accrue any grants from BIRD-F. At March 31, 2000, we employed 147 persons in research and development, of which 37 persons were based in our research and development facility in India. Net research and development expenses as a percentage of revenues decreased to 4.6% in 1999 from 7.2% in 1998.

Selling and Marketing Expenses, Net. Selling and marketing expenses increased 29.8% to $20.9 million in 1999 from $16.1 million in 1998, mainly due to the consolidation of the selling and marketing expenses of Magic Software Japan and the general growth in sales. Selling and marketing expenses as a percentage of revenues decreased to 32.7% in 1999 from 41.6% in 1998, mainly as a result of the increase in sales, principally software, which grew more rapidly than the selling and marketing expenses, net.

General and Administrative Expenses. General and administrative expenses increased 30.8% to $10.2 million in 1999 from $7.8 million in 1998. The increase was primarily attributable to expenses associated with our increase in sales, mainly in Japan. General and administrative expenses as a percentage of revenues decreased to 16.0% in 1999 as compared to 20.2% in 1998.

Restructuring and Other Non-Recurring Costs. We did not incur any restructuring or other non-recurring costs in 1999 as compared to 1998 when we incurred $2.7 million of restructuring and non-recurring costs.
Financial Expenses, Net. Financial expenses were immaterial in both 1999 and 1998.

Income Taxes. We incurred income taxes of $2,000 in 1999 and $50,000 in 1998. These taxes are primarily attributable to taxes paid in Japan and India.

Equity in Earnings (Losses) of Affiliates. In 1999, we recognized income of $52,000 from our minority interests as compared to a loss of $149,000 in 1998. The improvement is attributable to our share in the profits from our minority interests in our non-consolidated affiliates.

Minority Interest in Profits of Consolidated Subsidiaries. Minority interest in the profits of our consolidated subsidiaries represents the minority shareholders' share of the profits of some of our majority owned subsidiaries. In 1999, we recognized minority interest of $394,000 from the income attributed to the minority shareholders of our subsidiaries as compared to $12,000 from losses attributed to our minority shareholders of our subsidiaries in 1998.

Net Income (Loss). As a result of the foregoing, we reported net income of $10.9 million or $0.43 per share for the year ended December 31, 1999 as compared to net loss of $6.5 million or ($0.37) per share for the year ended December 31, 1998.

Quarterly Results of Operations

The following tables set forth unaudited quarterly results of operations in U.S. dollars and as a percentage of revenues for each of the nine fiscal quarters ended December 31, 2000. We have prepared this information on a basis consistent with our audited consolidated financial statements included in this annual report and include all necessary adjustments, consisting only of normal recurring accruals that we consider necessary for a fair presentation of the information for the periods indicated. The results of operations for any quarter are not necessarily indicative of results for any future periods.

Three months ended

	Dec. 31, 1988	Mar. 31, 1999	Jun. 30, 1999	Sept. 30, 1999	Dec. 31, 1999	Mar. 31, 2000	Jun. 30, 2000	Sep. 30, 2000	Dec. 31, 2000
	(U.S. dollars in thousands)								
Revenues:									
Software[1]	$6,542	$7,604	$8,815	$9,685	$10,920	$9,708	$6,565	$5,050	$5,582
Applications[1]	-	-	-	-	-	3,327	3,207	3,718	4,164
Maintenance and technical support	1,664	1,985	2,540	2,345	2,348	2,861	2,727	2,804	2,955
Professional services	4,183	4,042	3,968	4,379	5,361	5,755	7,559	13,890	10,385
Total revenues	12,389	13,631	15,323	16,409	18,629	21,651	20,058	25,462	23,085
Cost of revenues:									
Software[1]	727	796	1,021	1,066	1,089	941	985	836	873
Applications[1]	-	-	-	-	-	425	479	556	547
Maintenance and technical support	659	798	861	911	880	1,103	1,056	1,047	994
Professional services	2,839	2,600	2,777	2,705	3,284	3,641	4,712	8,743	6,918
Total cost of revenues	4,225	4,194	4,659	4,682	5,252	6,110	7,232	11,182	9,332
Gross profit	8,164	9,437	10,664	11,727	13,377	15,541	12,826	14,280	13,753
Operating expenses:									
Research and development, net	613	615	679	837	822	1,003	1,587	1,569	1,788
Selling and marketing, net	4,377	4,663	4,809	5,220	6,242	5,688	6,532	6,941	7,199
General and administrative	1,607	2,300	2,505	2,668	2,768	3,715	4,457	5,379	7,547
Restructuring and other non-recurring costs	-	-	-	-	-	-	-	-	2,466
Total operating expenses	6,597	7,578	7,993	8,725	9,832	10,406	12,567	13,889	19,000
Operating income (loss)	1,567	1,859	2,671	3,002	3,545	5,135	250	391	(5,247)
Financial income (expenses), net	(273)	(292)	(239)	524	177	149	1,268	698	304
Capital loss	-	-	-	-	5	-	(10)	-	(613)
Income (loss) before income taxes	1,294	1,567	2,432	3,526	3,727	5,284	1,508	1,089	(5,556)
Income taxes	(14)	(42)	(20)	(69)	(129)	(102)	(149)	(25)	(247)
Equity in earnings (losses) of affiliates	(65)	23	22	81	75	-	(57)	-	-
Minority interest in losses (earnings) of consolidated subsidiaries	(32)	(135)	(154)	(128)	(23)	(1,176)	606	100	(355)
Net income (loss)	$1,183	$1,413	$2,280	$3,410	$3,805	$4,006	$1,908	$1,164	$(6,158)

(1) In the years 1996 to 1998 software revenues included applications revenues and cost of software revenues included cost of revenues for applications.

Three months ended

	Dec. 31, 1988	Mar. 31, 1999	Jun. 30, 1999	Sept. 30, 1999	Dec. 31, 1999	Mar. 31, 2000	Jun. 30, 2000	Sep. 30, 2000	Dec. 31, 2000
	(As percentage of total revenues)								
Revenues:									
Software[1]	52.8%	55.8%	57.5%	59.0%	58.6%	44.8%	32.7%	19.8%	24.2%
Applications[1]	-	-	-	-	-	15.4%	16.0%	14.6%	18.0%
Maintenance and technical support	13.4	14.6	16.6	14.3	12.6	13.2%	13.6%	11.0%	12.8%
Professional services	33.8	29.6	25.9	26.7	28.8	26.6%	37.7%	54.6%	45.0%
Total revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Three months ended

	Dec. 31, 1988	Mar. 31, 1999	Jun. 30, 1999	Sept. 30, 1999	Dec. 31, 1999	Mar. 31, 2000	Jun. 30, 2000	Sep. 30, 2000	Dec. 31, 2000
	(As percentage of total revenues)								
Cost of revenues:									
Software[1]	5.9	5.8	6.7	6.5	5.8	4.3%	4.9%	3.3%	3.8%
Applications[2]	-	-	-	-	-	2.0%	2.4%	2.2%	1.8%
Maintenance and technical Support	5.3	5.9	5.6	5.6	4.7	5.1%	5.3%	4.1%	4.3%
Professional services	22.9	19.1	18.1	16.4	17.6	16.8%	23.5%	34.3%	30.6%
Total cost of revenues	34.1	30.8	30.4	28.5	28.2	28.2%	36.1%	43.9%	40.5%
Gross profit	65.9	69.2	69.6	71.5	71.8	71.8%	63.9%	56.1%	59.5%
Operating expenses:									
Research and development, net	4.9	4.5	4.4	5.1	4.4	4.6%	7.9%	6.2%	7.1%
Selling and marketing, net	35.3	34.2	31.4	31.8	33.5	26.3%	32.6%	27.3%	31.3%
General and administrative	13.0	16.9	16.4	16.3	14.9	17.1%	22.2%	21.2%	33.0%
Restructuring and other non - recurring costs	-	-	-	-	-	-	-	-	11.1%
Total operating expenses	53.2	55.6	52.2	53.2	52.8	48.0%	62.6%	54.6%	82.6%
Operating income (loss)	12.7	13.6	17.4	18.3	19.0	23.7%	1.3%	1.5%	23.1%
Financial income (expenses), net	(2.2)	(2.1)	(1.5)	3.2	1.0	-	-	-	1%
Capital loss	-	-	-	-	-	0.7%	6.3%	2.7%	2.1%
Income (loss) before -income taxes	10.5	11.5	15.9	21.5	20.0	24.4%	7.5%	4.3%	(24.1%)
Income taxes	(0.1)	(0.3)	(0.1)	(0.4)	0.7	(0.5)	(0.7%)	(0.1)	(1.1%)
Equity in earnings (losses) of affiliates	(0.5)	0.2	0.1	0.5	0.4	-	(0.3%)	-	(3.1%)
Minority interest in losses (earnings) of consolidated subsidiaries	(0.4)	(1.0)	(1.0)	(0.8)	0.1	(5.4%)	3.0%	0.4%	1.0%
Net income (loss)	9.5%	10.4%	14.9%	20.8%	20.4%	18.5%	9.5%	4.6%	(27.1%)

(1) In the years 1996 to 1998 software revenues included applications revenues and cost of software revenues included cost of revenues for applications.

Our quarterly results of operations have varied significantly in the past as a result of various factors, many of which are beyond our control. Accordingly, revenues and net income, if any, in any particular period may be lower than revenues and net income, if any, in a preceding or comparable period. Period-to-period comparisons of our result of operations may not be meaningful, and you should not rely upon them as indications of our future performance.

Conditions in Israel

We are incoporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel.

Political Conditions

Since the establishment of the State of Israel in 1948, a state of hostility has existed, varying in degree and intensity, between Israel and the Arab countries. While Israel has entered into peace agreements with both Egypt and Jordan and several other countries have announced their intentions to establish trade and other relations with Israel, Israel has not entered into any peace arrangement with Syria or Lebanon.

Moreover, while Israel is in the process of conducting peace negotiations with the Palestinian Authority, since October 2000 there has been a significant deterioration in the relationship between Israel and the Palestinian Authority, and as a result of riots in Gaza and the West Bank, the peace process between the parties has stagnated. Efforts to resolve the problem have failed to result in an agreeable solution.
Continued hostilities between the Palestinian community and Israel and any failure to settle the conflict may have a material adverse effect on us and our business.

Despite the peace between Israel and Egypt and Jordan, some countries, companies and organizations continue to participate in a boycott of Israeli firms and others doing business with Israel or with Israeli companies. Although we are precluded from marketing our products to such countries, we believe that in the past the boycott has not had a material adverse effect on us. However, restrictive laws, policies or practices directed towards Israel or Israeli businesses could have an adverse impact on the expansion of our business.

All male adult citizens and permanent residents of Israel under the age of 48 are, unless exempt, obligated to perform up to 30 days of military reserve duty annually. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. Many of our officers and employees are currently obligated to perform annual reserve duty. While we have operated effectively under these requirements since we began operations, we cannot assess the full impact of such requirements on our workforce or business if conditions should change, and we cannot predict the effect on us of any expansion or reduction of such obligations.

Economic Conditions

Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980s, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. The Israeli government has, for these and other reasons, intervened in various sectors of the economy, by utilizing, among other means, fiscal and monetary policies, import duties, foreign currency restrictions and control of wages, prices and foreign currency exchange rates. In 1998, the Israeli currency control regulations were liberalized significantly, as a result of which Israeli residents may deal in foreign currency and non-residents of Israel may purchase and sell Israeli currency and assets.

The Israeli government has periodically changed its policies in all these areas. There are currently no Israeli currency control restrictions on remittances of dividends on ordinary shares or the proceeds from the sale of shares; however, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time. In addition, Israeli residents are required to file reports pertaining to specific types of actions or transactions.

The Israeli government's monetary policy contributed to relative price and exchange rate stability in recent years, despite fluctuating rates of economic growth and a high rate of unemployment. We cannot assure you that the Israeli government will be successful in its attempts to keep prices and exchange rates stable. Price and exchange rate instability may have a material adverse effect on us.

Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan.
These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the EEC, known now as the "European Union," concluded a Free Trade Agreement in July 1975, which confers some advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the "EFTA," established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes redefinement of rules of origin and other improvements, such as allowing Israel to become a member of the Research and Technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and Asia.

Corporate Tax Rate

Israeli companies are generally subject to income tax at the corporate tax rate of 36% of taxable income. However, seven investment programs at our facility in Or Yehuda have been granted "approved enterprise" status under the Law for Encouragement of Capital Investments, 1959 and we are, therefore, eligible for some tax benefits. Subject to compliance with applicable requirements, the portion of our income derived from the approved enterprise programs will be tax-exempt for a period of two to four years commencing in the first year in which it generates taxable income and will be subject, for a period of five to eight years, to a reduced corporate tax of 25%. However, these benefits will not be available to us with respect to any income derived by our non-Israeli subsidiaries.

As of December 31, 2000, our net operating loss carry-forwards for Israeli tax purposes were approximately $10.0 million and as of June 30, 2000 the net operating loss carry-forwards of our U.S. subsidiary for U.S. tax purposes amounted to approximately $11.2 million. Our U.S net operating loss carry-forwards are available to offset any future U.S. taxable income of our U.S. subsidiary and will expire in the years 2007 through 2013.

Impact of Currency Fluctuations and of Inflation

Our financial statements are denominated in U.S. dollars, our functional currency. Nevertheless, a majority of our sales are made, and a majority of our expenses are incurred, in other currencies, particularly Euros, Japanese yen, NIS and U.K. pounds sterling. We maintain substantial non-U.S. dollar balances of assets, including cash and accounts receivable, and liabilities, including accounts payable. Fluctuations in the value of the currencies in which we do business relative to the U.S. dollar could have a material adverse effect on our business, results of operations and financial condition by decreasing the U.S. dollar value of assets held in other currencies and increasing the U.S. dollar amount of liabilities payable in other currencies.

The U.S. dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is (or is not) offset, or is offset on a lagging basis, by the devaluation of the NIS in relation to the U.S. dollar. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our profitability as we incur expenses, principally salaries and related personnel expenses, in NIS. For several years prior to 1997, the rate of inflation in Israel exceeded the rate of devaluation of the NIS against the U.S. dollar and companies experienced increases in the U.S. dollar cost of their operations in Israel. This trend was reversed during 1997 and 1998. In 1999 and 2000, the rate of inflation exceeded the rate of devaluation of the NIS against the U.S. dollar. We cannot assure you that we will not be materially and adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind inflation in Israel.

The following table sets forth, for the periods indicated, information with respect to the rate of inflation in Israel, the rate of devaluation of the NIS against the U.S. dollar, and the rate of inflation in Israel adjusted for such devaluation:

Year ended December 31,	Israeli consumer price index	Israeli inflation rate %	Israeli devaluation rate%	Israeli inflation adjusted for devaluation %
1996	335.2	10.6	3.7	6.6
1997	370.7	7.0	8.8	(1.7)
1998	402.6	8.6	17.6	(7.7)
1999	408.0	1.3	-	1.3
2000	408.0	0	(2.7)	2.8

A devaluation of the NIS in relation to the U.S. dollar has the effect of reducing the U.S. dollar amount of any of our expenses or liabilities which are payable in NIS (unless such expenses or payables are linked to the U.S. dollar). Such a devaluation also has the effect of decreasing the U.S. dollar value of any asset which consists of NIS or receivables payable in NIS (unless such receivables are linked to the U.S. dollar). Conversely, any increase in the value of the NIS in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked NIS assets and the U.S. dollar amounts of any unlinked NIS liabilities and expenses.

Because exchange rates between the NIS and the U.S. dollar fluctuate continuously (albeit with a historically declining trend in the value of the NIS), exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

B. Liquidity and Capital Resources

Historically, we have financed our operations through cash generated by operations, funds generated by our public offerings in 1991 (approximately $8.5 million), 1996 (approximately $5.0 million) and 2000 (approximately $80.6 million), private equity investments in 1998 (approximately $12.2 million), as well as from research and development and marketing grants primarily from the Government of Israel. In addition, we have also financed our operations through short-term loans and borrowings under available credit facilities.

Our principal commitments consist of obligations outstanding under operating leases. Capital expenditures were approximately $6.3 million for 2000 and $3.5 million for 1999. In 2000, the majority of capital expenditures was attributable to the construction of an additional floor in our building in Or Yehuda and the purchase of computers.

In 1999, the majority of capital expenditures was attributable to a purchase from Mashov Computers of a 50% interest in our building in Or Yehuda for $2.0 million and the balance of our capital expenditures was principally for computer and electronic equipment and software, office furniture and equipment, and vehicle purchases.

We currently do not have significant capital spending or purchase commitments. However, we anticipate an increase in capital expenditures and lease commitments consistent with our anticipated growth in operations, infrastructure and personnel.

Net cash used in operating activities was $7.3 million in 2000. This amount was primarily due to the depreciation and amortization of $6.4 million and a decrease in accrued expenses and other liabilities of $14.6 million. Net cash provided by operating activities was $10.4 million for 1999. This amount was attributable primarily to our net income of $10.9 million for the period, and an increase in trade payables of $2.8 million, an increase in accrued expenses and other liabilities of $571,000, an increase in trade receivables of $3.6 million, an increase in other receivables and pre-paid expenses of $2.8 million and depreciation and amortization of $3.1 million.

Net cash used in investing activities was approximately $29.2 million in 2000 and $12.6 million in 1999. The increase in investing activities in 2000 was primarily attributable to capitalized software costs of $7.0 million and acquisition of subsidiaries in a total amount of $17.2 million.

Net cash provided by financing activities was $70.7 million in 2000, primarily attributable to proceeds of approximately $79.6 million from our issuance of ordinary shares in a follow-on public offering. Net cash provided by financing activities was $4.8 million for 1999 mainly due to proceeds from the exercise of stock option by our employees.

As of December 31, 2000, we had $42.6 million in cash and cash equivalents and working capital of $49.0 million as compared to $8.3 million in cash and cash equivalents and working capital of $9.7 million at December 31, 1999.

As of December 31, 2000, we had a bank line of credit of approximately $1.0 million with the First International Bank LeIsrael Ltd., of which $500,000 was drawn as of that date. The short-term bank credit is secured by a first priority floating charge on all our assets and by a fixed charge on goodwill (intangible assets), unpaid share capital and insurance rights (rights to proceeds on insured assets in the event of damage). In addition, the agreement with the First International Bank LeIsrael Ltd. prohibits us from selling or otherwise transferring any assets except in the ordinary course of business, from placing a lien on our assets without the bank's consent and from declaring dividends to our shareholders.

C. Research and Development, Patents and Licenses

Research and Development

The software industry is characterized by rapid technological change and is highly competitive with respect to timely product innovation. We must maintain compatibility and competitiveness in the face of ongoing changes in industry standards.

We place considerable emphasis on research and development to improve and expand the functionality of our Magic technology and to develop new applications. We believe that our future success will depend upon our ability to maintain our technological leadership, to enhance our existing products and to introduce new commercially viable products addressing the needs of our customers on a timely basis. We also intend to support emerging technologies as they are introduced in the same way we have supported new technologies in the past. We will continue to devote a significant portion of our resources to research and development. We believe that internal development of our Magic technology is the most effective means of achieving our strategic objective of providing
an extensive, integrated and feature-rich development technology.

During the three years ended December 31, 2000, we invested significant resources in developing an e-business platform. Based on the assumption that web-based applications would become mission-critical applications in the near future, we developed a technology to facilitate interactive web application development. These development efforts included research on porting the Magic logic engine into a browser using Java and on the communication required for Magic back-end on the server. We also devoted research and development resources to providing a new component technology that significantly enhances Magic usability. Other development resources were utilized to maintain compatibility among previous and current versions, and among a growing number of environment platforms.

Our research and development and support personnel work closely with our customers and prospective customers to determine their requirements and to design enhancements and new releases to meet their needs. We periodically release enhancements and upgrades to our core products.

In the years ended December 31, 1998, 1999 and 2000, we invested $4.1 million, $4.3 million and $13.0 million, respectively in research and development.

Research and development activities take place in our facilities in Israel, India, Japan, Thailand and the United States. At March 31, 2001, we employed approximately 96 persons in research and development in Israel, 53 persons in India, 12 persons in Japan, 8 persons in the U.S, 7 persons in Thailand and 1 person in Australia. As part of our product development team, we employ technical writers who prepare user documentation for our products and have employed subcontractors in connection with the documentation and some development work.

D. Trend Information

The uncertain business environment and on-going softness in the markets in which we operate have negatively impacted our operating results since the fourth quarter of 2000. In order to improve our results, we initiated stringent cost-cutting actions, including the dismissal of approximately 10% of our workforce. We have concentrated our development efforts on web-based applications that are mission critical to enterprises, with a special focus on eCRM and eBusiness applications.

The decision to concentrate on these applications was based on prevailing market trends. Although the markets for these applications have become crowded and volatile, we expect, but are unable to assure you, that our operating results will improve during the remainder of 2001. If the markets for these applications do not improve, our revenues and profitability will be negatively impacted.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133, as amended by Statement of Financial Accounting Standards (SFAS) No. 138, requires that all derivative instruments be recorded on the balance sheet at their fair value.

Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. We were required to adopt SFAS No. 133 on January 1, 2001. We do not expect the application to have a material effect on our consolidated financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition". SAB 101 summarizes the staff's view in applying generally accepted accounting principles to revenue recognition. We applied the guidance in SAB 101 in the fiscal year 2000 and this did not have an impact on our operating results or financial position.

Cautionary Statement Regarding Forward-Looking Statements

This annual report on Form 20-F contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward-looking statements usually include the verbs, "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "understands" and other verbs suggesting uncertainty. We remind shareholders that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements.

Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Independent Auditors' Report to the Shareholders of

MAGIC SOFTWARE ENTERPRISES LTD.

We have audited the accompanying consolidated balance sheets of Magic Software Enterprises Ltd. and its subsidiaries (the "Company") as of December 31, 1999 and 2000 and the consolidated statements of operations, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management.

Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of a subsidiary, which statements reflect assets constituting 6% and 10% of the consolidated assets as of December 31, 1999 and December 31, 2000 respectively, and revenues constituting 9% and 31% of the related consolidated revenues for each of the two years in the period ended December 31, 2000.

Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those subsidiaries, is based solely on the report of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.

An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2000 and 1999, and the related consolidated results of its operations and cash flows for each of the two years in the period ended December 31, 2000, in conformity with generally accepted accounting principles in the United States.

Tel-Aviv, Israel, June 26, 2001

BDO Ziv & HAFT
Certified Public Accountants (Isr.)

Report of Independent Auditors
To the Shareholders of

MAGIC SOFTWARE ENTERPRISES LTD.

We have audited the accompanying consolidated statements of operations, changes in shareholders' equity and cash flows of Magic Software Enterprises Ltd.and its subsidiaries for the year ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain subsidiaries, which statements reflect revenues constitute 16% of the related consolidated revenues for the year ended December 31, 1998. These statements were audited by an auditor whose reports have been furnished to us, and our opinion, insofar as it relates to data included for this subsidiary, is based solely on the reports of the other auditor.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditor provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditor, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Magic Software Enterprises Ltd. and its subsidiaries as of December 31, 1998, and the related consolidated results of their operations and cash flows for the year ended December 31, 1998, in conformity with generally accepted accounting principles in the United States.

Tel-Aviv, Israel, February 8, 1999

Kost Forer and Gabbay

KOST FORER & GABBAY
A Member of Ernst & Young International

Magic Software Enterprises Ltd.

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 1999	December 31, 2000
	(in thousands)	
CURRENT ASSETS:		
Cash and cash equivalents	$8,298	$42,627
Trade receivables (net of allowance for doubtful accounts of $1,112 and $1,854 as of December 31, 1999 and 2000, respectively)	16,111	22,904
Related parties receivables (Note 14)	-	278
Other receivables and prepaid expenses (Note 3)	4,965	5,827
Inventories	188	402
Total current assets	29,562	72,038
LONG-TERM INVESTMENTS:		
Long term deposit	-	436
Investments in affiliates and other companies (Note 4)	376	250
Severance pay fund (Note 9)	1,507	2,042
	1,883	2,728
FIXED ASSETS, NET (Note 5)	8,649	11,050
OTHER ASSETS, NET (Note 6)	16,757	52,179
	$56,851	$137,995

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

Magic Software Enterprises Ltd.

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 1999	December 31, 2000
	(in thousands)	
CURRENT LIABILITIES:		
Short-term bank credit (Note 7)	$ 688	$1,462
Trade payables	5,525	5,610
Related parties payables (Note 14)	164	-
Accrued expenses and other liabilities (Note 8)	13,577	12,838
Restructuring accrual	-	3,160
Total current liabilities	19,954	23,070
ACCRUED SEVERANCE PAY (Note 9)	1,899	3,511
LONG-TERM LOANS (Note 10)	235	1,758
MINORITY INTEREST	917	251
SHAREHOLDERS' EQUITY (Note 12):		
Share capital:		
Authorized: 50,000,000 ordinary shares of NIS 0.1 par value; issued and outstanding: 26,068,185 shares and 29,429,978 shares as of December 31, 1999 and 2000, respectively.	684	781
Additional paid-in capital, net	34,862	115,240
Accumulated other comprehensive loss	(369)	(781)
Treasury stock	-	(5,424)
Accumulated deficit	(1,331)	(411)
Total shareholders' equity	33,846	109,405
	$56,851	$137,995

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

Magic Software Enterprises Ltd.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	1998	1999	2000
	in thousands, except per share data		
Revenues (Note 13A):			
Software sales	$20,479	$37,024	$41,320
Maintenance and technical support	5,780	9,218	11,347
Professional services	12,501	17,750	37,589
Total revenues	38,760	63,992	90,256
Cost of revenues:			
Software sales	2,994	3,972	5,642
Maintenance and technical support	3,306	3,450	4,200
Professional services	9,046	11,365	24,014
Total cost of revenues	15,346	18,787	33,856
Gross profit	23,414	45,205	56,400
Operating expenses:			
Research and development, net (Note 13B)	2,797	2,953	5,947
Selling and marketing, net	16,073	20,935	26,360
General and administrative	7,817	10,241	21,098
Restructuring and other non-recurring costs (Note 1I)	2,677	-	2,466
Total operating expenses	29,364	34,129	55,871
Operating income (loss)	(5,950)	11,076	529
Financial income (expenses), net (Note 13D)	(322)	175	2,419
Capital loss (Note 1D)	-	-	(623)
Income (loss) before taxes on income	(6,272)	11,251	2,325
Taxes on income (Note 11)	50	2	523
	(6,322)	11,249	1,802
Equity in earnings (losses) of affiliates	(149)	52	(57)
Minority interest in losses (earnings) of consolidated Subsidiaries	12	(394)	(825)
Net income (loss)	$(6,459)	$10,907	$920
Earnings (loss) per share (Note 16):			
Basic earnings (loss) per share	$(0.37)	$0.45	$0.03
Diluted earnings (loss) per share	$(0.37)	$0.43	$0.03

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

Magic Software Enterprises Ltd.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital	Additional paid-in capital, net*	Accumulasted other comprehensive income (loss)	Retained earnings (accumulated deficit)	Comprehensive income (loss)	Total shareholders' equity
			(in thousands)			
Balance as of January 1, 1998	183	17,213	(181)	(5,779)		11,436
Other comprehensive loss:						
Foreign currency translation adjustments	-	-	(68)	-	$(68)	(68)
Net loss	-	-	-	(6,459)	(6,459)	(6,459)
Total comprehensive loss					$(6,527)	
Issuance of shares, net	78	12,149	-	-		12,227
Balance as of December 31, 1998	261	29,362	(249)	(12,238)		$17,136
Other comprehensive income:						
Foreign currency translation adjustments	-	-	(120)	-	$(120)	(120)
Net income	-	-	-	10,907	10,907	10,907
Total comprehensive income					$10,787	
Exercise of stock options	14	4,787	-	-		4,801
Issuance of shares for investment in subsidiaries	3	982	-	-		985
Compensation resulting from options granted - for acquisitions	-	137	-	-		137
Three-for-one Ordinary Share split effected in the form of a 200% stock dividend (see Note 12A.2)	406	(406)	-	-		-
Balance as of December 31, 1999	$684	$34,862	$(369)	$(1,331)		$33,846

* Additional paid-in capital is stated net of loans granted to officers and directors of the Company for purchase of stock (see Note 12B).

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

Magic Software Enterprises Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS (cont.)

CASH FLOWS FROM FINANCING ACTIVITIES:

	Year ended December 31,		
	1998	1999	2000
		(in thousands)	
Proceeds from exercise of stock options	-	4,801	856
Proceeds from issuance of ordinary shares, net	12,227	-	79,597
Purchase of treasury stock	-	-	(5,424)
Changes in short-term bank credit, net	(2,909)	128	(2,985)
Long-term loan paid	-	(118)	(1,357)
Net cash provided by financing activities	9,318	4,811	70,687
Effect of exchange rate changes on cash and cash equivalent	35	(87)	216
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,448	2,470	34,329
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	1,380	5,828	8,298
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	$5,828	$8,298	$42,627
SUPPLEMENTAL DICLOSURE OF CASH FLOW INFORMATION:			
Net cash paid during the year for:			
Income taxes	$50	$52	$54
Interest	$140	$36	-
NON-CASH ACTIVITIES:			
Investment in subsidiaries recorded against accounts payable	$479	$1,836	$200

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

Magic Software Enterprises Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS (cont.)

	Year ended December 31,		
Schedule A: NEWLY-CONSOLIDATED SUBSIDIARIES:	1998	1999	2000
		(in thousands)	
Working capital deficiency	-	$(834)	$(13,878)
Fixed assets	-	855	2,025
Other assets	-	3,557	33,529
Investment in affiliate	-	(245)	(1,504)
Restructuring costs	-	-	(4,043)
Minority interest	-	(428)	914
Issuance of shares and compensation			
-resulting from the acquisition	-	(1,122)	-
	-	$1,783	$17,043
Schedule B: SALE OF CONSOLIDATED SUBSIDIARY:			
Working capital deficiency	-	-	$509
Fixed assets	-	-	(98)
Other assets	-	-	(1,223)
Inventory	-	-	(14)
Minority interest	-	-	186
Other comprehensive income	-	-	17
Capital loss	-	-	623
	-	-	-

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

Magic Software Enterprises Ltd.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital	Additional paid-in capital, net*	Accumulated other comprehensive income (loss)	Treasury stock	Retained earnings (accumulated deficit)	Comprehensive income (loss)	Total shareholders' equity
				(in thousands)			
Balance as of December 31, 1999	$684	$34,862	$(369)	-	$(1,331)		$33,846
Other comprehensive income:							
Foreign currency translation adjustments	-	-	(412)	-	-	$(412)	(412)
Net income				-	920	920	920
	-	-	-			$508	
Total comprehensive income							
Issuance of share capital	87	79,510	-	-	-		79,597
Exercise of stock options	10	846	-	-	-		856
Decrease in loans to shareholders	-	22	-	-	-		22
Purchase of treasury stock	-	-	-	(5,424)	-		(5,424)
Balance as of December 31, 2000	781	115,240	(781)	(5,424)	(411)		109,409

* Additional paid-in capital is stated net of loans granted to officers and directors of the Company for the purchase of stock (see note 12B).

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

Magic Software Enterprises Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS

CASH FLOWS FROM OPERATING ACTIVITIES:

	Year ended December 31, 1998	1999	2000
		(in thousands)	
Net income (loss)	$ (6,459)	$ 10,907	$ 920
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Write-off of capitalized computer software development costs	512	-	-
Depreciation and amortization	2,783	3,516	6,416
Equity in losses (earnings) of affiliates	149	(52)	57
Minority interest in earnings (losses) of consolidated - Subsidiaries	(12)	394	825
Translation loss on long-term loans	-	(62)	294
Increase (decrease) in accrued severance pay, net	(120)	(65)	54
Capital loss on sale of investments	-	-	623
Changes in operating assets and liabilities:			
Decrease (increase) in trade receivables	1,003	(3,582)	1,229
Decrease (increase) in related parties	(731)	(124)	(442)
Decrease (increase) in other receivables and prepaid Expenses	232	(2,863)	322
Decrease (increase) in inventories	234	28	(228)
Increase (decrease) in trade payables	(1,102)	2,828	(1,887)
Decrease in restructuring allowance	-	-	(883)
Increase (decrease) in accrued expenses and other Liabilities	1,894	(571)	(14,643)
Net cash provided by (used in) operating Activities	(1,617)	10,354	(7,343)

CASH FLOWS FROM INVESTING ACTIVITIES:

	1998	1999	2000
Capitalized software costs	(1,283)	(1,334)	(7,084)
Purchase of fixed assets	(846)	(4,184)	(2,018)
Additional investment in subsidiaries	(176)	(1,701)	(757)
Investment in affiliates and other companies	(351)	(165)	(1,437)
Proceeds from sale of fixed assets	118	-	-
Investment in other assets	(750)	(3,441)	(892)
Newly consolidated subsidiaries (Schedule A)	-	(1,783)	(17,043)
Net cash used in investing activities	(3,288)	(12,608)	(29,231)

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

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - GENERAL:

A. Magic Software Enterprises Ltd. (the "Company") develops, markets and supports software development and deployment technology (the "Magic technology"). Magic technology enables enterprises to accelerate the process of building and deploying software applications that can be rapidly customized and integrated with existing systems. During 2000 the Company expanded its business to include the sale of applications developed using its Magic technology. These applications are designed for e-Business, customer relationship management and other enterprise uses. Magic technology and Magic-based applications are used by software solution providers and enterprises (the "Magic community"). The Company also provides professional services and maintenance and technical support to the Magic community.

The Company distributes its products and services in approximately fifty countries worldwide. The Company markets and supports its products primarily through its own direct sales force in Europe, Asia, the United States and Israel, and through a network of distributors and software solution providers.

As to data about geographic areas - see Note 13A.

B. In the first quarter of 2000, MSE Netherlands B.V., a wholly owned subsidiary of the Company entered into an agreement to purchase 51% of the outstanding share capital of Caswell Holdings B.V. ("Caswell") in consideration of $330 thousand that was paid to the selling shareholders and $330 thousand that was paid to Caswell (see Note 17).

C. In February 2000, the Company exercised an option to purchase 18% of the outstanding share capital of Sintec Call Center Ltd. ("Sintec") for a total consideration of $440 thousand and converted convertible notes into 19% of the share capital of Sintec for a conversion price of $250 thousand. During the second quarter of 2000 the Company acquired from shareholders of Sintec the remaining outstanding shares for an aggregate consideration of $3,300 thousand.

D. In March 2000, the Company acquired a 51.0% equity interest in Burofa GmbH, a German corporation, in consideration of approximately $1.25 million. In November 2000 the Company sold back its stake in the subsidiary to its former shareholders for the same purchase price, to additional substantial investments, managerial and other resources the Company would have been required to invest in the subsidiary for its operations to become profitable. The Company incurred a capital loss of $623 thousands.

E. In May 2000, the Company signed an agreement to acquire 100% of the outstanding share capital of I.T.M Engineering and Information Systems Ltd. ("I.T.M") for an aggregate consideration of approximately $4,000 thousand.

F. In June 2000, the Company acquired 100% of the share capital of M.N.S Micronova Systems Ltd. for $2,500 thousand in ordinary shares of the Company. Under the agreement, the selling shareholders were granted an option, expiring in July 2001, to sell back these shares to the Company for $2,500 thousands. The option was exercised in October 2000.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - GENERAL (cont.):

G. In September 2000, the Company signed an agreement to acquire 52% of the outstanding share capital of Answer On Demand Inc. ("AOD") – a private Florida company that provides integrated software solutions for the long-term health care or nursing home industry. In consideration the Company provided the sellers with an advance payment of $1,170 thousand and an additional sum of $2,457 thousand was placed in escrow. The final amount is to be paid to the sellers subject to an earning formula for the three years period ending December 31, 2003.

H. In September 2000, the Company acquired CoreTech Consulting Group Inc. (hereinafter "Coretech") in consideration of $6,810 thousand. Coretech provides services and strategic solutions in the field of e-Business. The financial results were consolidated from the third quarter of the year. The goodwill that arose from the deal was approximately $17,237 thousand.

I. Restructuring and other non-recurring costs:
During 1998 and 2000, the Company incurred costs of $2,327 thousand and $3,089 thousand, respectively, in implementing its restructuring plan. The restructuring plan included the termination of distributor agreements in certain areas, a reduction in the number of employees and the termination of a product line.

In addition, during 1998 the Company approached the Binational Industrial Research and Development Foundation ("BIRD-F") with the objective of canceling its agreement with BIRD-F. Under such agreement, the Company had received $350 thousand in grants.

Following is a breakdown of the costs incurred:

	Year ended December 31,		
	1998	1999	2000
		(in thousands)	
Write-off of capitalized computer software development costs	$512	-	-
Expenses for termination of employment	1,208	-	2,466
Termination of distributor agreements	372	-	-
Other	235	-	-
Total restructuring	2,327	-	2,466
Provision for repayment of grants	350	-	-
	$2,677	-	$2,466

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States.

A. **Use of Estimates:**
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

B. **Financial Statements in United States Dollars:**
A substantial portion of the Company's revenues on a consolidated basis are made outside Israel in U.S. dollars ("dollars"). In additional a substantial portion of the Company's costs on a consolidated basis are incurred in dollars. Since the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate, the dollar is their functional and reporting currency. Accordingly, monetary accounts maintained in currencies other than the dollar are translated using the applicable foreign currency exchange rate at balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. For other subsidiaries, the functional currency has been determined to be their local currency, and operations items are translated at average rates prevailing during the year. Translation adjustments relating to the investment in such subsidiaries are recorded as other comprehensive income (loss) in shareholders' equity.

C. **Principles of Consolidation:**
The consolidated financial statements include the accounts of the Company and its subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation.

D. **Cash Equivalents:**
Cash equivalents include short-term, highly liquid investments that are readily convertible into cash and with maturities of three months or less when purchased.

E. **Inventories:**
Inventories consist of software packaging, diskettes, printed materials and hardware production devices, and are stated at the lower of cost or market value. Cost is determined by the "first-in, first-out" method

F. **Investments in Affiliates and Other Companies:**
Investments in affiliates are accounted for by the equity method. Investments in companies owned less than 20% are accounted for using the cost method. As to goodwill - see Note H below.

G. **Fixed Assets:**
Fixed assets are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates

	%
Buildings	4
Computers and peripheral equipment	20-33
Office furniture and equipment	6-15
Motor vehicles	15
Internet software developed for self use	33

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

H. **Goodwill:**
Goodwill is amortized by the straight-line method over ten years. The Company examines the realizability of the intangible assets annually and the appropriateness of the amortization period based on the estimated future undiscounted cash flows derived from the acquired businesses. Any impairment loss is recognized in the statement of operations.

I. **Revenue Recognition:**
The Company generates revenues from licensing the rights to use its software. The Company also generates revenues from sales of consulting services, training, support and maintenance.

Revenues from software license agreements are recognized, in accordance with Statement Of Position (SOP) 97-2 "Software Revenue Recognition" (as amended by SOP 98-4 and 98-9), upon delivery of the software when collection is probable; all license payments are due within one year, the license fee is otherwise fixed or determinable and persuasive evidence of an arrangement exists.

Revenues from professional services, maintenance contracts and training are recognized progressively over the contractual period or as services are performed .

Management believes that the Company's revenue recognition policies are in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101).

J. **Research and development costs:**
Research and development costs net of grants are charged to expenses as incurred. Statement of Financial Accounting Standards ("SFAS") No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software developmentcosts subsequent to the establishment of technological feasibility

Based on the Company's product development process, technological feasibility is established upon completion of a detailed program design. Costs incurred by the Company between completion of the detailed program design and the point at which the product is ready for general release have been capitalized.

Capitalized software costs are amortized by the greater of (i) the ratio of current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software or (ii) the straight-line method over the remaining estimated useful life of the product (not greater than five years).

K. **Royalty-bearing grants:**
Royalty-bearing grants from the Government of Israel and others for funding certain approved research projects and for funding marketing activity are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred.

L. **Advertising costs:**
Advertising costs are charged to selling and marketing expenses, as incurred. Advertising expenses for the years ended December 31, 1998, 1999 and 2000 were $669 thousand, $990 thousand and $1,465 thousand, respectively.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

M. **Income Taxes:**
The Company accounts for income taxes in accordance with SFAS 109, "Accounting for Income Taxes". This statement prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

N. **Basic and Diluted Earnings (Loss) Per Share:**
Basic earnings (loss) per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted earnings (loss) per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus the dilutive potential of ordinary shares considered outstanding during the year, in accordance with SFAS 128, "Earnings Per Share".

O. **Accounting for Stock-based Compensation:**
The Company has elected to follow Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees" in accounting for its employee stock options plans. Under APB 25, if the exercise price of the Company's share options equals or is above the market price of the underlying stock on the date of grant, no compensation expense is recognized.

The Company applies SFAS 123 "Accounting for Stock Based Compensation" with respect to options issued to non-employees. SFAS 123 requires use of an option valuation model to measure the fair value of the options at the grant date. The pro forma disclosures required by SFAS 123 are provided in Note 12.

P. **Concentrations of Credit Risk:**
Financial instruments which potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents, and accounts receivable. The Company's cash and cash equivalents are invested primarily in deposits with major banks worldwide. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments. The Company's trade receivables are derived from sales to customers located primarily in the U.S., Europe, Asia, Japan and Israel. The allowance for doubtful accounts is provided with respect to all balances deemed doubtful of collection.

Q. **Fair Value of Financial Instruments:**
The carrying amounts reported in the balance sheet of cash and cash equivalents, short-term bank credit and long-term loans approximate their fair value due to the short-term nature of these instruments.

R. **Comprehensive Income:**
As of January 1, 1998, the Company adopted SFAS 130, "Reporting Comprehensive Income". SFAS 130 establishes new rules for the reporting and display of comprehensive income and its components.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.):

S. **Impact of recently issued accounting standards:**
In June 1998, the FASB issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 123 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133 also requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement and requires that a company formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS 133 is effective for fiscal years beginning after June 15, 2000 and cannot be applied retroactively. The Company does not expect the impact of this new statement on the Company's consolidated balance sheets or results of operations to be material. The Company is required to adopt SFAS 133 in the first quarter of fiscal 2001.

NOTE 3 - OTHER RECEIVABLES AND PREPAID EXPENSES:

	December 31, 1999	2000
	(in thousands)	
Prepaid expenses	$1,310	$959
Government agencies	602	1,607
Employee loans[1]	1,364	109
Income receivable		881
Other	1,689	2,157
Advances to suppliers	-	114
	$4,965	$5,827
(1) Including loans to directors and officers, linked to the Israeli Consumer Price Index ("CPI")	$1,156	$87

Magic Software Enterprises Ltd.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 4 - INVESTMENTS IN AFFILIATES AND OTHER COMPANIES:

The composition of the investments in affiliates and other companies is as follows:

Equity:	December 31, 1999	2000
	(in thousands)	
Cost of shares	$376	$308
Goodwill	-	-
Equity in losses	-	(58)
Foreign currency translation adjustments	-	-
	$376	$250

NOTE 5 - FIXED ASSETS:

Cost:	December 31, 1999	2000
	(in thousands)	
Buildings and leasehold improvements	$6,267	$7,385
Computers and peripheral equipment	7,038	9,875
Office furniture and equipment	1,484	2,970
Motor vehicles	471	759
Internet software developed for self use	469	964
	$15,729	$21,953
Accumulated depreciation:		
Buildings	1,019	1,284
Computers and peripheral equipment	5,186	7,432
Office furniture and equipment	726	1,425
Motor vehicles	149	242
Internet software developed for self use	-	520
	7,080	10,903
Undepreciated cost:	$8,649	$11,050

Depreciation expenses amounted to $1,480 thousand and $1,497 thousand and $1,710 thousand for the years ended December 31, 1998, 1999 and 2000, respectively. As for charges, see Note 15C.

Magic Software Enterprises Ltd.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 6 - OTHER ASSETS:

Cost:	December 31, 1999	2000
	(in thousands)	
Capitalized software	$10,415	$17,212
Goodwill	12,211	44,683
Distribution rights	600	1,447
Issuance costs	70	-
	$23,296	$63,342
Accumulated amortization:		
Capitalized software	5,152	6,393
Goodwill	1,237	4,442
Distribution rights	150	328
	6,539	11,163
Other assets, net	$16,757	$52,179

Amortization expenses amounted to $1,554 thousand $2,019 thousand and $4,707 thousand for the years ended December 31, 1998, 1999 and 2000, respectively.

NOTE 7 - SHORT-TERM BANK CREDIT:

As of December 31, 2000, the Company has an additional authorized and unused credit facility in the amount of $2,000 thousand denominated in dollars.

The weighted average interest rate of the credit facility as of December 31, 1999 and 2000 was approximately 7%.

NOTE 8 - ACCRUED EXPENSES AND OTHER LIABILITIES:

	December 31, 1999	2000
	(in thousands)	
Employees and payroll accruals	$3,060	$5,520
Liabilities in respect of acquisition of a subsidiary	1,836	200
Accrued expenses	3,482	3,120
Deferred revenues	3,738	3,825
Fund for Encouragement of Marketing Activities	477	92
Government agencies and other	984	81
	$13,577	$12,838

Magic Software Enterprises Ltd.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 9 - ACCRUED SEVERANCE PAY:

Under Israeli law, the Company is required to make severance payments when dismissing employees and terminating their employment under certain circumstances. The Company's liability for severance pay pursuant to Israeli law is fully provided for. Part of the liability is funded through insurance policies. The value of these policies is recorded as an asset in the Company's balance sheets. The severance pay liability is calculated on the basis of one month's salary for each year of service, based on the most recent salary of each employee. Severance pay expenses for the years ended December 31, 1998, 1999 and 2000 were $728 thousand $454 thousand and $1,077 thousand, respectively.

NOTE 10 - LONG-TERM LOANS:

	Currency	Interest rate %	December 31, 2000 (in thousands)
Shareholders' loan	Unlinked	None	1,593
Bank and lease loans	U.S. Dollars	5.5-7	85
Bank loans	Rupees	17-18	140
Less current portion			(60)
			$1,758

NOTE 11 - TAXES ON INCOME:

A. **Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the "Law"):**
The Company's production facilities in Israel have been granted status as an "Approved Enterprise" under the Law. The main benefit arising from such status is the reduction in tax rates on income derived from "Approved Enterprises". The Company is entitled to a seven year period of benefits (and to a ten - year period of benefits for programs in which the Company qualifies as a "foreign investor company" as defined by the Law) including tax exemption for certain periods and reduced tax rates thereafter.

The Company has elected an alternative package of benefits under the Law, which entitles the Company to a tax exemption on undistributed income derived from "Approved Enterprises" for a period of between two and ten year from the first year in which taxable income is earned and reduced tax rates for the remainder of the benefits period.

Seven expansion projects have been granted status of "Approved Enterprises" under the Law.

The seven expansion programs are as follows:

1. Income derived from the first program was tax-exempt for the two-year period ended December 31, 1991, and was subject to a reduced tax rate of 25% for the five-year period ended December 31, 1996.

2. The second program was tax-exempt for the two-year period ended December 31, 1991 and was subject to a reduced tax rate of 25% for the five-year period ended December 31, 1996.

3. The third program entitles the Company to a tax exemption for the four-year period ended December 31, 1995, and is subject to a reduced tax rate of 25% for the six-year period ending December 31, 2001.

Magic Software Enterprises Ltd.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 11 - TAXES ON INCOME (cont.):

Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the "Law") (cont.):

4. The fourth program entitles the Company to a tax exemption for the four-year period ended December 31, 1997, and is subject to a reduced tax rate of 25% for the-six year period ending December 31, 2003.

5. In February 1996, the Company received approval for the fifth program, which entitles the Company to a two-year tax exemption period and to a reduced tax rate of 25% for an additional period of eight-years. The period of benefits for this expansion has not yet commenced.

6. In January 1998, the Company received approval for another expansion of its "Approved Enterprises" status. This program will entitle the Company to a two-year tax exemption period and to a reduced tax rate of 25% for an additional period of eight years. The period of benefits for this expansion has not yet commenced.

7. In November 1998, the Company received approval for another expansion of its "Approved Enterprises" status. This program will entitle the Company to a two-year tax exemption period and to a reduced tax rate of 25% for an additional period of eight years. The period of benefits for this expansion has not yet commenced.

The tax benefit periods provided by the fifth, sixth and seventh programs end the earlier of 12 years from the commencement of operation or production, or 14 years from receipt of the approval.

If a dividend were to be distributed out of tax-exempt profits deriving from an expansion program, the Company would be liable to corporate tax at a rate of 25%. The Company does not anticipate paying dividends in the foreseeable future.

The Law also entitles the Company to claim accelerated depreciation on buildings, machinery and equipment used by the "Approved Enterprise" during the first five tax years.

A. **Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the "Law") (cont.):**
The benefits available to an enterprise are conditional upon the fulfillment of conditions stipulated in the Law and its regulations and the criteria set forth in the specific certificate of approval. In the event that the Company does not meet these conditions, it would be required to refund the amount of tax benefits, with the addition of the CPI linkage adjustment and interest. In the Comp's management's opinion, the Company has been in full compliance with the conditions of the above programs through December 31, 2000, and with respect to the 1984 and 1992 programs, has received written confirmation to this effect from the Investment Center.

Should the Company and its Israeli subsidiaries derive income from sources other than the Approved Enterprises during the relevant benefit periods, such income will be taxable at a regular corporate tax rate of 36%.

B. **Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969 (the "Encouragement Law"):**
The Company is an "Industrial Company", as defined by the Encouragement Law and, as such, is entitled to certain tax benefits, mainly: accelerated depreciation of machinery and equipment, as prescribed by regulations published under the Inflationary Adjustments Law, the right to deduct for tax purposes public issuance expenses and patents and other intangible property rights, and the right to file, under specified conditions, a consolidated tax return with additional related Israeli "Industrial Companies".

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 11 - TAXES ON INCOME (cont.):

C. **Non-Israeli subsidiaries:**
Non-Israeli subsidiaries are taxed based upon tax laws in their countries of domicile.

D. **Net operating losses carry forwards:**
Through December 31, 2000, Magic Software Enterprises Inc. had U.S. federal net operating loss carry forwards of approximately $11,218 thousand, which can be carried forward and offset against taxable income for 15 years and will expire from 2007 to 2013.

E. **Income tax assessments:**
The Company has received final tax assessments through the 1995 tax year.

F. **The domestic and foreign components of income (loss) before taxes are as follows:**
Income (loss) before taxes on income:

	Year ended December 31,		
	1998	1999 (in thousands)	2000
Domestic	$(3,285)	$9,762	$1,331
Foreign	(2,987)	1,489	994
	$(6,272)	$11,251	$2,325

G. **The provision for taxes consists of the following:**

	Year ended December 31,		
	1998	1999 (in thousands)	2000
Current:			
Domestic	$47	$(100)	$222
Foreign	3	102	301
Taxes on income	$50	$2	$523

H. **Deferred tax assets consist of the following:**

	December 31,	
	1999 (in thousands)	2000
Deferred tax assets:		
Loss carry forwards	$4,248	3,412
Allowances and reserves	583	2,556
	4,831	5,968
Less: valuation allowance	(4,831)	(5,968)
Net deferred tax	-	-

The Company provided a 100% valuation allowance against the deferred tax assets in respect of its tax losses carry forward and other temporary differences due to uncertainty concerning its ability to realize these deferred tax assets in the future.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 11 - TAXES ON INCOME (cont.):

I. **Reconciliation of the theoretical tax expense (benefit) to the actual tax expense (benefit):**
A reconciliation between theoretical tax expense, assuming all income is taxed at the statutory rate applicable to the income of companies in Israel of 36% and the actual tax expense, is as follows:

	Year ended December 31,		
	1998	1999 (in thousands)	2000
Income (loss) before taxes on income, as reported in the consolidated statements of operations	$(6,272)	$11,251	$2,325
Statutory tax rate in Israel	36%	36%	36%
Theoretical tax expense (benefit)	(2,258)	4,050	837
Increase (decrease) in taxes resulting from:			
"Approved Enterprise" (benefit)	-	(1,741)	-
Carry forward (utilization of) losses and other deferred taxes for which valuation allowance was provided	1,993	(2,874)	(1,520)
Tax adjustment in respect of inflation in Israel	(82)	(45)	(64)
Non-deductible expenses, mainly amortization of goodwill	397	612	1,270
Taxes on income in the statements of operations	$50	$2	$523

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 12 - SHAREHOLDERS' EQUITY:

A. The ordinary shares of the Company are traded on both the Nasdaq National Market in the United States and the Tel Aviv Stock Exchange in Israel.

1. On February 25, 2000, the Company completed a public offering of 3,500,000 ordinary shares at a price of $25.00 per share, the net proceeds were approximately $79.6 million.

2. In December 1999, the Company's Board of Directors approved a three-for-one stock split effected in the form of a 200% stock dividend. On January 24, 2000, an extraordinary meeting of the Company's shareholders approved the stock split, which was made to shareholders of record as of February 4, 2000. This stock split recorded by a transfer of $406 thousand from additional paid-in capital, net, to share capital, representing NIS 0.1 par value for each additional share issued.

   All share and per share data in these financial statements including stock option plan information, have been restated retroactively to reflect this stock split.

3. In December 1999, the Company's Board of Directors approved an increase in the authorized share capital of the Company by NIS 4,000 thousand, divided into 40,000,000 ordinary shares of NIS 0.1 par value each. The increase was approved in the shareholders' meeting on January 24, 2000.

4. On March 12, 1998, the Company issued Formula 2,400,000 ordinary shares at a price of $1.67 per share, in consideration of approximately $4 million.

   The Company granted Formula for no additional consideration options to purchase 1,800,000 ordinary shares (first option) and 2,400,000 ordinary shares (second option) at an exercise price of $1.67 per share. Since the first option was not exercised during the exercise period ended September 30,1998, the second option was terminated as well.

5. On July 30, 1998, the Company issued Mashov 3,000,000 ordinary shares at a price of $1.17 per share, in consideration of approximately $3.5 million.

6. On December 31, 1998, the Company issued Formula 3,600,000 ordinary shares at a price of $1.33 per share, in consideration of approximately $4.8 million.

B. Stock Option Plan:

Under the Company's 1991 Stock Option Plan (the "Plan"), as amended, options may be granted to employees, officers, directors and consultants of the Company or any subsidiary.

Under the Plan, 6,750,000 ordinary shares of the Company were reserved for issuance. Options which are canceled or not exercised within the option period become available for future grants. The Plan has a ten-year term and will terminate on July 31, 2001, unless terminated earlier by the Board of Directors

On December 7, 1998, the Company implemented a re-pricing plan, with respect to 1,835,967 options issued to employees, whose new exercise price was established at $1 per share. The original exercise price of these options ranged from $1.708 to $3 per share. The re-pricing had no effect on the Company's consolidated financial statements.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 12 - SHAREHOLDERS' EQUITY (cont.):

B. Stock Option Plan (cont):

During the period 1993-1995 the Company granted loans to several directors and officers of the Company in connection with the exercise of options under the Plan. Such loans, which amounted to $1,300 thousand as of December 31, 1999 were initially repayable at the earlier of three years after issuance or upon sale of the shares purchased with these loans. The loans were adjusted for changes in the Israeli CPI and bear annual interest of 2% beginning April 1997. The loans were secured with the ordinary shares which were issued upon the exercise of the options. The Company extended the term of the loans through May 31, 2001, which was not later than the expiration date of the original options. These loans were repaid through 2000.

The following table is a summary of the status of the Company's Plan as of December 31, 1998, 1999 and 2000, and changes in the years then ended:

	Year ended December 31, 1998		Year ended December 31, 1999		Year ended December 31, 2000	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at beginning of period	$2,891,205	$1.59**	3,007,092	$1.41	2,261,232	$2.10
Granted	699,507	1.41	1,701,413	2.82	1,147,823	9.13
Exercised	-	-	(2,074,782)	1.68	(609,931)	1.93
Forfeited *	(583,620)	2.30	(372,491)	2.14	(301,711)	2.81
Outstanding at end of year	(3,007,092)	$1.41	2,261,232	$2.10	2,497,413	$5.29
Exercisable at end of year	1,634,217	$1.41	615,930	$2.02	1,087,472	$3.45
Weighted average fair value of options granted during the year		$0.55		$0.96		$4.91

* Forfeited options are returned to the pool of options for future grant.

** After giving effect to the re-pricing.

Magic Software Enterprises Ltd.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 12 - SHAREHOLDERS' EQUITY (cont.):

B. **Stock Option Plan (cont):**

The options outstanding as of December 31, 2000 have been separated into exercise price categories, as follows:

	Options outstanding			Options exercisable	
Range of exercise price	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
$0.01-$2.00	961,007	7.03	$1.35	628,436	$1.35
$2.01-$4.00	451,647	8.24	$3.33	199,389	$3.30
$4.01-$6.00	174,314	9.42	$4.97	87,231	$5.00
$6.01-$8.00	45,857	8.42	$6.74	30,607	$6.78
$8.01-$10.00	121,680	8.5	$9.52	30,420	$9.52
$10.01-$19.33	742,908	9.07	$10.86	111,389	$11.78

Pro forma information regarding net income and earnings per share is required by SFAS No. 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Valuation Model with the following weighted-average assumptions for 1998, 1999 and 2000: risk-free interest rates of 6.00%; dividend yields of 0%; volatility factors of the expected market price of the Company's ordinary shares of 0.584 for 1998, 0.694 for 1999 and 1.024 for 2000; and a weighted-average expected life of the option of four years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

For purposes of pro-forma disclosure, the estimated fair value of the options is amortized as an expense over the options' vesting period. The pro forma information is as follows:

	Year ended December 31,		
	1998	1999	2000
	(in thousands, except per share data)		
Net income (loss) for the year - as reported	$(6,459)	$10,907	$920
Pro forma net income (loss)	$(7,344)	$9,417	(1,479)
Pro forma basic earnings (loss) per share	$(0.42)	$0.39	$(0.02)
Pro forma diluted earnings (loss) per share	$(0.42)	$0.37	$(0.02)

Magic Software Enterprises Ltd.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 12 - SHAREHOLDERS' EQUITY (cont.):

C. In 1996, the Company issued a five-year warrant to purchase 30,000 ordinary shares to the placement agent for the Company's 1996 public offering of ordinary shares. The exercise price of the warrant is $11.40 per share. As of December 31, 2000 the warrant had not been exercised.

D. **Dividends:**
Dividends on ordinary shares, if any, will be paid in NIS. Dividends paid to shareholders outside Israel will be converted into dollars on the basis of the exchange rate prevailing at the date of payment.

NOTE 13 - SELECTED STATEMENTS OF OPERATIONS DATA:

A. **Summary information about geographic areas:**
The Company manages its business on a basis of one reportable segment. See Note 1 for a brief description of the Company's business. The Company's business is divided into six main geographic areas: Israel, Europe (excluding the United Kingdom), the United Kingdom, North America, Japan and other regions. Total revenues are attributed to geographic areas based on location of customers.

This data is presented in accordance with SFAS 131 "Disclosures about Segments of an Enterprise and Related Information", which the Company has retroactively adopted for all periods presented.

The following table presents total revenues classified according to geographical destination for the years ended December 31, 1998, 1999 and 2000:

	Year ended December 31,		
	1998	1999	2000
	(in thousands)		
Israel	$3,726	$5,192	$18,508
Europe (excluding United Kingdom)	17,310	21,205	22,129
United Kingdom	7,320	6,041	6,094
North America	6,289	7,605	24,724
Japan	1,550	13,134	12,078
Other	2,565	10,815	6,723
	$38,760	$63,992	$90,256

The Company's long-lived assets that consist of fixed assets and severance pay funds are as follows:

	December 31,		
	1998	1999	2000
	(in thousands)		
Israel	$5,333	$7,874	$9,729
Europe (excluding United Kingdom)	364	997	1,299
United Kingdom	175	173	345
North America	189	161	971
Japan	-	205	132
Other	35	746	616
	$6,096	$10,156	$13,092

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 13 - SELECTED STATEMENTS OF OPERATIONS DATA (cont.):

B. Research and development costs:

	Year ended December 31,		
	1998	1999 (in thousands)	2000
Total costs	$4,080	$4,287	$13,031
Less - capitalization of software costs	(1,283)	(1,334)	(7,084)
Research and development, net	$2,797	$2,953	$5,947

C. Provision for doubtful accounts:

	Year ended December 31,	
	1999 (in thousands)	2000
Balance at beginning of period	$990	$1,112
Charges to general and administrative expenses	246	304
Less - accounts written-off	(124)	(276)
Newly consolidated subsidiaries	-	714
Balance at end of period	$1,112	$1,854

D. Financial income (expenses), net:

	Year ended December 31,		
	1998	1999 (in thousands)	2000
Interest and bank charges	$(268)	48	$1,277
Gain (loss) arising from foreign currency transactions	(54)	127	1,142
	$(322)	$175	$2,419

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 14 - RELATED PARTIES TRANSACTIONS:

A. In 1995, the Company signed an agreement with Mashov whereby the Company agreed to lease part of a building owned by Mashov. The annual lease expense is $150 thousand.

B. In 1995, the Company signed an agreement with Mashov to lease a part of another building. The annual lease expenses is $36 thousand.

C. In July 1999, the Company acquired from Mashov all of its rights in a building for a consideration of $2,000 thousand. Mashov agreed to reimburse the Company for the rental paid by the Company for the period January 1, 1999 until July 19, 1999, the date of the agreement. The Company entered into an agreement with Mashov effective January 1, 1999, pursuant to which Mashov leased a part of the building owned by it for an annual lease income of $37 thousand.

D. In February 2000, the Company exercised an option to purchase 18% of the outstanding share capital of Sintec Call Center Ltd. ("Sintec") for a total consideration of $440 thousand and converted convertible notes into 19% of the share capital of Sintec for a conversion price of $250 thousand. During the second quarter the Company acquired from shareholders of Sintec, a related party, the remaining outstanding shares for an aggregate consideration of $3,300 thousand.

E. Transactions with related parties:

	Year ended December 31,		
	1998	1999 (in thousands)	2000
General and administrative expenses, net (1)	$542	$974	$162
Financial expenses, net	$51	$27	-
Purchase of property (see C. above)	-	$2,000	-
Purchase of subsidiary (see D. above)	-	-	$4,990

Including rent expenses paid to Mashov and management fees paid to a principal shareholder.

F. Balances of accounts with related parties are in part linked to foreign currency and bear no interest.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 15 - COMMITMENTS AND CONTINGENT LIABILITIES:

A. Lease commitments:

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2000 are as follows:

	(in thousands)
2001	$1,498
2002	1,567
2003	1,879
2004	678
2005	16
	$5,638

Rent expenses for the years ended December 31, 1998, 1999 and 2000, were approximately $738 thousand, $1,448 thousand and $1,747 thousand, respectively.

B. Guarantees:
The Company has given guarantees to several banks amounting to $500 thousand in favor of its affiliates.

C. Charges:
As collateral for the Company's liabilities, a floating charge on all of the Company's assets were recorded in favor of a bank.

Magic Software Enterprises Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 16 - EARNINGS (LOSS) PER SHARE:

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Year ended December 31,		
	1998	1999	2000
	(in thousands, except per share data)		
Net income (loss)	$(6,459)	$10,907	$920
Numerator for basic and diluted earnings (loss) per share - income available to shareholders	$(6,459)	$10,907	$920
Denominator for basic earnings (loss) per share - weighted average shares	17,610	24,281	29,084
Effect of dilutive securities	-	1,110	1,148
Denominator for diluted earnings (loss) per share - adjusted weighted average shares and assumed conversions	17,610	25,391	30,232
Basic earnings (loss) per share	$(0.37)	$0.45	$0.03
Diluted earnings (loss) per share	$(0.37)	$0.43	$0.03

NOTE 17 – SUBSEQUENT EVENTS:

In the first quarter of 2001, the Company posted restructuring charges of US$ 3.3 million and wrote off goodwill of US$ 2.2 million mainly on its investment in Caswell. Through the second quarter Caswell due to lack of liquidities filed bankruptcy.

Magic Software Enterprises Ltd.

APPENDIX A - DETAILS OF SUBSIDIARIES

Details of the percentage of control of the share capital and vote of subsidiaries as of December 31, 2000:

Name of subsidiary	Percentage of ownership and control (%)	Placement of incorporation
Magic Software Japan K.K.	100	Japan
Magic Software Enterprises Inc.	100	U.S.A.
Magic Software Enterprises (UK) Ltd.	100	U.K.
Magic Software Enterprises Canada Inc.	100	Canada
Magic Software Enterprises Netherlands B.V.	100	Netherlands
Magic Software Enterprises France	100	France
Magic Beheer B.V.	100	Netherlands
Magic Software Enterprises GMBH	100	Germany
Magic Software Enterprises Australia Pvt. Ltd.	100	Australia
Magic Software Enterprises Spain	100	Spain
CoretechConsulting Group Inc.	100	U.S.A.
Sintech Call Centers Ltd.	100	Israel
ITM Engineering and Information Systems Ltd.	100	Israel
MNS Micronova Systems Ltd.	100	Israel
Magic Software Enterprises Italy S.r.i.	81	Italy
Magic Rental Technologies International Rentpro Ltd.	75	Israel
ONYX Szoftverhaz Korlatolt Felelossegu Tarsasag	74	Hungary
Magic Software (Thailand) Corp. Ltd.	70	Thailand
Answer On Demand Inc.	52	U.S.A.
Nextstep Infotech Prt. Ltd.	51	India
Magic Software Enterprises India Pvt. Ltd.	51	India
Access Data Corporation Inc.	51	U.S.A.
Caswell Holdings B.V*	51	Netherlands
Betagro Software and Services Ltd.	51	Thailand

*see Note 17

Management

Dan Goldstein
Chairman

David Assia
Vice Chairman

Menahem Hasfari
CEO

Gad Goldstein
Director

Yigal Berman
Director

Maya Liquornik
Director

Guy Bernstein
Vice President
Finance

Amit Birk
Corporate Secretary

Avikam Perry
Vice President
Research & Development

David Leichner
Vice President
Worldwide Marketing

Assaf Medina
Vice President
Operations

Ronen Kaufman
Vice President
Human Resources

Oren Inbar
Vice President, Sales
Managing Director
Magic Software Enterprises Europe

Steve Nohe
Magic Software Enterprises, Inc.
CEO

Eran Kaplan
Managing Director
Asia Pacific

Jean-Jacques Clerx
Managing Director
Magic Software Enterprises France

Dirk Timmerman
Managing Director
Magic Software Enterprises
(Deutschland) GmbH

Laszlo Koranyi
Managing Director
Magic (Onyx) Software Enterprises
Hungary Ltd.

Nitin Bhosie
Managing Director
Magic Software Enterprises India
Private Limited

Ruvi Lang
Managing Director
Magic Professional Services Ltd.

Hideoki Nakamura
President
Magic Software Japan K.K.

Gert Visser
Managing Director
Magic Software Enterprises Nederland

Eitan Melnik
Managing Director
Magic Software Enterprises Spain

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Form 20-F
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