



EMBLAZE

2007 ANNUAL REPORT & ACCOUNTS

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2007

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CHAIRMAN STATEMENT

During 2007 Emblaze Ltd. (the "Group", "Emblaze" or the "Company") focused on its core competency and skills in the technology arena by addressing both growth and innovation activities. As part of this approach, the Group divided its activity into two main sections being the **Growth activity** division and the **Innovation arm** division.

The year ended December 31, 2007 was mainly characterised by the restructuring of subsidiaries, reduction of minority interests throughout the structure and divestment of businesses that did not fall within the Group's growth strategy. The financial activities implemented during 2007 resulted in a strong balance sheet for the Group that will enable us to consider and pursue new investments and to react swiftly and efficiently to market fluctuations in these turbulent times.


Emblaze holds a controlling interest in its subsidiaries through equity holdings and our management is working hand-in-hand with the management of portfolio companies to improve their performance, identify new investment opportunities and focus on growth and profitability.

The Group is focused on improving its business performance through constant examination of our businesses in order to achieve long-term sustainable growth in the economic value of the Group. We are targeting growth in revenue and profits through a combination of organic growth, active involvement in portfolio companies and strategic mergers & acquisitions targeting mature software and IT companies that add value through synergies offered with existing businesses, extend our product lines and expand geographical coverage.

We believe in the high potential of our investment in the Innovation arm to generate significant value in the future for Emblaze and its shareholders.

Going forward, we believe that our continuous improving performance will regain market sentiment and begin to reflect on the exchange trading of the Group.

As always, I would like to take this opportunity to thank our management and staff for their hard work and dedication.



Naftali Shani
Chairman

REVIEW

Emblaze Group consists of two main operating arms: **Growth and Innovation**. The Growth arm relates to the stable, mature and operational companies managed under the Formula group. The Innovation arm relates to the investments made by the Group in in-house technology research and development of future wireless and cellular products.

GROWTH ACTIVITY

The growth activity division of the Group consists primarily of Formula Systems (1985) Ltd. ("Formula") and its subsidiaries. Emblaze owns 50.1% of Formula and began consolidating the Formula results as of Q2 2007. Formula is a NASDAQ and TASE listed company principally engaged, through its subsidiaries, in providing software consulting services, developing proprietary software products and providing computer-based business solutions.

Formula consists of established companies, with developed products and services that are delivering revenue and profit as outlined henceforth:

Matrix IT Ltd. ("Matrix")

Matrix IT Ltd. (TASE: MTRX) is one of Israel's leading integration and information technology ("IT") services companies with expertise in banking, insurance, telecom, commerce and government IT solutions.

2007 was a great year for Matrix and its growth was mainly organic. The company won many projects in the Israeli market, completed a private fund raising of approximately \$60 million through the issuance of bonds rated AA3 by Moodys (Israel), expanded its offshore operation through the acquisition of Unicoders in Bulgaria, executed an MOU with Microsoft for a 3 year distribution agreement for Microsoft's ERP system and acquired Tangram, which provides Matrix a leading position within the Java and Mainframe market segment.

Matrix's revenues for the year ended 31 December 2007 amounted to US\$313.9 million, up from US\$262.4 million in the corresponding period last year. Its operational profit for the period increased by 27.3% to US\$24.5 million, up from US\$19.2 million in 2006 and its net profit for the period increased by 14% to US\$19.3 million compared to US\$16.9 million in 2006. Matrix has a dividend policy of distributing at least 50% of net profits and therefore distributed on 30 March 2008 a total amount of approximately US\$11.5 million as a dividend to its shareholders in consideration of its 2007 net profits.

Looking ahead, Matrix's main focus will be to expand its international reach as well as maintain its position as market leader in the Israeli IT sector.

Magic Software Enterprises Ltd. ("Magic")

Magic (NASDAQ & TASE: MGIC) provides leading software development and integration technology that enable organisations to improve their business processes while retaining more value from their existing investments, thereby increasing their business agility and improving efficiency. The company has worldwide presence and a strong customer base in Europe, the United States, Japan, APAC and Israel.

Following implementation of a restructuring program led by the Group, Magic's operating income for 2007 improved to US\$1.3 million compared to an operating loss of US\$6.7 million in 2006. Net profit for 2007 was US\$12.6 million, compared to a net loss of US\$5.0 million in 2006. During the fourth quarter of 2007, Emblaze initiated and managed the sale of Magic's wholly owned subsidiary, Advanced Answers on Demand (AAOD), to Fortissimo Capital for the sum of US\$17 million in cash. As part of the transaction, Magic entered into a three-year license agreement with AAOD worth, US\$3 million in total. Magic's net profit of US\$12.6 million includes a capital gain of US\$9.3 million from the sale of AAOD. Due to the measures implemented by the Group, Magic is

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now positioned for success during 2008 as a much better focused and more efficient company with over US\$30 million in cash.

Sapiens International Corporation N.V. (“Sapiens”)

Sapiens International Corporation N.V. (NASDAQ and TASE: SPNS) is a provider of IT solutions, mainly for financial uses and core applications for insurance organisations.

Sapiens achieved an operating profit of US\$0.8 million for the year ended 31 December 2007, a significant improvement from the operating loss of US\$1.3 million in 2006 and the first annual operating profit since 1999. Sapiens also achieved a 34.2% reduction of its annual net loss, down from US\$3.8 million in 2006 to US\$2.5 million in 2007. In June 2007, Sapiens successfully completed a US\$20 million private placement and has to-date repaid approximately 50% of the principal of its convertible debentures. During 2007 the company generated US\$4 million of cash flow from operations.

nextSource Inc. (“NextSource”)

NextSource is a private 100% owned subsidiary of Formula. It is a provider of human capital management solutions. It designs, develops and implements web-based workforce management solutions. Based in New York, it is an Oracle and Microsoft Certified Partner. Customers span all sectors and include Accenture, American Express, BP, EDS, IBM, and Pfizer.

INNOVATION ARM

Our innovation arm includes advanced technology companies. While high-risk in nature, Emblaze believes in the potential value derived from such activities and will seek to mitigate risks by sharing its investment with leading global industry partners and close management.

Emblaze Mobile Ltd. (“Emblaze Mobile”)

Emblaze Mobile, wholly owned by the Emblaze Group, is a designer of advanced mobile devices. It has embarked on an ambitious project to design the ultimate “all-in-one” mobile device. The main principle of the futuristic device is to create an all-in-one communication device whereby each part of the device (e.g. telephone, camera, MP3 player, GPS, Email, movie player etc.) provides functionality to match standalone dedicated devices (like a digital camera, iPod, etc.) while maintaining an exceptional ease and simplicity of use. The device is designed to have a revolutionary and intuitive operating system and a unique User Interface. Emblaze Mobile has signed an agreement with Japanese firms Sharp and Access for the development and manufacturing of the device.

EMOZE Ltd. (“EMOZE”)

EMOZE, a 95% subsidiary of the Emblaze Group, is a provider of Push email and PIM synchronization to mobile users. The company represents realisation of the mobile office vision, free and accessible for all mobile users around the world.

There are reportedly about 3 billion mobile devices and 1.4 billion email accounts but only around 15 million users of email from a mobile device (mostly BlackBerry users). Push email is clearly a potentially high-growth service for corporate users and is likely to penetrate the mass market - there is thus significant potential for growth in mobile email usage and this has resulted in a number of corporate transactions in this space.

During 2007, EMOZE moved from a technological incubator to having a mass market product. EMOZE was chosen by Nokia to be included in the Download folder of the Nokia Symbian 60 device as the consumer email solution.

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The total number of these handsets is expected to amount to over 300 million by the end of 2008. EMOZE has also moved to address the business community with the recent release of the EMOZE software of Enterprise Server.

ZONE-IP Ltd. (“ZONE-IP”)

ZONE-IP Ltd. (LSE:ZIP) is a 65% held subsidiary of the Emblaze Group and a holding company for Emblaze VCON Ltd. Emblaze VCON is engaged in the development and deployment of Video over-IP Conferencing Solutions, enabling enterprises of all sizes to optimize their productivity and efficiency through enhanced interaction and communication.

The year ended 31 December 2007 was a turnaround year for ZONE-IP. Following the completion of a strategic review in the last quarter of 2006, ZONE-IP focused its efforts on the launch of new products.

On the operational side, ZONE-IP has improved its execution capabilities. The release of a brand new up-to-standard product line has enabled the company to sign distribution agreements with leading audio and video resellers across the world and win new business. It has also enabled ZONE-IP to embark on new OEM discussions with leading video vendors.

Revenues for the period ending 31 December 2007 increased by 26% to US\$8.3 million (2006: US\$6.6 million), the operating loss decreased by 51% to US\$2.6 million (2006: US\$5.3 million) and net loss decreased by 53% to US\$2.7 million (2006: US\$5.9 million)

Orca Interactive Ltd. (“ORCA”)

Orca Interactive Ltd. (BLZ: ORCA) provides IPTV middleware and applications for broadband network operators and service providers. On March 2008, Orca has agreed the terms of its acquisition by Viaccess S.A., a wholly owned subsidiary of France Telecom SA, through a cash merger (the “Merger”).

The Merger consideration consists of an amount of US\$13 million plus Orca’s net cash as of the closing of the Merger. The merger was approved by Orca Shareholders at a general meeting on 15 April 2008 and closing of the Merger took place on 19 May 2008.

BOARD OF DIRECTORS

Naftali Shani, Chairman

Naftali Shani (60) is one of the four founding partners of Emblaze. Prior to founding Emblaze, he served as General Manager of Bartrade Ltd. (a subsidiary of Bank Leumi, one of Israel's leading banks), dealing with trade finance and counter-trade worldwide, and as General Manager of the Israeli Chemical Company, Pazchem. Prior to this, Mr Shani was the Treasurer and Controller of the Israeli Prime Minister's Office.

Eli Reifman, President

Eli Reifman (38) is one of the four founding partners of Emblaze. Prior to his appointment as President of the Company in December 2006, Mr Reifman served as Chief Executive Officer of the Company since September 2000, leading the Company through its growth stages from the early startup phase to the publicly traded, global corporation it is today. Before founding Emblaze, he was the head of the Technical Development Department and acting head of all production in the Training Development Center of the Israeli Defense Force, where he was responsible for producing high-end military simulators. In parallel to his business activities, Mr Reifman is a regular lecturer at BA and MBA courses to Israeli and International students and is involved with promoting social education agenda in Israel via his memberships at various nonprofit organizations.

Guy Bernstein, Chief Executive Officer

Guy Bernstein (40) joined the Emblaze Group as Chief Financial Officer and member of the Board of Directors in April 2004 and was appointed Chief Executive Officer in December 2006. Prior to joining Emblaze, Mr Bernstein served as Chief Financial and Operations Officer of Magic Software Enterprises (NASDAQ: MGIC), a position he held since 1999. At Magic, Mr Bernstein's responsibilities included the overseeing of all finance operations, legal and M&A worldwide including, budget planning, sales forecasting, board and SEC reporting and investor relations. Guy played a key role in Magic's corporate second offering raising US\$100 million in 2000. He also acted as the Interim CEO for Magic's subsidiaries: MSE Israel Ltd. and Coretech Consulting Group, turning them around to profitability. Guy joined Magic from Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, where he acted as senior manager from 1994 to 1997. Mr Bernstein is a Certified Licensed Public Accountant and holds a BA in Accounting and Economics from the Tel-Aviv University.

Hadas Gazit-Kaiser, Chief Financial Officer

Hadas Gazit-Kaiser (32) joined the Emblaze Group as VP Finance in 2005 and was appointed Chief Financial Officer and member of the Board of Directors in December 2006. Prior to joining Emblaze, Mrs Gazit-Kaiser was a member of the TTI Telecom International (NASDAQ:TTIL) team for two years where she came after acting as a manager at Ernst & Young Global (Kost, Forer Gabbay & Kasierer). Mrs Gazit Kaiser is a Certified Licensed Public Accountant and holds a BA in Economics and Accounting and an MBA in Finance, both from the Tel-Aviv University.

Ruth Berger, Non-Executive Director (Retired As Of September 2007)

Ruth Berger (56) joined the Board of Directors of Emblaze in October 1996 and served as its Finance Director in a part time capacity through the Company's startup phase. During that period, she was also Deputy General Manager of most of the subsidiaries of the Industrial Development Bank of Israel (IDBI) and General Manager of two of its subsidiaries, where she was responsible for the management of funds and development of new business. Ms Berger was also Chief of Financial Reporting for the subsidiaries of IDBI. Currently, she serves as an independent business consultant and holds several directorships. Ms Berger is a Certified Public Accountant in Israel.

BOARD OF DIRECTORS

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Bertrand Faure-Beaulieu, Non-Executive Director

Bertrand Faure-Beaulieu (42) joined the Board of Directors of Emblaze in August 2005. He is a graduate of ESSEC Business School and has a background in banking and risk management. Mr Faure-Beaulieu began his career in corporate banking and then spent four years looking after political risk management with Glencore, a leading commodities trading company. In 1993, Mr Faure-Beaulieu became a co-founder of Trafigura, a commodities trading and recycling group, which grew to over 600 people in four years with annual revenues in excess of US\$6 billion. After leaving Trafigura in 1997, Mr Faure-Beaulieu became an independent consultant and long-term investor, playing active role in the early financing stages of companies. In 1999, Mr Faure-Beaulieu founded Vielife Ltd., a UK based company that became a leading global provider of corporate health and productivity solutions. Mr Faure-Beaulieu acted as CEO for Vielife until 2002, when he stepped up to the position of executive chairman, a role he held until the company was sold to Cigna in 2007.

Ilan Flato, Non-Executive Director

Ilan Flato (52) joined the Board of Directors of Emblaze in April 2006. Until 2004, Mr Flato served as the VP for planning, economics & online banking in United Mizrahi Bank and as the Chief Economist of the bank, where he was responsible for strategic & business planning and all aspects of online banking. Between 1992 and 1996, Mr Flato served as the Economic Advisor to the Prime Minister of Israel. His responsibilities included participation in government meetings, membership of the economic delegation to peace talks with the Palestinians in Paris and membership of the board of directors of El-Al (Israel Airlines & Israel Aircraft Industry). Prior to this position, Mr Flato served in the Treasury Office as the deputy director of the budget department, responsible for the budgets of various governmental offices. In addition, Mr Flato served as a member of the board of directors of many government owned companies. Mr Flato has a BA in Economics and Work Relationships from the Tel-Aviv University and Master in Law from the Bar-Ilan University.

Shimon Laor, Non-Executive Director

Shimon Laor (41) served as the Chief Financial Officer of Emblaze until April 2000, also directing the operations and legal departments. Since then he has served as a non-executive director on the Emblaze Board and has been engaged in private business initiatives. Mr Laor also serves as a non-executive on the board of directors of several of the Company's subsidiaries and affiliated companies, namely, Orca Interactive Ltd. (LSE: ORCA) and ZONE-IP Ltd. (LSE:ZIP). Prior to joining Emblaze in August 1995, Mr Laor served as an economist at the Head Office of the Foreign Currency Division of the First International Bank in Israel.

Zvi Shur, Non-Executive Director (as of September 2007)

Zvi Shur (72) joined the Board of Directors of Emblaze in September 2007. Until 2002, Mr Shur served as the General Manager of the Israeli Diamond Manufacturers Association, a position he had held since 1983. Between the years 1982 and 1983, Mr Shur served as the General Controller of Tadiran, an electronics concern after serving in the Israeli Defense Force in a wide scope of duties for almost 30 years. His most recent post in the Israeli Defense Force was as Head of the Budget Department at the Ministry of Defense and Financial Advisor to the Chief of Staff, with the rank of Brigadier General. Between the years 1982 and 2005, Mr Shur served as non-executive director of over 20 Israeli companies engaged in a variety of businesses from manufacturing to finance. In 2003, Mr. Shur founded Shur Zvi Consulting and is an active member of management of the Maccabia village and Maccabi World Union. Mr Shur holds a Bachelor of Science in Electrical Engineering and a Masters of Industrial Science and Engineering Management.

REPORT OF THE DIRECTORS

FOR THE YEAR ENDED 31 DECEMBER 2007

The Directors present their report and business review, together with the audited financial statements for the year ended 31 December 2007.

GROUP PERFORMANCE

- The Group began consolidation of the Formula Group financials as of Q2 2007, upon reaching a 50.1% holding in the Formula Group;
- As a result, Formula contributed US\$379 million in revenue and US\$12.4 million in net income to the Emblaze Group;
- Net loss from continuing operations was circa US\$3.0 million incurred mainly due to continuous Research and Development investments in the Innovation arm of the Group (mainly Emblaze Mobile and EMOZE);
- The Group has a strong balance sheet with total assets amounting to US\$695 million (2006: US\$250 million); and
- The financial statements for the periods include reclassifications with respect to the discontinued operations of the distribution and trading activities of Emblaze Mobile and Orca Interactive.

The contribution of the principal divisions to the Emblaze Group is presented in the table below (selected items):

Emblaze Group - Financial Highlights* US\$ in thousands	Twelve months ended December 31, 2007		
	Growth Activity (Q2-Q4 2007)	Innovation Arm	Consolidated
Revenues	378,880	8,396	387,276
Gross profit	94,014	4,935	98,949
Operating income (loss)	17,228	(12,177)	5,051
Income (loss) from continuing operation	9,913	(12,917)	(3,004)
Income (loss) from discontinued operations	2,459	(2,691)	(232)
Net income (loss)	12,372	(15,608)	(3,236)

* Includes allocation of Corporate Headquarters operating expenses. For convenience of presentation, the sum of \$1.33 million per Corporate financial expenses and other expenses was allocated solely onto the innovation arm.

Revenue of our Growth activity, the Formula Group, for the year ended 31 December 2007 totaled US\$493.4 million compared to US\$416.8 million in 2006 with operating income in 2007 of US\$27.2 million compared to US\$10.1 million in 2006, representing an increase of 170%. In 2007, Formula recorded a net income of US\$37.3 million compared to a net income of US\$10.0 million in 2006.

During the year, Formula sold its entire holdings in BluePhoenix Solutions Ltd. for a consideration of approximately US\$64 million, which resulted in capital gain for Formula of approximately US\$18 million.

REPORT OF THE DIRECTORS

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The table below summarises the 2007 performance of our Growth activity in comparison to its 2006 performance (selected items):

Formula Systems - Financial Highlights Emblaze Group consolidation is for period Q2-Q4 2007	Twelve months ended		
	December 31		
	2007	2006	
	US\$ in thousands		% of change
Revenues	493,350	416,807	18
Gross profit	124,240	107,360	16
Operating income	27,235	10,097	170
Income (loss) from continuing operation	12,461	(492)	
Income from discontinued operations	24,798	10,507	136
Net income	37,259	10,015	272

PRINCIPAL ACTIVITIES, TRADING REVIEW AND FUTURE DEVELOPMENTS

The Group manages two principal activities, the first relates to the development, production and marketing of IT solutions and services, operated under the Company's holding of 50.1% in Formula Systems (1985) Ltd. and jointly referred to as the Growth arm. The second activity relates to investments made by the Group in in-house technology research and development of future wireless and cellular products, operated under several subsidiaries and jointly referred to as the Innovation arm.

Formula, our Growth activity, has experienced an exceptional year in 2007, both from a financial and operational point of view, as a direct result of efforts invested by the Group in refining Formula's activities. Formula's subsidiaries have all improved their operational performance. Sapiens moved to operational profit and significantly reduced its net loss. Magic achieved operating income of US\$1.3 million for 2007 compared to operating loss of US\$6.7 million in 2006. Matrix increased its operational profit in 2007 by 27% to US\$24.5 million compared to US\$19.2 million in 2006 and its net profit for the period increased by 14% to US\$19.3 million. In addition, Formula's financial resources increased significantly due to the issuance of debentures in its subsidiary Matrix, the sale of the entire holdings in BluePhoenix, a private placement in Sapiens and the sale of a subsidiary of Magic. These financial activities resulted in over US\$150 million in cash to the Formula Group.

Each of the Group's innovation activities was making significant progress during 2007 towards fulfillment of their goals and objectives in terms of technological capabilities as well as market exposure.

The positive momentum in the Group's Growth activity is continuing as the subsidiaries under this segment continue to gain traction within their sectors. The Directors believe that the Group's investment in the Innovation activities create assets that will generate significant value in the future.

The key performance indicators used by the Group revolve around improving operational performance of the Growth activity as well as closely monitoring the progress and activity of the Innovation activities in order to mitigate the risks associated with these investments.

CORPORATE GOVERNANCE

Incorporated in Israel, Emblaze is listed on the Official List of the London Stock Exchange and the board of directors of Emblaze (the "Board") has therefore decided, as a matter of best corporate practice, that the Company will comply, so far as practicable, with the main provisions of the Combined Code on Corporate Governance (the "Code").

The following statement of corporate governance reflects the position of the Company as at 31 December 2007.

THE BOARD

The Emblaze Board comprises 8 directors. The Board is responsible for the Company's corporate governance policy. It recognises the importance of high standards of integrity and consistently seeks to apply the provisions set out in the Code.

During the year ended December 2007, the Board comprised the following members:

Mr Naftali Shani, the non-executive Chairman
Mr Eli Reifman, the President
Mr Guy Bernstein, the Chief Executive Officer
Mrs Hadas Gazit-Kaiser, the Chief Financial Officer
Ms Ruth Berger, a non-executive director*
Mr Shimon Laor, a non-executive director
Mr Bertrand Faure Beaulieu, a non-executive director
Mr Ilan Flato, a non-executive director
Mr Zvi Shur, a non-executive director**

* Ms Ruth Berger retired from the Board in September 2007, upon expiration of her second three-year term as "External Director" under the Israeli Companies Law.

** Mr Zvi Shur joined the Board in September 2007.

The Board consists of a non-executive Chairman, a President, a Chief Executive Officer, a Chief Financial Officer and four non-executive directors, one of whom, Bertrand Faure-Beaulieu, is the senior non-executive director.

Directors are subject to re-election at every Annual General Meeting (with the exception of the External Directors, as further described below). The Board has the power at any time, and from time to time, to appoint additional directors (either to fill any vacancy or as additional directors) provided that the number of directors does not exceed the maximum permitted by the Company's articles of association.

Each of the directors has a service agreement with the Company. Details of the terms of the service agreements are set out in the Report on Directors' Remuneration.

While there is no formal process in place, the performance and effectiveness of each director is assessed on an on-going basis by the other members of the Board.

CORPORATE GOVERNANCE

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BOARD MEETINGS

The Board meets on a regular basis to discuss the overall direction and strategic plan of the Company. The Board also monitors the Company's budget, performance and achievements.

Prior to each Board meeting, each director receives background materials related to the matters for discussion at the meeting. Once a year, a budget is discussed and approved by the Board for the following year. All directors are properly briefed on progress with respect to matters discussed at Board meetings and further information requested by a director is made available.

The Company's non-executive directors are central to an effective and accountable board structure. Therefore, during the year ended December 2007, the non-executive directors of the Company met twice without the executives being present.

There is in place a procedure whereby the directors may, in furtherance of their duties, take independent legal and financial advice, at the Company's expense.

INDEPENDENCE

The Code recommends that the board of directors of a listed company should include a balance of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking. The Code states that the board of directors should determine whether a director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The Board has considered the independence of its non-executive directors in line with the principles of the Code (section A.3.1) and, following careful consideration, assessed the independence of the non-executive directors as set out below.

The non-executive Chairman, Naftali Shani, a founding shareholder of Emblaze, holds approximately 14% of the issued and outstanding shares of the Company and is therefore not considered under the Code to be independent. However, the Board has determined that Mr. Shani is performing his chairmanship obligations on an independent basis. In reaching such determination, the Board established clear criteria for the Chairman's responsibilities, which include:

- ensuring that the Board functions effectively in all aspects of its role;
- ensuring constructive relations between executive and non-executive directors;
- leadership of the Board and responsibility for ensuring that all directors receive accurate, timely and clear information;
- ensuring that the directors continually update their skills and the knowledge and familiarity with the Company required to fulfil their role both on the Board and on Board committees;
- guiding and appraising the CEO, assisting in setting strategy and balancing the power and authority of the CEO; and
- ensuring effective communication with shareholders and stakeholders and facilitating the contribution of non-executive directors to the Company's operations.

CORPORATE GOVERNANCE

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In August 2005, Ruth Berger, whose Board membership ended in September 2007, voluntarily waived her right to the options granted to her by the Company in order to be considered independent. Ms Berger did not receive any compensation from the Company for such waiver. Following such waiver, Shimon Laor remains the only non-executive director who holds Company options, which were granted to him at the time of his employment by the Company. The Board believes that the relatively modest number of options that he holds does not affect his independence.

Mr Ilan Flato, appointed to the Board in April 2006 and Mr Zvi Shur, appointed in September 2007, both meet the Code's independence requirements.

The Israeli Companies Law requires the Company to appoint two "External Directors" who meet certain statutory criteria of independence. Under Israeli law, the initial term of an External Director is three years and the term may be extended for one additional three-year period. Ruth Berger was appointed for a second term as an external director at the Company's Annual General Meeting held on 14 June 2004 and therefore has retired from the Board in September 2007. Mr Zvi Shur was appointed for a first three-year term as an external director at the Company's Annual General Meeting held on 11 September 2007. The second external director is Mr Ilan Flato, who was appointed for a first three-year term at the Annual General Meeting held on 20 April 2006.

BOARD COMMITTEES

The Board has established Audit, Remuneration and Nomination Committees. The duties of these committees are set out in formal terms of reference, which are available for inspection on the Company's website at www.Emblaze.com.

Audit Committee

The Audit Committee was chaired by Ruth Berger until September 2007 and by Mr Ilan Flato thereafter. The other members are Mr Bertrand Faure-Beaulieu and Mr Zvi Shur. Mr Ilan Flato and Mr Bertrand Faure-Beaulieu both have recent and relevant financial experience. Under the Israeli Companies Law, the audit committee must have at least three members, including all external directors, and neither the chairman of the Board, nor any person who is employed by or provides services to the Company nor any person having control over the Company (or any relative of such control person) may be a member of the Audit Committee.

In accordance with its terms of reference, the Audit Committee is required to oversee the relationship with the Company's external auditors, to review the Company's preliminary results, interim results and financial statements and to monitor compliance with statutory and listing requirements for any exchange on which the Company's shares are quoted. It reviews the Company's internal control and risk management as well as the Company's cash investment policy. The Audit Committee also reviews the arrangements by which the Company's employees may, in confidence, raise concerns about improprieties in matters of financial reporting and other matters (commonly referred to as "whistleblowing" procedures)

The Company's Chairman and Chief Financial Officer may attend meetings of the Audit Committee, at the Committee's request.

The Code and the Israeli Companies Law require the Company to ensure a sound system of internal control to safeguard shareholder's investments and the Company's assets. Such system should cover all material controls: financial, operational, compliance and risk management. To comply with this provision, the Board appointed an internal auditor, who is responsible for examination of the Company's internal controls and reviewing their

CORPORATE GOVERNANCE

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effectiveness. All the recommendations provided by the internal auditor are presented to the Audit Committee for review and evaluation. The Audit Committee then recommends the required measures, if any, to the Board of directors for final decision and execution.

The Company's auditors are Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global. For the year ended 31 December 2007, the Board of Directors of the Company has determined the audit remuneration of its auditors at a level of US\$130,000. In addition, the auditors were entitled for remuneration of approximately US\$26,000 in relation to non-audit consultancy.

Remuneration Committee

Under the Israeli Companies Law, at least one external director must be a member of the Remuneration Committee. The Remuneration Committee was chaired by Ms Ruth Berger until September 2007 and by Mr Ilan Flato thereafter. The other members are Mr Bertrand Faure-Beaulieu and Mr Zvi Shur.

In accordance with its terms of reference, the Remuneration Committee approves the remuneration of all of the Company's senior executives and is responsible for making recommendations to the Board on the Company's framework of executive remuneration and for determining on behalf of the Board the remuneration package for each executive director.

The remuneration of non-executive directors is determined by the entire Board. No director participates in Board discussions on, or votes on matters relating to, their own remuneration.

Nomination Committee

The Board has established a Nomination Committee which leads the process for Board appointments and makes recommendations to the Board. Under the Israeli Companies Law, at least one external director must be a member of the Nomination Committee. The committee is chaired by Mr Naftali Shani and its other members were Ms Ruth Berger until September 2007 and Mr Ilan Flato thereafter, and Mr Bertrand Faure-Beaulieu. The Nomination Committee's principal function is to regularly review the structure, size and composition of the Board (including the skills, knowledge and experience required of directors) and to make recommendations to the Board as to any changes required.

ACCOUNTABILITY AND INTERNAL CONTROL

The Board's accountability is demonstrated by the adoption of a formal schedule of matters specifically reserved to the Board for its decision, concerning all key areas across the Group's activities, thereby ensuring that all major decisions affecting the Group are taken at Board level.

The Board is responsible for the Company's system of internal control and for reviewing its effectiveness. The Board recognises that no system of internal control can provide absolute assurance. This system is designed to manage, rather than to eliminate, risks of failure to achieve business objectives and can therefore only provide the Board reasonable, but not absolute, assurance against material misstatement and loss.

There is an on-going process in place for identifying, evaluating and managing the Company's significant risks. Such process is reviewed by the Board at least annually. Risk assessment and evaluation takes place as an integral part of the Company's strategic annual planning process and in the day-to-day operations. The main

CORPORATE GOVERNANCE

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characteristics of the risk management process include:

- The Company carries out continuing assessments of the quality of risk management and control;
- The Board and the Audit Committee monitor the standards of internal and external audit;
- The Company's strategy review includes consideration of major business risks;
- Executives of the various business units are required to identify and assess risks to meeting objectives (which they are required to report to the Chief Executive Officer) and then to take timely action to manage or eliminate them. The effectiveness of these actions is monitored and reviewed by the Board and the Audit Committee; and
- The Company has established internal operational and reporting procedures to ensure that risk assessment and management procedures are incorporated into all areas of the Company's activities.

RELATIONS WITH SHAREHOLDERS

The Company welcomes dialogue with its shareholders and communicates with them through timely announcements, its interim and annual reports and through the Company's website, which is regularly updated. Regular meetings are held with institutional investors and the Company encourages the direct approach of its senior management by shareholders for questions and clarifications on the Company's business activities. Further, as senior non-executive director, Mr Faure-Beaulieu is available to shareholders if they have concerns which contact through the normal channels of Chairman, President, Chief Executive or Chief Financial Officer has failed to resolve or for which such contact is inappropriate.

The Company's Annual General Meeting is also used as an opportunity to communicate with shareholders. All shareholders are encouraged to attend the Company's Annual General Meetings in order to take advantage of the opportunity to ask questions of the directors. Separate resolutions are proposed on each substantially different issue so that each receives proper consideration, including the approval of the annual report and accounts. Proxy votes are announced after each proposed resolution is voted on by a show of hands.

Notice of the Annual General Meeting and related documentation are (subject to certain exceptions) sent to shareholders at least 35 days in advance of such meeting.

CORPORATE SOCIAL RESPONSIBILITY

Emblaze recognises the obligations it has towards those with whom it has dealings, including its staff, customers, suppliers, shareholders and the community as a whole. More information on the Company's approach to these matters can be found in the Company's Ethics and Environmental Policies, which are available on the Company's website at www.Emblaze.com.

The Company also contributes to the community with means that do not necessarily involve direct out-of-pocket expense. Following semi-annual and annual inventory counts, the Company donates its surplus computers and computer related accessories to local universities, welfare and the Ministry of Education organisations, kindergartens and youth-at-risk associations.

Although the Group is not a manufacturing industrial company, our activities do have an impact on the environment as a result of the use of electricity, generation of waste as well as business and local travelling. Emblaze endeavours to take steps to minimise the impact of the Group's operations on the environment in a responsible and appropriate manner, with the aim to provide a safe and healthy workplace for all employees. As

CORPORATE GOVERNANCE

CONTINUED

such, the main guiding principles of our policy focuses on minimising waste generation and preventing pollution, reducing energy consumption and encourage recycling. In leading general environmental good practice, Emblaze will:

- continue to comply with all environmental laws, regulations and industry standards of the countries in which we conduct business;
- continually seek to improve its environmental performance;
- minimise the consumption of energy and water used in our facilities;
- reduce, re-use and, wherever is environmentally practicable, recycle consumables and dispose of non-recyclable items in an environmentally acceptable manner;
- where possible, procure resources and services from suppliers who have a sympathetic approach to the environment; and
- carefully plan the business flights of its staff in order to maximise utilisation of each travel.

REPORT ON DIRECTORS' REMUNERATION

As it is incorporated outside the United Kingdom, the Company is not obliged to include in its Annual Report and Accounts a report to shareholders on directors' remuneration. Nonetheless, as part of its commitment to best corporate practice, the Board has decided to issue this report, which has been prepared in accordance with UK Listing Rules and the Code.

REMUNERATION COMMITTEE

The Remuneration Committee is responsible for approving the remuneration of the Company's senior executives, for making recommendations to the Board on the Company's framework of executive remuneration and for determining on behalf of the Board the remuneration package for each executive director.

POLICY ON EXECUTIVE DIRECTORS' REMUNERATION

The Company's executive remuneration policy is to set total remuneration at levels designed to attract, motivate and retain high quality executives of appropriate ability, experience and integrity to manage the affairs of the Company. In formulating its remuneration policy, the Remuneration Committee is mindful of the competitive pressures inherent in the sector in which it operates. It is the Company's policy that a significant element of total remuneration is related to the financial performance of the company. Remuneration is reviewed annually.

NON-EXECUTIVE DIRECTORS

The remuneration of the non-executive directors is set by the Remuneration Committee and approved by the Audit Committee and the Board of Directors, subject to the approval of the Annual General Meeting.

Non-executive directors and the Chairman are entitled to fees of £20,000 per annum, paid quarterly. These fees have been determined with reference to available information on the fees paid to non-executive directors in other companies of broadly similar size, market cap and complexity. Non-executive directors are entitled to reimbursement of reasonable out-of-pocket expenses in line with the Company's policy relating to its employees.

SERVICE CONTRACTS

Each of the directors has a service contract with the Company, providing a notice provision of a maximum of six months.

Non-executive directors have service contracts with the Company with the exception of the two external directors who are appointed, as required by Israeli law, for a term of three years and may be appointed for one additional three-year term. Each non-executive director is subject to re-election at each Annual General Meeting. None of the directors is involved in any discussion with the Board or any committee of the Board relating to their own remuneration, nor do they participate in any vote on their remuneration by the Board or any committee of the Board.

REPORT ON DIRECTORS' REMUNERATION

CONTINUED

EXECUTIVE DIRECTORS - REMUNERATION PACKAGES (US\$ in thousands)

Name	Salary	Bonus	Insurance and/ or pension plan	Educational fund	Other	Total
Eli Reifman	247	-	28	3	-	278
Guy Bernstein	356	245	43	3	-	647
Hadas Gazit-Kaiser	117	39	19	3	-	178

SHARE OPTIONS

The share options granted to Directors are as follows:

	Number of		Exercise Period		Vesting Schedule
	Emblaze Shares	Exercise Price(£)	From	Until	
Eli Reifman	4,000,000 ²	1.32	June 09, 2003	June 09, 2013	Fully vested as of July 5, 2005
	4,400,000 ²	2.00	Aug. 31, 2006	Aug. 31, 2016	Between Year End 2006 and
	4,300,000 ²	2.50	Aug. 31, 2006	Aug. 31, 2016	Year End 2010, according to
	4,300,000 ²	3.00	Aug. 31, 2006	Aug. 31, 2016	performance criteria set by the Board ⁴
Guy Bernstein	160,000 ²	1.1677	Apr. 01, 2004	Apr. 01, 2014	4 equal annual instalments
	240,000 ²	1.422	Dec. 14, 2004	Dec. 14, 2014	4 equal semi-annual instalments
	1,650,000 ²	0.755	May 31, 2007	May 31, 2017	Quarterly over a period of 4 years
Shimon Laor ³	268,045 ²	NIL	May 31, 2007	May 31, 2017	Fully vested as of May 31, 2008
	50,000 ¹	0.47	Mar. 01, 1999	Mar. 01, 2009	Fully vested as of March 01, 2003
Hadas Gazit- Kaiser	200,000 ¹	1.075	Sept. 08, 1999	Sept. 08, 2009	Fully vested as of Sept. 08, 2003
	40,000 ²	1.45	Oct. 11, 2005	Oct. 11, 2015	4 equal annual instalments
	150,000 ²	0.7525	May 07 2007	May 07 2017	4 equal annual instalments
	150,000 ²	NIL	May 07 2007	May 07 2017	4 equal annual instalments

¹ Options under the Emblaze 1999 Stock Option Plan.

² Options under the Emblaze 2001 Global Stock Option Plan.

³ Was formerly in an executive position and was granted options at the time of employment. Also holds 100,000 Company shares previously exercised from an option granted to him at the time of his employment.

⁴ Of the total 13,000,000 options granted to Mr. Eli Reifman pursuant to shareholders approval on June 29, 2006, a total of 4,875,000 options were forfeited as of December 31, 2007 as a result of not meeting performance criteria set by the Board.

REPORT ON DIRECTORS' REMUNERATION

CONTINUED

Mr Eli Reifman, who is the President and a shareholder of approximately 15.4% of the issued and outstanding shares of the Company, serves also as the CEO of Emblaze Mobile Ltd., a wholly owned private subsidiary of the Company that is currently devoted to the development of the next generation mobile device - the Monolith. As such, Mr Eli Reifman was granted an option to purchase 10% of the ordinary shares of Emblaze Mobile at an exercise price of US\$1.55 per share. The options vest equally over a period of four years commencing June 30, 2007. The exercise of the options is subject to meeting certain criteria determined by the Board.

Naftali Shani, the Chairman of the Board, has been serving as chairman of EMOZE Ltd. since its inception in 2005 and has actively contributed to its achievements to date. Mr. Shani was granted an option to purchase 4% of EMOZE ordinary shares at an exercise price of US\$0.125 per share (based on the investment of the Company in EMOZE through the date of the grant).

It is the policy of the Company to grant share options under its employee share ownership schemes to all of its full time employees in a manner that is consistent with that of other similar companies with whom Emblaze competes for recruitment and retention of staff, and which incentivises and rewards loyalty and high performance.

Options to acquire the Company's shares are granted in addition to other forms of remuneration. The price at which shares may be acquired is generally the higher of the fair market value at the date of grant or the average of 30 days trading prior to the grant date. The exercise of options granted is generally phased over four years. The grant or exercise of options may be linked to performance criteria, as was the case for options granted in the 2006 financial year.

On June 28, 2001 the Shareholders approved the Company's Global Option Plan. The Company reserved 10,000,000 registered (i.e. authorised) but unissued ordinary shares of the Company for the purpose of this option plan. On June 9, 2003 the shareholders approved the consolidation of the Geo Interactive Media Group Ltd. 1999 Stock Option Plan ("1999 Plan") with the Emblaze Ltd. 2001 Global Stock Option Plan ("2001 Plan") so as to treat shares reserved for allotment under the 1999 Plan as being reserved for allotment under the 2001 Plan (but without prejudice to the actual terms and conditions of each grant previously made under the 1999 Plan). The reason for the consolidation was that, following the adoption of certain amendments to Israeli tax laws, rules and regulations, grants under the 1999 Plan did not comply with such amendments. Therefore, the available pool of options under the 1999 Plan was transferred to the 2001 Plan. On August 31, 2006 the Shareholders approved an additional reserve of 13,000,000 registered (i.e. authorised) but unissued ordinary shares of the Company for the purpose of the Global Option Plan.

PENSION PLANS

The Company makes contributions for all of its employees to a pension fund and severance account, in amounts of 5% and 8.33%, respectively, of the employees' salary. In addition, the Company contributes up to 2.5% of the employees' salary to disability insurance.

REPORT OF INDEPENDENT AUDITORS

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF EMBLAZE LTD.



We have audited the accompanying consolidated balance sheets of Emblaze Ltd. ("the Company") and its subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. 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 reflects total assets constituting approximately 55% of total consolidated assets as of December 31, 2007, and total revenues constituting 78% of total consolidated revenues for the year then ended. 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 referred to above, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and, for 2007, the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with generally accepted accounting principles in the United States.

As discussed in Note 2s to the consolidated financial statements, in 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment".

A handwritten signature in black ink that reads "Kost Forer Gabbay and Kasierer".

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global
Tel-Aviv, Israel
June 29, 2008

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS

	December 31,	
	2006	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	10,784	172,456
Short-term investments (Note 4)	52,730	56,900
Trade receivables (including unbilled receivables of \$0 and \$27,208 as of December 31, 2006 and 2007, respectively)	1,800	141,922
Other receivables and prepaid expenses (Note 5)	3,492	37,220
Inventories	1,407	5,887
Assets held for sale and assets of discontinued operations	42,858	17,307
	<hr/>	<hr/>
Total current assets	113,071	431,692
	<hr/>	<hr/>
LONG-TERM RECEIVABLES AND INVESTMENTS (Note 6)	133,655	25,481
	<hr/>	<hr/>
SEVERANCE PAY FUND	690	37,599
	<hr/>	<hr/>
PROPERTY AND EQUIPMENT, NET (Note 7)	1,017	16,297
	<hr/>	<hr/>
GOODWILL (Note 8)	336	130,734
	<hr/>	<hr/>
OTHER ASSETS, NET (Note 9)	894	53,443
	<hr/>	<hr/>
Total assets	249,663	695,246
	<hr/>	<hr/>

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

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

	December 31,	
	2006	2007
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	2,257	60,689
Short-term liabilities to banks and others (Note 10)	45,423	34,284
Other payables and accrued expenses (Note 11)	18,126	77,727
Liabilities held for sale and liabilities of discontinued operations	32,937	9,726
Convertible Debt (Note 12)	-	3,524
Total current liabilities	98,743	185,950
LONG-TERM LIABILITIES		
Convertible and non-convertible Debt (Note 12)	-	71,880
Liabilities to bank and other (Note 13)	-	23,685
Deferred tax liability	-	5,764
Other long term liabilities	847	4,287
Accrued severance pay	1,133	44,002
Total long-term liabilities	1,980	149,618
MINORITY INTEREST	2,448	208,602
COMMITMENTS AND CONTINGENT LIABILITIES (Note 14)		
SHAREHOLDERS' EQUITY: (Note 15)		
Share capital:		
Ordinary shares of NIS 0.01 par value - Authorized: 200,000,000 shares at December 31, 2007 and 2006; Issued: 140,578,154 shares at December 31, 2006 and 2007; Outstanding: 111,473,687 and 111,476,687 shares at December 31, 2006 and 2007, respectively	416	416
Additional paid-in capital	468,400	470,891
Treasury stock, at cost	(76,441)	(76,433)
Accumulated other comprehensive income (loss)	(328)	4,993
Accumulated deficit	(245,555)	(248,791)
Total shareholders' equity	146,492	151,076
Total liabilities and shareholders' equity	249,663	695,246

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

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

	Year ended December 31,		
	2005	2006	2007
Revenues (Note 17)	8,076	7,629	387,276
Cost of revenues	4,022	4,071	288,327
Gross profit	4,054	3,558	98,949
Operating expenses:			
Research and development, net	2,674	5,571	13,742
Selling and marketing	10,853	7,185	36,681
General and administrative	4,950	6,634	43,474
Restructuring gain	(720)	-	-
Total Operating Expenses	17,757	19,390	93,898
Operating Income (loss)	(13,703)	(15,832)	5,051
Financial income (expenses) (Note 18(a))	9,455	5,830	(3,873)
Other income (expenses) (Note 18(b))	6,446	(3,600)	7,408
Income (loss) before taxes on income	2,198	(13,602)	8,586
Taxes on income (Note 16)	-	-	718
Income (loss) before minority interest and equity gains (loss)	2,198	(13,602)	7,868
Equity in earnings (losses) of affiliated companies, net	(613)	327	528
Minority interest	353	2,174	(11,400)
Income (loss) from continuing operations	1,938	(11,101)	(3,004)
Gain (loss) from discontinued operations, net	(23,012)	1,262	(232)
Net Loss	(21,074)	(9,839)	(3,236)
Basic and diluted earnings (loss) per share:			
From continuing operations	0.01	(0.09)	(0.03)
From discontinued operations	(0.16)	0.01	0.00
Net loss per share	(0.15)	(0.08)	(0.03)
Weighted average number of shares used in computing basic and diluted earnings (loss) per share	135,765,992	123,595,330	111,476,440

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. DOLLARS IN THOUSANDS

	Share capital	Additional paid-in capital	Treasury Stock, at cost	Accumulated other comprehensive income (loss)	Accumulated deficit	Total comprehensive income (loss)	Total
Balance as of January 1, 2005	416	465,896	(8,623)	1,501	(214,642)		244,548
Issuance of shares upon exercise of stock options	-	452	1,242	-	-		1,694
Debt security from related party	-	(2,500)	-	-	-		(2,500)
Comprehensive loss:							
Unrealized gains from available-for-sale marketable securities, net	-	-	-	(1,857)	-	(1,857)	(1,857)
Foreign currency translation adjustments	-	-	-	(1,831)	-	(1,831)	(1,831)
Net loss	-	-	-	-	(21,074)	(21,074)	(21,074)
Total comprehensive loss						(24,762)	
Balance as of December 31, 2006	416	463,848	(7,381)	(2,187)	(235,716)		218,980
Repurchase of shares from related parties, net	-	-	(70,953)	-	-		(70,953)
Issuance of shares upon exercise of stock options	-	49	182	-	-		231
Issuance of shares upon business combinations, net	-	1,139	1,711	-	-		2,850
Debt security from related party	-	2,500	-	-	-		2,500
Share based compensation expenses	-	864	-	-	-		864
Comprehensive loss:							
Unrealized gains from available-for-sale marketable securities, net	-	-	-	1,905	-	1,905	1,905
Foreign currency translation adjustments	-	-	-	(46)	-	(46)	(46)
Net loss	-	-	-	-	(9,839)	(9,839)	(9,839)
Total comprehensive loss						(7,980)	
Balance as of December 31, 2006	416	468,400	(76,441)	(328)	(245,555)		146,492
Issuance of shares upon exercise of stock options	-	(1)	8	-	-		7
Tax benefits related to exercise of options in a subsidiary	-	243	-	-	-		243
Increase of investment due to decrease in percentage in holding in a development stage subsidiary	-	1,897	-	-	-		1,897
Share based compensation expenses	-	352	-	-	-		352
Comprehensive loss:							
Unrealized gains from available-for-sale marketable securities, net	-	-	-	752	-	752	752
Foreign currency translation adjustments	-	-	-	4,569	-	4,569	4,569
Net loss	-	-	-	-	(3,236)	(3,236)	(3,236)
Total comprehensive Income						2,085	
Balance as of December 31, 2007	416	470,891	(76,433)	4,993	(248,791)		151,076

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	Year ended December 31,		
	2005	2006	2007
Cash flows from operating activities:			
Net loss	(21,074)	(9,839)	(3,236)
Less: loss (gain) from discontinued operations	23,012	(1,262)	232
Income (loss) from continuing operations	1,938	(11,101)	(3,004)
Depreciation and amortization	715	639	11,459
Amortization of marketable debt securities premiums and accretion of discounts, net	612	511	380
Share based compensation expenses	-	300	577
Share based compensation expenses of subsidiaries	248	461	577
Net loss (gain) on sales of marketable securities and changes in accrued interest, net	92	778	2,019
Impairment of investment in marketable securities and others	4,980	1,244	4,215
Equity (gain) losses, net	613	(327)	(528)
Changes in value of long term loans and deposits, net	-	-	708
Other income and capital losses (gains), net	(11,010)	2,356	(8,580)
Minority interests in gains (losses) of subsidiaries	(353)	(2,174)	11,400
Decrease (increase) in trade receivables, other receivables and prepaid expenses and inventories	(5,366)	6,863	(3,730)
Increase (decrease) in trade payables, other payables and accrued expenses, accrued severance pay, net and other long term liabilities	(2,288)	2,491	(15,437)
Changes in deferred tax, net	-	-	(1,903)
Other	58	205	(349)
Net cash provided by (used in) operating activities from continuing operations	(9,761)	2,246	(2,196)
Net cash provided by (used in) operating activities from discontinued operations	641	18,601	(10,429)
Net cash provided by (used in) operating activities	(9,120)	20,847	(12,625)
Cash flows from investing activities:			
Purchase of property and equipment, net	(805)	(395)	(3,176)
Proceeds from sale of property and equipment	123	54	108
Investment in (proceeds from) short-term bank deposits and deposits held in escrow	(45)	396	5,899
Investment in short-term marketable securities	(234,700)	(111,945)	(27,391)
Proceeds from maturity of short-term marketable securities	255,366	111,088	801
Investment in long-term marketable securities	(59,530)	(12,994)	(2,680)
Proceeds from sales, calls and maturity of marketable securities	32,851	86,545	76,917
Proceeds from (investment in) long-term bank deposits and restricted deposits	51,712	3,751	(10,233)
Capitalization of software development and other costs of subsidiaries	-	-	(4,355)
Purchase of minority interest in subsidiaries	-	-	(4,368)
Proceeds from realization of investment in BluePhoenix Solutions Ltd.	-	-	62,279

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	Year ended December 31,		
	2005	2006	2007
Investment in and loans to affiliated and other companies	(2,772)	(1,215)	(2,319)
Cash paid for the acquisition of subsidiaries thereof, net of cash acquired	-	-	(5,305)
Purchase of intangible assets by subsidiaries	(1,225)	-	(499)
Payment for acquisition of Formula Systems (1985) Ltd	-	(84,414)	-
Cash acquired in conjunction with the acquisition of Formula Systems (1985) Ltd, net of cash paid	-	-	88,865
Net cash provided by (used in) investing activities from continuing operations	40,975	(9,129)	174,543
Net cash provided by (used in) investing activities from discontinued operations	(66,139)	2,038	11,447
Net cash provided by (used in) investing activities	(25,164)	(7,091)	185,990
Cash flows from financing activities:			
Proceeds from exercise of stock options in subsidiaries	-	-	1,626
Proceeds from exercise of stock options	2,759	257	7
Issuance of convertible debt in a subsidiary	-	-	64,602
Dividend to minority shareholders in a subsidiary	-	-	(3,498)
Short-term borrowing and bank credit, net	-	44,759	(37,793)
Repayment of long-term loans in subsidiaries	-	-	(61,717)
Receipt of long-term loans in subsidiaries	-	-	13,000
Issuance of ordinary shares in a subsidiary to minority shareholders, net	1,803	-	14,898
Deposits - SWAP deal in a subsidiary	-	-	(1,040)
Repayment of convertible debt in a subsidiary	-	-	(7,818)
Purchase of treasury stock in a subsidiary by a subsidiary thereof	-	-	3,017
Purchase of treasury stock	-	(70,953)	-
Debt security from a related party	(2,500)	-	-
Net cash provided by (used in) financing activities from continued operations	2,062	(25,937)	(14,716)
Net cash provided by (used in) financing activities from discontinued operations	25,424	713	7
Net cash provided by (used in) financing activities	27,486	(25,224)	(14,709)
Effect of exchange rate on cash of continuing operations	-	-	3,517
Effect of exchange rate on cash of discontinued operations	-	(966)	-

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	Year ended December 31,		
	2005	2006	2007
Increase (decrease) in cash and cash equivalents from continuing operations	33,276	(32,820)	161,148
Increased (decrease) in cash and cash equivalents from discontinued operations	(40,074)	20,386	1,025
Cash and cash equivalents from continuing operations at the beginning of the year	1,977	15,238	10,784
Cash and cash equivalents from discontinued operations at the beginning of the year	29,931	9,872	1,892
Cash and cash equivalents from continuing operations at the end of the year	15,238	10,784	172,456
Cash and cash equivalents from discontinued operations at the end of the year	9,872	1,892	2,393

	Year ended December 31,		
	2005	2006	2007
Supplemental disclosure of cash flow information:			
(a) Cash paid during the year for:			
Interest	180	599	6,322
Income taxes	-	-	5,109
(b) Significant non cash activities (see Note 3(e)6):			
Sale of a subsidiary	-	-	16,000
(c) Acquisition of Formula (see Note 3(a)1):			
Working capital, excluding cash and cash equivalent	-	-	(11,991)
Other long term assets and investments	-	-	(70,053)
Investment in Formula	-	-	86,575
Goodwill	-	-	(117,387)
Other intangible assets	-	-	(47,781)
Minority interest	-	-	159,677
Other long term liabilities	-	-	89,825
Cash acquired, net of amount paid	-	-	88,865

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 1. GENERAL

a. Organization and business:

Emblaze Ltd. ("Emblaze" or "the Company") is an Israeli corporation. The Company's shares are traded on the London Stock Exchange ("LSE") under the symbol BLZ.

The Company operates in two principal business segments, namely Growth and Innovation.

The Growth segment relates to the development, production and marketing of information technology ("IT") solutions and services controlled under the Company's holding of 50.1% in Formula Systems (1985) Ltd., a NASDAQ and Tel Aviv Stock Exchange ("TASE") listed company, ("Formula") (see also Note 3(a)1). Formula holds the following subsidiaries:

Matrix IT Ltd. ("Matrix") (TASE: MTRX) is an integration and information technology services company. As at December 31, 2007, Formula held 50.13% of the issued share capital of Matrix.

Magic Software Enterprises Ltd. ("Magic") (NASDAQ & TASE: MGIC) develops, markets and supports composite application development and deployment platforms with a service-oriented architecture (SOA), including application integration and business process management (BPM), with existing and legacy systems. As at December 31, 2007, Formula held 51.26% of the issued share capital of Magic.

Sapiens International Corporation N.V. ("Sapiens") (NASDAQ & TASE: SPNS) is a global provider of IT solutions that modernize business processes and enable insurance organizations and other companies to adapt quickly to changes. As at December 31, 2007, Formula held 54.6% of the issued share capital of Sapiens.

NextSource Inc. ("NextSource") is a private wholly owned subsidiary of Formula. NextSource designs, develops and implements web-based, high quality, innovative human capital management solutions.

The Innovation segment relates to research and development of technology for advanced wireless and cellular solutions and products. This segment includes the following subsidiaries:

Emblaze Mobile Ltd. ("Emblaze Mobile") is a wholly owned subsidiary of the Company and a designer of advanced mobile devices.

ZONE-IP Ltd. ("ZONE-IP") (LSE: ZIP) is a holding company for IP related technologies, currently holding Emblaze VCON Ltd. ("EVC"), a provider of wireless video communications technologies and conferencing solutions for operators and enterprise markets over IP networks. As at December 31, 2007, the Company held 64.84% of the issued share capital of ZONE-IP (see also Note 3(a) 4).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 1. GENERAL (Continued)

EMOZE Ltd. ("EMOZE") is a provider of Push email and Personal Information Management ("PIM") synchronization to mobile users. The service is provided globally and to any device. As at December 31, 2007, the Company held 95% of the issued share capital of EMOZE.

Note 2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP").

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 U.S. dollars:

The Company's management believes that the U.S. dollar is the primary currency of the primary economic environment in which the Company and certain of its subsidiaries operate. Thus, the functional and reporting currency of the Company and certain of its subsidiaries is the U.S. dollar.

Accordingly, amounts in currencies other than U.S. dollars have been translated as follows in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation":

Monetary balances - at the exchange rate in effect on the balance sheet date.

Revenues and expenses - at the exchange rates in effect as of the date of recognition of the transaction.

All exchange gains and losses from the re-measurement mentioned above are reflected in the statement of operations in financial expenses (income), net.

For those subsidiaries whose functional currency has been determined to be their local currency, assets and liabilities are translated at year-end exchange rates and statement of operations items are translated at average exchange rates prevailing during the year. Related translation adjustments are recorded as a separate component of accumulated other comprehensive income (loss) in shareholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and the subsidiaries in which the Company has a controlling voting interest. Inter-company balances and transactions have been eliminated upon consolidation. The minority interest amount adjusts the consolidated net income (loss) to reflect only the Company's share in the earnings or losses of any subsidiary.

The significant subsidiaries held directly by the Company as of the balance sheet date whose accounts are consolidated in continuing operation are:

	December 31,		
	2005	2006	2007
	% of outstanding share capital		
Formula Systems (1985) Ltd.	-	-	50.1
ZONE-IP Ltd.	24.95	64.84	64.84
Emblaze Mobile Ltd.	100	100	100
EMOZE Ltd.	-	100	95
Orca Interactive Ltd. (represented as discontinued operations)	59	59	59
Adamind Ltd. (represented as discontinued operations)	49.98	-	-
Emblaze Inc (inactive)	100	100	100

d. Business combination:

Business combinations are accounted for using the purchase method of accounting. Under the purchase method of accounting, the results of operations of the acquired business are included from the date of acquisition. The costs of acquisition, including transactions costs, are allocated to the underlying net assets of each acquired company in proportion to their respective fair values. Any excess of the purchase price over estimated fair values of the identifiable net assets acquired has been recorded as goodwill.

Gains arising from issuance of common or in substance common shares by subsidiaries to third parties are recorded as income in the consolidated statements of operations, unless the issuing company is a development stage company for which the gain from issuance is accounted for as an equity transaction.

e. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

f. Short-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months but less than one year. Short-term bank deposits are presented at their cost, including accrued interest.

g. Marketable securities:

The Company and its subsidiaries account for investments in marketable debt and equity securities in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date.

Debt and equity securities that are classified as available-for-sale are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity, net of taxes. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the consolidated statement of operations.

In accordance with SFAS No. 115, the Company and its subsidiaries have classified certain of their marketable debt securities as trading securities. Trading securities are held for resale in anticipation of short-term market movements. Under SFAS No. 115, marketable securities classified as trading securities are stated at the quoted market prices at each balance sheet date. Gains and losses (realized and unrealized) related to trading securities, as well as interest on such securities, are included as financial income or expenses as appropriate.

FASB Staff Position ("FSP") No. 115-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investment" ("FSP 115-1") provides guidance for determining when an investment is considered impaired, whether impairment is other-than temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment decreased below its cost in another-than temporary manner. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss should be recognized equal to the difference between the investment's cost and its fair value. FSP 115-1 nullifies certain provisions of Emerging Issues Task Force ("EITF") Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1") while retaining the disclosure requirements of EITF 03-1 which the Company and its subsidiaries adopted in 2003.

Interest income resulting from investments in structured notes is accounted for under the provision of Emerging Issue Task Force No. 96-12, "Recognition of Interest Income and Balance Sheet Classification of Structured Notes" ("EITF No. 96-12"). Under EITF No. 96-12, the retrospective interest method should be used for recognizing interest income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

h. Provision for Doubtful Accounts:

The provision for doubtful accounts was calculated on the basis of specific receivables, where, in the opinion of the Company and its subsidiaries' management, doubt exists as to their collectibility. The provision for doubtful accounts as of December 31, 2006 and 2007 amounted to US\$179 and US\$4,809 respectively.

i. Long-term bank deposits:

Bank deposits with maturities of more than one year are included in long-term receivables and investments, presented at their cost.

j. Investments in affiliates:

The Company and its subsidiaries account for investments in affiliates in which it has the ability to exercise significant influence over the operating and financial policies using the equity method of accounting in accordance with the requirements of Accounting Principle Board 18, "The Equity Method of Accounting for Investments in Common Stock" ("APB No. 18"). Profits on inter-company sales, not realized outside the group, are eliminated.

k. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets as follows:

	%
Computers and peripheral equipment	7-33
Buildings	2-4
Motor vehicles	15
Office furniture and equipment	6-15
Leasehold improvements	by the shorter of the term of the lease or the economic life of the assets

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

I. Goodwill and other intangible assets:

Goodwill reflects the excess of the purchase price of a business acquired over the fair value of identified net assets acquired.

Goodwill is not amortized for financial reporting purposes. Instead, the Company is required, annually (or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable) to test for impairment of goodwill using a two-phase process. The first phase screens for impairment; while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. An impairment loss is recognized if the carrying amount of goodwill exceeds its implied fair value.

Intangible assets are being amortized using the straight-line method over their estimated useful life as follows:

	Amortization period in years
Developed technology	5-10
Customer relationships	7-9
Brand name	13

m. Software Development Costs:

Development costs of software, which is intended for sales that are incurred after the establishment of technological feasibility of the relevant product, are capitalized. Technological feasibility is determined when detailed program design is completed and verified in accordance with the provisions of SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed".

Software development costs incurred before technological feasibility has been established are charged to the statement of operation as incurred.

Amortization of capitalized software development costs begins when the product is available for general release to customers. Annual amortization is calculated according to the higher of the straight-line method over the remaining useful life of the product or based on the ratio of current gross revenues to current and anticipated future gross revenues. At present, amortization is computed under the straight-line method, mainly over a period of 3-5 years. During the nine months ended December 31, 2007, certain consolidated subsidiaries capitalized software development costs aggregating \$4,355 and amortized capitalized software development costs aggregating \$4,333.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management estimates that the total capitalized costs do not exceed the net realizable value of the software product. In the event that unamortized software development costs exceed the net realizable value of the product, they are written down to net realizable value. As of December 31, 2007 no impairment was recorded.

n. Impairment of long-lived assets other than goodwill:

The Company and its subsidiaries' long-lived assets are reviewed for impairment in accordance with SFAS No. 144 whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of by way of sale are reported at the lower of the carrying amount or fair value less costs to sell. During 2005, 2006 and 2007, no material impairment losses were recognized in continuing operations.

o. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This Statement prescribes the use of the liability method whereby deferred tax assets 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 and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income tax.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

p. Revenue recognition:

Revenues derived from direct software license agreements are recognized in accordance with Statement of Position (SOP) 97-2 "Software Revenue Recognition" (as amended by SOP 98-4 and SOP 98-9), upon delivery of the software when collection is probable, where the license fee is otherwise fixed or determinable, and when there is persuasive evidence that an arrangement exists.

When a project involves significant modification of software, revenue is generally recognized according to the percentage of completion method. Under this method, estimated revenue is generally accrued based on costs incurred to date as a percentage of the total updated estimated costs.

The arrangements, which include multiple elements, are usually arrangements where the Company sells software products and Post Contract Support (PCS).

In addition there are certain arrangements where the Company sells software and consulting services. Consulting service fees are based on time invested.

For these multiple elements, SOP 97-2 requires that the fair value of each component in a multiple element arrangement will be determined based on the vendor's specific objective evidence (VSOE) for that element, and revenue is allocated to each component based on its fair value.

SOP 98-9 requires that revenue be recognized under the "residual method" when VSOE does not exist for all the delivered elements, VSOE of fair value exists for all undelivered elements, and all other SOP 97-2 criteria are met. Under the residual method, any discount in the arrangement is allocated to the delivered elements.

The specific objective evidence for the PCS is established by the price charged on separate PCS renewal contracts. The VSOE for the consulting services is established by the price charged on other time based consulting service contracts where no sale of other elements is involved, considering, among other things, the territory where the service is performed, the size of the customer, the quantity of the purchased services and the professional expertise of the consultants. The revenue associated with the delivered elements is recognized using the residual method discussed above.

The Company recognizes revenues from consulting fees with respect to projects billed on a time and material basis, based on the number of hours performed.

In some of the agreements with the Company's customers, the customers have the right to receive unspecified upgrades on an if-and-when available basis (the Company does not provide specific upgrades). These upgrades are considered PCS.

Revenue allocated to the PCS is recognized ratably over the term of the PCS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company recognizes revenues from projects as follows:

Revenue from projects billed on a time and material basis is recognized in accordance with SOP 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts", using contract accounting on a percentage of completion method, on the basis of the relationship between actual costs incurred and the total costs that are expected to be incurred over the duration of the contract. Provision is made for estimated losses and uncompleted contracts, in the amount of the estimated losses on the entire contract in the period in which such losses first become evident. As of December 31, 2007, no such estimated losses were identified.

Revenue from fixed fee contracts is also recognized in accordance with the percentage of completion method. The Company recognizes contract losses, if any, in the period in which they first become evident.

Revenues from consulting services, consisting of billable hours for services provided, are recognized as the services are rendered.

Revenues from maintenance and training contracts are recognized relatively over the contract period.

Revenues from sale of hardware are recognized when the merchandise is delivered to the customer, provided no significant vendor obligations remain.

Some of the Company's contracts include client acceptance clauses. In these contracts, in determining whether revenue can be recognized, when an acceptance clause exists, the Company considers, among other things, its history with similar arrangements, the customer's involvement in the progress, and the existence of other service providers and the payment terms.

There are no rights of return, price protection or similar contingencies in the Company's contracts.

Deferred revenue includes unearned amounts received under maintenance contracts and amounts received from customers but not yet recognized as revenues. Payments for maintenance fees are generally made in advance and are nonrefundable.

Tax collected from customers and remitted to governments authorities (including VAT) are presented in statement of operation on a net basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

r. Concentrations of credit risks:

The majority of the Company and its subsidiaries' cash and cash equivalents and marketable securities are invested in dollar and dollar-linked investments, and in Shekels. The cash is deposited in major banks in Israel and the U.S. Deposits in the U.S. may be in excess of insured limits and are not insured in other jurisdictions. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk. The Company's marketable securities consist of investment-grade corporate bonds, U.S. government agency securities, Sovereign bonds and structured notes.

The Company is of the opinion that the credit risk in respect of these balances is remote.

The Company and its subsidiaries' trade receivables are derived mainly from sales to large organizations located mainly in Europe, North America and Israel. The Group performs ongoing credit evaluations of its customers and has established an allowance for doubtful accounts based upon factors relating to the credit risk of specific customers and other information. In certain circumstances, the Company and its subsidiaries' may require letters of credit, other collateral or additional guarantees. From time to time, the Company and its subsidiaries' sell certain of its accounts receivable to financial institutions, within the normal course of business. Where receivables are sold without recourse to the Company, the relevant receivable is de-recognized and cash recorded. Where receivables are sold with full or partial recourse to the Company and its subsidiaries', the receivable is not de-recognized and a liability reflecting the obligation to the financial institution is recorded within financial debts until the Company's liability is discharged through the financial institution receiving payment from the customer.

The provision for doubtful accounts charged to general and administrative expenses amounted to \$0, \$0 and \$689 in the years 2005, 2006 and 2007, respectively, and was determined for specific debts where doubt existed as to their collectibility.

SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS No. 140), establishes a standard for determining when a transfer of financial assets should be accounted for as a sale. The underlying conditions are met for the transfer of financial assets to qualify for accounting as a sale. The transfers of financial assets are typically performed by the sell of receivables to a financial institution.

The agreements, pursuant to which a certain subsidiary of the Company sells its trade receivables, are structured such that the Company (i) transfers the proprietary rights in the receivable from the subsidiary to the financial institution; (ii) legally isolates the receivable from the subsidiary's other assets, and presumptively puts the receivable beyond the legal reach of the subsidiary and its creditors, even in bankruptcy or other receivership; (iii) confers on the financial institution the right to pledge or exchange the receivable; and (vi) eliminates the subsidiary's effective control over the receivable, in the sense that the subsidiary is not entitled and shall not be obligated to repurchase the receivable other than in case of failure by the subsidiary to fulfill its commercial obligation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company and its subsidiaries had no off-balance-sheet concentration of credit risk as of December 31, 2007.

s. Accounting for stock-based compensation:

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options under the Company's stock plans based on estimated fair values. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") for periods beginning in fiscal 2006.

SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statement of operations.

Prior to the adoption of SFAS 123(R), the Company accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123").

Stock-based employee compensation cost was recognized in the statements of operations for the year ended December 31, 2005, for all options granted under those plans with an exercise price lower than market value of the underlying Common stock on the date of grant.

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. Under that transition method, compensation cost recognized in the year ended December 31, 2006, include: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). As required by the modified prospective method results for prior periods have not been restated.

The Company recognized compensation expenses for the value of these awards, which has straight-line vesting, over the requisite service period of each of the awards.

Since 2005, the Company estimates the fair value of stock options granted using the Binomial method option-pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the early exercise factor. Expected volatility was calculated based upon actual historical stock price

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

movements over the most recent periods ending at the date of grant. The early exercise factor represents the influence on the period that the Company's stock options are expected to be outstanding and was determined based on past exercise employee behavior. The Company has historically not paid dividends and has no foreseeable plans to issue dividends. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. Pro forma information regarding net loss and loss per share was required by SFAS 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant, using the Black-Scholes Option valuation model through the beginning of 2005 and the Binomial model for options granted thereafter.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting periods, on a straight line method.

Pro forma information under SFAS No. 123:

	2005
Net loss as reported	(21,074)
Add: share-based compensation expense included in reported net loss	248
Deduct: share-based compensation expense determined under fair value method	<u>(3,018)</u>
Pro forma net loss	<u>(23,844)</u>
Basic and diluted net loss per share as reported	<u>(0.15)</u>
Pro forma basic and diluted net loss per share	<u>(0.18)</u>

The fair value of the employee stock option was based on the following assumption:

	2005	2006	2007
Expected volatility	0.53-0.61	0.31-0.41	0.45-0.55
Risk-free interest rate	4.3%	4.9%	4.5%-4.9%
Dividend yield	0%	0%	0%
Early exercise multiple	1.5	1.5	1.5
Annual forfeiture rate	20.8%	8.8%	0%-15%

See also Note 15.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

t. Grants:

Royalty-bearing grants from the Government of Israel for the funding of research and development projects are recognized at the time that the Company's subsidiaries are entitled to such grants on the basis of the related costs incurred, and are recorded as a deduction from research and development costs. During 2005, 2006 and 2007, grants included as a reduction of research and development cost amounted to \$259, \$0 and \$0, respectively.

u. Severance pay:

The Company and its Israeli based subsidiaries' liabilities for severance pay are calculated pursuant to Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company and its Israeli subsidiaries' liabilities for all of their employees are fully provided by monthly deposits with insurance policies and by an accrual.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation, pursuant to Israeli Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrender value of these policies, and includes immaterial profits.

v. Fair value of financial instruments:

The estimated fair value of financial instruments has been determined by the Company using available market information and valuation methodologies. Considerable judgment is required in estimating fair values. Accordingly, the estimates may not be indicative of the amounts the Company could realize in a current market exchange. The carrying amounts of cash and cash equivalents, trade receivables, short-term bank credit and trade payables approximate their fair values due to the short-term maturity of such instruments. The fair value for marketable securities is based on quoted market prices or issuer valuation and do not significantly differ from a carrying amount.

The carrying amounts of the Company's non-traded long-term borrowing arrangements approximate their fair value. Fair values were estimated using discounted cash flow analyses, based on prevailing market borrowing rates.

The fair value of the traded convertible debentures with a carrying value in the amount of \$10,987 as of December 31, 2007 according to the quoted price in the Tel-Aviv Stock Exchange ("TASE") is \$10,306.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

w. Advertising expenses:

Advertising expenses are charged to the statements of operations, as incurred. Advertising expenses for the years ended December 31, 2005, 2006 and 2007 were \$0, \$87 and \$4,178, respectively.

x. Basic and diluted net loss per share:

Basic and diluted net loss per share is computed based on the weighted average number of Ordinary shares outstanding during each year.

y. Derivatives and hedging activities:

Financial Accounting Standards Board ("FASB") Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), as amended, requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not designated as part of a hedged transaction must be adjusted to fair value through income.

If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings. The Company uses derivatives to hedge certain cash flow foreign currency exposures, in order to further reduce the Company's exposure to foreign currency risks. The Company's forward contracts did not qualify as hedging instruments under SFAS 133.

Put options which were granted to minority interest during 2007 in a subsidiary have been measured in fair value pursuant to EITF 00-06 "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary". Changes in the fair value are reflected in the consolidated statements of operations as financial income or expense.

In addition, during 2007 the Company's subsidiary engaged in Swap deal to exchange interest which was linked to the CPI. This Swap deal did not qualify as hedging instrument under SFAS 133. Changes in the fair value are reflected in the consolidated statements of operation as financial income or expense.

z. Comprehensive income

The Company accounts for comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income". This statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders. The Company determined that its items of comprehensive income relate to gain and loss on foreign currency translation adjustments and unrealized gain and loss on available-for-sale marketable securities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

aa. Discontinued operation

Under SFAS 144, when a component of an entity, as defined in SFAS 144, has been disposed of or is classified as held for sale, the results of its operations, including the gain or loss on its disposal should be classified as discontinued operations and the assets and liabilities of such component should be classified as assets and liabilities attributed to discontinued operations; that is, provided that the operations, assets and liabilities and cash flows of the component have been eliminated from the Company's consolidated operations and the Company will no longer have any significant continuing involvement in the operations of the component.

bb. Impact of recently issued accounting standards:

1. In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) 157, "Fair Value Measurements". SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption will have material impact on its consolidated financial statements.
2. In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. The provisions of SFAS No. 159 are effective for the Company beginning January 1, 2008. The Company does not expect the adoption of SFAS No. 159 will have an impact on its consolidated financial statements.
3. In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008. Earlier adoption is prohibited. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 141R on its consolidated results of operations and financial condition.
4. In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, and an amendment of ARB No. 51". SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

parent and to the no controlling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 141R on its consolidated results of operations and financial condition.

cc. Restructuring:

In 2004 the Company implemented strategic initiatives to reduce costs, increase efficiencies and focus on key business areas. The following table details the major components of the restructuring and other charges and the reconciliation of the beginning and ending liability balances:

	Employee termination and severance costs	Exit costs	Impairment of property and equipment	Other	Total restructuring charges
Restructuring accrual as of January 1, 2005	98	6,045	-	-	6,143
Utilized:					
Cash	(98)	(1,380)	-	-	(1,478)
Accrual reversal	-	(720)	-	-	(720)
Restructuring accrual as of December 31, 2006	-	3,945	-	-	3,945
Utilized:					
Cash	-	(1,345)	-	-	(1,345)
Restructuring accrual as of December 31, 2006	-	2,600	-	-	2,600
Utilized:					
Cash	-	(2,600)	-	-	(2,600)
Restructuring accrual as of December 31, 2007	-	-	-	-	-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES

a. Business combinations and acquisitions:

1. Acquisition of Formula

On November 20, 2006, the Company consummated the purchase of an aggregate of 4,406,237 Ordinary shares of Formula representing approximately 33.4% of the issued and outstanding share capital of Formula, from FIMGold Limited Partnership ("FIMGold"), for an aggregate purchase price of \$70,500 (\$16 per share). Following the transaction, the Company was granted an option to purchase up to additional 325,000 Ordinary shares of Formula, constituting approximately 2.46% of the share capital of Formula, from the President and a director of Formula, at a price per share of \$16. Concurrently, the President and director of Formula had an option to sell to Emblaze, through December 31, 2007, such number of Ordinary shares of Formula, at a price per share of \$16.

Between September 2006 and until December 2006, the Company purchased an aggregate of 1,184,183 Ordinary shares of Formula in various private transactions, at an aggregate purchase price of approximately \$13.

On March 30, 2007 the Company exercised its right to purchase from the President and director of Formula 325,000 Ordinary shares of Formula for a purchase price of \$16 per share.

On March 30, 2007 Emblaze completed a special tender offer for the purchase of additional 695,780 Ordinary shares of Formula at a price per share of \$13.3.

As a result of the above, the Company's holding in Formula as of March 30, 2007 increased to 50.1%.

The total purchase price of Formula was composed as follows:

Cash paid in 2007	14,454
Acquisition related costs	896
Balance of investment in Formula as of March 30, 2007	86,575
Total acquisition price	101,925

Acquisition related transaction costs include investment banking fees, legal and accounting fees and other external costs directly related to the acquisition.

The acquisition of Formula was accounted for under the purchase method of accounting. The accounts of Formula were consolidated with those of the Company, commencing March 30, 2007, which was the day the Company effectively gained control over Formula.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

**Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES
(Continued)**

The estimated fair values of the identifiable assets acquired and liabilities assumed as of March 30, 2007 are as follows:

Current assets	263,119
Long-term investments	56,939
Property and equipment	<u>15,325</u>
	<u>335,383</u>
Capitalized software development costs	25,439
Customer Relationships	5,895
Developed Technology	4,021
Brand name	2,666
Deferred tax	7,185
Goodwill	117,387
Deferred expenses and other intangible assets	<u>4,955</u>
	<u>167,548</u>
Total assets acquired	<u>502,931</u>
Liabilities assumed:	
Credit and long term loans from banks and others	96,492
Trade payables, other payables and accrued expenses and severance pay	125,706
Debenture	15,386
Deferred tax	3,745
Minority interest	<u>159,677</u>
Total liabilities assumed	<u>401,006</u>
Total acquisition price	<u>101,925</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

**Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES
(Continued)**

In performing the purchase price allocation, the Company considered, among other factors, the intention for future use of acquired assets, analyses of historical financial performance and estimates of future performance of Formula's products. The fair value of intangible assets was based on a valuation completed by a third party valuation firm using an income approach and estimates and assumptions provided by management. The following table sets forth the expected useful life of the identified intangible assets of Formula:

Customer Relationships	Amortized over 7-9 years
Developed Technology	Amortized over 5-7 years
Brand name	Amortized over 13 years

The Company recorded a deferred tax liability on the purchase date for the difference between the assigned values and the tax bases of the net assets acquired in the acquisition.

The amounts allocated to intangible assets other than goodwill are amortized on a straight-line basis over their weighted average expected useful life.

Unaudited pro forma results:

The following represents the unaudited pro forma results of operations giving effect to the acquisition of Formula as if the acquisition had been consummated on January 1, 2006 and 2007:

	Year ended December 31, Unaudited Total consolidated	
	2006	2007
Revenues	492,440	520,891
Net loss	(7,409)	(3,061)
Basic and diluted loss per share	(0.06)	(0.03)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

**Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES
(Continued)**

2. Acquisition of Global Telecom Distribution PLC. ("GTD"):

On November 11, 2005, Emblaze Mobility Solutions, a UK subsidiary of Emblaze Mobile, effectively acquired 51% of the issued and outstanding ordinary shares of GTD, a UK distributor of multimedia handsets.

The total consideration paid by Emblaze Mobility Solutions for the acquisition of GTD was \$4,591.

This operation was discontinued during 2007 (see also Note 3(f)5).

3. Acquisition of business of Emblaze VCON Ltd. ("EVC"):

EVC was incorporated in August 2005 by the Company. Shortly after its incorporation, EVC purchased in consideration for \$1,631 a substantial portion of the business activities (including certain assets, liabilities and employees) of VCON Telecommunications Ltd. ("VCON"), formerly a public company listed on the Nouveau Marche in France

(i) Issuance of shares of EVC to the Company and other investors:

On December 15, 2005, the Company entered into an agreement with EVC and other investors for the issuance of Preferred Shares of EVC in total consideration of \$3,886 in cash, the Company transferred to EVC \$2,000.

Following the transactions, the Company's interest in EVC was 65%.

4. Investment in ZONE-IP (formerly known as Ki-Bi Technologies Ltd.):

In January 2005, Emblaze acquired preferred shares of ZONE-IP convertible into approximately 27% of the issued and outstanding share capital of ZONE-IP.

On May 5, 2005, ZONE-IP completed an IPO on the AIM. Immediately following the IPO, the Company's holdings in ZONE-IP (after giving effect to the conversion of all preferred shares) was reduced to 13.2%. The Company recorded a capital gain from this IPO in the consolidated statements of operations in the amount of approximately \$4,040.

Between November 2005 and February 2006, the Company purchased additional ZONE-IP shares in the open market and increased its holding in ZONE-IP to 29.95% of ZONE-IP's issued share capital.

Emblaze accounted for the investment retroactively in a manner consistent with the accounting for a step-by-step acquisition of a subsidiary under the equity method, in accordance with APB No. 18, "The Equity Method of Accounting for Investments in Common Stock".

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES (Continued)

On May 31, 2006, ZONE-IP entered into a conditional agreement to acquire the entire issued share capital of EVC for a consideration of 60% of the enlarged issued share capital of ZONE-IP (30,592,652 Ordinary shares) ("the Acquisition").

On July 12, 2006, the shareholders of ZONE-IP approved the Acquisition as required by the AIM rules. Immediately after, the Company purchased additional 4,165,631 Ordinary shares of ZONE-IP in consideration for \$1,500 in cash and issuance of 600,000 Ordinary shares of the Company. In addition, the Company exercised its call option under an option agreement executed between the Company and certain shareholders of ZONE-IP to purchase 2,958,574 Ordinary shares of ZONE-IP in consideration for 482,935 Ordinary shares of the Company. Following these transactions, the Company's interest in ZONE-IP reached 64.84%. The original operation of Ki-Bi Mobile Technologies Ltd. was discontinued at the time of the transaction.

Other-than-temporary impairment of the investment in ZONE-IP was recorded in the consolidated statements of operations, in the year ended 2005 and 2006 in the amount of \$2,400 and \$1,405, respectively.

The loss was recorded in the line item "Other income (expenses)" in the consolidated statements of operations.

5. Emblaze Defence Ltd. ("Emblaze Defence"):

In January 2004, the Company established a defence division which commenced its operations on July 1, 2004. In January 2005, the Company established a wholly owned subsidiary under the name Emblaze Defence and transferred the defence businesses to the newly established company in consideration for all its shares.

On April 22, 2005, the Company entered into an agreement with Girit Holding Inc. Pursuant to the agreement, the parties agreed to combine their businesses into a new company incorporated in Canada under the name of Visual Defence Inc. The Company transferred to Visual Defence Inc. all its shares in Emblaze Defence and a perpetual license in respect of the intellectual property owned by the Company and required by Visual Defence Inc. to carry on the Emblaze Defence business.

On May 6, 2005, Visual Defence Inc. completed an IPO on the AIM. Visual Defence Inc. issued 33,492,823 Ordinary shares, raising approximately £18.4 million (before expenses). Following the admission, the Company's interest in Visual Defence Inc. was 10.85% and the Company recorded a capital gain of approximately \$9,300, which is included in the consolidated statement of operations in the line item "Other income (expenses)". The investment in Visual Defence Inc. is included in the balance sheet as long-term marketable securities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES (Continued)

The Company recorded in the consolidated statement of operations, in the line item "Other income (expenses)", an other-than-temporary impairment on the investment in Visual Defence Inc., based on the investment's quoted market price, in the amount of approximately \$4,980, \$1,240 and \$915 for the years ended December 31, 2005, 2006 and 2007 respectively.

As at December 31, 2007, the Company held 12.6% of the outstanding share capital of Visual Defence Inc.

6. Adamind Ltd. ("Adamind"):

On February 21, 2005, Adamind, a subsidiary of the Company, completed an IPO on the AIM. Adamind issued 11,363,636 Ordinary shares, raising approximately \$28,000 (before expenses). Accordingly, the Company's holding in Adamind was reduced from 70% to 47.5%.

Following the IPO, the Company increased its holding in Adamind to 50.01% in consideration for \$2,607. The excess of the purchase price over the fair value of the net assets acquired in the amount of \$1,827 was recorded as goodwill.
(See also Note 3(f)2 below)

b. Sale of BluePhoenix Solution LTD. ("BluePhoenix")

In June 2007, Formula sold its entire holding in BluePhoenix to a number of international institutional investors at a price per share of \$8, representing total consideration of \$64,000 in cash. The Company recorded a capital gain of \$6,500, representing its portion in the gain, which is included in the line item "Other income (expenses)".

c. Private placement in Sapiens

In June 2007, Sapiens entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20,000 (excluding finders' fees and out of pocket expenses), \$6,500 of which was invested by Formula. Sapiens issued to the investors an aggregate of 6,666,667 Ordinary shares (of which 2,166,666 Ordinary shares were issued to Formula), at a price per share of \$3, reflecting a premium of approximately 25% above the trading price of Sapiens' Ordinary shares (as of the date that the board of directors of Sapiens approved the investment). Emblaze recorded a gain in the amount of \$2,562 that is included in the line item "Other income (expenses)" as a result of decrease in percentage of holdings in Sapiens.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

**Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES
(Continued)**

d. Issuance of non-convertible debentures by Matrix

In August 2007, Matrix completed an offering of debentures in an aggregate principal amount of approximately \$62,000 (see also Note 12). The debentures were sold to institutional and other investors in Israel.

e. Issuance of Ordinary shares by EMOZE

In November 2007, EMOZE issued to third party an aggregate of 1,436,378 Ordinary shares at a price per share of \$1.39. As EMOZE was considered a development stage company at the date of issuance, the unrealized gain in the amount of \$1,897 was recorded as additional paid in capital.

f. Discontinued operations:

The financial statements for the reported periods include discontinued operations in respect of the following businesses: (1) Innostream. (2) Adamind (3) Ki-Bi Mobile Technologies Ltd (4) Orca Interactive Ltd ("Orca") (5) GTD (6) Advanced Answers on Demand Holding Corporation ("AAOD").

The Company's consolidated balance sheets as of December 31, 2006 and 2007 reflect the assets and liabilities of all the businesses above as assets and liabilities held for sale and assets and liabilities of discontinued operations. The results of operations and cash flows of the above businesses are presented as discontinued operations as provided under SFAS No. 144 for all periods presented.

1. Innosteam

At the end of 2005, Innostream effectively ceased its business activities.

On December 31, 2005, the Company sold 20% of Innostream's shares for no consideration and decreased its holdings from 60% to 40%. The Company accounted for the investment under the equity method in accordance with APB No. 18 "The Equity Method of Accounting for Investments in Common Stock" ("APB No. 18"). As of December 31, 2005, all balances related to the investment in Innostream were written off and included in the loss from discontinued operations.

Summarized selected financial information of the discontinued operations of Innostream is as follows:

	Year ended December 31, 2005
Revenues	54,374
Loss on disposal, net	(8,293)
Net loss	(31,646)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES (Continued)

2. Adamind

On March 31, 2006, the Company sold its entire holding of 17,735,000 Ordinary shares in Adamind through a placing to institutional investors at a price per share of £1.1. The Company recorded a net gain on the sale of \$16.8 million.

Summarized selected financial information of the discontinued operations of Adamind is as follows:

	Year ended December 31,	
	2005	2006
Revenues	6,154	6,152
Capital gains from disposal	-	16,855
Net income	9,818	15,893

3. Ki-Bi Mobile Technologies Ltd.

In April 2006, the board of directors of ZONE-IP decided to scale down the Ki-Bi card operations. Discontinued expenses of \$531 were recorded in the third and fourth quarters of 2006. Summarized selected financial information of the discontinued operations of Ki-Bi is not provided due to immateriality.

4. Orca

In May 2007, the Company's Board resolved to dispose of its holding in Orca and initiated active steps towards fulfillment of this resolution.

In May 2008, the Company sold its entire holdings in Orca (see also Note 19(b)).

Accordingly, the Orca business has been treated as discontinued operations in the financial statements for all periods presented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES (Continued)

The carrying amounts of the major classes of assets and liabilities of Orca included as assets and liabilities held for sale are as follows:

	2006	2007
Current assets held for sale:		
Cash and cash equivalents, short-term deposit, and short-term marketable securities	11,044	11,696
Trade receivables	698	835
Other receivables and prepaid expenses	333	537
Total current assets held for sale	12,075	13,068
Long-term assets held for sale:		
Long-term investments and other long-term receivables	9,076	2,461
Property and equipment, net	394	244
Goodwill and other intangible assets	1,492	1,492
Total long-term assets held for sale	10,962	4,197
Total assets held for sale	23,037	17,265
Current liabilities of assets held for sale:		
Trade payables	425	499
Other payables and deferred income	4,962	3,927
Total current liabilities of assets held for sale	5,387	4,426
Long-term liabilities of assets held for sale:		
Accrued severance pay	887	116
Minority interest	6,165	4,680
Total long-term liabilities of assets held for sale	7,052	4,796
Total liabilities of assets held for sale	12,439	9,222

Summarized selected financial information of the discontinued operations of Orca is as follows:

	Year ended December 31,		
	2005	2006	2007
Revenues	5,325	3,339	6,388
Net loss	(1,749)	(2,877)	(2,621)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES (Continued)

5. GTD

At the beginning of 2007, the Company decided to discontinue its mobile trading and distribution business operated by GTD. The main reason for this decision was the genesis of working capital deficiency that resulted from a withholding of approximately £8.8 million (\$16,160) of VAT reclaims during 2006 by Her Majesty Revenue and Customs (the British Revenue & Customs) ("the HMRC"). The withholding of VAT reclaims by the HMRC was not specifically targeted at GTD but rather represent a part of general measures applied by the HMRC in its battle against VAT fraud exposed within the mobile telephone handset sector in which GTD operated. The Company has concluded that a resolution of this issue was unlikely to be achieved in the near future. As a result of the action taken by the HMRC, GTD ceased its business activities and an administrative receiver was appointed to GTD in May 2007.

The carrying amounts of the major classes of assets and liabilities of the trading and distribution business included as assets and liabilities of discontinued operations are as follows:

	2006
Current assets of discontinued operations:	
Cash and cash equivalents and restricted deposit	52
Trade receivables and Other receivables and prepaid expenses and Inventories	<u>15,262</u>
Total current assets of discontinued operations	<u>15,314</u>
Long-term assets of discontinued operations:	
Property and equipment, net	981
Goodwill and other intangible assets	<u>3,526</u>
Total long-term assets of discontinued operations	<u>4,507</u>
Total assets of discontinued operations	<u>19,821</u>
Current liabilities of discontinued operations:	
Short-term bank loans	4,512
Trade payables, Other payables, deferred income and minority interests	<u>15,986</u>
Total liabilities of discontinued operations	<u>20,498</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 3. BUSINESS COMBINATION, SIGNIFICANT TRANSACTIONS AND SALE OF BUSINESSES (Continued)

Summarized selected financial information of the discontinued operations of the trading and distribution business is as follows:

	Year ended December 31,		
	2005	2006	2007
Revenues	106,737	343,839	-
Net loss	565	(11,754)	(70)

6. AAOD

On December 30, 2007, Magic sold its wholly-owned subsidiary, AAOD, a Florida corporation that develops and markets application software targeted at the long-term care industry, to Fortissimo Capital ("Fortissimo") for \$17,000. Fortissimo paid to Magic \$1,000 of the sale price in December 2007 and the remaining \$16,000 in the beginning of 2008. As part of the transaction, Magic entered into a three year license agreement with AAOD according to which AAOD will continue to sell Magic's products, as an OEM partner, in consideration for \$3,000, to be paid quarterly over three years starting in 2008.

Summarized selected financial information of the discontinued operations of AAOD is as follows:

	Nine months ended December 31, 2007
Revenues	9,154
Capital gains from disposal	8,966
Net income	2,459

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 4. SHORT-TERM INVESTMENTS

	Interest rate	December 31,	
	December 31,	2006	2007
	2007		
	%		
Trading securities		807	32,050
Available-for-sale marketable securities		20,824	15,215
Restricted marketable securities		25,752	7,511
Short-term deposits	0-1.2	237	155
Restricted deposits	4.3-6	5,110	1,969
Total		52,730	56,900

a. Marketable securities

- The following is a summary of marketable securities which are classified as available-for-sale marketable securities and restricted marketable securities:

	December 31,					
	2006			2007		
	Amortized cost	Unrealized gain (loss)	Market value	Amortized costs	Unrealized gain (loss)	Market value
Government debentures	20,473	(210)	20,263	1,216	58	1,274
Corporate debentures	14,268	(155)	14,113	13,067	58	13,125
Equity fund	-	-	-	249	(47)	202
Other marketable securities	11,483	717	12,200	7,532	565	8,125
Total	46,224	352	46,576	22,064	634	22,726

- An other-than-temporary impairment on available for sale marketable securities was recorded in the consolidated statements of operations in the years ended 2005, 2006 and 2007 in the amounts of \$0, \$0 and \$1,788, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 4. SHORT-TERM INVESTMENTS (Continued)

3. The estimated fair value of available-for-sale debt securities as of December 31, 2007, by contractual maturity, is as follows:

	December 31,			
	2006		2007	
	Cost	Market value	Cost	Market value
Available-for-sale:				
Matures in one year	34,741	34,376	10,948	10,931
Matures in two to five years	-	-	2,731	2,826
Matures in more than five years	-	-	604	642
Total	34,741	34,376	14,283	14,399

4. The restricted marketable securities are to secure credit bank loan.

b. Restricted deposits

The Company pledges bank deposits mainly to cover bank guaranties in respect of an office rental agreement.

Note 5. OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31,	
	2006	2007
Government authorities	1,277	7,217
Prepaid expenses	508	8,415
Employees	202	606
Deferred tax	-	2,709
Receivable due upon sale of a subsidiary (see also Note 3(f)6)	-	16,000
Other	1,505	2,273
Total	3,492	37,220

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 6. LONG-TERM RECEIVABLE AND INVESTMENTS

	December 31,	
	2006	2007
Available for-sale marketable securities	24,188	6,402
Restricted marketable securities	25,357	-
Deposits	-	10,975
Restricted deposits	-	1,440
Investment in Formula	83,940	-
Investment in other affiliates	-	3,792
Other investments and long-term receivables	170	2,872
Total	133,655	25,481

a. Available for sale marketable securities

- The following is a summary of marketable securities which are classified as available-for-sale marketable securities and restricted marketable securities:

	2006		December 31,		2007	
	Amortized cost	Unrealized losses	Market value	Amortized costs	Unrealized gains (losses)	Market value
Government debentures	20,022	(186)	19,836	601	5	606
Corporate debentures	11,737	(180)	11,557	1,407	(144)	1,263
Equity securities	3,057	-	3,057	2,142	-	2,142
Other marketable securities	15,350	(255)	15,095	2,370	21	2,391
Total	50,166	(621)	49,545	6,520	(118)	6,402

- An other-than-temporary impairment on available for sale marketable securities was recorded in the consolidated statements of operations in the year ended 2005, 2006 and 2007 in the amount of \$4,980, \$1,244 and \$1,915, respectively.
- The contractual maturities of the available for-sale debt securities are two to five years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 6. LONG-TERM RECEIVABLE AND INVESTMENTS (Continued)

b. Deposits and restricted deposits

	Interest rate	Linkage	December 31,	
	%	basis	2006	2007
Restricted deposit	4.3%-6%	Dollar	-	400
Restricted deposit	-	NIS	-	1,040
Deposit	0-6%	Dollar	-	10,473
Deposit	-	NIS +CPI	-	502
Total			-	12,415

c. Other investments and long-term receivables

During 2007 impairment losses on investments at cost in the amount of \$ 512 have been recorded.

Note 7. PROPERTY AND EQUIPMENT, NET

	December 31,	
	2006	2007
Cost:		
Computers and peripheral equipment	6,824	54,176
Building	-	10,597
Motor vehicles	-	1,015
Office furniture and equipment	3,018	81
Leasehold improvements	2,886	8,371
	12,728	74,240
Accumulated depreciation:		
Computers and peripheral equipment	6,387	46,520
Building	-	4,822
Motor vehicles	-	705
Office furniture and equipment	2,724	35
Leasehold improvements	2,600	5,861
	11,711	57,943
Depreciated cost	1,017	16,297

Depreciation expenses amounted to \$629, \$394 and \$3,555 for the years ended December 31, 2005, 2006 and 2007, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 8. GOODWILL

	Growth	Innovation	Total
Balance as of January 1, 2007	-	336	336
Changes in 2007, net	130,398	-	130,398
Balance as of December 31, 2007	130,398	336	130,734

Note 9. OTHER ASSETS, NET

	December 31,	
	2006	2007
Cost:		
Capitalized software development costs	-	101,605
Acquired technology	1,225	5,043
Customer agreements	-	3,891
Deferred expenses and others	-	19,898
Deferred tax assets	-	11,437
	1,225	141,874
Accumulated amortization:		
Capitalized software development costs	-	74,461
Acquired technology	331	1,069
Customer agreements	-	386
Deferred expenses and others	-	12,515
	331	88,431
Amortized cost	894	53,443

- a. Amortization expense of intangible assets and other deferred expenses amounted to \$86, \$245 and \$3,571 for the years ended December 31, 2005, 2006 and 2007, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 9. OTHER ASSETS, NET (Continued)

- b. Estimated amortization expense of intangible assets and other deferred expenses for the years ended December 31:

2008	2,986
2009	2,577
2010	1,997
2011	1,639
2012	1,574

Note 10. SHORT-TERM LIABILITIES TO BANKS AND OTHERS

	Interest rate December 31, 2007 %	Linkage basis	December 31,	
			2006	2007
Bank overdraft	5.6-7	NIS	-	3,505
Short-term bank loans	5.4-5.7	NIS	-	4,731
Short-term bank loans	5.7-7.75	Dollar	45,423	13,150
Short-term bank loans	5.5-6	Euro	-	1,479
Short-term bank loans	5.25	Other	-	705
Current maturities of long-term loans from banks			-	10,714
Total			45,423	34,284

Note 11. OTHER PAYABLES AND ACCRUED EXPENSES

	December 31,	
	2006	2007
Employees and payroll accruals	2,947	32,122
Accrued expenses	1,498	14,864
Short-term restructuring accrual	2,600	-
Government departments	87	8,810
Deferred income and customer advances	628	21,118
Others	10,366	813
Total	18,126	77,727

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 12. CONVERTIBLE AND NON-CONVERTIBLE DEBT

	December 31,	
	2006	2007
Non-convertible debt	-	65,452
Convertible debt , net	-	11,897
	-	77,349
Less - convertible debt purchased by one of the Company's subsidiaries	-	(1,945)
Less - current maturities of convertible debt	-	(3,524)
	-	71,880

a. Non- convertible debentures

The non convertible debentures were issued by Matrix in August 2007 for an aggregate amount of NIS 250,000 (approximately \$62,000).

The debentures bear an interest at an annual rate of 5.15%. The principal will be paid in four equal annual installments on December 31 of each of the years 2010 through 2013. The principal and interest are linked to the Israeli consumer price index. On February 21, 2008, Matrix listed the debentures for trading on the TASE.

b. Convertible debentures

During December 2003, Sapiens issued the Convertible Debentures which are traded only on the TASE. However, any Common share issued upon conversion of the Debentures (Series A) will be traded on both TASE and NASDAQ.

The Debentures bear annual interest at the rate of 6.0%, payable on the 5th of June and the 5th of December each year ending on December 5, 2009. Principal is payable in four installments on the 5th of December of the years 2006-2009. The Debentures are convertible into Common shares at a conversion rate of one Common share per each NIS 27 (approximately \$6.14) amount of the Debentures.

On December 5, 2007, an amount of approximately \$4,400 was paid to the debenture holders, representing the second payment of the Debentures (Series A).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 13. LIABILITIES TO BANKS AND OTHERS

		December 31,			2006	
		2007				
Interest rate %	Linkage basis	Long-term liabilities	Current maturities	Total long-term liabilities net of current maturities	Total long-term liabilities net of current maturities	
6.1-6.6	Dollar	56	-	56	-	
4.3-5	CPI	552	552	-	-	
5.5	NIS	31,866	9,118	22,748		
2.2-5.7	NIS	564	-	564	-	
	Others	1,361	1,044	317		
Total		34,399	10,714	23,685	-	

Maturity dates:

First year (current maturities)	10,714
Second year	7,653
Third year	6,642
Fourth year	6,250
Fifth year	3,140
Total	34,399

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 14. COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

Some of the Company's subsidiaries have commitments to the Israeli Chief Scientist and Trade and to the Marketing Promotion Fund, to pay royalties at a rate of 3%-3.5% of the proceeds from the sale of software products which were developed with the assistance of the Chief Scientist and marketed with the assistance of the Marketing Promotion Fund. The amount of royalties is limited to 100%-150% of the amount received. The subsidiaries are only obliged to repay the grants received from the Chief Scientist if revenue is generated from the sale of the said software products.

The balance of the contingent liability in respect of the aforesaid amounted to approximately \$14,200 as at December 31, 2007.

b. Liens:

Some of the subsidiaries have liens on leased vehicles, leased equipment and other assets in favor of the leasing companies.

Some of the subsidiaries have provided floating charges on their assets in favor of banks and other financial institutions

c. Guarantees:

1. The Company pledges bank deposits and marketable securities to cover bank guaranties in respect of an office rental agreement and in respect of credit lines and bank loan. See Notes 4 and Note 6.

2. Subsidiaries have provided bank guarantees in the amount of approximately \$12,100 as security for the performance of various contracts with customers. If the subsidiaries were to breach certain terms of such contracts, the customers could demand that the banks providing the guarantees pay amounts claimed to be due.

3. Subsidiaries have provided bank guarantees in the amount of \$1,305 as security for rent to be paid for their offices. If the subsidiaries were to breach certain terms of their lease, the lessor could demand that the banks providing the guarantees pay amount claimed to be due.

d. Others:

In connection with credit facilities of subsidiaries, these subsidiaries have entered into agreements with various banks, accordingly the subsidiaries committed, among other things:

1. To maintain certain financial ratios.
2. Not to grant a security interest in all or substantially all of their respective assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 14. COMMITMENTS AND CONTINGENT LIABILITIES (Continued)

e. Legal Proceedings:

1. On March 7, 2001, Malam Systems Ltd. filed a claim against Geo Interactive Media Group Ltd. (now Emblaze Ltd.) and against its founding directors demanding approximately 29% of the Company's issued share capital (which is 50.1% of the shares held by the founding directors prior to any dilution). The Company's legal advisors have determined that this claim and its results should not have any adverse effect on the Company or its operations. The Company's legal advisors as well as its founding directors are of the opinion that there are no merits to the claim and the possibility that it shall prevail is extremely unlikely.
2. GTD is involved in a dispute with the HMRC regarding a decision made by the HMRC to withhold VAT reclaims and raise an assessment relating to GTD's VAT return in the sum of approximately £8,800, (approximately \$16,160 as of December 31, 2007). These actions taken by the HMRC are not specifically targeted at GTD but rather represent a part of general measures applied by the HMRC in its battle against VAT fraud exposed within the mobile telephone handset sector in which GTD had operated. As a result of the action taken by the HMRC, GTD ceased its business activities and an administrative receiver was appointed to GTD in May 2007. (See also Note 3(f)5 and note 19(a))
3. Some of the Company's subsidiaries are involved in various legal disputes within the ordinary course of business. The Company's management is of the opinion that it had provided a sufficient reserve should any of these disputes materialize to actual claims.

f. Lease Commitments:

The Company and its subsidiaries rent their offices under operating lease agreements, which expire on various dates. Aggregate minimum rental commitments under non-cancelable leases as of December 31, 2007, are as follows:

2008	7,841
2009	6,896
2010	3,399
2011 and thereafter	1,107
Total	19,243

Total rent expense for the years ended December 31, 2005, 2006 and 2007 amounted to \$1,979, \$1,095 and \$5,474, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 15. SHAREHOLDERS' EQUITY

a. Ordinary shares:

Ordinary shares confer upon their holders voting rights, the right to receive cash dividends, and the right to a share in excess assets upon liquidation of the Company.

b. Treasury stock:

1. In 2006, the district court in Israel approved a share buyback program for the Company's Ordinary shares in an amount of up to £40 million pursuant to which the Company may repurchase Ordinary shares of the Company.
2. On June 29, 2006, the extraordinary shareholders meeting of the Company approved to provide to the Company's CEO at the time, Mr. Eli Reifman ("the Former CEO"), a bridge loan in an amount of \$70,000 ("the Loan"). Upon the maturity of the Loan, the Company repurchased from the Former CEO 25,597,439 of Emblaze shares in order to allow for a full repayment of the Loan and its accrued interest, in the total amount of \$70,953. The shares were repurchased at a price per share of 149 pence.
3. During 2006 and as part of the business combination transaction between EVC and ZONE-IP, the Company re-issued 1,082,935 shares. (See also Note 3(a) 4)
4. During 2005, 2006 and 2007 the Company re-issued 792,572, 115,500 and 3,000, held in treasury stock, as part of employees' exercise of options under the Company's employee option plan. (See also Note 15(c))

As of December 31, 2006 and 2007 the outstanding treasury stock amounted to 29,104,467 and 29,101,467 shares, respectively.

c. Employee's stock option plans:

In 1998, the Company implemented the 1999 employee stock option plan ("the 1999 Plan"). Under the 1999 Plan, 12,000,000 options to purchase

Ordinary shares have been reserved for issuance. These options may be granted to officers, directors and employees and vest evenly each year over a period of four years after the date of grant and, if not exercised, the options will expire on the tenth anniversary of the date of grant. Generally the exercise price of these options may not be less than the fair market price of the share at the date of grant. Any options which are canceled or forfeited before expiration become available for future grants.

In 2001, the Company implemented the 2001 Global Stock Option Plan ("the 2001 Plan"). Under the 2001 Plan, 10,000,000 options to purchase Ordinary shares have been reserved for issuance. These options may be granted to the Company's employees, directors and consultants and vest evenly mainly every year or half a year in equal portions mainly over a period of two-four years commencing on the date of grant and, if not exercised, the options will expire on the tenth anniversary of the date of grant. Generally, the exercise price of these options may not be less than the fair market price of the shares at the date of grant.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 15. SHAREHOLDERS' EQUITY (Continued)

Any options which are cancelled or forfeited before expiration become available for future grants.

On June 9, 2003, the Company's shareholders meeting resolved to consolidate the 1999 Plan with the 2001 Plan, so that shares reserved for allotment under the 1999 Plan will be treated as being served for allotment under the 2001 Plan, but without prejudice to the actual terms and conditions of each grant previously made under the 1999 Plan.

On August 31, 2006, the Company's shareholders' resolved to increase the reserve of stock for issuance under the Company's 2001 Plan by an additional 13,000,000 shares.

Total number of options available for future grants as of December 31, 2007, amounted to 11,612,788.

On September 11, 2007, the Company's shareholders resolved to amend the Company's 2001 Plan such that the Board of Directors may grant employees of the Company options with an exercise price per share that is less than the fair market value of the shares on the date of approval of the grant, provided however that any such grant by the Board will be subject to the approval of the General Meeting of shareholders.

The following is a summary of the Company's stock options granted among the various plans:

	Year ended December 31,					
	2005		2006		2007	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at the beginning of the year	9,343,889	3.93	7,108,394	2.89	17,553,735	4.19
Granted	373,760	2.98	13,000,000	4.89	2,328,045	1.24
Exercised	(792,572)	2.11	(115,500)	2.13	(3,000)	2.16
Canceled or forfeited	(1,816,683)	6.43	(2,439,159)	5.46	(3,645,566)	4.85
Outstanding at the end of the year	7,108,394	2.89	17,553,735	4.19	16,233,214	3.71
Exercisable at the end of the year	5,924,809	3.00	5,615,396	1.47	5,606,207	2.88
Vested and expected to vest*	-	-	6,129,612	2.20	7,457,692	3.41

* Does not include options granted to an executive of the Company. (See also Note 15(f))

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 15. SHAREHOLDERS' EQUITY (Continued)

The following table summarizes information about options outstanding and exercisable as of December 31, 2007:

Range of exercise price	Options outstanding as of December 31, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2007	Weighted average exercise price of options exercisable
0.00 - 1.80	2,386,545	9.23	1.23	161,625	1.35
2.12 - 2.36	454,045	4.03	2.24	394,933	2.23
2.40 - 2.65	4,491,000	5.25	2.63	4,491,000	2.63
2.77 - 6.41	8,761,625	8.48	4.90	418,650	3.94
7.32 - 29.62	139,999	2.29	11.22	139,999	11.22
	<u>16,233,214</u>		<u>3.71</u>	<u>5,606,207</u>	<u>2.88</u>

For options outstanding at December 31, 2007, the aggregate intrinsic value was \$521 and for options exercisable at December 31, 2007, the aggregate intrinsic value was \$13.5. The aggregate intrinsic value represents the total pre-tax intrinsic value based on the Company's closing stock price of \$1.2 on December 31, 2007, less the weighted average exercise price. This represents the potential amount receivable by the option holders had all option holders exercised their options as of such date.

As of December 31, 2007, there was an unrecognized compensation cost of \$1,325 related to stock options that is expected to be recognized in future periods until December 31, 2011.

d. **Certain subsidiaries of the Company granted options to their employees to purchase shares in the respective companies.**

The options were mainly granted in the years 1999-2007. In general, the options are exercisable 1-4 years after the date of grant and expire 6-10 years after grant. Most of the options were granted as part of plans that were adopted in accordance with the provisions of Section 102 of the Israeli Income Tax Ordinance.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 15. SHAREHOLDERS' EQUITY (Continued)

The following table is a summary of the status of option plans the Company's subsidiaries as of December 31, 2007:

Subsidiary	Outstanding options	Weighted average exercise price	Exercisable options	Weighted Average exercise price of exercisable options
Matrix	2,967,981	\$3.08	1,217,981	\$1.72
Magic	3,673,528	\$2.22	2,407,532	\$2.22
Sapiens	2,825,900	\$4.01	2,130,900	\$4.58
Emblaze Mobile	1,360,375	\$1.62	51,250	\$3.00
EMOZE	5,224,000	\$0.11	2,001,250	\$0.105
ZONE-IP	1,573,006	\$0.49	382,002	\$0.49

e. Acceleration of options held by the Company's Former CEO:

On July 5, 2005, the Remuneration Committee of the Company resolved to immediately vest 1,500,000 options, which all comprised of the unvested options held by the Former CEO. This resolution was adopted by the Company's Board of Directors and following thereafter approved by the shareholders of the Company.

f. Grant of options to the Company's President and Former CEO:

1. On August 31, 2006, the shareholder of the Company approved to grant 13,000,000 share options to the Company's President and Former CEO: Mr. Eli Reifman. The exercise price of the stock options was determined at the range of £2 to £3 while the fair market value of the shares at the date of grant was £1.4. The share options vest quarterly over a period of four years until August 2010. The Board of Directors of the Company decided to implement performance criteria over the vesting of the options for each of the fiscal years until 2010. The respective number of options shall immediately be forfeited in the event that the performance criteria are not met.

The total compensation expense of the options at the date of grant was \$6,362. As of December 31, 2007, the performance criteria determined by the Board were not met and therefore 4,875,000 share options were forfeited. The Company did not record any compensation expenses in the years 2006 and 2007 related to these share options.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 15. SHAREHOLDERS' EQUITY (Continued)

2. On September 11, 2007, the Annual General Meeting of the Company approved to grant to the Company's President and Former CEO, in his capacity as CEO of Emblaze Mobile, a grant of option to purchase 10% of Emblaze Mobile Ordinary shares at an exercise price of \$1.55. These options vest equally over a period of four years commencing June 30, 2007 with immediate full vesting in a case that certain defined events will occur. The Board decided to implement performance criteria over the ability to exercise the options. In the event that Emblaze Mobile fails to achieve the performance criteria until December 31, 2009, the respective number of options shall immediately be forfeited, whether vested or unvested. As of December 31, 2007, the Company estimated that the performance criteria determined for eligibility of exercise of the options will not be met and therefore Emblaze Mobile did not record any compensation expenses in the year 2007.

g. Grant of options in EMOZE to the Company's Chairman:

On September 11, 2007, the Annual General Meeting of the Company approved to grant to the Company's Chairman an option to purchase 4% of EMOZE Ordinary shares, equivalent at the time to 1,080,000 shares, at an exercise price of \$0.125 per share. The grant is protected from any dilution except in a case of (a) an initial public offering of EMOZE securities or (b) merger of EMOZE with or into another corporation, or (c) an acquisition of all or part of the shares of EMOZE. The options are vested and exercisable upon the approval of the grant by the shareholders. The fair value of the options at the date of grant was \$0.09 per option. In 2007, the Company recorded compensation expense in the amount of \$95.

Note 16. INCOME TAXES

a. Israeli income taxes:

1. Measurement of taxable income:

Commencing with the taxable year 2002, the Company has elected to measure its taxable income and file its tax return under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986. Accordingly, commencing in taxable year 2002, results for tax purposes are measured in terms of earnings in dollar. The taxable income of certain subsidiaries is measured under the Income Tax (Inflationary Adjustments) Law, 1985. Accordingly, results for tax are measured and reflected in real terms in accordance with the change in the CPI. In February 2008, the Israeli parliament (the "Knesset") passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Starting 2008, the results for tax purposes will be measured in nominal values, excluding certain adjustments for changes in the Consumer Price Index carried out in the period up to December 31, 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 16. INCOME TAXES (Continued)

2. Tax rates:

On July 25, 2005, the Knesset approved the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%.

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

Some operations of certain subsidiaries have been granted "Approved Enterprise" status under the Law. Since the subsidiaries have elected to receive "alternative benefits" under the Law (i.e. waiver of grants in exchange for a tax exemption for a limited period), the following tax rates will apply to its income from the Approved Enterprise (which will be determined based on the increase in the revenue of the subsidiaries during the year, in relation to the revenue in the year preceding the first year of their having the above-mentioned status):

Tax exemption for 2 years, commencing in the first year it generates taxable income. For the remainder of the benefit period - 5 years - a reduced tax rate of 25%.

For some subsidiaries, the percentage of its share capital held by foreign shareholders has exceeded 25%. Therefore its Approved Enterprises qualify for reduced tax rates for an additional three years after the seven years mentioned above.

The period of tax benefits described above will terminate after 7-10 years elapse from the first year in which the subsidiaries have taxable income and 14 years elapse since the Approved Enterprise was granted and 12 years after the commencement of the Approved Enterprise.

The entitlement to the above benefits is subject to final ratification by the Investment Center in the Ministry of Industry and Trade, such ratification being conditional upon fulfillment of all terms of the approved program.

In the event of a distribution of a cash dividend out of retained earnings, which are tax exempt due to the above benefits, the subsidiaries would have to pay tax with respect to the amount distributed. Deferred taxes for such taxes were not provided because such undistributed earnings are essentially permanent in duration and could be distributed to shareholders tax free in liquidation, subject to certain conditions.

The Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that is included in an approved investment program.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 16. INCOME TAXES (Continued)

In the event the subsidiaries fail to comply with the approved program terms, the tax benefits may be canceled and the subsidiaries may be required to refund the amount of the benefits they utilized, in whole or in part, with the addition of linkage differences and interest.

4. Tax benefits under the Law for the Encouragement of Industry (Taxation), 1969:

Some subsidiaries currently qualify as an "Industrial Company" as defined by this law, and as such are entitled to certain tax benefits including, inter alia, depreciation at increased rates as stipulated by regulations published under the Inflationary Adjustments Law and the right to deduct, for tax purposes, over a period of 3 years, expenses relating to public issue of shares. If realized, any tax benefit relating to issuance expenses is credited to capital surplus.

b. Subsidiaries outside Israel:

Subsidiaries that are not an Israeli resident are taxed in the countries in which they are resident, according to the tax laws in those countries.

c. Net operating loss carryforwards:

The Company and its Israeli subsidiaries have accumulated losses for tax purposes as of December 31, 2007, in the amount of approximately \$439,166, which may be carried forward and offset against taxable income in the future for an indefinite period.

The Company's foreign subsidiaries have accumulated losses for tax purposes as of December 31, 2007, in the amount of approximately \$66,136.

The likelihood of the utilization of most of these losses in the future is low. Therefore, the company recorded a valuation allowance against the deferred taxes attributed to the operating losses carried forward for the amount it does not expect to utilize in the foreseeable future.

d. Deferred Taxes:

	December 31,	
	2006	2007
Operating loss carryforward	72,838	136,778
Reserves and allowances	(1,435)	845
Net deferred tax asset before valuation allowance	71,403	137,623
Valuation allowance	(71,403)	(129,241)
Net deferred tax	-	8,382

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 16. INCOME TAXES (Continued)

The Company and its subsidiaries have provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforwards and other differences. Management currently believes that since the Company and its subsidiaries have a history of losses it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized in the foreseeable future.

Most of the valuation allowances for which the Company and its subsidiaries provided, are against the deferred tax assets in respect of tax losses carryforward. As a result most of the valuation allowance is for long term.

Presentation in balance sheets:

	December 31,	
	2006	2007
In current assets	-	2,709
In other assets	-	11,437
In long-term liabilities	-	(5,764)
Total	-	8,382

e. Taxes on Income Included in Statements of Operations:

	Year ended December 31,		
	2005	2006	2007
Current taxes:			
In Israel	-	-	2,664
Abroad	-	-	338
	-	-	3,002
Taxes in Israel in respect of prior years	-	-	(381)
Deferred taxes, net	-	-	(1,903)
Total	-	-	718

f. Income before taxes on income:

	Year ended December 31,		
	2005	2006	2007
Domestic	6,597	(12,122)	6,052
Foreign	(4,399)	(1,480)	2,534
Total	2,198	(13,602)	8,586

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 16. INCOME TAXES (Continued)

g. Reconciliation of the theoretical tax expense to the actual tax expense:

The main reconciling item between the statutory tax rate of the Company and its subsidiaries and the effective tax rate are carryforward tax losses and other temporary difference for which a full valuation allowance was provided, and in 2007 also with respect to differences between the USD and the NIS.

Note 17. SEGMENTS, CUSTOMERS AND GEOGRAPHIC INFORMATION

a. General:

The Company operates in two principal business segments: Growth and Innovation (see Note 1(a) for a brief description of the Company's business). The Company's reportable operating segments have been determined in accordance with the Company's internal management reporting structure, which is organized based on operating activities. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.

The Company and its subsidiaries present their reportable operating segments in accordance with the requirements of Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131").

The composition of the reportable operating segments was changed in 2007. The Company had restated the corresponding items of segment information for the years ended December 31, 2006 and 2005 in accordance with 2007 reportable segments.

The following is a list of the companies included in each operating segment, as of December 31, 2007:

Growth	Innovation
Formula	Emblaze Mobile
Matrix	EMOZE
Magic	ZONE-IP
Sapiens	
NextSource	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 17. SEGMENTS, CUSTOMERS AND GEOGRAPHIC INFORMATION (Continued)

b. The following is information about operational segment gains, losses and assets:

	Growth	Innovation	Unidentified
Revenues:			
2005	-	8,076	-
2006	-	7,629	-
2007	378,880	8,396	-
Operating income (loss):			
2005	-	(13,703)	-
2006	-	(15,832)	-
2007	17,228	(12,177)	-
Financial income (expenses), net:			
2005	-	138	9,317
2006	-	382	5,448
2007	(3,259)	(194)	(420)
Equity gain (losses)			
2005	-	(613)	-
2006	1,093	(766)	-
2007	528	-	-
Net income (loss)			
2005	-	(34,711)	13,637
2006	-	(14,043)	4,204
2007	12,372	(14,273)	(1,335)
Total assets			
2006	83,940	59,968	105,754
2007	629,963	36,736	28,547

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 17. SEGMENTS, CUSTOMERS AND GEOGRAPHIC INFORMATION (Continued)

c. Summary information about geographic areas:

The following table presents revenues according to end customers' location for the years ended December 31, 2005, 2006 and 2007:

	2005	2006	2007
Europe	5,044	4,116	36,630
The Far East	1,194	1,767	12,438
North America	1,141	1,716	93,836
Israel	697	30	243,034
Others	-	-	1,338
Total	8,076	7,629	387,276

The majority of the long-lived assets are located in Israel

Note 18. SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION

a. Financial income (expenses), net.

	Year ended December 31,		
	2005	2006	2007
Financial income:			
Interest, net	8,082	7,930	8,299
Income from related party debt	2,000	214	-
Net gain on marketable securities	-	-	401
Foreign currency translation differences, net	29	205	-
	10,111	8,349	8,700
Financial expenses:			
Interest and other bank charges	(180)	(599)	(11,459)
Foreign currency translation differences, net	-	-	(1,114)
Net loss on marketable securities	(476)	(1,920)	-
	(656)	(2,519)	(12,573)
Total	9,455	5,830	(3,873)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 18. SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (Continued)

b. Other income (expenses)

	Year ended December 31,		
	2005	2006	2007
Gain on realization of investments	13,340	-	9,031
Impairment of long term investments	(7,380)	(2,694)	(1,456)
Other	486	(906)	(167)
Total	6,446	(3,600)	7,408

c. Comprehensive income (loss)

	Year ended December 31,	
	2006	2007
Accumulated unrealized gains from available-for-sale marketable securities	(236)	516
Accumulated foreign currency translation adjustments	(92)	4,477
Total	(328)	4,993

Note 19. SUBSEQUENT EVENTS

- a. In January 2008, Emblaze Mobility Solutions, a wholly owned subsidiary of Emblaze Mobile Ltd entered into an agreement with the Administrator Receivers of GTD for the assignment of GTD’s claim against the HMRC in respect of the GTD’s right to recover input tax (together with any subsequent claim for any interest, repayment supplements, penalties and or costs) to Emblaze Mobility Solution Ltd (see also Notes 3(f)5 and 14(e)2)
- b. In March 2008, Viaccess S.A., a wholly owned subsidiary of France Telecom SA, entered into a merger agreement with Orca to acquire all of its shares. The acquisition consideration consists of an amount of \$13,000 plus Orca’s net cash as of the closing, representing consideration of approximately \$12,900 for the Company. On April 9, 2008, the Company increased its holding in Orca to 61.97%. The closing of the merger took place on May 19, 2008. As a result of the closing, the Company has disposed its entire holdings in Orca (see Note 3(f)4).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Note 19. SUBSEQUENT EVENTS (Continued)

- c. In April, 2008 Formula distributed a cash dividend to its shareholders in the amount of approximately \$10,000 (approximately \$0.76 per share). As a 50.1% shareholder in Formula, the Company received the sum of approximately \$5,000.
- d. In January and February 2008, Sapiens re-purchased an aggregate amount of NIS7,600 nominal value, representing approximately \$2,100 of the outstanding debentures that were retired and removed from circulation on the TASE.

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