

ATTUNITY LTD. AND ITS SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2001

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AND ITS SUBSIDIARIES**

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IN U.S. DOLLARS

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REPORT OF INDEPENDENT AUDITORS

To the Shareholders of

ATTUNITY LTD.

We have audited the consolidated balance sheets of Attunity Ltd. ("the Company") and its subsidiaries as of December 31, 2001 and 2000, 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, 2001. 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 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, 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, 2001 and 2000, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in United States.

Tel-Aviv, Israel
April 11, 2002

KOST FORER & GABBAY
A Member of Ernst & Young Global

ATTUNITY LTD. AND ITS SUBSIDIARIES**CONSOLIDATED BALANCE SHEETS**

U.S. dollars in thousands

	December 31,	
	2001	2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,045	\$ 5,888
Restricted cash	202	-
Marketable securities	21	934
Restricted marketable securities	-	205
Trade receivables, net of allowance for doubtful accounts (2001 - \$ 63 and 2000 - \$ 214)	2,800	6,119
Other accounts receivable and prepaid expenses (Note 3)	1,082	1,586
<u>Total current assets</u>	<u>7,150</u>	<u>14,732</u>
SEVERANCE PAY FUND	<u>1,207</u>	<u>1,156</u>
PROPERTY AND EQUIPMENT, NET (Note 4)	<u>1,670</u>	<u>2,323</u>
OTHER ASSETS, NET (Note 5)	<u>11,267</u>	<u>15,295</u>
<u>Total assets</u>	<u>\$ 21,294</u>	<u>\$ 33,506</u>

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

U.S. dollars in thousands (except share data)

	December 31,	
	2001	2000
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit (Note 6)	\$ 174	\$ 67
Current maturities of long-term debt (Note 8)	231	193
Trade payables	1,320	2,219
Deferred revenues	2,221	2,552
Employees and payroll accruals	1,200	1,519
Accrued expenses and other liabilities (Note 7)	1,156	1,199
Accrued expenses related to restructuring (Note 1c)	788	-
<u>Total current liabilities</u>	<u>7,090</u>	<u>7,749</u>
LONG-TERM LIABILITIES:		
Long-term debt (Note 8)	211	268
Accrued severance pay	1,668	1,512
<u>Total long-term liabilities</u>	<u>1,879</u>	<u>1,780</u>
COMMITMENTS AND CONTINGENT LIABILITIES (Note 10)		
SHAREHOLDERS' EQUITY (Note 11):		
Share capital - Authorized: 30,000,000 Ordinary shares of NIS 0.1 par value as of December 31, 2001 and 2000; Issued and outstanding: 14,580,160 and 10,664,030 shares as of December 31, 2001 and 2000, respectively	432	431
Additional paid-in capital	86,645	82,472
Accumulated other comprehensive loss	(876)	(712)
Treasury Shares	(31)	-
Accumulated deficit	(73,845)	(58,214)
<u>Total shareholders' equity</u>	<u>12,325</u>	<u>23,977</u>
<u>Total liabilities and shareholders' equity</u>	<u>\$ 21,294</u>	<u>\$ 33,506</u>

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

ATTUNITY LTD. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
U.S. dollars in thousands (except share and per share data)

	Year ended December 31,		
	2001	2000	1999
Revenues (Note 15):			
Software licenses	\$ 6,757	\$ 7,783	\$ 7,596
Maintenance and support	4,576	4,426	4,727
Services	5,536	6,462	8,184
	<u>16,869</u>	<u>18,671</u>	<u>20,507</u>
Cost of revenues:			
Software licenses	2,547	2,113	1,304
Maintenance and support	1,042	858	990
Services	4,862	5,374	5,028
	<u>8,451</u>	<u>8,345</u>	<u>7,322</u>
Gross profit	<u>8,418</u>	<u>10,326</u>	<u>13,185</u>
Operating expenses:			
Research and development, net (Note 16a)	3,982	3,559	2,476
Selling and marketing	12,120	11,992	8,544
General and administrative	3,829	5,463	2,533
Restructuring (Note 1c)	1,326	-	-
Impairment of an investment and other assets (Note 13)	2,658	6,090	-
In-process research and development write-off	-	12,997	-
	<u>(15,497)</u>	<u>(29,775)</u>	<u>(368)</u>
Financial income, net (Note 16b)	48	416	160
Taxes on income (tax benefit) (Note 12)	402	(200)	188
	<u>(15,851)</u>	<u>(29,159)</u>	<u>(396)</u>
Loss from continuing operations			
Discontinued operations (Note 14):			
Earnings from discontinued operations of a segment of a business, net of income tax provision of \$ 74	-	82	-
Gain (loss) on disposal of segment	220	(2,224)	-
	<u>220</u>	<u>(2,142)</u>	<u>-</u>
Gain (loss) from discontinued operations, net of income tax			
Net loss	<u>\$ (15,631)</u>	<u>\$ (31,301)</u>	<u>\$ (396)</u>
Basic and diluted net loss per share from continuing operations	<u>\$ (1.36)</u>	<u>\$ (2.96)</u>	<u>\$ (0.05)</u>
Basic and diluted net gain (loss) per share from discontinued operations	<u>\$ 0.02</u>	<u>\$ (0.22)</u>	<u>\$ -</u>
Basic and diluted net loss per share	<u>\$ (1.34)</u>	<u>\$ (3.18)</u>	<u>\$ (0.05)</u>
Weighted average number of shares used in computing basic and diluted net loss per share	<u>11,668,397</u>	<u>9,844,288</u>	<u>8,365,494</u>

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

ATTUNITY LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Treasury Shares	Accumulated other comprehensive loss	Accumulated deficit	Total comprehensive loss	Total shareholders' equity
Balance as of January 1, 1999	\$ 371	\$ 44,214	\$ -	\$ (333)	\$ (26,517)	\$ -	\$ 17,735
Comprehensive loss:							
Net loss	-	-	-	-	(396)	(396)	(396)
Other comprehensive loss:							
Foreign currency translation adjustments	-	-	-	(359)	-	(359)	(359)
Issuance of shares upon conversion of convertible notes	3	1,484	-	-	-	-	1,487
Exercise of options	1	134	-	-	-	-	135
Exercise of warrants	4	910	-	-	-	-	914
Total comprehensive loss						<u>\$ (755)</u>	
Balance as of December 31, 1999	379	46,742	-	(692)	(26,913)		19,516
Comprehensive loss:							
Net loss	-	-	-	-	(31,301)	\$ (31,301)	(31,301)
Other comprehensive loss:							
Foreign currency translation adjustments	-	-	-	(20)	-	(20)	(20)
Issuance of shares, net	21	12,911	-	-	-	-	12,932
Issuance of shares, upon acquisition of Medatech	1	1,299	-	-	-	-	1,300
Issuance of shares, upon investment in Visop	6	6,494	-	-	-	-	6,500
Issuance of shares and options upon acquisition of BFI	19	13,982	-	-	-	-	14,001
Exercise of options	5	1,044	-	-	-	-	1,049
Total comprehensive loss						<u>\$ (31,321)</u>	
Balance as of December 31, 2000	431	82,472	-	(712)	(58,214)		23,977
Comprehensive loss:							
Net loss	-	-	-	-	(15,631)	\$ (15,631)	(15,631)
Other comprehensive loss:							
Foreign currency translation adjustments	-	-	-	(164)	-	(164)	(164)
Issuance of shares and warrants, net	1	4,665	-	-	-	-	4,666
Purchase of treasury shares as result of Medatech and Visopt annulment agreement		-	(492)	-	-	-	(492)
Issuance of shares upon price protection related to the acquisition of BFI		(492)	492	-	-	-	-
Write-off of loan granted to a senior employee	-		(31)	-	-	-	(31)
Total comprehensive loss						<u>\$ (15,795)</u>	
Balance as of December 31, 2001	<u>\$ 432</u>	<u>\$ 86,645</u>	<u>\$ (31)</u>	<u>\$ (876)</u>	<u>\$ (73,845)</u>		<u>\$ 12,325</u>

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

ATTUNITY LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2001	2000	1999
Cash flows from operating activities:			
Net loss	\$ (15,631)	\$ (31,301)	\$ (39,100)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,782	1,000	1,000
Impairment of property and equipment	389	1,000	1,000
Amortization of capitalized research and development costs	2,378	2,000	2,000
Loss (gain) from discontinued operations	(220)	2,000	2,000
Impairment of an investment	-	6,000	6,000
Impairment of capitalized software costs and assembled workforce	2,658	2,000	2,000
Decrease (increase) in trading marketable securities, net	866	-	(1,000)
Decrease (increase) in trade receivables	3,115	1,000	(2,100)
Decrease (increase) in other accounts receivable and prepaid expenses	321	-	-
Increase (decrease) in trade payables	(864)	-	-
Increase (decrease) in deferred revenues	(331)	-	-
Increase (decrease) in accrued expenses, employees and payroll accrual and other liabilities	358	-	-
Increase in accrued severance pay, net	117	-	-
In- process research and development write-off	-	12,000	-
Write off of loan granted to employee	90	-	-
Other	(3)	-	-
Net cash used in operating activities	(4,975)	(4,500)	(1,000)
Cash flows from investing activities:			
Proceeds from restricted cash	-	-	2,000
Proceeds from restricted marketable securities	205	-	-
Investment in restricted cash	(205)	-	-
Capitalization of software development costs	(2,000)	(1,500)	(2,000)
Purchase of property and equipment	(400)	(1,400)	(1,000)
Proceeds from sale of property and equipment	63	-	-
Loan granted to an employee	-	-	-
Payment of promissory note for acquisition of Infocom and Infopar	-	-	(1,000)
Payment for acquisition BFI, net of cash acquired (1)	-	(4,300)	-
Net cash used in investing activities	(2,337)	(7,800)	(1,000)
Cash flows from financing activities:			
Proceeds from exercise of options and warrants	-	1,000	1,000
Proceeds from issuance of shares and warrants, net	4,666	12,000	12,000
Short-term bank credit, net	108	-	-
Proceeds from long-term debt	33	-	-
Principal payment of long-term debt	(292)	-	-
Net cash provided by financing activities	4,515	14,000	14,000
Effect of exchange rate changes on cash and cash equivalents	(46)	-	-
Increase (decrease) in cash and cash equivalents	(2,843)	1,000	(1,000)
Cash and cash equivalents at the beginning of the year	5,888	4,000	4,000
Cash and cash equivalents at the end of the year	\$ 3,045	\$ 5,888	\$ 4,270

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

ATTUNITY LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2001	2000	1999
(1) Payment for the acquisition of BFI			
In February 2000, the Company acquired all of the outstanding shares of Bridges for Islands (see Note 1b). The net fair value of the assets acquired and liabilities assumed at the acquisition date was as follows:			
Working capital deficiency, excluding cash and cash equivalents		\$ (13)	
Property and equipment			
Long-term liabilities			
In process research and development		12,	
Goodwill		4	
Assembled workforce			
		18,	
Less - amount financed by issuance of shares and options		14,	
		\$ 4,3	
Supplemental disclosure of cash flow activities:			
Cash paid during the year for:			
Interest	\$ 209	\$	\$ 99
Income taxes	\$ 402	\$	\$ 115
Supplemental disclosure of non-cash investing and financing activities:			
Conversion of convertible notes	\$	\$	\$ 1,487
Capital lease obligation incurred upon the acquisition of property and equipment	\$	\$	\$ 22
Non cash transactions:			
Purchase of treasury shares as result of Medatech and Visopt annulment agreement	\$	\$	\$ -

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 1:- GENERAL**

- a. Attunity Ltd. and its subsidiaries ("Attunity" or "the Company") develops, markets and supports computer software integration tools and application development tools.

The Company's main products are the Attunity Connect and Attunity BPI. Attunity Connect is an enterprise information infrastructure product, which is available on multiple platforms and provides database-independent access to many databases and file systems. Attunity Connect standardizes the interaction between data sources and application programs utilizing various universally accepted standards. Attunity BPI provides users with the ability to transform legacy data and programs into dynamic reusable services.

The Company's principal application development tools are CorVision, an application generator, and APTuser, a database retrieval and production report generator. The Company also markets and supports through its Israeli subsidiary, Attunity Software Services Ltd. ("AS") (formerly: "Meyad"), "Mancal 2000", a logistics and financial application software package.

b. Acquisitions:

1. In February 2000, the Company consummated the acquisition of all the outstanding shares of Bridges for Islands Ltd. ("BFI"), an Israeli privately held company which is engaged in the development of Attunity BPI, a business integration solution, in consideration of \$ 18,587, including \$587 of costs related to the acquisition, of which \$4,364 was paid in cash and the remaining balance by the issuance of 747,650 Ordinary shares and 127,350 options of Attunity in exchange for the options held by employees of BFI as of the acquisition date, aggregating to a value of \$14,001. The Company entered into a share price protection guarantee with the shareholders and employees of BFI pertaining to the shares to be issued to them at \$ 16 per share for a one year period from the registration date with the SEC ("Securities and Exchange Commission") of the abovementioned shares.

The BFI acquisition has been accounted for according to the purchase method of accounting, and accordingly, the purchase price has been allocated to the assets acquired and liabilities assumed based upon the related fair values on the date of the acquisition.

The purchase price has been allocated as follows:

Working capital, net	\$	83
Property and equipment		
Long-term liabilities		
In process research and development (I)		12,99
Goodwill (II)		4,7
Assembled workforce (III)		
		<u>\$ 18,587</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 1:- GENERAL (cont.)**

- (I) In connection with the BFI acquisition, the Company recorded a one time expense of approximately \$ 12,997 in write-off of in process research and development acquired from BFI, for which technological feasibility has not yet been established and for which no alternative future use exists.
- (II) Goodwill is amortized over its useful life, which is estimated at 10 years.(see also Note 2g)
- (III) Assembled workforce is amortized over its useful life, which is estimated at 3 years. (see also Note 2g)

The operations of BFI are included in the consolidated statements from January 2000.

In June 2001 the purchase agreement was amended to provide that, instead of the price protection, the Company issued an additional 350,000 ordinary shares (of which 300,000 were transferred from the shareholders of Medatech Information Technology Ltd. ("Medatech"), and VisOpt B.V. ("VisOpt")), at their par value to the former shareholders of BFI. According to the agreement in the event of a merger, consolidation or other business combination in which the Company is not the surviving entity, or in an acquisition of all or substantially all of the Company's outstanding share capital or assets, the Company agreed to provide the shareholders with either cash or additional ordinary shares in order to ensure that they will receive \$11,962 for their 1,097,650 ordinary shares. An amendment to the price protection agreement was also signed with certain employees. According to the agreement, certain former employees were granted 70,632 fully vested options with an exercise price of \$0.024 in exchange for their waiving of the shares of which they were eligible to as result of the price protection mechanism. Subsequent to the balance sheet date the Company signed similar agreements with other former employees, granting 76,659 options under the same terms.

Pro forma information:

The following represent pro forma unaudited results of operations for the year ended December 31, 1999 representing the combined results of operations as if the acquisition had been completed on January 1, 1999 as follows:

	Year ended December 31, 1999
Revenues	<u>\$ 20,50</u>
Net loss	<u>\$ (15,012)</u>
Basic and diluted net loss per share	<u>\$ (1.65)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 1:- GENERAL (cont.)

2. In March 2000, the Company acquired 100% of the Ordinary shares of Medatech a company which provides software system integration services and 19.9% of the Ordinary shares of VisOpt. a provider of ERP system integration services in consideration of \$ 7,800, which was paid in the form of the issuance of 300,000 of the Company's ordinary shares. Medatech and VisOpt were owned by the same shareholders.

The Company entered into a share price protection agreement with the shareholders of Medatech and VisOpt pertaining to the shares to be issued to them, at \$ 26 per share for a one year period from the registration date with the SEC (Securities and Exchange Commission) of the abovementioned shares.

The acquisition of Medatech was accounted for by the purchase method of accounting, and the investment in VisOpt was accounted for under the cost method.

The total purchase price was allocated as follows: \$ 1,300 to Medatech and \$ 6,500 to VisOpt based upon the related fair values on the date of the acquisition. Proforma information in accordance with APB 16 "Business Combinations" has not been provided since the results of operations of Medatech were discontinued.

On March 19, 2001, in light of the exposure related to price protection, the Board of Directors decided to reverse the acquisition of Medatech and VisOpt. On May 28, 2001, the Company signed an annulment agreement with the former owners of Medatech and VisOpt, which specifies the terms of the separation.

This agreement stated that the Company would transfer the Medatech shares to the former shareholders, in exchange for their waiving of the shares of which they were eligible to as result of the price protection mechanism, and the shareholders would transfer their Attunity shares to an escrow agent on behalf of Attunity. The parties also agreed that all share options granted by the Company to the employees of Medatech pursuant to the Medatech agreement, would be null and void.

The agreement also states that none of the parties would have any claims, demands or causes of action with respect to the Medatech agreement or the annulment thereof, except for the shares transfer.

The Company accounted for the reversal of the acquisition of Medatech in accordance with APB- 30 "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" and EITF 95-18 "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs After the Balance Sheet Date But Before the Issuance of Financial Statements" (see also Note 14).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands**NOTE 1:- GENERAL (cont.)**

As a result of the annulment agreement as mentioned above, the Company recorded gain (loss) from discontinued operations totaling \$ 220 and \$ (2,142) as of December 31, 2001 and 2000, respectively (see also Note 14).

The write off of the investment in VisOpt (\$6,090) was recorded as an impairment of the investment.

c. Restructuring

In September 2001, after sustaining substantial losses, the Company implemented a restructuring plan. In connection with the restructuring plan, and in accordance with Statement of Financial Accounting Standard No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of" ("SFAS No.121"), EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs in a Restructuring)" and Staff Accounting Bulletin No.100 "Restructuring and Impairment Charges" ("SAB No. 100"), the Company recorded restructuring charges of \$ 1,326.

The charge approximates \$ 1,326, of which \$ 788 is included in accrued expenses related to restructuring as of December 31, 2001 and \$ 389 represents write off of property and equipment.

The plan is based upon reduction of 30 employees from the following groups:

Consulting	6
Support	5
R&D	8
S&M	6
Other	<u>5</u>
Total	<u><u>30</u></u>

Since a substantial portion of the Company's employees in its facilities in the U.S were dismissed, the Company impaired leasehold improvements which had no useful use as a result of these employees dismissal.

NOTE 1:- GENERAL (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

The following is a breakdown of the restructuring costs incurred:

	Year ended December 31, 2001
Termination of employees	\$ 385
Future rent of unoccupied facilities	484
Write off of leasehold improvement	389
Other	68
	<hr/>
Included in operating expenses	<u>\$ 1,326</u>

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

One. 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:

A majority of the revenues of Attunity and certain of its subsidiaries is generated in U.S. dollars ("dollar"). In addition, a substantial portion of the Company's costs is incurred in dollars. Company's management believes that the dollar is the primary currency of the economic environment in which those companies operate. Thus, the functional and reporting currency of those companies is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of Financial Accounting Standard No. 52 "Foreign Currency Translation" ("SFAS No .52"). All transactions gains and losses of the remeasurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

The financial statements of the Israeli and other foreign subsidiaries whose functional currency is determined to be their local currency, have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders' equity, accumulated other comprehensive loss.

c. Principles of consolidation:

The consolidated financial statements include the accounts of Attunity Ltd. and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

d. Cash equivalents:

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

Restricted cash (restricted marketable securities in 2000) is subject to an ongoing dispute with the French tax authorities.

e. Marketable securities:

The Company accounts for its investments in marketable securities using Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115").

Management determines the appropriate classification of its investments in marketable debt and equity securities at the time of purchase and reevaluates such determinations at each

balance sheet date. The Company's trading securities are carried at their fair value based upon the quoted market price of those investments. Net realized and unrealized gains and losses on these securities are included in financial expenses or income, as appropriate.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****f. Property and equipment:**

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method, over the estimated useful lives of the assets, at the following annual rates:

	<u>%</u>
Computers and peripheral equipment	20 - 33
Office furniture and equipment	10 - 20
Motor vehicles	15
Leasehold improvements	Over the related lease period

The Company and its subsidiaries periodically assess the recoverability of the carrying amount of property and equipment and provide for any possible impairment loss based upon the difference between the carrying amount and fair value of such assets in accordance with Statement of Financial Accounting Standard No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS No. 121").

As of December 31, 2001, as part of the restructuring plan the Company recorded an impairment charge totaling \$ 389 (see also Note 1c).

g. Other assets:

Goodwill is amortized using the straight-line method over the estimated useful life, which is 7- 10 years *)

Assembled workforce is amortized by a straight -line method over a period of three years. *)

The carrying value of goodwill and workforce are periodically reviewed by management, based on the expected future undiscounted operating cash flows over the remaining goodwill and workforce amortization period. If this review indicates that goodwill and workforce will not be recoverable, the carrying value is reduced to estimated fair value.

During 2001, the Company recorded impairment expenses amounting to \$ 272 attributed to assembled workforce, which were included in "Impairment of investment and other assets". (see Note 5).

*) See Note 2r

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)**h. Research and development costs:**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

Research and development costs incurred in the process of software development before establishment of technological feasibility are charged to expenses as incurred. Costs of the production of a product master incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in Statement of Financial Accounting Standard No.86 "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed" ("SFAS No.86"), and are included in other assets.

Capitalized software costs are amortized on a product by product basis commencing with general product release by the amount computed using the straight-line method over the estimated useful life of the product (five years), and are included in costs of revenues.

At each balance sheet date, the Company assesses the recoverability of this intangible asset by comparing the unamortized capitalized software costs to the net realizable value on a product by product basis. Should the amount of the unamortized capitalized costs of a computer software product exceed the net realizable value, these products will be written down by the excess amount. As of December 31, 2001, the Company recorded \$ 2,386 as impairment of capitalized software costs, in statement of operations, which were included in Impairment of an investment and other assets.

i.Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standard No.109 "Accounting for Income Taxes", ("SFAS No.109"),. This Statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

j.Royalty-bearing grants:

Royalty bearing grants from the Government of Israel for funding of approved research and development projects are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred, and recorded as a deduction of research and development costs. Research and development grants amounted to none, none and \$ 26 in 2001, 2000 and 1999, respectively

k.Advertising expenses:

Advertising expenses are carried to the statement of operations, as incurred. Advertising expenses for the years ended December 31, 2001, 2000 and 1999 amounted to \$ 648, \$ 572 and \$ 343, respectively.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

l.Revenue recognition:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

To date, the Company has derived its revenues from license fees and sub-license fees of its software licenses, maintenance and support and rendering of consulting services, including implementation, training and installation. The Company sells its products primarily through its direct sales force. When the Company sells through distributors and value-added resellers ("VARs") they are considered to be end users.

The Company has adopted Statement of Position 97-2, "Software Revenue Recognition", ("SOP No. 97-2") as amended. SOP No. 97-2, generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair value of the elements. The Company has also adopted SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions", for all transactions entered into after January 1, 2000. SOP No. 98-9 requires that revenue be recognized under the "residual method" when vendor specific objective evidence (VSOE) of fair value exists for all undelivered elements and no VSOE exists for the delivered elements.

Revenue from license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable, and collectibility is probable. The Company does not grant a right of return to its customers. The Company considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer provided that all other revenue recognition criteria have been met.

When contracts contain multiple elements wherein VSOE of fair value exists for all undelivered elements, the Company accounts for the delivered elements in accordance with the "Residual Method" prescribed by SOP No. 98-9. Maintenance and support revenue included in these arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement. The VSOE of fair value of the undelivered elements (maintenance, support and services) is determined based on the renewal price charged for the undelivered element when sold separately.

Arrangements that include consulting services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When services are considered essential, revenues under the arrangement are recognized using contract accounting. When services are not considered essential, the revenues allocable to the software services are recognized as the services are performed. To date, the Company had determined that the services are not considered essential to the functionality of other elements of the arrangement.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

Royalties from licensing the right to use the Company's software are recognized when the related sales are made. The Company determines such sales by receiving confirmation of sales subject to royalties from licensees. Non refundable payments on account of future royalties from similar agreements are recognized upon payments, provided that no future obligation exists.

Some royalty contract include a minimum royalty payment per year .

Revenues from services including consulting, training, implementation and installation are recognized at the time that services are rendered.

Deferred revenues includes amounts received from customers for which revenue has not yet been recognized.

m. Concentrations of credit risks:

Cash and cash equivalents and restricted cash are invested in major banks in Israel, Europe and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company and its subsidiaries are mainly derived from sales to customers located primarily in the United States, Israel, Europe, Far East and South America. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection.

The Company's marketable securities include investments in debentures of corporations. Management believes that those corporations are financially sound, the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities.

The Company has no significant off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

n. Accounting for stock-based compensation:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

The Company has elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25") and FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN 44") in accounting for its employee stock option plans. Under APB 25, when the exercise price of the Company's share options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized. The pro forma disclosures required by Statement of Financial Accounting Standard No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123"), are provided in Note 11c.

The Company applies SFAS No.123 and EITF 96-18 "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" with respect to warrants issued to non-employees. SFAS No.123 requires use of an option valuation model to measure the fair value of the warrants on the date of grant.

o. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128. "Earnings Per Share" ("SFAS No. 128").

All outstanding stock options and warrants have been excluded from the calculation of the diluted net loss per share because all such securities are antidilutive for the years ended December 31, 2001, 2000 and 1999. The total number of shares related to the outstanding stock options and warrants excluded from the calculations of diluted net loss per share were 6,950,161, 1,383,713 and 1,040,996 for the years ended December 31, 2001, 2000 and 1999, respectively.

p. Severance pay:

The Company's liability for severance pay is 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's liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance pay expenses for the years ended December 31, 2001, 2000 and 1999 were \$ 1,375, \$ 554 and \$ 402, respectively.

q. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, restricted cash, trade receivable, short-term bank credits, and trade payable approximate their fair value due to the short-term maturity of such instruments.

The fair value for marketable securities is based on quoted market prices.

The carrying amount of the Company's long-term borrowing approximates its fair value. The fair value was estimated using discounted cash flow analyses, based on the Company's incremental borrowing rates for similar type of borrowing arrangements.

r. Impact of recently issued accounting standards:

In July 2001, the Financial Accounting Standards Board, issued Statement of Financial Accounting Standard No. 141 "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standard No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (but with no maximum life). The amortization provisions of SFAS 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, the Company is required to adopt SFAS 142 effective January 1, 2002.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the second quarter of 2002.

Application of the nonamortization provision of the statements is expected to result in a decrease in the net loss of \$ 733 per year, respectively, and a decrease in the net loss per share of \$ 0.06 per year.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

Assets" (FAS 144), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and superseded SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations for a disposal of a segment of a business". FAS 144 is effective for fiscal years beginning after December 15, 2001, with earlier application encouraged. The Company expects to adopt FAS 144 as of January 1, 2002 and it does not expect that the adoption of the Statement will have a significant impact on the Company's financial position and results of operations.

s. Reclassification:

The Company has reclassified certain previous amounts to conform with the 2001 presentation. The reclassification had no effect on previously reported net loss, shareholders' equity or cash flows.

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2001	2000
Prepaid expenses	\$ 54	\$ 31
Government authorities		
Employees		
Other		
	<u>\$ 1,08</u>	<u>\$ 1,58</u>

NOTE 4:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2001	2000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

	Cost:		
Computers and peripheral equipment		\$ 3,0	\$ 2,9
Office furniture and equipment		2	2
Motor vehicles			
Leasehold improvements			
		<u>7</u>	<u>6</u>
	Accumulated depreciation:		
Computers and peripheral equipment		2	2
Office furniture and equipment		1	1
Motor vehicles			
Leasehold improvements			
		<u>5</u>	<u>4</u>
	Depreciated cost	<u>\$ 1,6</u>	<u>\$ 2,3</u>

Depreciation expenses for the years ended December 31, 2001, 2000 and 1999 are \$ 806, \$ 728 and \$ 727, respectively.

During 2001, as part of the restructuring plan, the Company recorded impairment expenses amounting to \$ 389 attributed to leasehold improvements and computer equipment (see Note 1c).

For charges on the Company's property and equipment, see Note 9.

NOTE 5:- OTHER ASSETS, NET

	<u>December 31,</u>	
	<u>2001</u>	<u>2000</u>
Original amounts:		
Software development costs	\$ 16,298	\$ 16,684
Goodwill	7,540	7,540
Assembled workforce	-	724
	<u>23,838</u>	<u>24,948</u>
Accumulated amortization:		
Software development costs	10,228	7,832
Goodwill	2,343	1,610
Assembled workforce	-	211
	<u>12,571</u>	<u>9,653</u>
	<u>\$ 11,267</u>	<u>\$ 15,295</u>
	Amortized cost	

NOTE 5:- OTHER ASSETS, NET (cont.)

Amortization expenses amounted to \$ 3,354, \$ 2,948 and \$ 909 for the years ended December 31, 2001, 2000 and 1999, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

During 2001, the Company recorded impairment expenses amounting to \$ 2,386 attributed to software development costs, which were included in statement of operations under impairment of an investment and other assets.

Assembled workforce attributed to BFI's employees was impaired during 2001, since all the BFI development staff was replaced (see Note 1b) The impairment expense was included in statement of operations under impairment of an investment and other assets.

NOTE 6:- SHORT-TERM BANK CREDIT

As of December 31, 2001, the Company has an authorized line of credit in the amount of \$ 364 of which \$ 190 is unutilized. The credit line is denominated in NIS and generally bears interest at an annual rate between Prime + 1% to Prime + 2%.

The weighted average interest rate at December 31, 2001 and 2000 was 4.3% and 7.2%, respectively.

NOTE 7:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2001	2000
Government authorities	\$ 3	\$ 2
Accrued expenses - mainly professional fees, commissions and rent		
Royalties to Government authorities		
Other		
	<u>\$ 1,1</u>	<u>\$ 1,1</u>

NOTE 8:- LONG-TERM DEBT

	December 31,	
	2001	2000
Capital lease obligations, linked to the U.S. dollar +2.25% interest	\$:	\$:
Others loans, linked to the Israeli CPI (consumer price		

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

index) + 5.5% to 7.8% interest	_____	_____
Less - current maturities		
Capital lease obligations		
Other loans	_____	_____
	\$:	\$:
As of December 31, 2001, the aggregate annual maturities of long-term loans are as follows:		
First year (current maturities)	\$:	\$
Second year		
Third year		
Fourth year	_____	_____
	\$:	\$:

NOTE 9:- CHARGES (ASSETS PLEDGED)

- a. As collateral for certain liabilities of the Company to banks and others, fixed charges have been recorded on certain property and equipment of the Company.
- b. As for restricted cash and marketable securities, see Note 2d.

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

- a. Lease commitments:

The Company leases its operating facilities under non-cancelable operating lease agreements. Future minimum commitments under these leases as of December 31, 2001, are as follows:

<u>Year ending December 31,</u>	<u>Operating leases</u>
2002	\$ 1,125
2003	1,187
2004	1,054
2005	689
	<u>\$ 4,055</u>

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

Rent expenses under operating leases for the years ended December 31, 2001, 2000 and 1999 were \$ 1,298, \$ 850 and \$ 659, respectively.

- b. Royalties:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

Royalties are due to participants in the financing of the development of certain products, by the Office of the Chief Scientist of the Ministry of Industry and Trade. Under the Company's research and development agreements with the Chief Scientist and pursuant to applicable law, the Company is required to pay royalties at the rate of 2%-5% of sales of products developed with funds provided by the Chief Scientist, up to an amount equal to 100% - 150% of the Chief Scientist's research and development grants (linked to the U.S. dollar) related to such projects.

Royalties expenses for the three years ended December 31, 2001, 2000 and 1999 were \$ 156, \$ 220 and \$ 229, respectively.

As of December 31, 2001, the Company has a contingent liability to pay royalties in the amount of \$ 1,522.

NOTE 11:- SHAREHOLDERS' EQUITY

- a. The Ordinary shares of the Company are quoted on Nasdaq stock market. The Ordinary shares confer upon the holders the right to receive notice to participate and vote in general meetings of the Company, and the right to receive dividends, if declared.
- b. In October 2001, the Company issued 3,846,156 Ordinary Shares to private investors in consideration of approximately \$ 4,666. In addition, the Company granted the investors and agents warrants to purchase 4,150,387 of the Company's Ordinary Shares at an exercise price of \$1.75 - \$ 2.25. The holders of the warrants have anti-dilution provisions. The agreement states that in the event that the share price reaches \$ 3 and \$ 4 respectively, the Company may force the investors to exercise the warrants, otherwise they would be forfeited. These warrants will expire in October 2005.

In March 2000, the Company issued 850,000 Ordinary Shares to private investors in consideration of approximately \$13 thousand.

NOTE 11:- SHAREHOLDERS' EQUITY (cont.)

- c. Stock Option Plans:

Under the Company's 1992, 1994, 1998 and 2001, Stock Option Plans (the "Plans"), the Company has granted options to purchase Ordinary Shares to key employees, directors and officers as an incentive to attract and retain qualified personnel. The exercise price of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

options granted under the Plans may not be less than 100% (110% in the case of a 10% shareholder) of the fair market value of the Company's Ordinary shares on the date of the grant for ISO options and 75% of the fair market for non-qualified. Under the terms of these three plans, options generally become exercisable ratably over a three to five - year period commencing with the date of grant.

The options generally expire no later than 10 years from the date of the grant, and are non-transferable, except under the laws of succession.

Under the Plans 4,000,000 Ordinary shares of the Company were reserved for issuance. Any options which are canceled or forfeited before expiration become available for future grants.

As of December 31, 2001, 2,105,994 options under the plans are available for future grants.

Below is a summary of the Company's stock option activity, and related information:

	Year ended December 31					
	2001		2000		1999	
	Amount In thousands	Weighted average exercise price	Amount In thousands	Weighted average exercise price	Amount In thousands	Weighted average exercise price
Outstanding at the beginning of the year	1,226	\$ 8.61	1,068	\$ 8.02	891	\$ 7.55
Granted	1,710	\$ 1.26	539	\$ 8.81	463	\$ 8.28
Exercised	(20)	\$ 0.02	(189)	\$ 5.54	(154)	\$ 5.62
Forfeited	(678)	\$ 5.57	(192)	\$ 8.33	(132)	\$ 8.59
Outstanding at the end of the year	<u>2,238</u>	<u>\$ 3.87</u>	<u>1,226</u>	<u>\$ 8.61</u>	<u>1,068</u>	<u>\$ 8.02</u>
Exercisable at the end of the year	<u>1,218</u>	<u>\$ 5.74</u>	<u>387</u>	<u>\$ 7.44</u>	<u>807</u>	<u>\$ 8.19</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 11:- SHAREHOLDERS' EQUITY (cont.)**

The options outstanding as of December 31, 2001, have been separated into ranges of exercise price as follows:

<u>Range of exercise prices</u>	<u>Outstanding at December 31, 2001</u>	<u>Weighted average remaining contractual life</u>	<u>Weighted average exercise price</u>	<u>Exercisable at December 31, 2001</u>	<u>Weighted average exercise price</u>
<u>U.S. dollars</u>	<u>In thousands</u>	<u>Years</u>	<u>U.S. dollars</u>	<u>In thousands</u>	<u>U.S. dollars</u>
0.024	41	2.6	0.024	42	0.024
1-1.49	1,194	6.27	1.16	304	1.09
1.5-1.99	65	4.08	1.77	39	1.83
2 - 3	139	3.15	2.62	94	2.55
4.5 - 6.6	80	4.17	5.71	69	5.92
6.66 - 9.812	589	3.28	8.08	545	8.10
10-13.3	92	2.85	10.59	89	10.57
16	38	4	16	36	16
	<u>2,238</u>		<u>3.87</u>	<u>1,218</u>	<u>5.74</u>

Under SFAS No.123, proforma information regarding net income (loss) and net earnings (loss) per share is required (for grants issued after December 1994), and has been determined as if the Company had accounted for its employee stock option under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option valuation pricing model, with the following weighted-average assumptions for 2001, 2000 and 1999: risk-free interest rates of 3%, 4.5% and 6%, respectively, dividend yields of 0% for each year, volatility factors of the expected market price of the Company's Ordinary shares of 130%, 91% and 68% in 2001, 2000 and 1999, respectively, and a weighted-average expected life of the options of six years for each year.

Weighted average fair values and weighted average exercise prices of options whose exercise price is equal to, lower than or exceeds market price of the shares at date of grant are as follows:

	<u>Year ended December 31,</u>					
	<u>2001</u>		<u>2000</u>		<u>1999</u>	
	<u>Weighted average fair value</u>	<u>Weighted average exercise price</u>	<u>Weighted average fair value</u>	<u>Weighted average exercise price</u>	<u>Weighted average fair value</u>	<u>Weighted average exercise price</u>
Equals market price at date of grant	<u>\$ 0.98</u>	<u>\$ 1.322</u>	<u>\$ 7.08</u>	<u>\$ 7.83</u>	<u>\$ 5.3</u>	<u>\$ 8.28</u>
Exceeds market price at date of grant	<u>\$ 1.30</u>	<u>\$ 1.829</u>	<u>\$ 11.11</u>	<u>\$ 21.876</u>	<u>\$ -</u>	<u>\$ -</u>
Lower than market price at date of grant	<u>\$ 1.77</u>	<u>\$ 0.024</u>	<u>\$ 7.89</u>	<u>\$ 1.78</u>	<u>\$ -</u>	<u>\$ -</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands****NOTE 11:- SHAREHOLDERS' EQUITY(cont.)**

For purposes of pro forma disclosure, the estimated fair value of the options is amortized as an expense over the options' vesting period. Pro forma information under SFAS No. 123:

	Year ended December 31,		
	2001	2000	1999
Net loss as reported	<u>\$ (15,631)</u>	<u>\$ (31,301)</u>	<u>\$ (396)</u>
Proforma net loss	<u>\$ (17,139)</u>	<u>\$ (34,953)</u>	<u>\$ (1,876)</u>
Proforma basic and diluted net loss per share from continuing operations	<u>\$ (1.49)</u>	<u>\$ (3.33)</u>	<u>\$ (0.22)</u>
Proforma basic and diluted net gain (loss) per share from discontinued operations	<u>\$ 0.02</u>	<u>\$ (0.22)</u>	<u>\$</u>
Proforma basic and diluted net loss per share	<u>\$ (1.47)</u>	<u>\$ (3.55)</u>	<u>\$ (0.22)</u>

d Stock warrants:

The Company has issued warrants, as follows:

<u>Issuance date</u>	<u>Outstanding as of December 31, 2001</u>	<u>Exercise price</u>	<u>Exercisable as of December 31, 2001</u>	<u>Exercisable through</u>
February 2000 (1)	20,	\$12	20,	November 1, 2002
June 2000 (2)	425,0	\$20 - \$25.50	425,0	March 31, 2005
October 2000 (3)	72,	\$12	72,	October 31, 2005
October 2001 (4)	<u>4,140,38</u>	\$1.75 - \$2.5	<u>4,140,38</u>	October 16, 2005
	<u>4,657,38</u>		<u>4,657,38</u>	

- (1) Issued to consultants in respect to consulting investing services. These warrants will expire on November 1, 2002
- (2) Issued to investors and underwriters of the June 2000 private placement. These warrants will expire on March 31, 2005.
- (3) Issued to consultants and underwriters of the June 2000 private placement. These warrants will expire on October 31, 2005.
- (4) Issued to investors and underwriters of the October 2001 private placement. These warrants will expire on October 16, 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 11:- SHAREHOLDERS' EQUITY(cont.)

- e. During 2000, the Company granted a senior employee a loan in the amount of \$ 121 to satisfy tax payment in respect of options exercised. The Company accounted for shares resulted from the options exercised as a variable plan in accordance with FIN 44.

During 2001, an agreement was signed by the Company and the employee according to which the debt was waived and the Company is authorized to exercise the employee's shares and options, the proceeds from the exercised shares and options will be transferred to the Company, as a result the Company recorded expenses at an amount of \$ 90. The rest of the amount, which represents the fair value of the shares, was accounted as treasury shares.

- f. During 2001, the Company issued to the former shareholders and employees of BFI 350,000 shares at their par value and 70,632 options with an exercise price of \$ 0.024 as result of the price protection mechanism described in Note 1b1.

- g. Dividends:

In the event that cash dividends are declared in the future, such dividends will be paid in New Israeli Shekels "NIS". The Company does not intend to pay cash dividends in the foreseeable future.

NOTE 12:- TAXES ON INCOME

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

The production facilities of Attunity Ltd. and its subsidiary Attunity Software Services Ltd. ("AS") have been granted "Approved Enterprise" status under the Law.

In December 1997, Attunity Ltd. filed an application for a third investment program which was approved by the Investment Center of the Ministry of Industry and Trade in December 1998. The first two investment programs, which related investments were completed in June 1994 and December 1997, received final approval during 1998.

According to the provisions of the Law, Attunity Ltd. has elected to enjoy "alternative benefits" - waiver of grants in return for tax exemption - and, accordingly, income derived from the "Approved Enterprise" will be tax-exempt for a period of two years commencing with the year it first earns taxable income, and will be taxed at 10% to 25%, based upon the percentage of foreign investment in Attunity Ltd., for an additional period of five-eight years. The period of tax benefits, detailed above, is subject to limits of the earlier of 12 years from the commencement of production, or 14 years from the date of approval.

NOTE 12:- TAXES ON INCOME (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

AS has been granted status as an "Approved Enterprise" whereby it has elected to receive Government grants and to enjoy the benefit of a reduced tax rate of 25% during a period of seven years commencing with the year it first earns taxable income. The period of tax benefits, detailed above, is subject to limits of the earlier of 12 years from the commencement of production, or 14 years from the date of approval. In 1993, AS received approval for an expansion of the aforementioned program whereby it has elected to enjoy "alternative benefits" - waiver of grants in return for tax exemption - and, accordingly, its income from the "Approved Enterprise" will be tax-exempt for a period of ten years commencing with the year it first earns taxable income.

AS did not receive final approvals for such programs.

If a dividend is distributed out of the tax-exempt profits, as detailed above, Attunity Ltd. will be required to pay tax at the rate of 10%-25% in respect of the amount distributed.

The Company's decision is not to distribute dividends, other than upon the liquidation of the Company.

As Attunity Ltd. currently has no taxable income, the benefits have not yet commenced for all programs.

The Law also grants entitlement to claim accelerated depreciation on equipment used by the "Approved Enterprise" during five tax years.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the above law, regulations published thereunder and the instruments of approval for the specific investments in "approved enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest.

Should Attunity or AS derive income from sources other than the "Approved Enterprise" during the periods of benefits, such income shall be taxable at the regular corporate tax rate of 36%.

b. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results of Attunity Ltd. and its Israeli subsidiaries for tax purposes are measured and reflected in real terms in accordance with the changes in the Israeli CPI. As explained in Note 2b, the financial statements are presented in U.S. dollars. The difference between the change in the Israeli Customer Price Index and in the NIS/U.S. dollar exchange rate causes a difference between taxable income or loss and the income or loss before taxes reflected in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on this difference between the reporting currency and the tax bases of assets and liabilities.

NOTE 12:- TAXES ON INCOME (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

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

Attunity Ltd. and AS are "industrial companies" under the above law and as such are entitled to certain tax benefits, including accelerated depreciation and deduction of public offering expenses in three equal annual installments.

- d. Tax loss carryforwards:

Net operating loss carryforwards as of December 31, 2001 are as follows:

Israel	\$ 30,975
United States *)	13,352
UK	2,246
Hong Kong	1,079
France	94
	<u>\$ 47,746</u>

Net operating losses in Israel, UK and Hong Kong may be carried forward indefinitely, and in the U.S. they are available through 2020 and in France they are available through 2005.

- *) Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

- e. Deferred taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

	December 31,	
	2001	2000
Net operating loss carryforwards	\$ 17,189	\$ 13,220
Other	372	431
	<u>17,561</u>	<u>13,651</u>
Less - valuation allowance	(17,561)	(13,651)
	<u>\$ -</u>	<u>\$ -</u>

NOTE 12:- TAXES ON INCOME (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

In the year ended December 31, 2001, the Company has increased its valuation allowances by approximately \$ 3,910 in respect of deferred tax assets resulting from tax loss carryforwards and other temporary differences. Management currently believes that since the Company has 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.

f. Reconciliation:

A reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to the income of the Company and the actual tax expense, is as follows:

	Year ended December 31,		
	2001	2000	1999
Loss before income taxes, as reported in the consolidated statements of perations	<u>\$ 15,449</u>	<u>\$ 29,359</u>	<u>\$ 2</u>
Theoretical tax expense (income tax benefit) computed at the rate applicable to the Company (1)	\$ (5,562)	\$ (10,569)	\$ (142)
Tax adjustments in respect of inflation in Israel and effect of different tax rates for foreign subsidiaries			
Losses for which valuation allowance was provided	3,9	7,0	
Nondeductible expenses including goodwill amortization, investment impairment and others	1,6	3,3	
Withholding tax	<u> </u>	<u> </u>	<u> </u>
Taxes on income (tax benefit)	<u>\$ 4</u>	<u>\$ (200</u>	<u>\$ 18</u>
(1) Statutory rate applicable to the Company	<u> </u>	<u> </u>	<u> </u>

g. Pre-tax loss:

Domestic	\$ (13,548)	\$ (29,062)	\$ (30)
Foreign	<u>(1,90</u>	<u>(2</u>	<u> </u>
	<u>\$ (15,449)</u>	<u>\$ (29,359)</u>	<u>\$ (20)</u>

NOTE 13: - IMPAIRMENT OF INVESTMENT AND OTHER ASSETS

Year ended December 31,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Impairment of capitalized software costs *)	\$ 2,380	\$	\$
Impairment of assembled workforce *)			
Impairment of investment **)		6,000	
	<u>\$ 2,650</u>	<u>\$ 6,000</u>	<u>\$</u>

*) See Note 5

**) See Note 1b

NOTE 14: - DISCONTINUED OPERATIONS

In March 2001, the Board of Directors decided to reverse the acquisition of Medatech and VisOpt (see Note 1b(2)). As of December 31, 2000, the annulment of the acquisition of Medatech was accounted for as discontinued operations in accordance with APB- 30 "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" and EITF 95-18 "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs After the Balance Sheet Date But Before the Issuance of Financial Statements"

The Company recognized a loss from the discontinued operations in 2000, in accordance with EITF 95-18 which states that if a loss is expected from the planned disposal of a segment, the estimated loss, as determined in accordance with Opinion 30, should be recognized in the not yet issued financial statements for the period prior to the measurement date, and the segment's operating results should be presented as discontinued operations.

NOTE 14: - DISCONTINUED OPERATIONS (cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

As a result of the annulment of the Medatech agreement as mentioned above, the results of operations of the Medatech were reported separately as discontinued operations in the statements of operations for the year ended December 31, 2000, and are summarized as follows:

	For the period from March 2, 2000 (date of acquisition) through December 31, 2000
Earnings from discontinued operations of a segment:	
Revenues	\$ (3,871)
Cost of revenues	2,715
Research and development expenses	300
Selling, general and administrative expenses	657
Financial income, net	(21)
Income tax	74
Goodwill amortization	64
	<hr/>
	(82)
	<hr/>
Loss on disposal of segment:	
Impairment of goodwill	474
Loss from annulment of agreement	1,272
Expenses in connection with the annulment agreement	970
Fair value of the shares which will be returned to the Company	(492)
	<hr/>
	2,224
	<hr/>
	<u><u>\$ 2,142</u></u>

During 2001, the Company recorded income totaling \$ 220, which resulted of the difference between the provision made in 2000 and the actual results.

NOTE 15:- GEOGRAPHIC INFORMATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

The Company manages its business on a basis of one reportable segment: computer software integration tools and application development tools (See Note 1a for a brief description of the Company's business). Total revenues are attributed to geographic areas based on the location of the end customers. This data is presented in accordance with Statement of Financial Accounting Standard No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131").

	Year ended December 31,		
	2001	2000	1999
Revenues from sales to unaffiliated customers:			
Israel	\$ 2,761	\$ 3,231	\$ 4,366
United States	7,589	9,037	8,434
Europe	4,012	5,001	5,920
Far East	1,212	889	1,288
South America	1,066	-	-
Other	229	513	499
Total	<u>\$ 16,869</u>	<u>\$ 18,671</u>	<u>\$ 20,507</u>

The Company's long-lived assets are as follows:

	December 31,		
	2001	2000	1999
Israel	\$ 12,276	\$ 16,571	\$ 11,816
United States	470	780	107
Other	191	267	258
	<u>\$ 12,937</u>	<u>\$ 17,618</u>	<u>\$ 12,181</u>

NOTE 16:- SELECTED STATEMENTS OF OPERATIONS DATA

a. Research and development costs, net:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**U.S. dollars in thousands**

	Year ended December 31,		
	2001	2000	1999
Total costs	\$ 5,771	\$ 5,554	\$ 4,502
Less - royalty-bearing grants	-	-	(26)
Less - capitalized software development costs	(1,789)	(1,995)	(2,000)
	<u>\$ 3,982</u>	<u>\$ 3,559</u>	<u>\$ 2,476</u>
b. Financial income, net:			
Financial income:			
Gain on trading marketable securities	\$ -	\$ 40	\$ 111
Interest and other income	142	411	191
Foreign currency translation differences	515	237	2
	<u>657</u>	<u>688</u>	<u>304</u>
Financial expenses:			
Interest	(304)	(57)	(92)
Foreign currency translation differences	(305)	(215)	(52)
	<u>609</u>	<u>(272)</u>	<u>(144)</u>
	<u>\$ 48</u>	<u>\$ 416</u>	<u>\$ 160</u>
