BOS BETTER ONLINE SOLUTIONS LTD
Form 20-F
June 27, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

( )REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002

OR

( )TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-14184

B.O.S BETTER ON LINE SOLUTIONS LTD.
(Exact name of Registrant as specified in its charter)

ISRAEL
(Jurisdiction of incorporation or organization)

Beit Rabin, 100 Bos Road, Teradyon Industrial Park, Misgav, 20179, Israel
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

NONE
(Title of each class)

Securities registered or to be registered pursuant to Section 12(g) of the Act:

Ordinary Shares, par value NIS 4.00 per share (post reverse split effected May 29, 2003)
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

NONE
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

3,177,264 Ordinary Shares, NIS 4.00 par value per share, as of December 31, 2002 (on a post reverse split basis, taking into account the 4 to 1 reverse stock split effected on May 29, 2003).

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No ____

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 ____ Item 18 __X__

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PART I

Item 1: Identity of Directors, Senior Management and Advisors

Not required.

Item 2: Offer Statistics and Expected Timetable

Not required.

Item 3: Key Information Regarding B.O.S.

Unless the context in which such terms are used would require a different meaning, all references to BOS, we or our refer to B.O.S. Better On-Line Solutions Ltd

3A. Selected Consolidated Financial Data

The consolidated statement of operations data for B.O.S Better On-Line Solutions Ltd. set forth below with respect to the years ending December 31, 1998, 1999, 2000, 2001, and 2002, and the consolidated balance sheet data as of December 31, 1998, 1999, 2000, 2001, and 2002, have been prepared in accordance with Israeli GAAP which is substantially identical in all material aspects to those followed in the United States (U.S. GAAP), except as described in Note 19 to the Consolidated Financial Statements.

Financial information for the years ended December 31, 2001 and 2002 was audited by Kost, Forer & Gabbay, independent certified public accountants and a member of Ernst & Young Global, while financial information for the years ended December 31, 1998, 1999 and 2000 was audited by Somekh Chaikin, independent certified public accountants in Israel and members of KPMG International. The selected consolidated financial data presented below should be read in conjunction with Item 5: Operating and Financial Review and Prospects and the Notes to the Financial Statements included in this Form 20-F.

Since the Companys shares are traded on the NASDAQ in the United States, the Company elected to adjust its financial statements according to the changes in the exchange rate of the U.S. dollar, in conformity with Section 29b to Statement No. 36 of the Institute of Certified Public Accountants in Israel. Thus, the functional and reporting currency of the Company is the U.S. dollar. Accordingly, monetary accounts maintained in currencies other than the dollar are translated to the U.S. dollar using the foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. The effects of foreign currency conversion are reported in current operations.

Certain subsidiaries of the Company, which operate independently of the Company, prepare their financial statements in a functional currency other than the U.S. dollar. The functional currency of these companies was determined based on their economic environment and on the currency in which the majority of their sales are made and costs are incurred. The financial statements of these companies, whose functional currency is not the U.S. dollar, have been translated into U.S. dollars, in accordance with Interpretation 8 to Statement 36 of the Institute of Certified Public Accountants in Israel. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. The amounts on the statement of operations have been translated by using the average exchange rate for the year.

The resulting difference between the investment and the re-measurement of shareholders' equity, in respect of the said companies, and according to changes in the exchange rates of the different functional currencies is recorded as financial income (expenses).

Statement of Operations Data:
(In US thousands of dollars with the exception of per share data)

Year Ended December 31:

	2002	2001	2000	1999	1998
Revenues	9,441	6,042	7,294	6,720	7,463
Cost of revenues	2,300	2,703	2,399	1,936	2,418
Gross profit	**7,141**	**3,339**	**4,895**	**4,784**	**5,045**
Operating expenses:					
Research and development, net	2,182	1,757	2,177	1,486	1,793
Selling and marketing	3,705	4,811	4,185	3,024	3,017
General and administrative	1,697	1,243	2,279	2,181	1,650
Total operating expenses	**7,584**	**7,811**	**8,641**	**6,691**	**6,460**
Operating loss:	(443)	(4,472)	(3,746)	(1,907)	(1,415)
Financial income (expense), net	295	427	639	(91)	73
Restructuring costs	-	(132)	(83)		
Other expenses	(285)	(480)	(479)	2,150	12
Profit (Loss) before equity in losses of an affiliated company	**(433)**	**(4,657)**	**(3,669)**	**152**	**(1,330)**
Equity in losses of an affiliated company	-	-	(1,283)	(696)	(221)
Net loss from continuing segment	**(433)**	**(4,657)**	**(4,952)**	**(544)**	**(1,551)**
Net loss related to discontinued segment	(7,674)	(8,313)	(2,743)	(522)	(839)
Net loss	**(8,107)**	**(12,970)**	**(7,695)**	**(1,066)**	**(2,390)**
Basic and diluted net loss per share from continuing segment	$ (0.03)	$ (0.38)	$ (0.39)	$ (0.04)	$ (0.19)
Basic and diluted net loss per share related to discontinued segment	$ (0.62)	$ (0.67)	$ (0.23)	$ (0.06)	$ (0.10)

Basic and diluted net loss per share	$ (0.65)	$ (1.05)	$ (0.62)	$ (0.10)	$ (0.29)
Weighted average number of shares outstanding during the year (post 1:4 reverse-split)	3,115	3,097	2,982	2,388	2,040

Year Ended December 31:

Balance Sheet Highlighted Data:	**2002**	**2001**	**2000**	**1999**	**1998**
Cash and Cash Equivalents	5,246	8,325	16,470	261	1,005
Working Capital (*)	5,980	7,008	17,378	290	1,223
Total Assets	16,439	30,767	45,670	33,151	21,042
Short-term bank credit and current maturities of long-term debt	0	286	429	421	0
Long-term debt	231	280	591	1,056	131
Shareholders equity	8532	16,478	29,444	13,675	11,310
(*)Working capital comprises of:					
Current assets	9,525	10,677	20,795	3,411	3,748
Less: current liabilities	3,545	3,669	3,417	3,121	2,525
	5,980	7,008	17,378	290	1,223

3B. Capitalization and Indebtedness

Not applicable

3C. Reasons for the Offer and Use of proceeds

Not applicable

3D. Risk Factors

The following factors, in addition to other information contained or incorporated by reference in this Form 20-F, should be considered carefully.

This report on Form 20-F contains forward-looking statements that are intended to be, and are hereby identified as forward looking statements for the purposes of the safe harbor provisions of the Private Securities Reform Act of 1995. These statements address, among other things: our strategy; the anticipated development of our products; our anticipated use of proceeds; our projected capital expenditures and liquidity; our development of additional revenue sources; our development and expansion of relationships; the market acceptance of our products; and our technological advancement. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed below and elsewhere in this report.

We urge you to consider that statements which use the terms "believe", "do not believe", "expect", "plan", "intend", "estimate", "anticipate", "projections", "forecast" and similar

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expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the federal securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Market data and forecasts used in this report have been obtained from independent industry sources. We have not independently verified the data obtained from these sources and we cannot assure you of the accuracy or completeness of the data. Forecasts and other forward-looking information obtained from these sources are subject to the same qualifications and additional uncertainties accompanying any estimates of future market size.

A year ago we decided to sell our subsidiary, Pacific Information Systems, Inc. ("PacInfoSystems"), but were unsuccessful, and due to PacInfoSystems' severe financial situation, we decided to dissolve the business and we are currently negotiating a settlement with PacInfoSystems' creditors.

On May 24, 2002, the Company announced its intention to sell PacInfoSystems due to a change in the Company's business strategy. PacInfoSystems is the Company's wholly owned U.S. subsidiary that resells, installs and provides computer networking products to various business entities, yet, management formulated a new strategic plan that provided for the discontinuation of the computer networking business. As a result, the Company decided in May 2002 to sell PacInfoSystems and to write-off amortized goodwill associated with PacInfoSystems in the amount of $3.9 million.

However, the Company's efforts to sell PacInfoSystems, whose financial situation was deteriorating, were not successful. Further developments, such as the arbitration judgment rendered against PacInfoSystems in the sum of approximately $650K, continuation of poor sales results, termination of line of credit, as well as the loss of some key employees and sales force, left the Company with little choice but to dissolve the business. The Company is now in the process of working out a settlement with PacInfoSystems' creditors. Although, as of this date, a settlement has been reached with a majority of PacInfoSystems' creditors, there can be no assurance that such a settlement will be reached with the remainder of the creditors, thus resulting in additional costs to the Company, and a risk that those creditors will force PacInfoSystems into bankruptcy proceedings, in which case a trustee will be appointed.

Furthermore, certain actions involving the dissolution of the business, if occurring before the end of 2003, may trigger a tax event for Mr. Jacob Lee, who sold PacInfoSystems to the Company in 1998, and to whom the Company may be obligated, under the purchase agreement, to grant Mr. Lee a loan and to reimburse Mr. Lee for certain tax payments, currently estimated at approximately $1.5 million, towards the tax payment, while receiving a security interest in the Company's shares Mr. Lee currently holds. There can be no assurance that the Company will be able to avoid the trigger of a tax event resulting in an obligation to loan Mr. Lee such a substantial amount of money. Such a loan may adversely affect our business condition and results of operations.

In early 2002 we transformed the corporate structure of the Company into a holding company specializing in technology. Later on in 2002, we decided that due to the promise of our new line of IP products, the Company would focus on its core business – that of its Israeli subsidiary, BOScom Ltd. Our transformation into a holding company may not be successful, which would adversely affect our long-term growth, and our decision to concentrate on our core business, may not prove profitable.

In January 2002, we transformed the corporate structure of the Company into a holding company specializing in technology, which represents a new operating strategy for the Company. We do not have experience operating as a holding company, which may require different resources than those that are currently available to the Company. Accordingly, there can be no assurance that the Company will be able to make the necessary adjustments to achieve long-term growth. If we were to fail to make the corporate transition in an efficient, timely manner, the business and operations of the Company may be adversely affected. Additionally, later on in 2002, we decided that due to the promise of our new line of IP products, the Company would focus on its core business that of its Israeli subsidiary, BOScom Ltd. There can be no assurance that this focus on IP telephony, rather than seeking a wide-range of technology investments, shall be successful and profitable, and may adversely affect our business condition and results of operations.

The Companys shares may be delisted from the Nasdaq National Market for failure to meet Nasdaqs requirements.

The Companys Ordinary Shares had been trading under the $1.00 per share continued listing requirement of the Nasdaq National Market, for a few months. The Company received notice from the Nasdaq Stock Market that its ordinary shares were subject to delisting from the Nasdaq National Market for failure to meet Nasdaqs minimum bid price and shareholders equity requirements ($10 million) for continued listing on the National Market, and requested a hearing, which was held on February 13, 2003.

As a result of the hearing and supplemental information presented to the Nasdaq Listing Qualifications Panel by the Company, the Panel, in a letter dated March 31, 2003, advised that it was of the opinion that the Company had presented a definitive plan that will enable it to evidence compliance with all requirements for continued listing on the Nasdaq National Market within a reasonable period of time and to sustain compliance with those requirements over the long term. Accordingly, the Panel determined to continue the listing of the Companys securities on the Nasdaq National Market pursuant to a detailed exception, which included the filing of a proxy statement evidencing its intent to seek shareholder approval for a reverse stock split sufficient to satisfy the $1.00 bid price requirement, and the demonstration of a closing bid price of at least $1.00 per share on or before June 2, 2003, and immediately thereafter evidencing such a closing bid price for a minimum of ten consecutive trading days. Additionally, according to the exception, the results of the first fiscal quarter of 2003 must show shareholders equity of at least $10 million.

The Company successfully met all conditions of the exception. However, there can be no assurance that the Company will be able to continue to meet this or other Nasdaq requirements to maintain its Nasdaq National Market listing, in which case it will need to apply for a transfer of its Ordinary Shares to the Nasdaq Small Cap Market.

The market value of the Company may suffer as a result of the reverse-split of our shares.

On May 22, 2003, the shareholders approved a reverse-split of the Companys Ordinary Shares with a 1:4 ratio, in order to meet the $1.00 minimum bid price requirement, and the listing exception granted to us. It is anticipated that the increase in the price level of the Ordinary Shares as a consequence of the reverse-split might be proportionately less than the decrease in the number of Ordinary Shares outstanding, thus reducing the aggregate market value of the Company, and there can be no assurance that the aggregate market value prior to the reverse-split shall be regained in the future.

Our future levels of sales and profitability are unpredictable.

Our ability to maintain and improve future levels of sales and profitability depends on many factors.

These factors include:

- the continued demand for our existing products;
- our ability to develop and sell new products to meet customer needs;

- managements ability to control costs and successfully implement our business strategy; and
- our ability to manufacture and deliver products in a timely manner.

There can be no assurance that we will experience any growth in sales or profitability in the future or that the levels of historic sales or profitability experienced over previous years will continue in the future.

We depend on certain key products for the bulk of our sales.

Our IBM midrange related products account for most of our sales. We anticipate that our IBM midrange related products will continue to account for a significant portion of our sales and profitability in the foreseeable future. If sales of our IBM midrange products were to decline significantly for any reason, or the profit margins on such products were to decrease significantly for any reason (including in response to competitive pressures), our financial results would be adversely affected.

To reduce the risk of such a decline or decrease due to competitive pressures or technical obsolescence, we are continually seeking to reduce costs, upgrade and expand the features of our IBM related products, expand the applications for which the products can be used and increase marketing efforts to generate new sales.

Although we are developing and introducing new remote communications products and increasing our marketing efforts, there can be no assurance that the planned enhancements or the new developments will be commercially successful, or that we will be able to increase sales of our IBM midrange products.

If we are unsuccessful in developing and introducing new products, we may be unable to expand our business.

The market for some of our products is characterized by rapidly changing technology and evolving industry standards. The introduction of products embodying new technology and the emergence of new industry standards can render existing products obsolete and unmarketable and can exert price pressure on existing products.

We established our subsidiary Lynk, which is now known as BOScom, for the purpose of developing, manufacturing and marketing new products for remote networking connectivity and IP telephony However, the IP telephony market has been unstable and vulnerable over the past years, and competing in such a market may be a risky endeavor. The IP telephony market has suffered from low image due to availability, reliability and quality problems. As such, there can be no assurance that we will realize significant revenues from products developed and introduced by BOScom.

Our ability to anticipate changes in technology and industry standards and successfully develop and introduce new and enhanced products as well as additional applications for existing products, in each case on a timely basis, will be critical in our ability to grow and remain competitive. Although these products are related to, and even incorporate our existing products, there can be no assurance that we will be able to successfully develop and market any such new products. If we are unable to develop products that are competitive in technology and price and responsive to customer needs, for technological or other reasons, our business will be materially adversely affected.

We depend on key personnel and need to be able to retain them and our employees.

Our success depends, to a significant extent, on the continued active participation of our executive officers, other members of management and key technical and sales and marketing personnel. In addition, there is intense competition for employees with technical expertise in our industry. Our success will depend, in part on:

- our ability to retain the employees who have assisted in the development of our products;
- our ability to attract and retain additional qualified personnel to provide technological depth and support to enhance existing products and develop new products; and
- our ability to attract and retain highly skilled computer operating, marketing and financial personnel.

We cannot make assurances that we will be successful in attracting, integrating, motivating and retaining key personnel. If we are unable to retain our key personnel and attract additional qualified personnel as and when needed, our business may be adversely affected.

We may be unable to effectively manage our growth and expansion, and as a result, our business results may suffer.

Our goal is to grow significantly over the next few years. The management of our growth, if any, will require the continued expansion of our operational and financial control systems, as well as a significant increase in our manufacturing, testing, quality control, delivery and service capabilities. These factors could place a significant strain on our resources.

Our inability to meet our manufacturing and delivery commitments in a timely manner (as a result of unexpected increase in orders for example) could result in loss of sales, our exposure to contractual penalties, costs or expenses, as well as damage to our reputation in the marketplace.

Our inability to manage growth effectively could have a significant effect on our business, financial condition and results of operations.

We have limited experience in making acquisitions.

We may wish to pursue the acquisition of businesses, products and technologies that are complementary to ours. However, to date, our management has had limited experience in making acquisitions. In June 1998, we acquired PacInfoSystems, which is based in Portland, Oregon.and in 2001, PacInfoSystems acquired Dean Technologies LLC (Dean Tech), which is based in Grapevine, Texas. Acquisitions involve a number of other risks, including the difficulty of assimilating geographically diverse operations and personnel of the acquired businesses or activities and of maintaining uniform standards, controls, procedures and policies. There can be no assurance that we will not encounter these and other problems in connection with any acquisitions we may undertake. There can be no assurance that we will ultimately be effective in executing additional acquisitions. Any failure to effectively integrate future acquisitions could have an adverse effect on our business, operating results or financial condition.

We are engaged in a highly competitive industry, and if we are unable to keep up with or ahead of the technology our sales could suffer. Additionally, we are fairly new players in the highly competitive IP telephony sector, and there are no assurances that we will be able to effectively compete with the more established businesses.

IBM sells competing products to our own, and can exercise significant customer influence and technology control in the IBM host connectivity market. We may experience increased competition in the future from IBM or other companies, which may adversely affect our ability to continue to market our products and services successfully.

We also compete against various companies that offer computer communications products based on other technologies that in certain circumstances can be competitive in price and performance to our products. There can be no assurance that these or other technologies will

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not capture a significant part of the existing or potential IBM midrange computer communications market.

The market for our products is also characterized by significant price competition. We may therefore face increasing pricing pressures. There can be no assurance that competitors will not develop features or functions similar to those of our products, or that we will be able to maintain a cost advantage or that new companies will not enter these markets. We believe, however, that our significant proprietary know-how and experience in emulation technology gives us long-term advantages.

The IP Telephony market is very competitive with large companies such as Cisco competing for the same market segment. There can be no assurance that we will be able to successfully penetrate the market or realize significant revenues from our line of products and become profitable.

The measures we take in order to protect our intellectual property may not be efficient or sufficient.

Our success is dependent upon our proprietary rights and technology. We currently rely on a combination of trade secret, copyright and trademark law, together with non-disclosure and invention assignment agreements, to establish and protect the proprietary rights and technology used in our products. Much of our proprietary information is not patentable. We generally enter into confidentiality agreements with our employees, consultants, customers and potential customers and limit the access to and the distribution of our proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our technology without authorization, or to develop similar technology independently. We do not believe that our products and proprietary rights infringe upon the proprietary rights of others. However, there can be no assurance that any other party will not argue otherwise. The cost of responding and adequately protecting ourselves against any such assertion may be material, whether or not the assertion is valid. Further, the laws of certain countries in which we sell our products do not protect our intellectual property rights to the same extent as do the laws of the United States. Substantial unauthorized use of our products could have a material adverse effect on our business. We cannot make assurances that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology.

We rely on certain key suppliers for the supply of components in our products.

We purchase certain components and subassemblies used in our existing products from a single supplier or a limited number of suppliers. In the event that any of our suppliers or subcontractors become unable to fulfill our requirements in a timely manner, we may experience an interruption in production until an alternative source of supply can be obtained, although we are of the opinion that the level of inventory held by the Company would probably be sufficient to cover such a period.

Sales in the US depend on one master distributor

Up until the fourth quarter of 2002, we marketed our BOScom products through a US subsidiary (the BOS US division of PacInfoSystems). Currently, we market our products through one master distributor, Bosanova Inc. The sales of our products in the US market currently account for more than 50% of our sales. In the event that we will encounter problems working with the master distributor, we may experience an interruption in sales until an alternative source of distribution can be found.

Fluctuations in our operating results could result in lowered prices.

Our sales and profitability may vary in any given year, and from quarter to quarter, primarily depending on the number of products sold in the United States and in Europe. In order to maintain and increase sales to the United States and to Europe, we may find it necessary to

decrease prices. We will need to offer competitive, low entry prices in order to enter into new markets with new products such as entering the European market with our VoIP products.

We have limited capital resources and we may encounter difficulties raising capital.

The expansion into the IP market will require additional resources and especially working capital. Our efforts to obtain a credit line from a financial institution have not been successful, and therefore we plan to raise capital and/or to collaborate with strategic alliances. However, the IP telephony market has been unstable and vulnerable and we may encounter difficulties raising capital. If our efforts to raise capital do not succeed, our efforts to increase the business and to compete with our competitors may be seriously jeopardized.

There can be no assurance that we will not be classified as a passive foreign investment company (a PFIC).

Based upon its current and projected income, assets and activities, we do not believe that at this time the Company is a passive foreign investment company (a PFIC) for US federal income tax purposes, but there can be no assurance that we wont be classified as such in the future. Such classification may have grave tax consequences for US shareholders. One method of avoiding such taxation is by making a qualified electing fund election for the first taxable year in which the Company is a PFIC, however, such an election is conditioned upon the Company furnishing US shareholders annually with certain tax information. The Company does not presently prepare or provide such information, and such information may not be available to US shareholders if the Company is subsequently determined to be a PFIC.

We have significant sales worldwide and could encounter problems if conditions change in the places where we market our products.

We have sold and intend to continue to sell our products in markets through our subsidiaries in the United Kingdom, and France, and through distributors in North America and Europe.

A number of risks are inherent in engaging in international transactions, including -

- international sales and operations being limited or disrupted by longer sales and payment cycles,
- possible encountering of problems in collecting receivables,
- governmental controls, or export license requirements being imposed,
- political and economic instability in foreign countries
- trade restrictions or changes in tariffs being imposed, and
- laws and legal issues concerning the foreign countries

If we should encounter such difficulties in conducting our international operations, it may adversely affect our business condition and results of operations.

As part of a global slow down in the world's technology markets, technology-focused corporations have suffered and as a result their shares have declined in value.

Our Company, like other technology companies, has been significantly impacted by the current market slowdown in the technology industry. There can be no assurance that the technology market will fully recover or that our operating results will not suffer as a consequence.

Inflation and foreign currency fluctuations significantly impact on our business results.

The vast majority of our sales are made in US Dollars and most of our expenses are in US Dollars and New Israeli Shekel ("NIS"). The Dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel over the rate of

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inflation in the United States is offset by the devaluation of the NIS in relation to the Dollar. Our Dollar costs in Israel will increase if inflation in Israel exceeds the devaluation of the NIS against the Dollar or if the timing of such devaluations lags behind inflation rate increases in Israel.

Political, economic, and security conditions in Israel affect our operations and may limit our ability to produce and sell our products or provide our services.

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and our principal manufacturing, research and development facilities. Political, economic, security and military conditions in Israel directly influence us. We could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel. The future of the "peace process" with the Palestinians is uncertain and has deteriorated due to Palestinian violence. Furthermore, the threat of a large-scale attack by Palestinians of Israeli civilians and key infrastructure remains a constant fear. The past two years of renewed terrorist attacks by the Palestinians has severely affected the Israeli economy in many ways. In addition, several countries still restrict business with Israel and with companies doing business in Israel. We could be adversely affected by adverse developments in the "peace process" or by restrictive laws or policies directed towards Israel or Israeli businesses.

Additionally, the recent conflict in Iraq has caused many investors to shy away from Israel, and this has had considerable ripples across the entire Israeli economy.

Generally, male adult citizens and permanent residents of Israel under the age of 48 are obligated to perform up to 31 days of military reserve duty annually, depending on their age and position. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. This requirement directly impacts on our workforce and overall business structure when some of our officers and employees are called upon to perform military service, and such interruptions are difficult to predict (and therefore cannot usually be planned in advance).

If the Israeli Government programs that we benefit from are reduced or terminated, our costs and taxes may increase.

Under the Israeli Law for Encouragement of Capital Investments, 1959, facilities that meet certain conditions can apply for Approved Enterprise status. This status confers certain benefits including tax benefits. Our existing facilities have been designated as Approved Enterprises. If we attain taxable income in Israel, these tax benefits will help reduce our tax burden.

The Government of Israel has indicated its intention to reexamine its policies in these areas. The Israeli Government authorities have indicated that the government may reduce or eliminate these benefits in the future. The termination or reduction of these benefits could harm our business and our future profitability.

In addition, in order to maintain our eligibility for the grants and tax benefits we receive, we must continue to satisfy certain conditions, including making certain investments in fixed assets and operations and achieving certain levels of exports. If we fail to satisfy such conditions in the future, we could be required to refund tax benefits which may have been received with interest and linkage differences to the Israeli Consumer Price Index.

Under the Law for the Encouragement of Industrial Research and Development, 1984 (the Research Law), research and development programs approved by a research committee appointed by the Israeli Government are eligible for grants against payment of royalties from the sale of products developed in accordance with the Program. Regulations set under the Research Law generally provide for the payment of royalties to the Office of the Chief

Scientist of 3.5% on sales of products developed as a result of a research project so funded until 100% of the dollar-linked grant is repaid. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate of LIBOR applicable to U.S. dollar deposits.

The Research Law requires that the manufacture of any product developed as a result of research and development funded by the Israeli Government take place in Israel. It also provides that know-how from the research may not be transferred to third parties without the approval of the Israeli Office of the Chief Scientist in the Ministry of Industry and Trade.

All of our directors and officers are non-U.S. residents and enforceability of civil liabilities against them is uncertain.

All of our directors and officers reside outside of the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, because the majority of our assets are located in Israel, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

Item 4: Information on the Company

4A. History and Development of the Company

We were incorporated in Israel in 1990 as a private corporation under the Israeli Companies Ordinance, 1983. Our headquarters and manufacturing facilities are located at 100 Bos Road, Teradyon Industrial Zone, Misgav 20179 Israel. Our telephone number is 972-4-990-7555.

In January 2002, the Company changed its organizational structure. As part of this change, the Company s marketing, development, production and support activities were sold to Lynk, a B.O.S. subsidiary founded in 1995, to develop and market high-quality data access convergence and remote access solutions, and later IP telephony hardware and software telephony, for the corporate market. Following the reorganization, Lynk changed its name to BOScom Ltd.

On May 24, 2002, the Company announced its intention to sell PacInfoSystems (see Risk Factors and Note 18 of the Financial Statements) due to a change in the Company's business strategy. PacInfoSystems is the Company's wholly-owned U.S. subsidiary that resells, installs and provides computer networking products to various business entities, yet, management formulated a new strategic plan that provided for the discontinuation of the computer networking business. As a result, the Company decided in May 2002 to sell PacInfoSystems and to write-off amortized goodwill associated with PacInfoSystems in the amount of $3.9 million.

However, the Company's efforts to sell PacInfoSystems, whose financial situation was deteriorating, were not successful. Further developments, such as the arbitration judgment rendered against PacInfoSystem in the sum of approximately $650K, continuation of poor sales results, termination of line of credit, as well as the loss of some key employees and sales force, left the Company with little choice but to dissolve the business. The Company is now in the process of working out a settlement with PacInfoSystems' creditors. Although, as of this date, a settlement has been reached with a majority of PacInfoSystems' creditors, there can be no assurance that such a settlement will be reached with the remainder of the creditors.

Our U.S. subsidiaries are Lynk USA, Inc. and its subsidiary Pacific Information Systems, Inc (into which our US subsidiary, Better On-Line Solutions Inc. was merged in early 2001). Our other subsidiaries are BOScom Ltd., in Israel, and its subsidiaries - Better On-Line Solutions Ltd in the U.K; Better On-Line Solutions S.A.S in France; and BOSDelaware, Inc. in the US. We established another BOScom subsidiary, in Italy in the first quarter of 2001, but decided to close it in December 2001.

In addition, we have an interest in Surf Communications Solutions Ltd. ("Surf"), the leading supplier of embedded network convergence software that lends flexibility and scalability to network products handling data modem, fax, and voice transmissions. Surf's open system software is integrated into equipment such as media gateways and remote access concentrators developed by original equipment manufacturers in the telecommunications, telephony, and data networking industries. As of December 31, 2002 the Company held 16.13% of the outstanding share capital of Surf (12.8% on a fully diluted basis), and had signed a term sheet with Catalyst Investments, L.P. ("Catalyst"), for the purchase of most of the Surf shares held by Catalyst (the "Transaction"). The Transaction with Catalyst closed on March 30, 2003. Under the terms of the Transaction, the Company purchased 191,548 of Catalyst's Preferred C shares in Surf, and a pro rata share of the Surf Preferred C warrants held by Catalyst, and in exchange it issued to Catalyst 2,529,100 Ordinary Shares of the Company (representing 19.9% of its current outstanding shares pre-issuance, as a result of which Catalyst held 16.6% of the outstanding Company shares, after the issuance). The Company has an option to purchase the remaining Catalyst Preferred C shares in Surf by January 31, 2006, and until such purchase shall be granted voting rights in these Surf shares, in addition to being entitled to profits resulting from the sale of these shares to a third party. Thus, the Company now holds 20.6% in Surf, and 16.7% on a fully diluted basis. It holds 23.5% of the voting rights in Surf, and 19.2% on a fully diluted basis.

We design, integrate and test our products in our facilities in northern Israel. In early 1996, we moved into a new facility, which resulted in the expansion of our production capabilities and has allowed us to continue to benefit from substantial Israeli tax incentives.

For a description of our principal capital expenditures, please see Notes 8 and 9 of our Financial Statements.

4B. Business Overview

Industry Background

In the 1960s and 1970s, the business computing environment was typically organized, with the mainframe in the data center and minicomputers at the division or department level. The host mainframe and minicomputers were accessed by "dumb" terminals at the user level. These host systems featured high performance and throughput and often ran custom-designed, critical applications such as organization-wide payroll, general ledger, inventory management and order processing programs. Because of the importance of the mainframe and minicomputers as central repositories of corporate data and critical applications, significant corporate resources were, and continue to be, dedicated to maintaining this installed hardware and software base. Although these host systems are capable of supporting enterprise-wide information system networks, their applications are generally characterized by limited availability, complex command sequences and character-based user interfaces.

With the introduction and proliferation of the personal computers in the 1980s, a substantial amount of corporate computing power was added to the worker's desktop, a change facilitated by the availability of increasingly powerful personal productivity applications such as spreadsheets and word processors. Personal computers began replacing dumb terminals and, as the business computing environment became increasingly heterogeneous, organizations found themselves with significant investments in multiple, but often incompatible, systems each performing different functions within an organization.

Despite the functionality of personal computers, users still needed access to certain data and applications residing on host systems. Terminal emulation hardware and software was developed to provide host connectivity by allowing personal computers to emulate the dumb terminals they had replaced. Often, however, these terminal emulation products were complicated, difficult to use and allowed only a single connection to a single host. In addition, terminal emulation products made little or no provision for the integration of host data and

applications with personal computers data and applications such as spreadsheets. Therefore, the full capabilities of the personal computers were not available to the user when the personal computer was used as a terminal.

In the mid-1980s, the desire of personal computer users to share files and peripheral devices, and to communicate with other users, led to the widespread implementation of Local Area Networks. Local Area Networks significantly expanded an organization's ability to more efficiently connect increased numbers of its personal computer users to host environments through a "gateway" dedicated to LAN-to-host communication services. The personal computer software enabling this LAN-to-host connectivity continued to use terminal emulation technology.

The emergence of the Internet/intranets in the 1990s has encouraged the development of numerous new products and services that enable and facilitate access and connectivity of host computers with computer networks. New IBM midrange products have expanded capabilities of the AS/400 in the area of electronic commerce.

Continued widespread use of Twinax cable infrastructure has created a need to develop solutions that can provide these users with such features as e-mail, networking, and Internet. In addition, the advent of the telephony revolution, which allows transmittal of voice data over TCP/IP connections, has created a new direction for IP Telephony products.

An industry trend noticed in the late 1990s was a move to a "thin client" environment. Larger enterprises use this method as a means to reduce cost of ownership by employing Microsoft Windows NT/2000 Terminal Servers, which enable central configuration and user management. Terminals ("thin clients") are deployed to users throughout the network to provide the requisite connectivity to host applications. BOS moved into this arena in early 2003 with a Linux-based line of thin clients and Ethernet terminals featuring embedded TN5250e/TN3720e emulation and Web browser.

In 1995 the first Client IP telephony solution was introduced to the market by VocalTec, an Israeli company that demonstrated telephone calls over the internet.

Since then, in an accelerated mode, the VoIP (Voice over Internet Protocol) and IP telephony (Internet Protocol Telephony) have become a market with a turnover of billions of dollars.

Large companies like Cisco, as well as telephony players such as Lucent, Nortel, Siemens, Alcatel, Avaya and others are selling IP telephony solutions and embedding such technologies into their product line.

Some players in this market develop solutions for carriers, others focus on the corporate market.

According to market research performed by professional market analysis firms such as Advanced Business Link, the revenues in this market are expected to grow for at least the next 5 years.

Description of Business Product Lines

Our Company operates in two main business product lines:

(a) Connectivity -

We create innovative and powerful solutions for seamless integration of personal computers and Local Area Networks into the midrange host environment. We also design, integrate, test, market and support superior products that provide efficient solutions to personnel connecting personal computers to IBM midrange hosts. Realizing the changing role of this IBM midrange environment in today's workplace, our mission is to provide our users with technologically advanced and cost-efficient solutions for connectivity between them and

personal computers and local area networks, whether local or remote. We sell and support our products worldwide through a network of subsidiaries, distributors, and value-added resellers.

Our proprietary products are sold to users of IBM iSeries, AS/400 and System 3x computers, which are predominantly medium to large sized corporations that use large data banks in their businesses and require the ability to integrate and manipulate the data into graphics and popular personal computer programs. The target market for our products is composed of the owners of approximately 500,000 IBM AS/400 and System 3x computers and the growing number of users who connect to these computers through the Internet, intranets and various other connectivity products. During 1999, we have been expanding our line of products and are now marketing and selling products that are not limited solely to users of midrange IBM computers.

Our main product line is comprised primarily of TCP/IP to Twinax controllers that allows Legacy Twinax equipment to work locally or remotely via TCP/IP line to the AS/400. In addition we have a line of emulation software, to simulate a personal computer environment having the same functionality to which the users are accustomed (i.e. Windows or similar graphical interfaces), while using a midrange computer. The emulation solutions are offered at two levels - at the user interface level and at the computer connectivity level. At the user interface level, our emulation technology allows customers to utilize popular Windows functions and graphics. At the connectivity level, our connectivity technology provides personal computers with the ability to act as terminals for IBM midrange computers either through gateway, Internet or direct connection.

We are using our expertise in the midrange computer environment to develop Internet/intranet solution products that will enable and enhance connectivity between IBM iSeries computers and personal computers via the Internet and intranets.

In 2002 67% of our sales of connectivity products and services were made to customers in the United States and Europe. We believe that the growth potential for our emulation products in the United States and Europe is significant as additional personal computer users seek to access the already substantial databases of midrange computers.

Below is a description by category of our development activity in the connectivity business segment:

(a1) Document Design, Distribution and Management

PrintBoss, introduced in late 1998, provides document design and distribution solutions for a wide range of operating systems, including mainframe and UNIX. Recent collaborative efforts with printer manufacturers and software houses have proven PrintBoss' appeal as an original equipment manufacturer component, in addition to its suitability as an end user solution. We believe that both the MorphMaster (one of our client solution products, described later in this Item 4), and the PrintBoss facilitate the implementation of graphic representation of screens and printouts.

The year 2000 saw the second major release of PrintBoss, which added support for e-Mail distribution, secure printing (complementing the existing check printing functionality), and document routing to multiple destinations capability.

In 2001 we were awarded a large contract with one of Israel's leading banks to provide uniform, customized electronic forms to all its branches. This project was completed in 2002.

(a2) AS/400 Display and Printing Emulation for LAN/WAN

In December 1997, we announced our BOSaNOVA transmission control protocol / internet protocol product, a connectivity tool for organizations with either local or remote TCP/IP networks (intranet or extranet) of personal computers using Windows 9x/Me or NT/2000/XP operating systems connected to the AS/400. Development resources in 1999 were directed

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toward making TCP/IP connectivity available for Twinax users. The e-Twin@x technology has now been implemented in products such as the BOSaNOVA Plus, BOSaNOVA TCP/IP, and e-Twin@x Controller, which made its debut in the middle of 1999, and has been rapidly established as the remote computer controller of choice.

(a3) Browser-based Web-to-Host GUI Display and Printing

In December 1997, we introduced Jadvantage, a Java-based application that provides AS/400 and iSeries computer users with TN5250e emulation and printing on personal computers via an Internet browser. Jadvantage enables any user equipped with a Java-enabled Web browser to securely access iSeries or AS/400 applications, eliminating the need for the user to install and upgrade emulation software. Over the years, the Jadvantage has been improved greatly by the inclusion of support for native SCS printing, SQL-based data transfer, SSL protocol for bi-directional secure communications, and extended administrative capabilities.

Version 5 of Jadvantage was released in 2003. The latest version expands client support to Netscape browsers, Macintosh computers and Linux platforms. The product is especially attractive to enterprises that want to make their iSeries applications available to remote users, whether they be branch offices, road warriors, home workers, distributors or customers. The built-in GUI toolbox makes Web facing applications (improving the applications interface with graphics, fonts, colors, mouse-sensitive hot-spots, etc.) both quick and simple, in direct contrast to other products in the field.

(a4)Twinax-to-Ethernet Controllers

The e-Twin@x Controller, which made its debut in 1999, supplies a secure, encrypted TN5250e connection to the AS/400 over the Internet or WAN, and provides local or remote Twinax networks with access to LAN resources. The e-Twin@x Controller allows enterprises to leverage their Twinax investments (in equipment and cabling) while providing the benefits of a TCP/IP connection. Dramatic improvements in performance, uptime and cost-efficiency are the result. A new model, the e-TwinSt@r, was released in 2002. It features native support for CAT5 cabling, in the form of built-in RJ45 sockets, saving customers with this environment the cost of an active star hub

(b) IP Telephony Solutions

BOS has developed a series of intelligent and highly versatile IP telephony products designed for the corporate market. The gateways (described below see products) enable enterprises to reduce or completely eliminate inter-office communication costs or bypass long-distance costs using their private Intranet or the public Internet to carry telephone calls. They also provide a powerful means to extend PBX functionality to the enterprises branch offices. The IP Telephony family of products includes a series of gateways and clients which work together seamlessly for a variety of business applications. All gateways are built using standard protocols and pass interoperability tests. Special attention is given to build a robust platform with a user-friendly interface with automated installation procedures. All enhancements complement the priority target of top-level voice quality connection

Until late 2002, we operated in a third business product line ***computer networking***:

On June 1, 1998, we acquired 100% of the share capital of Pacific Information Systems, Inc. (PacInfoSystems), a U.S. corporation which resells, installs and provides computer networking products to various business entities. PacInfoSystems sold thousands of computer products and provided individual adaptation of product solutions suited to customer needs based on their technology challenges. PacInfoSystems also provided a variety of support services, such as Network Design, Network Performance Measurement and others. PacInfoSystems was a value added reseller of many manufacturers including: IBM, Bay Networks, Hewlett Packard, Microsoft, Cisco Systems, Toshiba, Intel and others. The aggregate consideration for this acquisition included $3,044,000 (excluding related costs) in cash and 405,634 shares of our Company. Certain payments and grants of shares were subject to the performances of PacInfoSystems, which were achieved. The acquisition of PacInfoSystems also provided us with improved distribution of our IBM midrange connectivity products and remote computer and telephony products, as well as an entry into the computer networking reseller market in the United States.

In 1999, PacInfoSystems entered the e-Commerce field and began providing e-Commerce solutions by assisting customers to establish their own fully secured e-Commerce Web sites, and by servicing e-Commerce businesses via its own Web site. In 2000, PacInfoSystems introduced its Computer Telephony Integration and Convergence (CTI) department. CTI enables customers to transfer voice and data over the traditional communication platforms and over the Internet. In 2001, PacInfoSystems launched its Managed Service Provider (MSP) division and opened its Network Operating Center (NOC) which provided monitoring and event management service 24 hours per day, 7 days a week. In 2001, PacInfoSystems acquired 100% of Dean Tech Technologies Associates, L.L.C. (Dean Tech). Dean Tech was an IBM Advanced Business Partner providing complete IT solutions utilizing IBMs industry-leading eServer pSeries and xSeries lines of servers, as well as IBM TotalStorage Solutions. Dean Tech specialized in highly available solutions for mission critical applications, storage management and disaster recovery planning, storage area network and network attached storage solutions, and systems design, implementation and administration.

100% of our computer networking revenues were derived from sales to US customers.

As of today, both PacInfoSystems and Dean Tech have ceased all operations. Dean Tech began its dissolution process in the fourth quarter of 2002 and as aforementioned, PacInfoSystems is in the process of dissolving as well.

Products

We currently offer a variety of products that provide various connectivity and IP telephony solutions to customers.

(a) Connectivity Solutions -

Our products are divided into three areas:

(1) connectivity emulation solutions,

(2) gateway/server solutions,

(3) client solutions,

(a1) Connectivity Emulation Solutions

Our emulation products provide personal computer users with easy access to computer applications and data on IBM midrange computers. These products establish communications connections between a customers personal computer or Local Area Network and IBM midrange computers using familiar, easy-to-use modem network or Twinax hardware and software.

Our connectivity emulation products are comprised of personal computer adapter cards which, when installed with emulation software (of ours or of other providers), enable personal computers to function as Twinax terminals. These products are based on Stealth Technology which can easily integrate our products with those of other manufacturers, and the Ornev Chip, a computer chip for the software level that interfaces with the hardware of the computer IBM compatible, and which we believe is superior to the other chips currently available in the market. We believe the Ornev Chip is faster (which is important during file transfer) and incorporates more sophisticated signal processing algorithms that make it especially reliable in situations involving communication lines of marginal quality. The

Stealth Technology and the Ornev Chip reduce the personal computer resources consumed, such as memory or IRQ, as compared to other currently available products. As a result, products based on the Ornev Chip are easier to install than other currently available products, especially on Pentium computers.

Our connectivity emulation products include emulation boards, emulation software, and terminals as described below:

Emulation Boards

- *Native Plus.*
  An IBM-compatible Twinax card with 5250 Stealth Technology . This product does not require a memory segment of the personal computer or its valuable resources in order to facilitate interaction with the hardware.

- *BOSaNOVA Plus.*
  An enhanced version of the Native Plus that includes a Twinax adapter card with feature-rich 5250 display/printer emulation software for either DOS, 16- or 32-bit Windows and 32-session APPC display/printer emulation software. This product is based on an IBM compatible Twinax card with 5250 Stealth Technology.

Emulation Software

- *BOSaNOVA TCP/IP.*
  A robust client application that provides Windows9x/Me/NT/2000/XP users on a TCP/IP network with essential iSeries and AS/400 connectivity. The product includes BOSs rich 5250 emulation, LPD printing capabilities, file transfer and a remote command facility. This product was announced at the end of 1997 and released in the first quarter of 1998.

- *Jadvantage.*
  A Java-based application that provides iSeries and AS/400 users with TN5250e emulation and printing and SQL-based data transfer on personal computers via an Internet browser. It is aimed at organizations that use the Internet and intranet for an increasing number of applications. Jadvantage enables any user equipped with a Java-enabled Web browser to securely access iSeries and AS/400 applications, eliminating the need to install and upgrade emulation software on each of the attached clients, and reducing the maintenance and overhead usually associated with installation and updating of client applications for secure communication over traditionally non-secure TCP/IP networks. Jadvantage includes SSL data encryption, IP address restriction and Jadvantage server log-in.

Terminals

- *BOSaNOVA LTC Series*
  The BOSâNOVA LTC Series of thin client terminals provides an easily configurable solution to desktop computing. Whether the application is data entry, point of sale, training, ISPs, or web kiosks, these thin clients provide a highly cost-effective access to Windows desktop applications residing on a Microsoft Windows NT/2000 Terminal Server. Central configuration and user management drastically reduces cost of ownership, while the versatility of the hardware platform and customization capabilities increase user productivity. The high end LTC-600 provides almost twice the processing power and up to seven times the performance when compared to industry-standard Windows CE-based thin clients!.

- *BOSaNOVA TBT-300*
  The BOSâNOVA TBT-300 Ethernet terminal offers the very best TN5250e and TN3270e emulation available for a LAN environment. In contrast to standard text-

based terminals, the BOSâNOVA TBT-300 includes Windows 2000 Terminal Server (RDP) and Citrix Metaframe (ICA) clients in its basic configuration. Full support for 122 key keyboards is also built in to allow maximum productivity for users migrating from other 5250 or 3270 terminals. Performance tests measuring response time for its TN5250e and TN3270e embedded emulation indicate that the BOSâNOVA TBT-300 outperforms similar products based on Windows CE by a ratio of five to one!

(a2) Gateway/Server Solutions

Our gateway solutions provide host access to personal computers not directly connected to the host, either through remote gateways, which allow personal computer users to receive emulation sessions over telephone lines, or through Local Area Network gateways, which provide a bridge between the host and all personal computers on a local area network. Gateways, residing in the same physical premises as the host and connected to it directly, are connected to the host on one side, and either Local Area Network or serial communication port on the user side. Remotely attached gateways replace controllers and primarily serve users of one remote office or site. Most users at the remote site are connected through the Local Area Network to the gateway. Remote gateways usually utilize some sort of System Network Architecture protocol to connect to the host.

Our gateway/server products include:

- *e-Twin@x Controller*.
  This product provides IP over Twinax connection to local and remote iSeries and AS/400s, adding the benefits of a Local Area Network to existing Twinax infrastructure. This product eliminates the difficulty of maintaining System Network Architecture and Anynet protocols, replacing them with fast, state-of-the-art Transmission Control Protocol / Internet Protocol (TCP/IP).

- *Advanced Server for SAA*.
  A gateway package for connecting LAN-based personal computers to IBM midrange (iSeries, AS/400 or Advanced 36) hosts. Advanced Server for SAA is comprised of server and client workstation software that facilitates communication between the personal computer and the host, thereby conserving host resources for more important tasks such as serving more simultaneous users. The product was introduced to the European market at the end of 1996 and to the US market in the fourth quarter of 1997.

- *PrintBoss*.
  A multi-platform forms design, distribution and management tool that can be installed on a personal computer and enables companies to eliminate pre-printed forms and create their own templates. Forms can be customized and improved with logos, barcodes, fonts, static and dynamic graphics, and formatted, resizable tables. Documents can be routed to different printers, fax servers, e-mail recipients or archives for efficient and aesthetic printing, without programming or changes to the host application.

(a3) Client Solutions

Our client solution products provide personal computer users with access to IBM midrange hosts in several different ways. These products provide for workstation function with additional interfacing capabilities for host access on personal computers e.g. shared folders, file transfer, Dynamic Data Exchange (DDE) interfaces, High Level Language Application Programming Interface (HLLAPI) interfaces, along with documented application programming interfaces. Recent developments are Graphical User Interfaces (GUIs) (such as MorphMaster) in which the standard black and green host screens are transformed into

graphic, Windows-like screens, and Structured Query Language (SQL) file transfers, whereby users can define and perform file transfers from the host to the personal computer (and vice versa) based on keywords.

The Client Solution product line emulates Windows software and offers a personal computer/host file transfer system for Windows and Windows graphics.

Client solution products include:

- *BOSaNOVA Client for Windows*.

  An advanced midrange Windows client software solution, which enables communication with host systems through Twinax, Ethernet, Token Ring, SDLC, and TCP/IP. The product provides workstation and other functions in a variety of protocols.

- *via BOSaNOVA*.

  A versatile PC/host file transfer system for Windows that provides flexible and powerful file transfer between a midrange host and stand-alone, LAN-based, or remote personal computers. When used in conjunction with LANbada/Twinax for Windows, all personal computers across a Local Area Network instantly receive file transfer capability. This software product has the built-in capability to convert host data into popular personal computer file formats, incorporating data into personal computer spreadsheet and database applications.

(b) IP Telephony Solutions

- *BOSâNOVA Gateways (FXO, FXS, E1/T1)*

  a series of modular point-to-point IP Telephony gateways that integrate voice, telephony and data over IP, frame relay and circuit switched networks. The BOSâNOVA gateways family provides a complete, end-to-end IP Telephony solution including security, management and gatekeeper functionality, and deliver outstanding voice quality calls over IP networks. Gateways are available in FXO (2-, 4-, and 8-port) models and FXS models (2-, 4-, 8-, and 16-port models), which connect to corporate Public Telephone Exchanges (PBXs) and/or extensions using standard analog interfaces and E1/T1 models (23/30 digital channels per adapter).

- *BOSâNOVA Connect*

  a desktop device that allows mobile/remote workers to place and receive high-quality voice calls over IP networks using regular telephones.

- *BOSâNOVA Claro*

  A new family of intelligent IP Telephony gateways, premised on BOSâNOVA gateway technology automatically and transparently route calls from the PBX to either the PSTN or the IP network.

  Positioned between the enterprise PBX and the PSTN (Public Switched Telephony Network), the Claro gateway selectively routes all PSTN-designated traffic over the PSTN, and captures all potential IP traffic for routing over the IP network. Traffic is routed over the IP network only when QoS (quality of service) meets user-designated threshold levels. If QoS degrades below this level, in spite of quality-boosting algorithms, calls are dynamically routed over the PSTN instead of the IP network. In this way, carrier-grade quality of service is guaranteed for each call.

Remote Multi-Access Solutions

Surf Communication Solutions Ltd. in which the Company has invested, is a leading developer and supplier of software-based access solutions for premier original equipment manufacturers in the telecommunications, data communications, telephony and wireless

industries. Addressing the growing demand for high density, cost - effective V.92 modem, fax, V.34 voice and broadband solutions, Surfs Multi-Service Framework enables OEMs to build equipment that is enabling the convergence of traditional Circuit Switched Networks and emerging Packet Data Networks.

Addressing the growing demand for high density, modem, fax (FoIP) & voice (VoIP) solutions, Surfs products provide full convergence of these different types of services.

Surfs solutions provide the highest channel density, outperforming all other solutions. The Companys open system software is integrated into embedded data communication equipment developed by original equipment manufacturers in the telecommunications, telephony, and wireless industries. Surf offers both customized solutions and off-the-shelf products.

Marketing, Distribution and Sales

We market our products primarily to medium to large sized corporations through a combination of direct sales, indirect distribution and original equipment manufacturers.

In the United States, up until the fourth quarter of 2002, we marketed our BOScom products through a US subsidiary (the BOS US division of PacInfoSystems). Currently, we market our products through one Master Distributor (Bosanova, Inc.) located in Phoenix, Arizona who coordinates the midrange connectivity-related marketing efforts of 15 distributors, and also offers technical support and after-sales service.

In the United Kingdom and Ireland, we market and support our entire range of product through Better On-Line Solutions Limited, our U.K. subsidiary. In late 1999, we transferred the responsibility for most of the sales and service activity in Europe from Israel to our U.K. subsidiary. In early 2001, we established a new wholly owned subsidiary in France (Better On-Line solutions S.A.S) to market and service our entire product line in that country, but we recently decided, due to cost-efficiency considerations, to cease operations through the subsidiary and to market in France through distributors. In the German-speaking nations (Germany, Switzerland and Austria), we sell our products through a master distributor called Products for Europe. In the rest of Europe, we market our products through local distributors, with our UK subsidiary providing post-sales support. Products sold in the rest of the world are serviced from our headquarters in Israel.

We further rely on peripheral product distributors who offer our products along with other products for the IBM midrange market. We also rely on value added resellers who offer system sales and installation which include a variety of our products. In addition, we heavily depend upon our own marketing resources operating from Israel.

In 2002 we began an intensive campaign to recruit IBM Business Partners to join our distribution channel.

Our principal customers include: Informatics, TwinData, Peak Systems Group, System One Support, I/O Connections, KGA Technologies, and Machines & Media.

We generally do not have any significant backlog because orders are usually shipped when received.

Our Companys sales do not fluctuate seasonally.

The following table sets forth our revenues from the continuing segment, by major geographic area for the periods indicated below:

Year ended December 31,
(in thousands US$)

	2002	%	2001	%	2000	%
United States	4,989	53%	3,184	53%	3,243	45%
Rest of World (mainly Europe)	2,158	23%	1,603	26%	2,713	37%
Total outside of Israel	7,147	76%	4,787	79%	5,956	82%
Israel	2,294	24%	1,255	21%	1,338	18%
Total Revenues	9,441	100%	6,042	100%	7,294	100%

See Note 20 to the Financial Statements.

Manufacturing

Our products are designed, integrated and tested at our facility in Teradyon, Israel. The manufacturing is done by Israeli sub contractors using components and subassemblies supplied by vendors to our specifications. We have developed our own proprietary technology related to ASIC (ASIC is an acronym for "Application-specific Integrated Circuit" and its a microchip), and the circuit board incorporating such technology is manufactured for us by a subcontractor. Certain components and subassemblies used by us in our existing products are purchased from a single supplier or a limited number of suppliers. Most of the imported components are purchased in Israel from local representatives of the manufacturers. Some of them have exclusive representative rights in Israel. In the event that these suppliers are unable to meet our requirements in a timely manner, we may experience an interruption in production until an alternative source of supply can be obtained. We do our best effort to keep sufficient quantities of components that will enable us to find a second source, when needed. We generally maintain an inventory of components and subassemblies which we believe is sufficient to limit the potential for such an interruption. Our current manufacturing facilities have sufficient capacity to exceed current demand. The prices of raw materials used in our industry are not volatile.

Intellectual Property

We currently rely on a combination of trade secrets, copyright and trademark law, together with non-disclosure agreements and technical measures, to establish and protect proprietary rights in our products.

We believe that the improvement of existing products, reliance upon trade secrets and unpainted proprietary know-how and the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage. We believe that the value of our products is dependent upon our proprietary software and hardware remaining trade secrets or subject to copyright protection.

Generally, we enter into non-disclosure and invention assignment agreements with our employees and subcontractors. However, there can be no assurance that our proprietary technology will remain a trade secret, or that others will not develop a similar technology or use such technology in products competitive with those offered by us.

While our competitive position may be affected by our inability to protect our proprietary information, we believe that because of the rapid pace of technological change in the industry, factors such as the technical expertise, the knowledge and innovative skill of our management and technical personnel, name recognition, the timeliness and quality of support services

provided by us and our ability to rapidly develop, produce, enhance and market software products may be more significant in maintaining our competitive position.

To date, no material claims have been made against us for infringement of proprietary rights of third parties. There can be no assurance, however, that third parties will not assert material infringement claims against us in the future.

As the number of software products in the industry increases and the functionality of these products further overlaps, we believe that software programs will increasingly become subject to infringement claims. The cost of responding to any such assertion may be material, whether or not the assertion is valid.

Competition

The connectivity market is subject to rapidly changing technology and evolving standards incorporated into personal computers, networks and host computers. BOSs products compete with products that have already been on the market for a number of years and manufactured by competitors, most of which have substantially greater financial, marketing and technological resources and name recognition than ours.

Our competitors include IBM, Perle, Advanced Business Link, PowerTerm, NLynx, NetManage, Attachmate, and Seagull.

BOScom is developing and introducing new products in an industry that is highly competitive. BOScom’s competitors in the VoIP market include Cisco Systems, Inc., VocalTec, Multi-Tech, and Quintum. There can be no assurance that these or other companies will not offer lower priced or more sophisticated products than those being developed or introduced by BOScom, and by so doing capture the market for such products.

Strategy

We believe that the trends described, together with the continuing proliferation of more powerful personal computers and the continued growth of information system networks, will stimulate increasing demand for personal computer interaction with enterprise information systems. We believe that our products can improve the cost effectiveness of customer information systems and increase user productivity with:

- easy simultaneous access to and use of customer host and LAN-based computing resources;
- familiar and easy-to-set-up and use communications among personal computers, LANs and host computers;
- utilities and tools that simplify distributing computing between IBM midrange host systems and personal computer and LAN systems;
- utilities and tools that improve the appearance and distribution efficiency of forms throughout the organization; and
- utilities and tools that enhance and preserve customer investment in equipment and personnel training.

Our strategic objective is to strengthen our product line for the IBM midrange connectivity and emulation market and use our expertise to offer personal computer users the ability to access mainframe hosts through a lower cost personal computer platform. We believe our proprietary technology which permits personal computer users to increase speed without utilizing additional memory at the personal computer level and its advanced graphic capabilities give our product line distinct marketing advantages over competitive products.

We believe we can expand our successful technological application to other markets and users.

The key elements of our strategy are as follows:

- *Maximize efficiency for IBM midrange market.* We intend to expand and support our emulation product line for IBM midrange computers. This includes continuous upgrading and improvement of our connectivity emulation products for direct, gateway and Internet connection, and Windows emulation and graphics capabilities. We continually upgrade our client software to ensure its compatibility with each new Windows platform. We intend to streamline our manufacturing and distribution to better serve our present client base and access a greater share of the IBM midrange market. We have already begun to incorporate common components into our products in an effort to streamline manufacturing and intend to take steps to improve our destination networks.

- *Develop New Products and Applications for Remote Networking Connectivity.* Through our VoIP division, we expect to penetrate a new market significantly greater than our present market of IBM midrange users. BOScom’s VoIP products, which allow users to emulate their office telephony at a remote location, appeal to the small office home office market, telemarketers operating from home, sales personnel traveling to client locations and employees interested in working at home.

- *Develop new markets for our IP Telephony products.* We intend to develop new markets for our IP telephony products, including corporate IP telephony infrastructures as well as IP telephony solutions for telephony service providers.

- *Expand Marketing Network.* We intend to increase our marketing presence in the United States and Europe and to expand our distribution channels in these markets through the use of acquisitions, additional independent distributors and original equipment manufacturers as well as our sales representatives. We also intend to increase our marketing efforts to penetrate new markets within Europe.

- *Acquisition of Complementary Technologies*. We may, from time to time, make selective acquisitions of complementary technologies that we can sell through our existing distribution network. Since October 1997, we have held interests in Surf, and have recently increased our holdings.

- *Web sites:* We maintain web sites where potential customers, investors and others can obtain the most updated information about its activities, products, press releases and financial information.

Our Web sites may be found at:

boscorporate.com

Bosweb.com

boscom.com

Jadvantage.com

Bosanova.com

e-twinaxcontroller.com

Printbos.com

Exchange Controls

See Item 10D.

For other government regulations affecting the Company's business, see Item 5, paragraph entitled "Grants and Participation".

4C. Organizational Structure

The following diagram illustrates the organizational structure of the Company as of the date of this report. Other than Surf Communication Solutions Ltd., each entity is a 100% wholly owned subsidiary of its parent company.

The Company's wholly owned subsidiaries include:

In Israel - BOScom Ltd. (changed its name from Lynk, a Division of B.O.S., in March 2002). Our initial investment in BOScom Ltd. was $336,000 for 86% of BOScom's shares. In 1999 BOScom entered into an agreement with The Industrial Finance Corporation ("IFC") under which it received a three years $1,000,000 long-term loan and 3% of BOScom's share capital at par value. Thus, our shareholdings at BOScom were reduced to 83%. In 2000, we purchased an additional 14% of BOScom's shares and increased our holding in BOScom from 83% to 97%. The aggregate consideration for this acquisition includes $640,000 in cash and 17,804 shares of our Company. In February 2002, we purchased from IFC its 3% of the BOScom's shares (in consideration of the issuance of 3,750 Company ordinary shares), thereby bringing our ownership interest to 100%.

In Europe – BOScom has its UK subsidiary, Better On-Line Solutions Ltd, and its subsidiary, Better On-Line Solutions S.A.S in France, which distribute and service BOScom's products abroad. The UK subsidiary was originally a subsidiary of the Company itself, but became a subsidiary of BOScom as part of the reorganization implemented in January 2002. We have recently decided, due to cost-efficiency considerations, to cease operations through the French subsidiary and to market in France through distributors. We had established another subsidiary, Better On-Line solutions Srl., in Italy, but decided to close it in December 2001.

In the U.S. - Lynk USA Inc., and its subsidiary PacInfoSystems (both Delaware corporations). Until the fourth quarter of 2002, PacInfoSystems had a subsidiary, Dean Tech Technologies Associates, L.L.C. ("Dean Tech"), a Texan corporation, which is in the process of being dissolved. As abovementioned, PacInfoSystems is in the process of dissolving as well.

Lynk USA Inc was established by the Company in 1999, and during 2000, the Company reorganized its operations in the USA under Lynk USA, Inc. which became the holding company of PacInfoSystems and Better On-Line Solutions, Inc (which was the subsidiary that marketed and distributed the BOScom and Company products in the US). Better On-Line

Solutions, Inc, merged into PacInfoSystems in early 2001, and until the fourth quarter of 2002, the marketing and distribution of the BOSccom products was carried our through the BOS US division of PacInfoSystems.

In October 2002, BOScom established a new wholly-owned subsidiary, BOSDelaware, a Delaware corporation, and in the future may market and distribute its products in the US through this subsidiary. Currently, the US marketing is carried out through a master distributor, and BOSDelaware is not operational.

The voting power we (or our subsidiaries) have in all subsidiaries, equates to the shareholdings.

The Company also has an interest in an affiliated company: Surf Communication Solutions Ltd. (Surf). Surf is a leading supplier of embedded network convergence software that lends flexibility and scalability to network products handling data modem, fax, and voice transmissions. Surfs open system software is integrated into equipment such as media gateways and remote access concentrators developed by original equipment manufacturers in the telecommunications, telephony, and data networking industries. We have been investing in Surf since 1997, and have recently purchased additional shares (see Item 4A). We currently hold 20.6% in Surf, and 16.7% on a fully diluted basis. Additionally, we hold 23.5% of the voting rights in Surf, and 19.2% on a fully diluted basis

4D. Property, Plants and Equipment

Our executive offices and engineering, development, testing, shipping and service operations are located in a facility occupying a total of approximately 3,300 square meters in Teradyon, Israel, pursuant to a lease which commenced in January 1996 and will expire in 2005. Under the terms of the lease, we had to pay rent of approximately $11,000 per month until December 31, 2000. Beginning January 1, 2001, the monthly rental payment has been reduced to approximately $9,300 per month.

The facility is located in a part of Israel which has been designated by the government as development A area. This designation relates to the benefits available to us as an Approved Enterprise under Israeli law, that entitles us and our shareholders to reduced income tax rates on our income and on dividends distribution.

We believe that our facilities are sufficient to accommodate our anticipated needs in the foreseeable future.

We also maintain offices in U.K. and in France, of approximately 450 square meters, with an aggregate total monthly rental of approximately $9,100.

The latest lease commitment will expire in 2015.

Item 5: Operating and Financial Review and Prospects

The following managements discussion and analysis of financial condition and results of operations should be read in conjunction with our financial statements and notes thereto. Certain matters discussed below and throughout this annual report are forward-looking statements that are based on our beliefs and assumptions as well as information currently available to us. Such forward-looking statements may be identified by the use of the words anticipate, believe, estimate, expect, plan and similar expressions. Such statements reflect our current views with respect to future events and are subject to certain risks and uncertainties. While we believe such forward-looking statements are based on reasonable assumptions, should one or more of the underlying assumptions prove incorrect, or these risks or uncertainties materialize, our actual results may differ materially from those described herein. Please read the section below entitled Factors That May Affect Future Results to review conditions that we believe could cause actual results to differ materially from those contemplated by the forward-looking statements.

The Company's discussion and analysis of its financial condition and result of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with Generally Accepted Accounting Principles ("GAAP") in Israel, which is substantially identical in all material respects with US GAAP, except as described in Note 19 to the Consolidated Financial Statements. The preparation of these financial statements required the Company to make estimations and judgments, in accordance with Israeli GAAP, that affect the reporting amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, bad debts, goodwill and other intangible assets, capitalized software development costs, deferred taxes, income taxes and legal contingencies. The Company based its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about the values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

For a review of the accounting policies that form the basis of the above-referenced estimates and judgments that the Company made in preparing its consolidated financial statements, please see Note 2 (Significant Accounting Policies) to the Financial Statements. The following accounting policies had the most significant impact on the Financial Statements for the year ended December 31, 2002:

Revenue Recognition

The Company derives its revenues from the sale of products, license fees for its products, maintenance, support and services. The Company adopted Staff Accounting Bulletin No. 101 "Revenue Recognition In Financial Statements".

Revenues from the sale of products and licenses are recognized when persuasive evidence of an agreement exists, delivery of the product and acceptance by the customer has occurred, no significant obligation with regard to implementation remains, the fee is fixed or determinable, and collectability is probable.

The provision for product returns is based on prior experience and is net of estimated manufacturer reimbursements. Revenues from maintenance are recognized on a pro rata basis over the period of the maintenance contract. Revenues from software licenses that require significant customization, integration and installation are recognized as such services are completed according to Israeli Accounting Standard No. 4 "Construction-Type Contracts".

Inventories

Inventories are valued at the lower of cost or market value. Cost is determined as follows:

Raw and packaging materials	- Moving Average Cost Method
Products in progress and finished products	- On the production costs basis with the addition of allocable indirect manufacturing costs

Inventory write-offs are provided to cover risks arising from slow-moving items or technological obsolescence. As of December 31, 2002, inventory is presented net of $300,000 general provision for technological obsolescence and slow moving items (see also Note 6 to the Consolidated Financial Statements).

Fair value of Financial Instruments

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

The carrying amounts of cash and cash equivalents, restricted cash, bank deposits, trade receivables, other accounts receivable and trade payables approximate their fair value due to the short-term maturity of such instruments. The carrying value and fair value for marketable securities are based on quoted market price.

Discontinued Operation

In May 2002, the Board of Directors of the Company decided to sell PacInfoSystems. PacInfoSystems is the Company's wholly-owned U.S. subsidiary that resells, installs and provides computer networking products to various business entities.

During the fourth quarter of 2002, following unsuccessful efforts to sell PacInfoSystems and based upon poor economic condition and continued operating losses together with a loss of key officers and employees, the Company initiated a plan to cease operations of PacInfoSystems and to dissolve the company.

As a result of the Company's plans to cease the operations in PacInfoSystems (and as the Board of PacInfoSystems has resolved to dissolve its subsidiary, Dean Tech), the assets, liabilities and operations of PacInfoSystems and Dean Tech represent a discontinuing segment and therefore are disclosed according to Israeli Accounting Standard No. 8, regarding discontinued operations ("Standard No. 8"). During 2002, the Company impaired its goodwill in PacInfoSystems in the amount of $3,946,000 and its goodwill in Dean Tech in the amount of $174,000. See also Note 18 of the Financial Statements.

5A. Results of Operations

On May 29, 2003 we effected a 1:4 reverse stock split. All share and per share data for periods prior to that date have been retroactively adjusted to reflect this reverse stock split.

Comparison of 2002 and 2001

Consolidated revenues for 2002 were $9,441,000 compared with $6,042,000 in 2001, a 56% increase.

During 2002 we focused our sales on our core business products. The S&M activity was aimed to expand our customer base and distribution channels.

During 2002 we succeeded to close a software deal with one customer which represents about 12% of the total revenues.

Gross profit in 2002 totaled $7,141,000 representing 76% of revenues compared with $3,339,000 constituting 55% of revenues in 2001. The difference is related mainly to high provisions for slow inventory that the company made in 2001 relating to its IP old product line.

Net research and development costs in 2002 increased 24% to $2,182,000 compared with $1,757,000 in 2001. The net expenses in 2001 include $989,000 funding that the Company received from the Office of the Chief Scientist. In 2002 the company did not receive such funding.

Gross research and development costs in 2002 decreased 21% to $2,182,000 compared with $2,746,000 in 2001, mainly due to HR costs reduction. We improved the R&D staff by replacing some of our engineers with new ones, who are better skilled, more efficient but paid lower salaries.

In Europe we closed branches that were not economically efficient and made some personnel changes. These steps saved us $500,000 in operational and other expenses compared to 2001. In addition, we reduced our operational costs in the US by $550,000 compared to 2001.

Selling, general and administrative expenses decreased by 11% to 5,402,000 in 2002 compared to $6,054,000 in 2001.

As a result of the foregoing, our operating loss in 2002 was $443,000 compared with an operating loss of $4,472,000 in 2001.

The Company had net financial income of $295,000 in 2002 compared with net financial income of $427,000 in 2001. The decrease in the financial income is related to the decrease in cash and investments balances during 2002.

Restructuring costs and other expenses for 2002 were $285,000 compared with other expenses of $612,000 in 2001.

As a result of the foregoing, net loss from the continuing segment for 2002 amounted to $433,000 compared with $4,657,000 in 2001. On a per share basis, the net loss from continuing segment in 2002 was $0.03 per share compared with a $0.38 net loss per share in 2001. (For details regarding computation of net loss per share, see Note 16e of the Financial Statements.)

The net loss related to discontinuing segment for 2002 was $7,674,000 compared with 8,313,000 in 2001. On a per share basis, the net loss from discontinuing segment in 2002 was $0.62 per share compared with a $0.67 net loss per share in 2001.

The total net loss for 2002 was $8,107,000 compared with $12,970,000 in 2001. On a per share basis, the net loss in 2002 was $0.65 per share compared with a $1.05 net loss per share in 2001.

In 2002, the Company's holding in Surf was 16.13% (12.8% on a fully diluted basis). Accordingly, the Company did not consolidate its equity loss in Surf during 2002.

Comparison of 2001 and 2000

Consolidated revenues for 2001 were $6,042,000, a 17% decrease from consolidated revenues of $7,294,000 in 2000. Regarding its connectivity business, in 2001 the Company experienced a drop-off in revenues in Europe due to a change in management and a lack of focus on sales of our interconnectivity products.

Gross profit in 2001 totaled $3,339,000 representing 55% of revenues compared with $4,895,000 constituting 67% of revenues in 2000. The increase in cost of goods sold was due to high provisions for inventory that the company made, relating to its IP product line.

Our investment in research and development during 2001 remained fairly constant. Research and development costs in 2001 increased moderately to $2,746,000 from $2,564,000 in 2000. Grants received in 2001 from the Office of the Chief Scientist in Israel were $989,000, an increase of 150% from $387,000 received in 2000. Grants from the Office of the Chief Scientist in Israel are subject to royalties of 3.5% on the sale of products resulting from funded projects, up to 100% of the amount of the grant.

Net research and development costs in 2001 decreased 19% to $1,757,000 compared with $2,177,000 in 2000. The reduction was primarily due to the increased funding that the Company received from the Office of the Chief Scientist.

Selling, general and administrative expenses decreased by 6% in 2001 to $6,054,000 from $6,464,000 in 2000.

As a result of the foregoing, our operating loss in 2001 was $4,472,000 compared with an operating loss of $3,746,000 in 2000.

The Company had net financial income of $427,000 in 2001 compared with net financial income of $639,000 in 2000.

Restructuring costs and other expenses for 2001 were $612,000 compared with other expenses of $562,000 in 2000. See Note 16d of the financial statements.

As a result of the foregoing, net loss from continuing segment for 2001 amounted to $4,657,000 compared with $4,952,000 in 2000. On a per share basis, the net loss from continuing segment in 2001 was $0.38 per share compared with a $0.39 net loss per share in 2000. (For details regarding computation of net loss per share, see

Note 16e. of the Financial Statements.)

The net loss related to discontinuing segment for 2001 was $8,313,000 compared with $2,743,000 in 2000. On a per share basis, the net loss from discontinuing segment in 2001 was $0.67 per share compared with a $0.23 net loss per share in 2000.

The total net loss for 2001 was 12,970,000 compared with 7,695,000 in 2000. On a per share basis, the net loss in 2001 was $1.05 per share compared with a $0.62 net loss per share in 2000.

In 2001, the Company's holding in Surf was 17% (13.4% on a fully diluted basis). Accordingly, the Company did not consolidate its equity loss in Surf during 2001. In 2000 the Company's share in Surf's loss was $1,283,000.

Variability of Quarterly Operating Results

Our revenues and profitability may vary in any given year, and from quarter to quarter, depending on the number of products sold. In addition, due to potential competition, uncertain market acceptance and other factors, we may be required to reduce prices for our products in the future.

Our future results will be affected by a number of factors including our ability to:

- increase the number of products sold,
- develop, introduce and deliver new products on a timely basis,
- anticipate accurately customer demand patterns and
- manage future inventory levels in line with anticipated demand.

These results may also be affected by currency exchange rate fluctuations and economic conditions in the geographical areas in which we operate. There can be no assurance that our historical trends will continue, or that revenues, gross profit and net income in any particular quarter will not be lower than those of the preceding quarters, including comparable quarters.

Impact of Inflation and Currency Fluctuations

The US Dollar cost of our operations in Israel is influenced by the differential between the rate of inflation in Israel and any change in the value of the NIS to the Dollar.

A devaluation of the NIS in relation to the US Dollar will have the effect of decreasing the costs in NIS and converse effect in case of devaluation of the US Dollar in relation to the NIS.

A devaluation of the NIS in relation to the US Dollar will have the effect of decreasing the Dollar value of any of our assets which consist of NIS (unless such asset is linked to the Dollar). Such a devaluation would also have the effect of reducing the Dollar amount of any of our liabilities which are payable in NIS (unless such payables are linked to the Dollar). Conversely, any increase in the value of the NIS in relation to the Dollar will have the effect of increasing the Dollar value of our assets which consist of NIS (unless such asset is linked to the Dollar) Such an increase would also have the effect of increasing the Dollar amount of any of our liabilities which are payable in NIS (unless such payables are linked to the Dollar)

In the years ended December 31, 2002, 2001, 2000, 1999 and 1998, the annual inflation rate in Israel as adjusted for the devaluation of the Israeli currency in relation to the Dollar was (0.8)%, (7.8)%, 2.7%, 1.5% and (9.0)%, respectively. The closing representative exchange rate of the Dollar at the end of each such period, as reported by the Bank of Israel, was NIS 4.737, NIS 4.416, NIS 4.041, NIS 4.153 and NIS 4.160, respectively. As a result, the Company experienced increases in the Dollar costs of operations in Israel in 1999 and 2000, and decreases in 1998, 2001 and 2002.

Effective Corporate Tax Rate

The Israeli tax rate imposed on companies is 36%, however, the effective tax rate payable by a company (such as ours) which derives income from an Approved Enterprise, may be considerably less. See Note 15 to the Financial Statements and Item 10E ahead. Subject to relevant tax treaties, dividends or interest received by an Israeli corporation from subsidiaries are generally subject to tax (unless the subsidiary's income is subject to Israeli corporate tax) regardless of its status as an Approved Enterprise. We anticipate that most of our taxable income over the next several years will be tax exempt in Israel. Our U.S. and U.K. subsidiaries, however, will be subject to U.S. and U.K. corporate income taxes, respectively, on their taxable income.

On January 1, 2003, a comprehensive tax reform took effect in Israel. Pursuant to the reform, resident companies are subject to Israeli tax on income accrued or derived in Israel or abroad. In addition, the concept of "controller foreign corporation" was introduced, according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). The tax reform also substantially changed the system of taxation of capital gains.

The implications of the tax reform on our company are not yet clear.

Grants and Participation

Under the Law for the Encouragement of Industrial Research and Development, 1984 (the Research Law), research and development programs approved by a research committee appointed by the Israeli Government are eligible for grants against payment of royalties from the sale of products developed in accordance with the Program. Regulations set under the Research Law generally provide for the payment of royalties to the Office of the Chief Scientist of 3.5% on sales of products developed as a result of a research project so funded until 100% of the dollar-linked grant is repaid. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate of LIBOR applicable to U.S. dollar deposits.

The Research Law requires that the manufacture of any product developed as a result of research and development funded by the Israeli Government take place in Israel. It also provides that know-how from the research may not be transferred to third parties without the approval of the Israeli Office of the Chief Scientist in the Ministry of Industry and Trade. As of December 31, 2002, the total amount of grants which we received from the Office of the Chief Scientist, net of royalties paid or accrued, totaled 5,875,000, compared with $ 5,920,000 on December 31, 2001.

We are committed to paying royalties to the Fund for the Encouragement of Exports for its participation, by way of grants, in our marketing expenses outside of Israel. Royalties payable are 3% of the growth in exports, from the year we received the grant, up to 100% of the dollar-linked amount of the grant received.

The total amount of the grants we received, net of royalties paid or accrued, was $225,000 on December 31, 2002, compared with $301,000 on December 31, 2001.

Conditions in Israel

We are incorporated under the laws of Israel. Our offices and product development and manufacturing facilities are located in Israel. As a consequence, we are directly affected by political, economic and military conditions in Israel. Our operations would be substantially impaired if major hostilities involving Israel should occur or if trade between Israel and its present trading partners should be curtailed.

Political and Economic Conditions

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. A peace agreement between Israel and Egypt was signed in 1979. However, economic relations have been limited.

Since 1993, a joint Israeli - Palestinian Declaration of Principles and several agreements between Israel and Palestinian representatives have been signed outlining interim self-government arrangements. Israel has since transferred the civil administration of the Gaza Strip and several major towns and villages in the West Bank to the Palestinian Authority.

In addition, Israel and several other Arab States announced their intention to establish trade and other relations and are discussing certain projects. As of the date hereof, Israel has not entered into any peace agreement with Syria or Lebanon. There is substantial uncertainty with regard to how the "peace process" will develop or what effect it may have on us.

Furthermore, full diplomatic ties between Israel and Jordan were created following a peace treaty signed in 1994. The treaty expressed a mutual desire for full economic cooperation, the lifting of economic barriers and a strive towards the lifting of any economic boycotts by third parties.

Despite the progress towards peace between Israel, its Arab neighbors and the Palestinians, certain countries, companies and organizations continue to participate in a boycott of Israeli firms. We do not believe that the boycott has had a material adverse effect on us, but there can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on our business or financial condition in the future.

Some of our employees are obligated to perform annual reserve duty in the Israel Defense Forces and may, at any time, be called for active military duty. While we have operated effectively under those and similar requirements in the past, no assessment can be made of the full impact of such requirements on us in the future, particularly if emergency circumstances occur.

Israel's economy has been subject to many destabilizing factors including a period of high inflation in the early to mid-1980s. It has also been subject to low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. The Government of Israel has intervened in several sectors of the economy, employing among other means, fiscal and monetary policies, import duties, foreign currency restrictions and control of wages, as well as prices and foreign currency exchange rates.

In 1998, the Israeli currency control regulations were liberalized dramatically. As a result, Israeli citizens can generally freely purchase and sell Israeli currency and assets. The Government of Israel has periodically changed its policies in these areas. There are currently no Israeli currency control restrictions on remittances of dividends on ordinary shares or proceeds from the sale of ordinary shares; however, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time.

The costs of our operations in Israel are generally incurred in New Israeli Shekels ("NIS"). If the inflation rate in Israel exceeds the rate of devaluation of the NIS against the US Dollar in

any period, the costs of our Israeli operations, as measured in US Dollars, could increase. Israel's economy has, at various times in the past, experienced high rates of inflation. Like many Israeli companies, we receive grants and tax benefits from the Israeli Government. We also participate in programs sponsored by the Israeli Government. The reduction or termination of any such grants, programs or tax benefits, especially those benefits available as a result of the "Approved Enterprise" status of certain facilities in Israel, could have a materially adverse effect on future investments by us in Israel.

Trade Agreements

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

Israel and the European Union signed a Free Trade Agreement, which became effective on July 1, 1975, that confers certain advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area ("FTA"). The FTA has eliminated all tariff and certain non-tariff barriers on most trade between the two countries.

On January 1, 1993, Israel and the European Free Trade Association (EFTA), entered into an agreement establishing a free-trade zone between Israel and the EFTA nations. In recent years, Israel has established commercial and trade relations with a number of the other nations, including Russia, the Peoples Republic of China, India and the nations of Eastern Europe, with which Israel had not previously had such relations.

5B. Liquidity and Capital Resources

In April 1996, we received net proceeds of $6,589,000 from the issuance of securities in our initial public offering in the United States. Prior to the initial public offering, we financed our activities by different means, including proceeds of equity financing, long-term loans, grants from the Office of the Chief Scientist in Israel and income from operating activities.

In 2000, we received net proceeds of $22,005,000 from the exercising of warrants and options to purchase units, made up of shares and warrants previously issued to the public and to our underwriters, and from a private placement.

As of December 31, 2002, we had $5,246,000 in cash and cash equivalents and working capital of $5,980,000.

The company does not currently have borrowings from financial institutions.

Working capital and working capital requirements will vary from time-to-time and will depend on numerous factors, including but not limited to operating results, the level of resources devoted to research and development, new product introductions, grants from the Office of the Chief Scientist in Israel, marketing and acquisition activities.

We have in-balance sheet financial instruments and off balance sheet contingent commitments. Our in balance sheet financial instruments consist of our assets and liabilities. Our cash is invested in short-term (less than 3 months) U.S. dollars and NIS interest bearing deposits with banks. Our receivables aging is approximately 90 days and our current liabilities aging is approximately 60 days. The fair value of our financial instruments is similar to their book value, with one exception. We believe that our investment in Surf, has a substantial value. Our off balance sheet contingent commitments consist of: (a) royalties

commitments that are directly related to our future revenues, (b) lease commitments of our premises and vehicles, and (c) directors and officers indemnities, in excess of the proceeds received from liability insurance which we obtain.

We believe that cash resources are sufficient to meet our needs for at least 12 months following the date of this submission. However, it is our intention to engage in equity financing for our subsidiary, BOScom. Funds are intended for further developing the Companys core business of feature-rich IP Telephony products and establishing distribution channels in new markets. There is, however, no assurance that we shall be able to obtain such financing.

5C. Research and Development

We believe that our future growth will depend upon our ability to enhance our existing products and introduce new products on a timely basis. Since we commenced operations, we have conducted extensive research and development activities. In 2002, gross research and development costs totaled $2,182,000, compared to $2,746,000 in 2001. Our net expenditures, as no grant was received in 2002 from the Israeli Office of the Chief Scientist, were 2,182,000 in 2002, compared with $1,757,000 in 2001.

Our research and development efforts have been focused on IP Telephony VOIP solutions, and our existing products for the IBM midrange market. We intend to finance our research and development activities with our own resources and grants from the Office of the Chief Scientist.

The following table sets forth, for the periods indicated, amounts spent by us on research and development activities:

Year ended December 31,
(in thousands US$)

	2002	2001	2000
Gross Research and Developments Costs	2,182	2,746	2,564
Less:			
Grants received	-	(989)	(387)
Net Research and Development Costs	2,182	1,757	2,177

5D. Trend Information

The global slowdown in the telecommunications industry, has taken its toll on our company as well. The effect of a prolonged slowdown may result in lower sales and lower gross margins as our products may be subject to price pressure due to reduced demand, write downs and write offs.

Over the past few years there has been a continuous global decrease in sales and revenues from the connectivity solutions sector (also known as the legacy family products) (see Item 4B). Although the Company's revenues in this sector have decreased as a result, in comparison to other players in this field, we have faired quite well.

Currently the Company's R&D focuses mainly on the company's VoIP line of products, that will successfully compete with the Legacy telephony quality and reliability, and will allow special CTI (Computer Telephony Integration) features that are not available in legacy telephony today. These products will allow seamless integration with legacy telephony systems, thus reducing the implementation price. In addition, the products will guaranty the quality of service and will allow the end users to use the telephone system at the same way that they used their non-IP-enabled system. Until now, complicated installation, non-

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transparent usage and non-consistent quality of service were the major issues that slowed-down the implementation of VoIP Telephony in the corporate market. With the new line of intelligent gateways, these hurdles are solved thus opening new opportunities in this market. According to market research performed by professional market analysis firms such as Advanced Business Link, the revenues in this VoIP market are expected to grow for at least the next 5 years.

Item 6: Directors, Senior Management and Employees

6A. Directors and Senior Management
The following is a listing of our directors, senior officers and key employees:

Name	Age	Position
Mr. Edouard Cukierman	38	Chairman of the Board of Directors
Mr. Israel Gal	52	Director, Chief Executive Officer and President

Mr. Zvi Greengold	51	Director
Mr. Eli Ben-Mayor	62	Director
Mr. Yair Shamir	58	Director
Mr. Boaz Harel (2)	39	Director
Mr. Ronen Zavlik (1)	42	Director
Mr. Jacob Tenenboem	45	Director
Dr. Yael Ilan (1)	54	External Director
Prof. Adi Raveh (1)(2)	55	External Director
Mr. Nehemia Kaufman	54	Chief Financial Officer
Mr. Reuven Arbiv	36	Controller

(1) Member of the Audit Committee.

(2) Member of the Remuneration Committee.

Mr. Edouard Cukierman, 38, has been a director since May 2003, and has recently been appointed Chairman of the Company. He is the Chairman of Cukierman & Co. Investment House and CEO of the Catalyst Fund. He served until March 2000 as General Manager of Astra Technological Investment Ltd., the first Israeli firm listed in Paris. Edouard Cukierman is on the board of numerous High-Tech companies including VCON and MTI. He is also a board member of Lamina Technologies in Switzerland, of Compagnie Financiere Otto in Paris, a French investment house and the Vice Chairman of Citec Environnement in France. In addition, Mr. Cukierman is on the board of Sar-El, an Israeli Defense Forces volunteer organization. Mr. Cukierman holds an M.B.A. from INSEAD, Fontainebleau, France and a B.Sc. from the Technion - Israel Institute of Technology.

Mr. Israel Gal, 52, B.O.S.' founder, served as B.O.S.' Chief Executive Officer and President from its inception in 1990 until January 2002, and then again from September 2002 until today. Mr. Gal was the Chairman of the Board of Directors from 1990 until 2000 and also serves as the CEO of one of the Company's subsidiaries, BOScom Ltd. From 1983 to 1989, Mr. Gal served as IBM midrange product manager at IIS. In 1989, Mr. Gal served as the product manager for sales and marketing of IIS in the United States. In 1979, Mr. Gal co-founded Liad Electronics Ltd. where he worked until 1983. From 1976 to 1979, Mr. Gal served as research and development engineer and product manager for Elbit Ltd. Mr. Gal received a Bachelors of Science in Electronic Engineering from the Technion-Israel Institute of Technology (the "Technion").

Mr. Zvi Greengold, 51, has been a director since June 2002, and served as Chairman from September 2002 to June 2003. Mr. Greengold is currently self-employed in the field of

industrial management, promotion and consulting, and serves as Chairman of Polysac Ltd. and Polyraz of kibbutz Maoz-Haim. From 2000 to 2001 he served as Managing Director of Caribbean Petroleum, Corp., a company that manufactures and markets fuel products in Puerto Rico. From 1999 to 2000 he served as General Manager of the

Israeli Oil Refineries Ltd. From 1996 to 1998 Mr. Greengold served as Managing Director of Electrochemical Industries (1952) Ltd. (traded on TASE), a company that manufactures polyvinyl chloride and unorganic chemicals. From 1986 to 1996 he held various positions with Electrochemical Industries (1952) Ltd., including Chief Financial Officer, Vice President of Organization and Logistics, Vice President of Finance and Organization and Vice Managing Director. Mr. Greengold currently serves as an external director of two public Israeli companies. He holds a B.A degree in Economics and Administration from the Rupin College in Israel.

Mr. Eli Ben-Mayor, 62, has been a director since June 2002. Mr. Ben-Mayor currently serves as General Manager of ACME International Trading Ltd., a subsidiary of a multinational corporation, specializing in importation, packaging and distribution of white cement, operating an advanced storage and production facility near the Ashdod port. Previously he was the General Manager of Rogosin Ltd. where he implemented a program geared to improve the operational and financial situation of the company. Prior to joining Rogosin, Mr. Ben-Mayor served as General Manager of several companies within the Clal Industries group. Recently he concluded a five-year service term as a director of ICL Israel Chemicals Financing and Issuing Ltd. Mr. Ben-Mayor holds a B.Sc. degree in Mechanical Engineering from the Technion - Israel Institute of Technology, and an MBA from Tel-Aviv University.

Mr. Yair Shamir, 58, has been a director since May 2003. He is the Chairman of the Catalyst Fund since 1999. He served as VCON Communication Chief Executive Officer and Director since 1997. From 1995 to 1997, Mr. Shamir served as Executive Vice President of the Challenge Fund-Etgar L.P., an Israeli venture capital firm. From 1993 to 1995, he served as Chief Executive Officer of Elite Food Industries Ltd., one of Israel□s largest branded food product companies. From 1988 to 1993, he served as Executive Vice President and General Manager of Scitex Corporation Ltd., a leading supplier of computer graphic systems. From 1963 to 1988, Mr. Shamir served in the Israeli Air Force as a pilot and commander. During his term in the Air Force, he attained the rank of colonel and the served as head of the Electronics Department, the highest professional electronics position within the Air Force. Mr. Shamir currently serves as a director of several public companies listed on the NASDAQ including, Orckit Communications Ltd, Mercury Interactive Corporation and DSP Group Corporation as well as serving as a director of several private companies. Mr. Shamir is the Chairman of The Catalyst Fund, an Israel-based venture capital fund investing in late-stage companies mainly in the high technology sector. Mr Shamir holds a B.Sc. in Electronic Engineering from the Technion - Israel Institute of Technology.

Mr. Boaz Harel, 39, has been a director since May 2003. He serves as the managing partner in Catalyst, bringing 14 years of management experience in various industries including hi-tech to the Catalyst management team. From 1993 until 1996, Boaz served as President and CEO of Leedan Holdings, a holding company with major stakes in approximately 25 companies. From 1996 until 2000, he worked in Leedan□s NY office in order to develop the business activities of the group in the U.S. Mr. Harel oversaw acquisitions and new investments, and developed a reputation as a company turn-around specialist. In January 1990, he established Mashik- Research & Systems for Business Development Ltd., a consulting firm consisting of 40 management consultants and industrial engineers. Mr. Harel holds a B.Sc. in Industrial and Management Engineering from the Technion - Israel Institute of Technology.

Mr. Ronen Zavlik, 42, is a partner in the CPA firm of Grinberg-Zavlik, which he founded in 1987. His firm provides a wide range of audit, tax consultancy and CFO services, to a wide variety of companies. Mr. Zavlik provides internal auditing services to a number of

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large companies whose shares are traded on the Tel Aviv Stock Exchange, including Ma□ariv Holdings Ltd, Extra Plastic Ltd. Israel Land Development Malls and Shopping Centers Ltd and Israel Land Development Company Hotels Ltd.. Mr. Zavlik holds a B.A. in Accountancy and Business Management from the College of Management in Tel-Aviv.

Mr. Jacob Tenenboem, 45, is the founder and CEO of I.T. Net Investments, a privately held investment company with 10 investments in Israeli and US high tech companies. He has over twenty years of experience in the IT arena worldwide, which includes extensive experience in M&A activities in approximately 20 companies. Mr. Tenenboem has served in various management positions in several private and public companies, among them Formula Systems (1985) Ltd., Sintec Advanced Technologies, Aman Computers, Malal Group, Mainsoft Inc., Noyotec Ltd., Sabratech Ltd. And Magic Software Ltd.. He has and continues to serve on the board of directors of several companies. Mr. Tenenboem holds a B.Sc. in Management and Industrial Engineering from Tel-Aviv University.

Dr. Yael Ilan, 54, has been an external director since November 2002. Dr. Ilan is the president of Yedatel Ltd., an economic consulting company, and serves as a director in a number of corporations, most of them in the technology sector. Until 1998 she served on the board of Bezeq - Israels Telecommunication Company in which she headed the committee of technological policy and infrastructure and was a member of the audit committee and the committee for strategic planning and investment. From 1998 through 2000 she served as an external director of Elron Industries. In 2000-01 she founded and managed Optichrom, an optical component start-up. From 1995 through 2000 Dr. Ilan served as the head of program of the Broad Band Communication, a consortium of MAGNET the Israeli Government hi-tech cooperation initiative. Dr. Ilan holds a Ph.D. in industrial engineering from Stanford University, a Ph.D. in physical chemistry from the Hebrew University and a Masters degree in business administration from the Hebrew University.

Prof. Adi Raveh, 55, has been an external director since February 2003. Prof. Raveh is a professor and head of the B.A. Program at the School of Business Administration, Hebrew University, Jerusalem. Since 1998 he served as an external director at Clal Insurance Company Ltd. Since 2002 he served as the Chairman of the Board of Jerusalem Capital Markets Underwriting limited. He also serves as a director of Meitav - a Mutual Funds Management company (since 1995), and as a director of Peilim a Portfolio Management company part of Bank Hapoalim Group (since 1996). Since 1992 he is a director who represents the Hebrew University at Hi-Tech a Technology Entrepreneurship located at Har-Hahotzvim, Jerusalem. Prof. Raveh also serves as a director of two start-up companies: A.D.M (Advanced Dialysis Methods Ltd.) and Virtouch Ltd. Between 1994-1999 he served as a director and a member of the executive committee of the Bank of Jerusalem, Ltd. Between 1996-1998 he served as a member of an ad-hoc committee of the Council of Higher Education. In 1999 he served as a member of the Budget Committee for Research at the Israel Science Foundation. Prof. Raveh holds a Ph.D. from the Hebrew University. He is the author of about 50 professional publications, was a visiting professor at Stanford University, Columbia University and Baruch College, N.Y., and has received a number of grants and honors.

Mr. Nehemia Kaufman, 54, has been the Companys CFO service provider since September 2002. Before then, from May 2002, he served as a consultant and CFO of the Companys subsidiary, BOScom Ltd.. Mr. Kaufman is currently the Managing Director of Mocha Global Managerial Services Ltd. From 1999 to 2002 he co-founded and served as CFO of Trellis Photonics Ltd., from 1997 to 1999 Mr. Kaufman was self-employed as a CFO service provider, from 1995 to 1997 he served as CFO of Computer Direct Ltd. (TASE: CMDR), and from 1993 through 1995 he served as CFO of Rogosin Enterprises Ltd. (TASE: ROGO). Mr. Kaufman holds an MBA degree from the Hebrew University in Jerusalem (graduated with

distinction) and a BA degree in Economics and Business Administration from Haifa University.

Mr. Reuven Arbiv, 36, has been serving as the Companys Controller since October 2002. He gained his accounting training and experience in the offices of Deloitte & Touche. Before working for the Company, Mr. Arbiv was the Controller of Mellanox Technologies Ltd, a high-tech start-up in the field of semi-conductors. From 1996 to 1999, he was CFO of Computer Direct. Mr. Arbiv holds a BA in Economics and Accounting from Bar-Ilan University.

6B. Board Compensation

The directors who are not executive officers are paid a fee for their services as directors to the extent that such fees are approved by a general meeting of our shareholders. During the fiscal year ended December 31, 2002, only the Companys external directors were paid for their service on the Companys Board of Directors and its committees. As resolved by the shareholders, the external directors are compensated according to the maximum rate permitted (now and in the future) by Israeli law and regulation. The current rates for companies the size of ours, are an annual fee of approximately $5400, and a participation fee in meetings of approximately $280. On February 18, 2003 the shareholders approved compensation for all directors who are not employees or consultants, including directors appointed in the future, at the same rate the external directors of the Company are paid. With respect to two incumbent directors, the shareholders resolution provides that the compensation be paid retroactively since their appointment in June 2002. On June 26, 2003 the Board of Directors resolved to reduce the annual fee for all directors by 18%, effective July 1, 2003, as part of a cost reduction plan. Additionally, the Companys directors are granted options (see Share Ownership ahead, and Related Party Transactions under Item 7).

The following table presents the total compensation paid to or accrued on behalf of all of our directors and officers as a group for the year ended December 31, 2002:

	Salaries, Directors Fees, Service Fees1, Commissions and Bonuses	Pension, Retirement and Similar Benefits
All directors and officers as a group (then 9 persons)	$507,000	$28,000

Such remuneration does not include amounts expended by the Company for expenses, including business association dues and expenses, reimbursed to said officers and other fringe benefits commonly reimbursed or paid by companies in the location in which the particular executive officer of the Company is located, as the case may be.

6C. Board Practices

Our Board of Directors is currently comprised of ten directors, including two external directors. The directors are elected at the annual shareholders meeting, by a simple majority, to serve until the next annual meeting of our shareholders and until their respective successors are elected and qualified, with the exception of the external directors who, by rule of the Companies Law 1999, serve for three years. Our Articles of Association provide that the number of directors in the Company (including external directors) shall be determined from time to time by the annual general meeting of shareholders, provided that it shall not be less

1 We receive CFO services from Mocha Global Managerial Services Ltd., and the services are provided by Mr. Nehemia Kaufman. Until August 2002 we received CEO services from a company owned by Mr. Moti Weiss, who served on our Board, and who personally performed the CEO services.

than four nor more than eleven. Our Articles of Association provide that the directors may appoint additional directors (whether to fill a vacancy or to expand the Board) so long as the number of directors so appointed does not exceed the number of directors authorized by shareholders at the annual general meeting.

Under the Companies Law and the regulations promulgated pursuant thereto, Israeli companies whose shares have been offered to the public in, or that are publicly traded outside of, Israel are required to appoint at least two natural persons as external directors. No person may be appointed as an external director if the person, or a relative, partner or employer of the person, or any entity under the persons control, has or had, on or within the two years preceding the date of the persons appointment to serve as an external director, any affiliation with the company to whose board the external director is proposed to be appointed or with any entity controlling or controlled by such company or by the entity controlling such company. The term affiliation includes an employment relationship, a business or professional relationship maintained on a regular basis, control and service as an office holder (which term includes a director).

In addition, no person may serve as an external director if the persons position or other business activities create, or may create, a conflict of interest with the persons responsibilities as an external director or interfere with the persons ability to serve as an external director or if the person is a member or employee of the Israel Securities Authority or of an Israeli stock exchange. If, at the time of election of an external director, all other directors are of the same gender, the external director to be elected must be of the other gender.

External directors are elected for a term of three years and may be re-elected for one additional three-year term. Each committee of a companys board of directors that has the authority to exercise powers of the board of directors is required to include at least one external director and its audit committee must include all external directors.

External directors are elected at the general meeting of shareholders by a simple majority, provided that the majority includes at least one-third of the shareholders who are not controlling shareholders, who are present and voting, or that the non-controlling shareholders who vote against the election hold one percent or less of the voting power of the company.

Under the Companies Law an external director cannot be dismissed from office unless: (i) the board of directors determines that the external director no longer meets the statutory requirements for holding the office, or that the external director is in breach of the external director's fiduciary duties and the shareholders vote, by the same majority required for the appointment, to remove the external director after the external director has been given the opportunity to present his or her position; (ii) a court determines, upon a request of a director or a shareholder, that the external director no longer meets the statutory requirements of an external director or that the external director is in breach of his or her fiduciary duties to the company; or (iii) a court determines, upon a request of the company or a director, shareholder or creditor of the company, that the external director is unable to fulfill his or her duty or has been convicted of specified crimes.

Our Articles of Association provide that a director may appoint, by written notice to us, any individual to serve as an alternate director, up to a maximum period of one month, if the alternate is not then a member of the Board. Any alternate director shall have all of the rights and obligations of the director appointing him or her and shall be subject to all of the provisions of the Articles of Association and the Companies Law. Unless the time period or scope of any such appointment is limited by the appointing director, such appointment is effective for all purposes for a period of one month, but in any event will expire upon the expiration of the appointing director's term, removal of the alternate at an annual general meeting, the bankruptcy of the alternate, the conviction of the alternate for an offense under

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Section 232 of the Companies Law, the legal incapacitation of the alternate, the removal of the alternate by court order or the resignation of the alternate. Currently, no alternate directors have been appointed.

Officers serve at the discretion of the Board or until their successors are appointed.

Audit Committee:

The Companies Law requires public companies to appoint an audit committee comprised of at least three directors, including all of the external directors, and further stipulates that the chairman of the board of directors, any director employed by or providing other services to a company and a controlling shareholder or any relative of a controlling shareholder may not be members of the audit committee. The responsibilities of the audit committee include identifying flaws in the management of a company's business, making recommendations to the board of directors as to how to correct them and deciding whether to approve actions or transactions which by law require audit committee approval. An audit committee may not approve an action or transaction with a controlling shareholder or with an office holder unless at the time of approval two external directors are serving as members of the audit committee and at least one of them is present at the meeting in which the approval is granted.

As a result of the Sarbanes-Oxley Act of 2002, the Audit Committee's functions have recently expanded, and it now provides assistance to the Board of Directors in fulfilling its legal and fiduciary obligations with respect to matters involving the accounting, auditing, financial reporting and internal control functions of the Company. In carrying out these duties, the Audit Committee must meet at least once in each fiscal quarter with management at which time, among other things, it reviews, and either approves or disapproves, the financial statements of the Company for the immediately preceding fiscal quarter and conveys its conclusions in this regard to the Board of Directors. The Audit Committee also monitors generally the services provided by the Company's external auditors to ensure their independence, and reviews, and either approves or disapproves, all audit and non-audit services provided by them. The Company's external and internal auditors must also report regularly to the Audit Committee at its meetings, and the Audit Committee discusses with the Company's external auditors the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the Company's financial statements, as and when it deems it appropriate to do so.

Under the Sarbanes-Oxley Act of 2002, the Audit Committee is also responsible for the appointment, compensation, retention and oversight of the work of the Company's external auditors. However, under Israeli law, the appointment of external auditors requires the approval of the shareholders of the Company.

Furthermore, the Board of Directors is the organ that has the authority to determine the compensation of the external auditors, as the Company's Articles of Association so provides. Accordingly, in the future, the appointment of the external auditors will need to be approved and recommended to the shareholders by the Audit Committee and ratified by the shareholders. The compensation of the external auditors will need to be approved by the Audit Committee and the Board of Directors (unless the Board of Directors delegates this authority to the Audit Committee).

Remuneration Committee

The role of the Remuneration Committee is to provide assistance and make recommendations to the Board of Directors regarding matters related to the compensation of directors and certain employees of the Company. The Remuneration Committee of the Company meets on an ad hoc basis, and in the past has not always been active. Under the Israeli Companies Law, the Remuneration Committee may only make recommendations to the Board of Directors concerning the grant of options (and in some cases, such grants may need approval of the audit committee, the Board of Directors and the shareholders as well).

6D. Employees

As of December 31, 2002, we employed 104 employees worldwide, including those in our subsidiaries. Of the 104 employees, 68 are based in our facility in Israel (employed by us or BOScom), including 1 2 employees in administration and finance, 8 employees in marketing and sales, 33 employees in engineering, research and development, 8 employees in technical support, and 7 employees in manufacturing. We have 21 employees in the U.S., 10 in the U.K. and 5 in France. As of December 31, 2001 we employed 181 employees worldwide. As of December 31, 2000, we employed 205 employees worldwide. We believe that our relations with our employees are satisfactory. We have not experienced a collective labor dispute or strike.

Israeli labor laws are applicable to all of our employees in Israel. The laws principally concern the length of the work day, minimum daily wages for professional workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment.

All Israeli employers, including us, are required to provide a certain escalation of wages in relation to the increase in the Israeli Consumer Price Index. The specific formula of such escalation varies according to agreements reached between the Government of Israel, the Manufacturers' Association and the Histadrut, the general labor union in Israel. The majority of our employees are covered by comprehensive life and pension insurance policies. The remainder are covered by retirement accounts. Israeli employees and employers are required to pay predetermined sums to the Israel National Insurance Institute which amounts also include, since January 1, 1995, payments for national health insurance.

6E. Share Ownership

As of June 15, 2003, our directors and officers as a group, now consisting of 11 persons, hold an aggregate of approximately 330,000 ordinary shares. We have also granted these officers and directors options to purchase 168,750 ordinary shares under our Stock Option Plans. Of these options, none have been exercised until now and 106,250 had vested as of June 15, 2003.

The only directors or officers who hold shares are:

- Mr. Israel Gal (Director, CEO and President) holds 321,332 ordinary shares, amounting to 8.4% of the Company's outstanding shares.[2]
- Mr. Yair Shamir has indirect holdings of less than 1%.

The options granted to directors or officers who are serving as of the date of this report are outlined below:

Name	No. of options	Terms

Israel Gal	18,750	1. All vested 2. Exercisable until November 10, 2004. 3. Exercise price $18.00
Israel Gal	75,000	1. All vested. 2. Exercisable until April 17, 2006.

[2] Does not include indirect ownership of 244,467 Ordinary Shares owned by Ms. Yael Gal, Mr. Israel Gals spouse, as to which Mr. Gal disclaims beneficial ownership. Does not include options held by Mr. Gal.

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		3. Exercise price $28.00
Nehemia Kaufman3	75,000	1. 6,250 vested at the end of each fiscal quarter, beginning 31.12.02 2. Exercisable until June 26, 2011. 3. Exercise Price - $4.00

Additionally, on February 18, 2003 the Companys shareholders approved the grant of 7,500 options (30,000 options pre-split) to each director then serving on the Board (including external directors) and any future first-time director, who is not an employee or paid consultant of the Company. These options shall be granted over the next few weeks, once the Companys newly adopted 2003 Option Plan shall be approved by the Israeli tax authorities. The terms and conditions of the grant, as approved by the shareholders, are as follows: the exercise price shall be $1.84 (pre-split price of $0.46 - the closing price of the shares on the Nasdaq National Market on the date of approval by the shareholders); the options will vest over a three year period from the date of grant (one-third vesting every year) and be exercisable within five years from the date of grant.

Share Option Plans

The purpose of the Share Option Plans is to enable us to attract and retain qualified persons as employees, officers, directors, consultants and advisors and to motivate such persons by providing them with an equity participation in the company. In addition, the Incentive Stock Options (ISO)/ Restricted Stock Option (RSO) Plan is designed to afford qualified optionees certain tax benefits available under the U.S. Internal Revenue Code of 1986, as amended (the Code). The Section 102 Plan is designed to afford qualified optionees certain tax benefits under the Israel Income Tax Ordinance. The Share Option Plans will expire 10 years after their adoption, unless terminated earlier by the Board of Directors.

The Share Option Plans are administered by the Board of Directors that has broad discretion, subject to certain limitations, to determine the persons entitled to receive options or rights to purchase (in the case of the Section 102 Plan).

Under the Share Option Plans, the terms and conditions on which options or rights to purchase (in the case of the Section 102 Plan) are granted and the number of shares subject thereto shall be determined by the Board of Directors (or in some cases, and subject to Israeli law, a committee appointed by the Board). The Board of Directors also has discretion to determine the nature of the consideration to be paid upon the exercise of an option and/or right to purchase granted under the Share Option Plans. Such consideration generally may consist of cash, or, at the discretion of the Board of Directors, cash and a recourse promissory note.

Stock options issued as incentive stock options pursuant to the ISO/RSO Plan will only be granted to our employees, including those of all subsidiaries. The exercise price of incentive stock options issued pursuant to the ISO/RSO Plan must be at least equal to the fair market value of the ordinary shares as of the date of grant. The price per share under options awarded pursuant to the Section 102 Plan may be any price determined by the Board. The exercise price of options issued after the offering are equal to at least 85% of the fair market value of the ordinary shares at the date of grant.

The ordinary shares acquired upon exercise of an option are subject to certain restrictions on transfer, sale or hypothecation. Options are exercisable and restrictions on disposition of shares lapse pursuant to the terms of the individual agreements under which such options were granted or shares issued.

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[3] Additional terms of these options include certain restrictions on the sale of most of the shares derived from the exercise of the options, and an acceleration of the vesting terms in the event that the CEO of the Company will be replaced.

Due to a recent tax reform in Israel, after January 1, 2003 the Company may not grant options pursuant to an old Section 102 Plan. Therefore, the Company may not grant anymore options pursuant to the 2000 and 1995 Plans described below. Previous grants under these Plans remain unaffected

2003 Plan

The Companys Board of Directors recently adopted the 2003 Stock Option Plan, pursuant to which 625,000 Ordinary Shares are reserved for purchase by the employees, directors, consultants and service providers of the Company and its subsidiaries. At the annual general meeting of shareholders held May 22, 2003, the shareholders approved the Plan. The Plan must now be approved by the Israeli tax authorities. The Board of Directors has resolved that once the 2003 Plan is approved, no further grants shall be made from the existing plans, which, as of December 31, 2002, had in the aggregate 274,000 options left for issuance from the existing option pools previously approved by the shareholders. Pursuant to an election made by the Company, capital gains derived by optionees arising from the sale of shares derived from the exercise of options granted to them under Section 102, will be subject to a flat capital gains tax rate of 25% (instead of the gains being taxed as salary income at the employees marginal tax rate). However, as a result of this election, the Company will no longer be allowed to claim as an expense for tax purposes the amounts credited to such employees as a benefit when the related capital gains tax is payable by them, as the Company was previously entitled to do.

No options have yet been granted from the Plan. As abovementioned, after obtaining the approval of the Israeli tax authorities to the Plan, the Company will grant each of its directors who are not employees or paid consultants of the Company, 7,500 options each.

2001 Plan

In March 2002, the Companys shareholders approved the adoption of the 2001 Stock Option Plan, pursuant to which 250,000 Ordinary Shares were reserved for purchase by the Companys employees, directors, consultants or service providers, as determined by the Board of Directors or its authorized sub-committee. As of December 31, 2002, we had 123,264 options outstanding under this plan, 75,000 at an exercise price of $4.00 per share, 45,764 at an exercise price of $6.80 per share, and 2,500 at an exercise price of $3.72 per share. Of these options, 44,514 were vested as of December 31, 2002.

2000 Plan

In April 2001, the Companys shareholders approved our 2000 Employees Incentive Share Option Plan, pursuant to which 112,500 Ordinary Shares were reserved for purchase. The plan is subject to Section 102 of the Israeli Income Tax Ordinance. As of December 31, 2002, we had 61,325 options outstanding under this plan, 47,825 at an exercise price of $28.00 per share and 13,500 at an exercise price of $6.80 per share. Of these options, 36,383 were vested as of December 31, 2002.

1999 Plan

In November 1999, the Companys shareholders approved the adoption of the 1999 Stock Option Plan (incentive and restricted stock options). The 1999 plan has 193,750 ordinary shares reserved in its favor. As of December 31, 2002 44,258 of the options granted under this plan had been exercised, and there were 70,859 more options outstanding, 57,034 at an exercise price of $18.00 per share, 3,850 at an exercise price of $10.625 per share, and

9,975 at an exercise price of $10.04 per share. Of these outstanding options, 61,642 vested as of 31.12.2002.

1995 Plans

In December 1995, we adopted the following plans: (i) the Stock Option Plan (Incentive and Restricted Share Options) (the ISO/RSO Plan), which provides for the grant of incentive

and restricted stock options and (ii) the Section 102 Stock Option/Stock Purchase Plan (the Section 102 Plan and together with the ISO/RSO Plan, the Share Option Plans).

The Share Option Plans provide for the grant of options to purchase up to an aggregate of 50,000 ordinary shares. For the purposes of the tax benefits under Section 102 of the Israel Income Tax Ordinance, the Section 102 Plan was subject to approval by the Tax Authority which was obtained on March 4, 1996.

As of December 31, 2002, 22,300 of the options granted under this plan had been exercised, and there were 13,788 more options outstanding, 8,038 at an exercise price of $17.00 per share, and 5,750 at an exercise price of $18.00 per share. All of the outstanding options had vested as of December 31, 2002.

1994 Plan

In 1994, we adopted a plan for the grant of options to purchase 50,000 ordinary shares to our employees. As of December 31, 2002, 28,613 of the options granted under this plan had been exercised, and there were 17,694 more options outstanding, 3,694 at an exercise price of $10.60 and 14,000 at an exercise price of $14.00. All of the outstanding options had vested as of December 31, 2002.

Item 7: Major Shareholders and Related Party Transactions

7A. Major Shareholders

We are not directly or indirectly owned or controlled by another corporation or by any foreign government.

The following table presents, to the best of our knowledge, certain information as of June 15, 2003 with respect to each shareholder known to the Company to be the beneficial owner of more than 5% of our outstanding ordinary shares. Except where indicated, we believe, based on information provided by the owners, that the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to those shares (subject to community property laws, where applicable). Applicable percentage ownership in the following table is based on 3,810,366 shares outstanding as of June 15, 2003.

	Shares Beneficially Owned	
Name and Address	Number	Percent
Catalyst Fund, LP 3 Daniel Frisch Street, Tel-Aviv 64731, Israel	947,275	24.9%
Mr. Israel Gal (1) C/o B.O.S. Better OnLine Solutions Ltd. 100 Bos Drive Teradion 20197, Israel	321,332	8.4%
Ms. Yael Gal (2) C/o B.O.S. Better OnLine Solutions Ltd. 100 Bos Drive	244,467	6.4%

Teradion 20197, Israel		
Mr. Jacob Lee (3) 2230 Brandon Place West Linn, Oregon 97068, USA	126,905	3.3%

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Ms. Miran Lee (4) 2230 Brandon Place West Linn, Oregon 97068, USA	126,905	3.3%
M. Wertheim Holdings, Ltd. Twin Towers 2, 35 Zabotinski Street Ramat-Gan, Israel	279,958	7.3%