DATA SYSTEMS & SOFTWARE INC
Form 10-Q/A
March 30, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 1
ON
FORM 10-Q\A
TO
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003 COMMISSION FILE NUMBER 0-19771

DATA SYSTEMS & SOFTWARE INC.
(Exact name of registrant as specified in charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	22-2786081 (I.R.S. employer identification no.)
200 ROUTE 17, MAHWAH, NEW JERSEY (Address of principal executive offices)	07430 (Zip code)

(201) 529-2026
Registrant's telephone number, including area code

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

| | | Yes | X | No

Number of shares outstanding of the registrant's common stock, as of November 10, 2003: 7,902,025

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A amends our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003 as filed by us on November 14, 2003. This Amendment deletes the introduction to Item 1 of Part I of the Form 10-Q as originally filed which disclosed that, due to the resignation of our previous auditor, the interim consolidated financial statements had not been reviewed as required by Rule 10-01(d) of Regulation S-X. The consolidated financial statements included in this Amendment No. 1 fully comply with Rule 10-01(d).

The interim financial statements included in this Amendment No.1 have been restated from those included in the Form 10-Q as originally filed. The changes relate primarily to our accounting for our investment in and our recording of our share of the losses of Comverge, Inc. The primary changes in our results and financial position are as follows: (1) a $1.0 million decrease in equity losses from unconsolidated subsidiary and a $1.1 million decrease in net loss resulting in a $0.4 decrease in basic and diluted net loss per share for the nine months ended September 30, 2003; (2) a $2.2 million decrease in investment in affiliated company and total assets; and (3) a $3.3 million decrease in additional paid-in-capital. Changes to reflect the restated financial information have been made to Management's Discussion and Analysis in Item 2 of Part I. This Amendment No.1 also includes the items of the Form 10-Q that are not being amended.

Except as noted above, this Amendment No.1 on Form 10-Q/A does not purport to provide a general update or discussion of any developments at the Company after the date of the original filing of the 10-Q.

==

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES

TABLE OF CONTENTS

Certain statements contained in this report are forward-looking in nature. These statements are generally identified by the inclusion of phrases such as "we expect", "we anticipate", "we believe", "we estimate" and other phrases of similar meaning. Whether such statements ultimately prove to be accurate depends upon a variety of factors that may affect our business and operations. Many of these factors are described in our most recent Annual Report on Form 10-K as filed with Securities and Exchange Commission.

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

ASSETS	AS OF DECEMBER 31, 2002
Current assets:	
Cash and cash equivalents	$1,150
Restricted cash	241
Accounts receivable, net	12,267
Inventory	2,217
Other current assets	1,443
Total current assets	17,318
Investment in Comverge, net	-
Property and equipment, net	1,972
Goodwill	4,929
Other intangible assets, net	404
Long-term deposits - restricted	5,700
Other assets	599
Prepaid employee termination benefits	2,425
Total assets	$33,347
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Short-term debt and current maturities of long-term debt, net	$2,531

Convertible note, net	1,224
Trade accounts payable	5,185
Accrued payroll, payroll taxes and social benefits	2,211
Other current liabilities	3,411
Total current liabilities	14,473
Long-term liabilities:	
Long-term debt	6,278
Other liabilities	477
Liability for employee termination benefits	3,364
Total long-term liabilities	10,119
Minority interests	1,609
Shareholders' equity:	
Common stock - $0.01 par value per share:	
Authorized - 20,000 shares;	
Issued - 8,162 and 8,750 shares as of December 31, 2002 and September 30, 2003, respectively	82
Additional paid-in capital	37,687
Warrants	364
Deferred compensation	(7)
Accumulated deficit	(26,787)
Treasury stock, at cost - 846 and 848 shares as of December 31, 2002 and September 30, 2003, respectively	(3,913)
Stockholder's note	(298)
Total shareholders' equity	7,128
Total liabilities and shareholders' equity	$33,305

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

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)
(in thousands, except per share data)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2003
		(restated)
Sales:		
Products	$24,868	$16,900
Services	8,915	7,478
Projects	3,077	2,459

	36,860	26,837
Cost of sales:		
Products	19,749	13,951
Services	6,636	5,236
Projects	2,542	2,087
	28,927	21,274
Gross profit	7,933	5,563
Operating expenses:		
Research and development expenses	1,266	153
Selling, general and administrative expenses	12,675	8,394
Impairment of goodwill	2,760	--
Total operating expenses	16,701	8,547
Operating loss	(8,768)	(2,984)
Interest income	203	42
Interest expense	(743)	(721)
Other income (expense), net	148	(408)
Losses before taxes on income	(9,160)	(4,071)
Taxes on income	64	7
Loss from operations of the Company and its consolidated subsidiaries	(9,224)	(4,078)
Minority interests	852	139
Equity loss in Comverge	--	(1,161)
Net loss	$(8,372)	$(5,100)
Basic and diluted net loss per share:		
Net loss per share	$(1.14)	$(0.66)
Weighted average number of shares outstanding - basic and diluted	7,353	7,680

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

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited) (restated)
Nine months ended September 30, 2003
(in thousands)

	Number of Shares	Common Stock	Additional Paid-In Capital	Warrants	Deferred Compensation	Accumulated Deficit

Balances as of December 31, 2002	8,162	$ 82	$37,687	$ 364	$ (7)	$(26,787)
Amortization of deferred compensation	--	--	--	--	5	--
Issuance of shares as compensation	50	--	50	--	--	--
Exercise of options	11	--	17	--	--	--
Issuance of shares in lieu of debt repayment	127	1	239	--	--	--
Conversion of line of credit, net of professional fees	400	4	559	--	--	--
Warrants issued for professional services	--	--	--	97	--	--
Purchase of treasury shares	--	--	--	--	--	--
Write-off of stockholder's note	--	--	--	--	--	--
Equity from issuance of shares by Comverge Inc.	--	--	1,085	--	--	--
Net loss	--	--	--	--	--	(5,100)
Balances as of September 30, 2003	8,750	$ 87	$39,637	$ 461	$ (2)	$(31,887)

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

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(in thousands)

20

Cash flows provided by (used in) operating activities:	
Net loss..	$(8
Adjustments to reconcile net loss to net cash used in operating activities - Appendix:	2
Net cash used in operating activities..	(5
Cash flows (used in) provided by investing activities:	
Restricted cash..	
Proceeds from sale and maturity of debt securities...........................	1
Proceeds from sale of property and equipment.................................	
Investment in debt securities..	
Acquisitions of property and equipment.......................................	
Funding of termination benefits..	
Acquisition of intangible assets...	
Business disposition - see Schedule A..	
Investment in equity method investee...	
Net cash provided by investing activities....................................	1
Cash flows (used in) provided by financing activities:	
Short-term debt, net...	
Proceeds from issuance of convertible note...................................	2
Borrowings of long-term debt...	
Repayments of long-term debt...	
Convertible note issuance costs..	
Investment in subsidiary by minority interest................................	
Exercise of options..	
Purchase of treasury stock...	
Net cash provided by (used in) financing activities..........................	1
Net decrease in cash and cash equivalents....................................	(2
Cash and cash equivalents at beginning of period.............................	4
Cash and cash equivalents at end of period...................................	$1
Supplemental cash flow information:	
Cash paid during period for interest...	
Cash paid during period for income taxes.....................................	
Non-cash investing and financing activities:	
Issuance of common stock in lieu of debt repayment...........................	
Increase in investment in Comverge from issuance of preferred and common stock credited to additional paid-in capital..	
Accounts payable incurred in investment of Comverge..........................	
Accounts payable incurred in acquisition of fixed assets.....................	
Value of beneficial conversion feature and related warrants on issuance of convertible note..	
Adjustment of goodwill and intangible assets.................................	
Increase in deferred tax liability associated with adjustment of intangible assets..	

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

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS - APPENDIX (unaudited)
(dollars in thousands)

	20
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization..	$
Allowance for doubtful accounts..	
Stock and stock option compensation..	
Accretion of discount on convertible note and amortization of related costs and warrants..	
Minority interest and write-off of minority interest balance.....................	
Equity loss in Comverge..	
Unrealized gain on debt securities...	
Impairment of goodwill and acquired software...	
Settlement of payable to contract settlement...	
Loss on write-off of stockholder's note..	
Restricted cash..	
(Decrease) increase in liability for employee termination benefits................	
Exchange adjustment on long-term debt...	
Loss on disposition of property and equipment..	
Deferred taxes...	
Change in operating assets and liabilities:	
Decrease in accounts receivable and other current assets.....................	
(Decrease) increase in inventory..	(
Increase (decrease) in other assets..	
Increase (decrease) in accounts payable and other liabilities................	
Total..	$

A. Assets/liabilities disposed of in disposition of Comverge:

Current assets..
Property, equipment and other assets..
Goodwill ....
Intangibles...
Short-term debt...
Current liabilities...
Other liabilities...
Cash Investment in Comverge...

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

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share data)

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed interim consolidated financial statements of Data Systems & Software Inc. ("DSSI") and subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. These unaudited condensed interim consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Certain reclassifications have been made to the Company's prior period's consolidated financial statements to conform to the current period's consolidated financial statement presentation.

These condensed consolidated interim unaudited financial statements have been restated following the determination that no change of DSSI interest in Comverge has occurred following issuance of Comverge's preferred stock, and that the issuance of 877,000 of Comverge's common stock in connection with its purchase of 6D at April 2003 resulted a combined decrease of $3,269 in gain previously recorded in DSSI Additional paid-in capital. In addition DSSI determined that it is no longer committed to fund Comverge and due to the Company's negative common stock investment in Comverge it should cease to record equity losses against its common investment and will continue to record equity losses against its preferred investment in Comverge.

The effect of the restatement on the Company's net loss and basic and diluted loss per share for the nine month and three month periods ended September 30, 2003, is shown below:

	NINE MONTHS ENDED	THREE MONTHS ENDED
	SEPTEMBER 30, 2003	
Net loss - as reported	(6,153)	(1,731)
Effect of restatement	1,053	102
Net loss - as restated	(5,100)	(1,629)
Basic and diluted net loss per share - as reported	(0.80)	(0.22)

Effect of restatement	0.14	0.01
Basic and diluted net loss per share - as reported	(0.66)	(0.21)

NOTE 2: FINANCING OF OPERATIONS

As of September 30, 2003, the Company had working capital of $1,046, including $707 in unrestricted cash and cash equivalents. Net cash used in operating activities in the first nine months of 2003 was $187. The net loss for the period of $5,100 included a non-cash expenses and losses of $1,240 and an equity loss in Comverge of $1,161. The primary source of the Company's cash provided by operating activities during the first nine months of 2003 was collections of trade accounts receivables and other current assets in excess of reductions in accounts payable and other liabilities of $2,150, net. Net cash provided by investing activities was $248, primarily from the release of previously restricted cash of $4,200, of which $3,327 was invested in Comverge. Net cash used in financing activities of $504 was primarily due to net payments of debt of $541.

The working capital of $1,046 at September 30, 2003 included negative working capital of $89 in the Company's majority owned Israeli subsidiary, dsIT. Due to Israeli tax and company law constraints, as well as the significant minority interest in dsIT, positive working capital and cash flows from dsIT's operations in past periods were not readily available to finance U.S. activities.

dsIT is utilizing approximately $1,213 of its $1,576 lines of credit as of September 30, 2003. dsIT's lines of credit are denominated in NIS and bear an average interest rate of the Israeli prime rate plus 0.9% per annum. The Israeli prime rate fluctuates and on September 30, 2003 was 7.9%. Since April 2003, the Company's formerly consolidated subsidiary, Comverge, Inc. (Comverge) completed private equity financings totaling approximately $18,600 (see Note 3). As a result of the financing, Comverge no longer requires additional funding from the Company. As part of the agreements related to the private equity financing, Comverge received a new $6,500 credit facility, which included a $1,500 term loan secured by a $1,500 restricted deposit of DSSI. Comverge is obligated to prepay the term loan and facilitate the release of the Company's $1,500 deposit over the six months commencing December 31, 2003, subject to certain conditions (see Note 3). The Company believes that the proceeds of the financing and new credit arrangements provide sufficient financing for Comverge to independently fund its activities.

As of October 31, 2003, the Company's wholly-owned US operations (i.e., excluding dsIT and Comverge) had an aggregate of $740 in unrestricted cash and cash equivalents, reflecting a $292 decrease from the balance as of December 31, 2002.

The Company believes it has sufficient liquidity to finance its US-based operating activities and its corporate activities for at least the next 12 months. The Company intends to finance these activities from cash on hand, including the freeing up of the restricted deposit pledged to secure Comverge's term loan, and operating cash flows.

(in thousands, except per share data)

NOTE 3: COMVERGE EQUITY FINANCING TRANSACTIONS

On April 7, 2003, the Company and its then consolidated subsidiary Comverge signed and closed on a definitive agreement with a syndicate of venture capital firms raising an aggregate of $13,000 in capital funding. The Company purchased $3,250 of Series A Convertible Preferred Stock issued by Comverge in the equity financing and incurred transaction costs of an additional $94. A syndicate of venture capital firms purchased $7,750 of Series A Convertible Preferred Stock issued by Comverge, and one member of the syndicate also purchased $2,000 of Series A-1 Convertible Preferred Stock of Comverge. In connection with the transaction, the Company converted to equity in Comverge the balance of the intercompany loans of $9,673.

The purchaser of the Series A-1 Preferred Stock was granted a put option exercisable in April 2004 and Comverge received a right to call all the Series A-1 Preferred Stock for $2,000, at anytime on or before April 18, 2004. In September 2003, Comverge completed an agreement raising an additional $2,000 in capital funding in exchange for additional Series A Convertible Preferred Stock issued by Comverge. Comverge utilized these funds to repurchase the Series A-1 Convertible Preferred Stock previously issued by Comverge.

The Series A Convertible Preferred Stock has priority over Comverge common stock for dividends and liquidations (which includes a sale of Comverge). Additionally, the Preferred Stock has anti-dilution protection for stock issuances by Comverge below the per share purchase price of the Series A Preferred Stock (subject to customary exceptions such as employee stock options) as well as approval rights for major corporate transactions, stock issuances, declaration or payment of dividends, changing corporate governance documents, liquidation or dissolution of Comverge and other corporate matters. Each share of the Preferred Stock is convertible into one share of Comverge common stock at any time at the holder's option, or, at Comverge's option, upon an initial public offering with gross proceeds of at least $30,000 and an offering price of at least $10.40 per share. The Preferred Stock votes on an "as converted" basis with the common stock.

Under Comverge's Amended and Restated Certificate of Incorporation, the holders of Comverge common stock have the right to elect two of the five directors on Comverge's Board. Certain preferred shareholders other than the Company have the right to elect the other three directors. Pursuant to a voting agreement, one of the directors elected by the holders of the Comverge common stock must be the Chief Executive Officer (CEO) of Comverge. The Company's chairman and CEO and Comverge's CEO were elected as the initial directors by the Comverge common stockholders.

In connection with Comverge's April equity financing transactions, Comverge acquired Sixth Dimension, Inc. ("6D") in a purchase business combination, valued at approximately $1,052, in exchange for 877,000 of Comverge's common shares. Some of the venture capital participants in Comverge's equity financing transaction were the principal owners in 6D prior to the acquisition. 6D is an early stage Internet-based software company, whose iNET product enables a broad range of energy services including: upstream facility metering, monitoring, and control; performance-based operations and proactive maintenance; economic demand response and active load curtailment; aggregated distributed generation; power reliability and quality monitoring; and other real-time capital equipment analysis using a low-cost, robust, software for service delivery. The acquisition adds to Comverge's product offering, technology for upstream monitoring & control of capital assets, by combining 6D's real-time, internet-based, data warehousing iNET software with the analytical and metering capabilities of Comverge's PowerCAMP software applications. In connection with this transaction, as a result of our dilution and a new valuation of the exchanged common stock of Comverge at approximately $509, we recorded an increase of $1,085 to our common stock investment in Comverge. The increase was recorded as an adjustment to additional-paid-in-capital.

Following Comverge's April 2003 equity transaction, the Company held approximately 50.6% of the outstanding capital voting stock of Comverge (approximately 76% of Comverge's common stock and approximately 26% of Comverge's Preferred Stock). As a result of the April 2003 transaction, the Company is no longer obligated to fund Comverge. Additionally, subsequent to the April equity transaction, the Company has a negative investment balance in Comverge's common stock of $1,824. As the Company is no longer committed to fund Comverge, the Company has ceased to record equity losses against its common stock investment. The Company's negative common investment will only be adjusted upon disposition of the Company's common stock investment or when the Company realizes equity income from Comverge in excess of any accumulated equity losses recorded on its Preferred Stock investment.

Also in connection with the equity financing in April, Comverge secured a $6,500 credit facility with a leading financial institution. Comverge's new credit facility includes a $1,500 term loan secured by a Company pledge of a $1,500 restricted deposit at Comverge's new lender, and a revolving line of credit of up to $5,000 secured by the assets of Comverge. Comverge agreed to make certain prepayments of the $1,500 term loan and the new lender agreed to the release of amounts equal to such payments from the pledge account, subject to Comverge's compliance with certain financial and other covenants in its agreement with the lender. Such covenants have been subsequently either fulfilled or waived.

Based on the total capital raised (some of which occurred after September 30, 2003), and the redemption of the put, the prepayments by Comverge and release of the pledge account, are to be made in two payments of $750 each on December 31, 2003 and June 30, 2004.

Subsequent to the third quarter, in October 2003, Comverge completed an agreement raising an additional $5,600 in capital funding in exchange for additional Series A Convertible Preferred Stock issued by Comverge.

The Company entered into various agreements with Comverge and the syndicate of venture capital investors. These agreements provide for, among other things, restrictions on the transfer of the Company's shares of Series A Preferred Stock and Comverge common stock, the voting of the Company's Series A Preferred Stock and Comverge common stock, the Company's right to receive quarterly and annual financial reports from Comverge and registration rights for the Company's Series A Preferred Stock and Comverge common stock.

Until December 31, 2003, the Company has the option to purchase from Comverge up to $1,500 of Series A-2 Convertible Preferred Stock. The amount of Series A-2 Preferred Stock that the Company may purchase from Comverge will be limited to the number of shares that could be purchased by the principal balance of the $1,500 term loan as of the date the Company gives notice of exercising the Series A-2 option. The Series A-2 Preferred Stock has the same purchase price as the Series A-1 Preferred Stock. The Series A-2 Preferred Stock has the same rights as the Series A and the Series A-1 Preferred Stock, except the Series A-2 Preferred Stock is junior in priority in liquidation (which includes the sale of Comverge) to both the Series A and Series A-1 Preferred Stock.

At September 30, 2003, following Comverge's April equity transaction, the Company owned approximately 49.6% of the outstanding capital voting stock of Comverge, comprised of approximately 25% of the Preferred Stock and approximately 76% of Comverge's common stock. As a result of the last equity transaction in October 2003, the Company owned approximately 40.9% of the outstanding capital voting stock of Comverge, comprised of approximately 17% of the Preferred Stock and approximately 76% of Comverge's common stock.

- 8 -

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share data)

NOTE 4: EQUITY INVESTMENT IN COMVERGE

As a result of the private equity financing transactions and other agreements described in Note 3, Comverge is no longer a controlled subsidiary of the Company. Thus, effective April 1, 2003, the Company no longer consolidates Comverge's balance sheet and results of operations, and accounts for its investment in Comverge under the equity method. The Company's Preferred Stock investment of $3,344 (which was primarily financed by the release of $3,000 of previously restricted cash) has been reduced by equity losses in Comverge for the period of April 1, 2003 to September 30, 2003 of $1,161.

Summary unaudited financial information for Comverge as of September 30, 2003 and for the period from April 1 to September 30, 2003 is as follows:

FINANCIAL POSITION
Current assets
Property, plant, and equipment, net
Intangible and other assets, net

Total assets

Current liabilities
Long-term debt
Other non-current liabilities

Total liabilities
Shareholders' equity

Total liabilities and shareholder's equity

RESULTS OF OPERATIONS

Sales
Operating loss

Net loss

The activity in the Company's investments in Comverge during the six months ended September 30, 2003 is as follows:

Investment in Comverge common stock
Conversion of inter-company balances to equity
Accumulated deficit at March 31, 2003
Adjustment of the Company's investment from dilution of common shares

Total investment in Comverge common stock

Investment in Comverge preferred stock
Cash paid for preferred stock of Comverge
Transaction costs

Investment balance prior to equity loss

Equity (preferred) loss in Comverge - April 1 to September 30, 2003

Total investment in Comverge preferred stock

Investment in Comverge, net

As a result of Comverge's net loss during the six months ended September 30, 2003 the Company recorded an equity loss of $1,161, which represents 26% of Comverge's losses against the Company's Preferred Stock investment.

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share data)

NOTE 5: INVENTORY

Inventory consists of the following:	As of December 31, 2002	As of September 30, 2003
Raw materials, spare parts and supplies	$1,396	$23
Work-in-process	161	-
Finished goods and merchandise	660	32
	$2,217	$55

NOTE 6--GOODWILL AND OTHER INTANGIBLE ASSETS

The table below presents the carrying amount of goodwill, by segment. There were no acquisitions or impairments of goodwill recorded during the nine-month period ended September 30, 2003.

	Software Consulting and Development	Energy Intelligen Solution
Segment balances as of December 31, 2002	$4,430	$
Deconsolidation of Comverge investment (See Notes 3 and 4)	--	(
Segment balances as of September 30, 2003	$4,430	$

The following table presents certain information regarding the Company's amortizable intangible assets as of September 30, 2003 and December 31, 2002. All intangibles assets are being amortized over their estimated useful lives, with no estimated residual values.

		As of September	
	Weighted average amortization period	Gross carrying amount	Accumulate amortizati
Amortizing intangible assets:			
Software licenses	4.5 yrs	$260	$

		As of December	
	Weighted average amortization period	Gross carrying amount	Accumulate amortizati
Amortizing intangible assets:			
Licenses	5.0 yrs	$568	$
Patents	15.0 yrs	288	
Software licenses	4.5 yrs	260	
Total		$1,116	$

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share data)

Amortization in respect of license, patents and software licenses intangible amounted to $304 and $59 for the nine months ended September 30, 2002 and 2003, respectively (2002 includes amortization of $108 with respect to acquired backlog which was fully amortized in 2002).

Estimated amortization expense for the remainder of 2003 is $17 and as follows with respect to intangible assets for each of the next five years:

YEAR ENDED SEPTEMBER 30,	
2004	$41
2005	32
2006	32
2007	22
2008	4
	$131

NOTE 7: WARRANTY PROVISION

The Company generally warrants its products against certain manufacturing and other defects. These product warranties are provided for specific periods of time and/or usage of the product depending on the nature of the product, the geographic location of its sale and other factors. The accrued product warranty costs are based primarily on historical experience of actual warranty claims as well as current information on repair costs.

The following table provides the changes in the Company's provision for product warranties for the nine-month periods ended September 30, 2002 and 2003:

	Nine months ended September 30,	
	2002	2003
Warranty provision at beginning of the period	$302	$52
Accruals for warranties issued during the period	85	23
Warranty settlements made during the period	(300)	(23)
Other - deconsolidation of Comverge (see Notes 3 and 4)	--	(52)
Warranty provision at the end of the period	$87	$--

The Company's product license and services agreements include a limited indemnification provision for claims from third parties relating to the Company's intellectual property included in the Company's products and projects. Such indemnification provisions are accounted for when amounts of liabilities are probable and estimable. The indemnification is generally limited to the amount paid by the customer and to date there have not been material claims under such indemnification provisions. At this time, the Company cannot reasonably estimate future potential indemnifications, if any.

DATA SYSTEMS & SOFTWARE INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share data)

NOTE 8: STOCK-BASED COMPENSATION

Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock Based Compensation" permits companies to (i) recognize as expense the fair value of stock-based awards, or (ii) continue to apply the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations ("APB 25"), and provide pro forma net income and earnings per share disclosures for employee stock option grants as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company continues to apply the provisions of APB 25 and provide the pro forma disclosures in accordance with the provisions of SFAS No. 123 as amended to its Stock Option and Incentive Plan. Under APB 25, the Company has recorded minimal stock-based employee and director compensation cost associated with its stock option plan, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net loss and net loss per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to its stock option plan:

	THREE MONTHS ENDED SEPTEMBER 30,		NIN S
	2002	2003	2002
		(restated)	
Net loss as reported...........................	$(4,271)	$(1,629)	$(8,
Plus: Stock-based employee and director compensation expense included in reported net loss........................	2	2	
Less: Total stock-based employee compensation expense determined under fair value based method for all awards..............	394	2	1,
Pro forma net loss.............................	$(4,663)	$(1,629)	$(9,
Net loss per share:			
Basic and diluted - as reported...........	$(0.58)	$(0.21)	$(0
Basic and diluted - pro forma.............	$(0.63)	$(0.21)	$(1

The pro forma information in the above table also gives effect to the application of SFAS No. 123 on the share option plans of the Company's subsidiaries (The application of SFAS No. 123 with respect to Comverge is included only for the nine month period ended September 30, 2002 and the first three months of 2003 until the Company's deconsolidation of its interest in Comverge - see Notes 3 and 4).

(in thousands except per share data)

NOTE 9: WARRANTS

On February 25, 2003, the Company engaged a third-party for the purposes of providing investor awareness and business advisory services for a period of one year. The Company pays a monthly advisory fee, totaling $90 over the period of the agreement. In addition, the Company granted the third-party common stock purchase warrants for the purchase of 120,000 shares of the Company's common stock (60,000 at $2.00 per share and 60,000 at $2.50 per share). The warrants became fully vested on May 26, 2003 and expire on February 25, 2005. The Company used the Black-Scholes valuation method to estimate the fair value of the warrants, using a risk free interest rate of 1.75%, their contractual life of two years, an annual volatility of 88% and no expected dividends. The Company estimated the fair value of the warrants to be approximately $97, which has been charged to selling, general and administrative expense.

NOTE 10: SEGMENT INFORMATION

	SOFTWARE CONSULTING AND DEVELOPMENT	ENERGY INTELLIGENCE SOLUTIONS(**)	COMPUTER HARDWARE	OTH
Nine months ended September 30, 2003 (restated):				
Revenues from external customers	$9,138	$4,700	$12,974	
Intersegment revenues	-	284	20	
Segment gross profit	1,949	1,313	2,276	
Segment loss	(493)	(2,772)	(247)	
Nine months ended September 30, 2002:				
Revenues from external customers	$10,636	$12,683	$13,415	
Intersegment revenues	72	870	73	
Segment gross profit	1,704	3,918	2,260	
Segment income (loss)***	(3,553)	(2,465)	36	
Three months ended September 30, 2003 (restated):				
Revenues from external customers	$2,827	--	$3,856	
Intersegment revenues	--	--	--	
Segment gross profit	549	--	653	
Segment loss	(28)	(909)	(156)	
Three months ended September 30, 2002:				
Revenues from external customers	$3,339	$3,259	$4,638	
Intersegment revenues	53	391	27	
Segment gross profit	412	1,144	801	
Segment income (loss)***	(2,862)	(597)	61	

(*) Represents the operations of a VAR software operation in Israel that did not meet the quantitative thresholds of SFAS No. 131.

(**) Operating results of Comverge (the Energy Intelligence Solutions segment) are no longer consolidated beginning the second quarter of 2003 - see Note 4. Segment loss for the nine ended September 30, 2003 includes consolidated losses of $1,313 during the period from January 1 to March 31, 2003, equity losses of $1,161 on the Company's preferred investment in Comverge and other expense of $298, relating to the write-off of a stockholder's note from segment CEO. Segment loss for the three months ended September 30, 2003 include equity losses off $611 on the Company's preferred investment in Comverge and other expense of $298, relating to the write-off of a stockholder's note from segment CEO.

(***) Segment loss for the nine and three month periods ended September 30, 2002 in the software consulting and development segment include a charge of $3,000 for impairment of goodwill and acquired software, reduced by $528 for minority interests.

- 13 -

RECONCILIATION OF SEGMENT LOSS TO CONSOLIDATED NET LOSS

	Nine months ended September 30,		Th
	2002	2003	20
		(restated)	
Total loss for reportable segments	$(5,982)	$(3,512)	$(3
Other operational segment loss	(2)	(17)	
Total operating loss	(5,984)	(3,529)	(3
Net loss of corporate headquarters*	(2,388)	(1,571)	
Total consolidated net loss	$(8,372)	$(5,100)	$(4

(*) Net loss of corporate headquarters for the nine and three months ended September 30, 2002 includes $311 and $256 of interest expense related to the amortization of the fair value of the beneficial conversion feature and related warrants at the issuance of the convertible note in June of 2002.

-14-

DATA SYSTEMS & SOFTWARE INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion includes statements that are forward-looking in nature. Whether such statements ultimately prove to be accurate depends upon a variety of factors that may affect our business and operations. Certain of these factors are discussed below under "Factors That May Influence Future Results" and in "Item 1. Description of Business - Factors That May Influence Future Results" in our Annual Report on Form 10-K for the year ended December 31, 2002, (the "2002 10-K").

OVERVIEW AND TREND INFORMATION

We operate in three reportable segments: software consulting and development, energy intelligence solutions, and computer hardware. As we no longer have control over Comverge (see Notes 3 and 4 to the unaudited condensed interim consolidated financial statements), effective the second quarter of 2003 we account for our investment in Comverge on the equity method and no longer consolidate Comverge's balances and operating activity into our consolidated balance sheet and statement of operations. The following analysis should be read together with the segment information provided in Note 10 to our unaudited financial statements included in this report.

SOFTWARE CONSULTING AND DEVELOPMENT

Segment revenues continued to decrease in the third quarter of 2003. The decrease resulted primarily from the continued general weakness in the global hi-tech markets and in the software consulting and development market in particular. We currently do not see the market improving and, while increasing our marketing efforts, we are constantly implementing cost cutting measures so as to prevent this activity from incurring losses, until the market improves. These measures are what caused the segment's gross profit and segment loss in 2003 periods to improve on those of the 2002 periods.

In June 2003 Clalit Health Services, Israel's largest HMO and one of the largest HMOs in the world, awarded our dsIT subsidiary, together with Yael Software, a $4 million contract, of which dsIT's portion is approximately 50%. The contract includes the development and implementation of a new Customer Care and Billing system, based entirely on dsIT's e-asyBillTM billing system. The system is to be implemented over a one-year period and includes a seven-year maintenance contract. In the future, we expect that this product, our OncoProTM product and sonar technology systems will have increased impact on our results, offsetting the continued deterioration in the software consulting market. Revenues from this contract are expected to begin in the fourth quarter of 2003.

In addition, dsIT has been successful in bidding together with Databit (from our Computer Hardware segment) for certain Israeli Ministry of Defense (MoD) contracts and we expect this cooperation to produce increased revenues in the future.

ENERGY INTELLIGENCE SOLUTIONS

On April 7, 2003 Comverge signed and closed on an agreement (see Note 3 to our unaudited consolidated financial statements) for private equity financing in the amount of $13.0 million. We invested $3.25 million, and $9.75 million was invested by a group of leading energy venture capital investors, in exchange for Series A Convertible Preferred Stock of Comverge. In September 2003, Comverge signed and closed another agreement with two other venture capital firms raising an additional $2.0 million in capital funding in exchange for additional Series A Convertible Preferred Stock issued by Comverge, utilizing these funds to repurchase the Series A-1 Convertible Preferred Stock previously issued by Comverge. Subsequent to the third quarter, in October 2003, Comverge signed and closed on its last agreement with two other venture capital firms raising an additional $5.6 million in capital funding in exchange for additional Series A Convertible Preferred Stock issued by Comverge, completing this round of equity investment, totaling $18.6 million.

Comverge's operating results for the period from January 1, 2003 to March 31, 2003 have been consolidated and are included in our consolidated statements of operations. Our share of Comverge's operating results for the period from April 1, 2003 to September 30, 2003 (effective April 1, 2003) are reflected as equity loss in Comverge in our consolidated statements of operations.

Towards the end of the first quarter and through the third quarter of 2003, Comverge devoted significant attention to the capital raising process mentioned above. In addition, during this period, Comverge signed its first major, long-term Virtual Peaking Capacity(TM) contract to provide significant peak load reduction to PacifiCorp, a subsidiary of Scottish Power. Although little revenue was recognized with respect to this contract, we expect it to have a positive effect on revenues in future periods. Comverge and Gulf Power have agreed in principle to modify their long-term agreement for the deployment of Maingate gateway systems, temporarily delaying shipments. This will significantly reduce revenues from this contract in the short term, but is not expected to negatively impact operating results at Comverge. Over the longer term, the modifications are expected to improve this project's profitability, due to product improvements and reductions in component costs.

COMPUTER HARDWARE

Sales in the third quarter of 2003 continued to be below expectations and below the level of sales achieved in the first quarter of this year. We expect computer hardware sales to improve in the coming quarters and are beginning to see signs of such improvement. To offset the weakness in this market, and diversify our revenue base, we have initiated efforts towards adding more value added software products and services, which we hope to leverage off the expertise of our existing sales force and customer base. These activities, together with continuing joint marketing efforts with dsIT for Israeli Ministry of Defense projects, are intended to reduce Databit's dependency on the computer hardware markets in the future.

CORPORATE

With the completion of Comverge's venture financing over the last few months, we do not need to fund Comverge and no longer have control over its activities. Mr. George Morgenstern, has informed our Board that he intends to retire from full-time employment as of December 31, 2003 and to remain as a consultant to us as called for in his employment agreement and has agreed within this construct to make himself available to fill any position the Board may desire. In light of our reduced involvement at Comverge, the capable independent management in place at our dsIT and Databit subsidiaries and our CEO's retirement, we continue to evaluate our corporate activities and structure. This evaluation includes exploration of restructuring and/or acquisitions or mergers. We expect to continue this process during the next few months, completing it before year-end.

RESULTS OF OPERATIONS

These condensed consolidated interim unaudited financial statements have been restated following the determination that no change of DSSI interest in Comverge has occurred following issuance of Comverge's preferred stock, and that the issuance of 877,000 of Comverge's common stock in connection with its purchase of 6D at April 2003 resulted a combined decrease of $3,269 in gain previously recorded in DSSI Additional paid-in capital. In addition DSSI determined that it is no longer committed to fund Comverge and due to the Company's negative common stock investment in Comverge it should cease to record equity losses against its common investment and will continue to record equity losses against its preferred investment in Comverge.

The effect of the restatement on the Company's net loss and basic and diluted loss per share for the nine month and three month periods ended September 30, 2003, is shown below:

	NINE MONTHS ENDED	THREE MONTHS ENDED
	SEPTEMBER 30, 2003	
Net loss - as reported	(6,153)	(1,731)
Effect of restatement	1,053	102
Net loss - as restated	(5,100)	(1,629)
Basic and diluted net loss per share - as reported	(0.80)	(0.22)
Effect of restatement	0.14	0.01
Basic and diluted net loss per share - as reported	(0.66)	(0.21)

The following table sets forth certain information with respect to our consolidated results of operations for the three and nine months ended September 30, 2002 and 2003, including the percentage of total revenues during each period attributable to selected components of the operations statement data and for the period-to-period percentage changes in such components. Being that starting the second quarter of 2003 we do not fully consolidate Comverge's results of operations, but rather include them on an equity basis, the results of the periods presented are not fully comparable.

	Nine months ended September 30,					Three months ended S		
	2002		2003 (restated)		Change	2002		2 (res
	($,000)	% of sales	($,000)	% of sales	% of 2002	($,000)	% of sales	($,00
Sales	$36,860	100%	$26,837	100%	(27)%	$11,269	100%	$6,68
Cost of sales	28,927	78	21,274	79	(26)	8,906	79	5,48
Gross profit	7,933	22	5,563	21	(30)	2,363	21	1,20

R&D expenses	1,266	3	153	1	(88)	256	2	-
SG&A expenses	12,675	34	8,394	31	(34)	3,923	35	1,98
Impairment of goodwill	2,760	7	--	--	(100)	2,760	24	-
Operating loss	(8,768)	(24)	(2,984)	(11)	(66)	(4,576)	(41)	(78
Interest expense, net	(540)	(1)	(679)	(3)	26	(393)	(3)	(5
Other income (loss), net	148	0	(408)	(2)	(376)	56	0	(24
Minority interests	852	2	139	1	(84)	649	6	3
Equity loss in Comverge	--	--	(1,161)	(4)		--	--	(61
Loss before provision for income taxes	(8,308)	(23)	(5,193)	(19)	(37)	(4,264)	(38)	(1,65
Provision (benefit) for income taxes	64	0	7	0	(92)	7	0	(2
Net loss	$(8,372)	(23)%	$(5,100)	(19)%	(39)	$(4,271)	(38)%	$(1,62

SALES. Sales in the third quarter and first nine months of 2003 were $6.7 million and $26.8 million, compared to $11.3 million and $36.9 million in the same periods of 2002, respectively. The decreases were primarily attributable to not consolidating Comverge sales starting the second quarter of 2003.

Comverge sales in the first quarter of 2003, third quarter of 2002 and first nine months of 2002 were $4.7 million, $3.3 million and $12.7 million, respectively.

Sales in the computer hardware segment in the third quarter and first nine months of 2003 were $3.9 million and $13.0 million, decreasing by 17% and 3%, from sales of $4.6 million and $13.4 million, in the same periods of 2002, respectively. The decrease was attributable to the increased competition and the continued decline in the hardware market during the second and third quarters of 2003.

Software consulting and development sales were $2.8 million and $9.1 million in the third quarter and first nine months of 2003, respectively, compared to $3.3 million and $10.6 million in the same periods of 2002. This decrease was primarily attributable to the decrease in consulting revenues resulting from the continued general weakness in the global hi-tech markets and in the software consulting and development market in particular.

GROSS PROFIT. Gross profit in the third quarter and the first nine months of 2003 was $1.2 million and $5.6 million, respectively, compared to $2.4 million and $7.9 million in the same periods of 2002. The decreases were almost entirely attributable to not consolidating Comverge's gross profit starting the second quarter of 2003. The gross profit margin in the computer hardware segment, slightly increased to 18% in the first nine-months of 2003, compared to 17% in the same period of 2002. However, in the third quarters of both 2003 and 2002, the gross profit margin was stable at 17%. As a result of our continued effort to improve the cost structure of the software consulting and development segment, gross profit margins increased to 21% and 19%, in the first nine months and third quarter of 2003, respectively, compared to 16% and 12% in the same periods of 2002. In addition, in the third quarter of 2002, we had a non-recurring expense of $240,000 for the write down of acquired software.

RESEARCH AND DEVELOPMENT EXPENSES ("R&D"). The decrease in R&D expenses in each 2003 period, as compared to the comparable periods in 2002, was primarily attributable to not consolidating Comverge's R&D starting the second quarter of 2003, although R&D in our software consulting and development segment has ceased as well.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES ("SG&A"). In the third quarter and first nine months of 2003, SG&A decreased to $2.0 million and $8.4 million, respectively, from $3.9 million and $12.7 million in the same periods of 2002. The decrease was primarily attributable to not consolidating Comverge's SG&A, which was $2.9 million and $1.6 million in the second and third quarters of 2002, respectively. However, corporate SG&A and SG&A in the software consulting and development segment continued to decrease as well, as we continued to reduce our overhead.

IMPAIRMENT OF GOODWILL. With the acquisition of Endan by our dsIT subsidiary in December 2001, we recognized goodwill and acquired software valued at a total of $6.4 million. This value was supported by third party valuations prepared at the time of the acquisition, based on sales and business projections made at that time. Since then, the hi-tech market in general and that of software consulting in particular continued to deteriorate. We have made concerted efforts to offset this negative trend with cost cutting measures already implemented. As we looked forward in September 2002 to the coming year, the expense recorded reflected our reassessment of the values then recorded with respect to the entire software consulting and development segment to reflecting our sales projections then, based on the same valuation models then employed. We are confident that the cost cutting measures already implemented will provide for breakeven and even positive performance in the coming quarters, justifying the remaining goodwill and value attached to this segment.

INTEREST EXPENSE, NET. Prior to the investment recently secured for our energy intelligence solution segment, we raised capital through issuing convertible debentures and utilized lines of credit to finance our activities. We incurred finance expenses in connection with the capital raised including interest and amortization of non-cash costs associated with the convertible debt and warrants issued. Although the interest associated with the utilization of lines of credit is expected to continue at the current level, the amortization expenses are expected to decrease over the coming quarters. Of the $721,000 of interest expense incurred during the first nine months of 2003, $396,000 was related to the accretion of discounts and the amortization of related costs in connection with convertible debt and warrants.

OTHER INCOME (EXPENSE), NET. We had previously entered into a restricted stock purchase agreement with the CEO of our energy intelligence solutions segment subsidiary. Pursuant to this agreement, we issued to the segment CEO 50,000 shares of our common stock. The common stock was paid for by assigning and endorsing to us a 6% subordinated note, due April 15, 2010, in the principal amount of $297,500. The note was issued by Philip Services Corp. (NasdaqNM: PSCD) in favor of the segment CEO under a trust indenture with Wilmington Trust Company. PSCD has recently filed for bankruptcy and we therefore wrote-off this note to other loss in the third quarter of 2003.

EQUITY LOSS IN COMVERGE. The equity loss in 2003 was from our formerly consolidated subsidiary, Comverge, whose results we account for on an equity basis starting the second quarter of 2003 (see Note 4 of our unaudited consolidated Financial Statements). The equity loss for the three and six-month periods ended September 30, 2003 is based on our share of Comverge's $2.3

million and $4.5 million of net losses, respectively. Comverge has common and preferred shares, issued to its investors, including DSSI, and our share of Comverge's losses is calculated based on the percentage of our preferred share investment. Because our common share investment is currently negative, we do not record equity losses on our common stock investment. As a result, during the third quarter of 2003 and for the period from April 1, 2003 to September 30, we recorded equity losses of $0.6 million and $1.2 million, respectively. Comverge's increased losses in the third quarter of 2003 of $2.3 million compared to $0.6 million in the third quarter of 2002, was primarily attributable to a decrease in sales, particularly those related to Comverge's Gulf Power contract, where shipments have been suspended. In addition, SG&A in Comverge has increased primarily due to increased advertising and marketing expenses, particularly those related to marketing and advertising its new Utah - PacifiCorp program.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2003, we had working capital of $1.0 million, including $707,000 in unrestricted cash and cash equivalents. Net cash used in operating activities in the first nine months of 2003 was $187,000. The net loss for the period of $5.1 million included non-cash expenses and losses of $1.2 million and an equity loss from Comverge of $1.2 million). The primary source of our cash provided by operating activities during the first nine months of 2003 was collections of trade accounts receivables and other current assets in excess of reductions in accounts payable and other liabilities, of $2.2 million, net. Net cash provided by investing activities was $248,000, primarily from the release of previously restricted cash of $4.2 million, of which $3.3 million was invested in Comverge. Net cash used in financing activities of $504,000 was primarily due to net payments of debt of $541,000.

The working capital of $1.0 million at September 30, 2003, included negative working capital of $89,000 in our majority owned Israeli subsidiary, dsIT. Due to Israeli tax and company law constraints, as well as the significant minority interest in dsIT, positive working capital and cash flows from dsIT's operations are not readily available to finance U.S. activities.

dsIT is utilizing approximately $1.2 million of its $1.6 million lines of credit as of September 30, 2003. dsIT's lines of credit are denominated in NIS and bearing an average interest rate of the Israeli prime rate plus 0.9% per annum. The Israeli prime rate fluctuates and on September 30, 2003 was 7.9%. We believe dsIT will have sufficient liquidity to finance its activities from cash flow from its own operations and available lines of credit over the next 12 months.

Since April 2003, our formerly consolidated subsidiary, Comverge, signed and closed a number of private equity financing transactions raising approximately $18.6 million (see Note 3 of our unaudited Consolidated Financial Statements). As a result, Comverge no longer requires additional funding from us. As part of the agreement for the private equity financing, Comverge received a new $6.5 million credit facility, which included a $1.5 million term loan secured by a $1.5 million restricted deposit of DSSI at Comverge's new lender. Comverge has agreed to prepay the term loan and permit release our $1.5 million deposit over the 12 months commencing December 31, 2003, subject to certain conditions (see Note 3 of our unaudited Consolidated Financial Statements). We believe that the proceeds of the financing and new credit arrangements provide sufficient financing for Comverge to independently fund its activities.

As of October 31, 2003 our wholly owned US operations (i.e., excluding dsIT and Comverge) had an aggregate of $740,000 in unrestricted cash and cash equivalents, reflecting a $780,000 increase from the balance as of December 31, 2002.

We believe we have sufficient liquidity to finance our US-based operating activities and corporate activities for at least the next 12 months. We intend to finance these activities from cash on hand and operating cash flows.

- 19 -

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Our contractual obligations and commitments at September 30, 2003, excluding certain severance arrangements described below, principally including obligations associated with our outstanding indebtedness, future minimum operating lease obligations and contractual obligations to our CEO for payments for his post-retirement consulting services to us, are as set forth in the table below.

	Cash Payments Due During Year Endin			
		(amounts in thousands		
	Total	2004	2005	200
Long-term debt related to Israeli operations	$ 997	$ 468	$ 285	$ 1
Guarantees	558	558	--	
Operating leases	3,362	1,206	1,027	3
Consulting agreement with CEO	1,572	1,572	--	
Total contractual cash obligations	$6,489	$3,804	$1,312	$ 5

We expect to finance these contractual commitments from cash on hand and cash generated from operations.

Previously, we accrued a loss for contingent performance of bank guarantees. Our remaining commitment under these guarantees is $0.6 million at September 30 2003. We have collateralized a portion of these guarantees by means of a deposit of $0.2 million as of September 30, 2003. The obligation is presented as a current liability, though it is uncertain as to when actual payment will be made.

Under Israeli law and labor agreements, dsIT is required to make severance payments to dismissed employees and to employees leaving employment in certain other circumstances. The obligation for severance pay benefits, as determined by the Israeli Severance Pay Law, is based upon length of service and last salary. These obligations are substantially covered by regular deposits with recognized severance pay and pension funds and by the purchase of insurance policies. As of September 30, 2003, we had a total of $3.2 million in potential severance obligations, of which approximately $2.3 million was funded with cash held by insurance companies and approximately $0.9 million was unfunded. The entire $3.2 million was accrued for as of September 30, 2003.

We are obligated to pay our Chief Executive Officer consulting fees over a seven-year period upon his retirement on December 31, 2003. It is currently contemplated those payments will begin on January 1, 2004. During the first four years of the consulting period, we will be obligated to pay the CEO 50% of his salary in effect at the time of termination and 25% of that salary during the last three years of the consulting period, plus contributions to a non-qualified defined contribution retirement plan equal to 25% of the consulting fee and benefits similar to those received as an employee. At the start of the consulting period, which is expected to begin on January 31, 2004, we are also required to fund amounts payable to the CEO for the term of the consulting period, by the purchase of an annuity or similar investment product. The CEO has agreed to forgo this funding for as long as there is no change in control in DSSI, as defined in his employment agreement. The CEO`s base salary for 2003 (including cost of living adjustments through the beginning of 2003) is $474,000. We also have obligations under various agreements and other arrangements with officers and other employees with respect to severance arrangements and multiyear employment agreements as described below.

Under an employment agreement with the Chief Financial Officer, we also have obligations to pay severance upon termination of his employment for any reason other than for cause. Under this agreement, we must pay him (i) an amount equal to 150% of his last month's salary multiplied by the number of years (including partial years) that the CFO worked for us, plus (ii) an amount equal to six times his last month's salary. The severance obligation would be reduced by the amount contributed by us to certain Israeli pension and severance funds pursuant to the CFO`s employment agreement. As of September 30, 2003, the unfunded portion of such severance obligation was $36,000.

- 20 -

We also have arrangements under an employment agreement with the Chief Executive Officer of dsIT to pay severance under certain circumstances. If his employment agreement is terminated by him or by our company for reasons other than for cause, we must pay him an amount equal to his last month's salary multiplied by the number of years (including partial years) that he worked for Endan and dsIT. Our severance obligation would be reduced by the amounts contributed by us to certain Israeli pension and severance funds pursuant to his employment agreement. As of September 30, 2003, the unfunded portion of such severance obligation was approximately $33,000.

PAYMENTS TO RELATED PARTIES

We paid an individual as a vice-president (and director in 2002), who is the son of our Chief Executive Officer, approximately $188,000 and $212,000 for the nine months ended September 30, 2002 and 2003, respectively. We also have engaged certain of our directors and former directors to render professional services to us. One of our former directors, who is also the son-in-law of our Chief Executive Officer, is principal of a law firm that we engage to perform legal services for us. We paid to this firm legal fees and out-of-pocket disbursements (which included fees and expenses of special counsel hired on our behalf) of approximately $580,000 and $306,000 for the nine months ended September 30, 2002 and 2003, respectively. We also previously engaged an asset management firm controlled by one of our directors (who resigned in April 2003). This firm provided discretionary asset management services to us, and in the nine months ended September 30, 2002, we paid it fees of $12,000 for asset management. The engagement with the asset management firm was terminated in September 2002. The chief executive officer of the Company's Israeli subsidiary has a loan, originally made by a company that subsidiary acquired in 2001. The loan balance and accrued interest at December 31, 2002 and at September 30, 2003 was $48,000 and $52,000, respectively. The loan has no defined maturity date, is denominated in NIS, is linked to the Index and bears interest at 4% per annum; the increase in the loan balance over the nine month period is entirely due to the linkage and interest accrual.

The Company's Comverge subsidiary has made loans of $10,000 each to both our Chief Executive Officer and Chief Financial Officer. The loans had an initial maturity date of January 3, 2002 and were extended at that time to mature on January 3, 2004. The loans bear interest at 4.25% per annum. The balance of each of the loans and accrued interest at December 31, 2002 and September 30, 2003 was $12,500 and $13,000, respectively.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENT

In May 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity" (SFAS 150). The statement establishes standards on the classification and measurement of certain financial instruments with characteristics of both liabilities and equity and requires that such instruments be classified as liabilities. The standard is effective for financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after September 15, 2003. Adoption of the standard is not expected to have an impact on the Company's consolidated financial position or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, we are exposed to fluctuations in Israeli interest rates on amounts outstanding on our line of credit and a term loan used to finance our Israeli operations. As of September 30, 2003, $1.2 million was outstanding on our line of credit and we had $1.0 million outstanding under the term loan. Of our $1.0 million term loan (which is from a bank located in Israel and is denominated in NIS), $130,000 is linked to the Israeli consumer price index and $0.9 million is unlinked.

Additionally, our monetary assets and liabilities (net liability of approximately $1.3 million) in Israel are exposed to fluctuations in foreign currency exchange rates. During the second quarter, we recorded exchange gains of $53,000 due to a 3.0% appreciation of the NIS in relation to the dollar during the period. Since the end of the third quarter until October 31, 2003, the dollar has strengthened in relation to the NIS by 1.1%.

We do not employ specific strategies, such as the use of derivative instruments or hedging, to manage our interest rate or foreign currency exchange rate exposures.

IMPACT OF INFLATION AND CURRENCY FLUCTUATIONS

A majority of our sales are denominated in dollars. The remaining portion is primarily denominated in NIS, linked to the dollar. Such sales transactions are negotiated in dollars; however, for the convenience of the customer they are settled in NIS. These transaction amounts are linked to the dollar between the date the transactions are entered into until the date they are effected and billed. From the time these transactions are effected and billed, through the date of settlement, amounts are primarily unlinked. The majority of our expenses in Israel are in NIS, while a portion is in dollars or dollar-linked NIS.

The dollar cost of our operations in Israel may be adversely affected in the future by a revaluation of the NIS in relation to the dollar, should it be significantly different from the rate of inflation. In the first nine months of 2003 the appreciation of the NIS against the dollar was 6.2%, whereas during the first nine months of 2002 the devaluation of the NIS against the dollar was 7.9%. During the period from October 1 to October 31, 2003, there was a devaluation of the NIS against the dollar of 1.1%. In the first nine months of 2003, the rate of deflation in Israel was 1.5% whereas in the first nine months of 2002, the rate of inflation was 7.0%.

As of September 30, 2003, virtually all of our monetary assets and liabilities that were not denominated in dollars or dollar-linked NIS were denominated in NIS, and the net amount of such monetary assets and liabilities was not material. In the event that in the future we have material net monetary assets or liabilities that are not denominated in dollar-linked NIS, such net assets or liabilities would be subject to the risk of currency fluctuations.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information we are required to disclose in the reports we file under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms.

CHANGES IN CONTROLS AND PROCEDURES

During the period covered by this report, we did not have any changes to our internal controls over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

Report on Form 8-K, dated August 18, 2003, filed on August 19, 2003, relating to the announcement of our results for the second quarter and six months ended June 30, of 2003.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to be signed on its behalf by its Principal Financial Officer thereunto duly authorized.

DATA SYSTEMS & SOFTWARE INC.

Dated: March 30, 2004

By: /s/ Yacov Kaufman

Yacov Kaufman
Vice President and Chief Financial Officer