

MAGIC SOFTWARE ENTERPRISES LTD
Form 20-F
March 27, 2012

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 20-F

OR

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from _____ to _____

OR

**..SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Date of event requiring this shell company report

Commission file number: 0-19415

MAGIC SOFTWARE ENTERPRISES LTD.

(Exact name of Registrant as specified in its charter

and translation of Registrant's name into English)

Israel

(Jurisdiction of incorporation or organization)

5 Haplada Street, Or Yehuda 60218, Israel

(Address of principal executive offices)

Amit Birk; +972 (3) 538 9322; abirk@magicsoftware.com

5 Haplada Street, Or Yehuda 60218, Israel

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 0.1 Par Value	NASDAQ Global Select Market

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

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:

Ordinary Shares, par value NIS 0. 1 per share **36,490,020** (as of December 31, 2011)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

This annual report on Form 20-F is incorporated by reference into the registrant's Registration Statements on Form S-8, File Nos. 333-13270, 333-113552, 333-132221 and 333-149553.

INTRODUCTION

Magic Software Enterprises Ltd. develops, markets, sells and supports an application platform and business and process integration solutions and offers information technology, or IT, professional services. Our products and services are available through a global network of regional offices, independent software vendors, or ISVs, system integrators, distributors and value added resellers, or VARs, as well as original equipment manufacturers, or OEMs, and consulting partners in approximately 50 countries. Our technology provides our partners and customers with the ability to develop business applications, leverage existing IT resources, enhance business agility, and focus on core business priorities to gain maximum return on their existing and new IT investments. We are known for our metadata driven, code-free approach, allowing users to focus on business logic rather than technology requirements. This approach forms the driving principle of both our uniPaaS application platform and our iBOLT business and process integration platform. Our ordinary shares are listed on the NASDAQ Global Select Market under the symbol "MGIC" and are also traded on the Tel Aviv Stock Exchange.

As used in this annual report, the terms "we," "us," "our," and Magic mean Magic Software Enterprises Ltd. and its subsidiaries, unless otherwise indicated.

We have obtained trademark registrations for Magic® in the United States, Canada, Israel, the Netherlands (Benelux), Switzerland, Thailand and the United Kingdom. All other trademarks and trade names appearing in this annual report are owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with United States generally accepted accounting principles, or U.S. GAAP. All references in this annual report to "dollars" or "\$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any previous filing with the Securities and Exchange Commission, you may read the document itself for a complete recitation of its terms.

This annual report on Form 20-F contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. Statements which use the terms "anticipate," "believe," "expect," "plan," "intend," "estimate" and similar expressions are intended to identify forward looking statements. We remind readers that forward-looking statements

are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3D. “Key Information - Risk Factors.”

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following table presents selected consolidated financial data as of the dates and for each of the periods indicated. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. "Operating and Financial Review and Prospects" and our consolidated financial statements and notes thereto included elsewhere in this annual report.

We have derived the following consolidated income statement data for the years ended December 31, 2009, 2010 and 2011 and the consolidated balance sheet data as of December 31, 2010 and 2011 from our audited consolidated financial statements and notes included elsewhere in this annual report. We have derived the consolidated income statement data for the years ended December 31, 2007 and 2008 and the consolidated balance sheet data as of December 31, 2007, 2008 and 2009 from our audited consolidated financial statements that are not included in this annual report.

Income Statement Data:

	Year ended December 31,				
	2007	2008	2009	2010	2011
Revenues:					

(U.S. dollars in thousands, except share and per share data)

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Software	\$ 17,707	\$ 20,913	\$ 17,261	\$ 20,111	\$ 23,110
Maintenance and technical support	12,605	14,530	13,821	14,407	16,751
Consulting services	28,116	26,537	24,268	54,060	73,467
Total revenues	58,428	61,980	55,350	88,578	113,328
Cost of revenues:					
Software	4,557	4,898	5,388	5,320	5,771
Maintenance and technical support	1,602	2,263	2,189	2,070	2,250
Consulting services	21,181	19,978	18,687	44,058	59,237
Total cost of revenues	27,340	27,139	26,264	51,448	67,258
Gross profit	31,088	34,841	29,086	37,130	46,070
Operating costs and expenses:					
Research and development, net	2,716	2,350	1,310	2,072	2,047
Selling and marketing	15,558	17,357	15,308	17,526	20,147
General and administrative	11,532	10,867	8,210	8,194	9,159
Other income, net	-	-	1,972	-	-
Operating income	1,282	4,267	6,230	9,338	14,717
Financial income (expense), net	161	448	238	(224)	221
Other income, net	170	-	42	159	125
Income before taxes on income	1,613	4,715	6,510	9,273	15,063
Tax benefit (taxes on income)	(362)	(199)	(334)	102	203
Income after taxes on income	1,251	4,516	6,176	9,375	15,266
Equity in earnings (losses) of affiliates	(86)	(8)	-	-	-

	Year ended December 31,				
	2007	2008	2009	2010	2011
	(U.S. dollars in thousands, except share and per share data)				
Net income from continued operations	\$ 1,165	\$ 4,508	\$ 6,176	\$ 9,375	\$ 15,266
Net income from discontinued operations	11,465	-	-	-	-
Net income	12,630	4,508	6,176	9,375	15,266
Less: Net income (loss) allocated to non-controlling interest	(22)	-	-	-	222
Net income attributable to Magic's Shareholders	12,608	4,508	6,176	9,375	15,044
Basic earnings per share	\$ 0.40	\$ 0.14	\$ 0.19	\$ 0.29	\$ 0.41
Diluted earnings per share	\$ 0.39	\$ 0.14	\$ 0.19	\$ 0.29	\$ 0.41
Shares used to compute basic earnings per share	31,443	31,769	31,899	32,140	32,268
Shares used to compute diluted earnings per share	32,023	32,032	32,107	32,731	37,046
Dividends	-	-	15,974	-	-

Balance Sheet Data:

	December 31,				
	2007	2008	2009	2010	2011
	(U.S. dollars in thousands)				
Working capital	\$28,737	\$33,851	\$28,021	\$48,815	\$37,802
Cash, cash equivalents, short term deposits and marketable securities	16,446	32,588	41,868	46,542	32,122
Total assets including discontinued operations	82,298	81,164	87,551	111,950	134,055
Total equity	61,244	66,755	57,188	88,865	105,646

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. Our business, prospects, financial condition and results of operations could be adversely affected due to any of the following risks. In that case, the value of our ordinary shares could decline, and you could lose all or part of your investment.

Risks Related to Our Business and Our Industry

We face intense competition in the software as a service, or SaaS, market, also known as hosted or “cloud-based” computing market, for our application platforms as well as in the process and business integration technologies and IT services market. This competition could adversely affect our business, results of operations and financial condition.

We compete with other companies in the areas of application platforms, business integration and business process management, or BPM, tools, and in the applications and services markets in which we operate. The enhancement of the SaaS market increases the competition in these areas, and some of our competitors claim to offer a fully automated uniPaas conversion process, converting uniPaas based applications to .NET based applications. We expect that competition will increase in the future, both with respect to our technology, applications and services which we currently offer and applications and services which we and other vendors are developing. Increased competition, direct and indirect, could adversely affect our business, financial condition and results of operations.

Some of our existing and potential competitors are larger companies, have substantially greater resources than us, including financial, technological, marketing, skilled human resources and distribution capabilities, and enjoy greater market recognition than us. We may not be able to differentiate our products and/or services from those of our competitors, offer our products as part of integrated systems or solutions to the same extent as our competitors, or successfully develop or introduce new products that are more cost-effective, or offer better performance than our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

We face intense competition in the strategic IT consulting and staffing services market. This competition could adversely affect our business, results of operations and financial condition.

The technical IT consulting and staffing services industry is highly competitive and fragmented and has low barriers to entry. We, through three of our subsidiaries in the United States, compete for potential clients with providers of outsourcing services, systems integrators, computer systems consultants, other providers of technical IT consulting services and, to a lesser extent, temporary personnel agencies. We compete for technical personnel with other providers of technical IT consulting and staffing services, systems integrators, providers of outsourcing services, computer systems consultants, clients and temporary personnel agencies. We believe that the principal competitive factors in obtaining and retaining clients are accurate assessment of clients’ requirements, timely assignment of technical employees with appropriate skills and the price of services. We believe that the principal competitive factors in attracting qualified technical personnel are compensation, availability, quality and variety of projects and schedule flexibility. We expect competition to increase and we may not be able to remain competitive.

Some of our existing and potential competitors are larger companies, having substantially greater resources than us, including financial, technological, marketing, skilled human resources and distribution capabilities, and enjoy greater market recognition than us. We may not be able to differentiate our strategic IT consulting and staffing services from those of our competitors, or offer better performance than our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

We may not succeed in increasing our market share in the business and process integration markets with our iBOLT products, or leverage our advantage in the rich internet application, mobile, cloud and SaaS enabled application platform fields, which could adversely affect our business, results of operations and financial condition.

Our iBOLT Integration platform provides business integration and process management with a particular focus on enterprise business applications. iBOLT allows the integration and interoperability of diverse solutions, including legacy applications, in a quick and efficient manner. Since we launched iBOLT in 2003, we have continued to develop this product and enhance it, releasing successive versions over the years (the current version is 3.2). In 2005, we started a line of special editions of iBOLT tailored for specific application packages, and we have released several such special editions, for SAP, Oracle JD Edwards, Salesforce.com, IBM i, HL7, Lotus Notes and Lotus Domino, Microsoft Dynamics CRM and Microsoft Sharepoint. The business integration market in which we

operate is extremely competitive and subject to rapid changes. Our competitors utilize varying approaches to the provision of technology to business application integration. We may not have the resources, skills and product variety required to successfully increase our market share in these markets. In addition, even if we succeed in convincing prospective customers and the market that our products are effective and provide real business benefits, our target customers may not choose them due to technical, cost, support or other reasons.

We are dependent on a limited number of product families and a decrease in revenues from these products would adversely affect our business, results of operations and financial condition.

We derive significant portion of our revenues from sales of application platforms and integration products primarily under our uniPaaS and iBOLT brands , and from related professional services, software maintenance and technical support as well as from other IT professional services, which include IT consulting and staffing services. Our future growth depends heavily on our ability to effectively develop and sell new products developed by us or acquired from third parties as well as add new features to existing products. A decrease in revenues from our principal products would adversely affect our business, results of operations and financial condition.

We have a history of quarterly fluctuations in our results of operations and expect these fluctuations to continue.

We have experienced, and in the future may continue to experience, significant fluctuations in our quarterly results of operations. Factors that may contribute to fluctuations in our quarterly results of operations include:

- The size and timing of orders;

- The high level of competition that we encounter;

- The timing of our products introductions or enhancements or those of our competitors or of providers of complementary products;

- Market acceptance of our new products, applications and services;

- The purchasing patterns and budget cycles of our customers and end-users;

- The mix of product sales;

Exchange rate fluctuations;

General economic conditions; and

The integration of newly acquired businesses.

Our customers ordinarily require the delivery of our products promptly after we accept their orders. With the exception of contracts for services, we usually do not have a backlog of orders for our products. Consequently, revenues from our products in any quarter depend on orders received and products provided by us and accepted by the customers in that quarter. A deferral in the placement and acceptance of any large order from one quarter to another could adversely affect our results of operations for the prior quarter. Our customers sometimes require an acceptance test for services we provide and as a result, we may have a significant backlog of orders for our services. Our revenues from services depend on orders received and services provided by us and accepted by our customers in that quarter. If sales in any quarter do not increase correspondingly or if we do not reduce our expenses in response to level or declining revenues in a timely fashion, our financial results for that quarter may be adversely affected. For these reasons, quarter-to-quarter comparisons of our results of operations are not necessarily meaningful and you should not rely on the results of our operations in any particular quarter as an indication of future performance.

Unfavorable national and global economic conditions could adversely affect our business, operating results and financial condition.

During periods of slowing economic activity our customers may reduce their demand for our products, technology and professional services, which would reduce our sales, and our business, operating results and financial condition may be adversely affected. In addition, this could result in longer sales cycles, slower adoption

of new technologies and increased price competition for our products and services. We could also be exposed to credit risk and payment delinquencies on our accounts receivable, which are not covered by collateral. Any of these events would likely harm our business, operating results and financial condition.

We may encounter difficulties in realizing the potential financial or strategic benefits of recent business acquisitions. We expect to make additional acquisitions in the future that could disrupt our operations and harm our operating results.

It is a part of our business strategy to pursue acquisitions and other initiatives in order to expand our product offerings or services or otherwise enhance our market position or strategic strengths. During 2011 we made a number of acquisitions, including: (i) our distributor in South Africa, Magix Integration (Proprietary) Ltd., or Magix Integration, which specializes in the software integration and application development of our platforms as well as the support of large-scale and complex systems in the public and financial sectors in South Africa; (ii) the AppBuilder activity of BluePhoenix Solutions Ltd., or AppBuilder, a development platform for managing, maintaining, and reusing business applications required by large-scale enterprises; and (iii) a software solution provider and a Business Partner of SAP.

Acquisitions involve numerous risks, including the following:

· Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired businesses or enterprises;

· Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;

· Potential difficulties in completing projects associated with in-process research and development;

· Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;

· Initial dependence on unfamiliar supply chains or relatively small supply partners;

· Insufficient revenue to offset increased expenses associated with acquisitions; and

The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

Mergers and acquisitions of high-technology companies are inherently risky and subject to many factors outside of our control and no assurance can be given that our future acquisitions will be successful and will not adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could materially harm our business and operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products and technologies to a failure to do so. Even when an acquired company has previously developed and marketed products, there can be no assurance that new product enhancements will be made in a timely manner or that pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products.

The revenues of our principal IT professional services subsidiary are dependent upon one key customer and a significant decrease in revenues from such customer could adversely affect our business, results of operations and financial condition.

The revenues of our principal IT professional services subsidiary are dependent upon Ericsson Inc., or Ericsson, which is currently our largest customer, accounting for 29% and 25% of our total revenues in 2010 and 2011, respectively. We do not know if, or for how much longer, Ericsson will continue to purchase the services of such subsidiary. A significant decrease in revenues from Ericsson may adversely affect our business, results of operations and financial condition.

We derive a significant portion of our revenues from independent distributors who are under no obligation to purchase our products and the loss of such independent distributors could adversely affect our business, results of operations and financial condition.

We sell our products through our direct sales representatives, as well as through third parties that use our technology to develop and sell solutions to their customers, referred to as ISVs or Magic Solution Providers, or MSPs, and also through system integrators. These independent MSPs then sell the applications they develop on the uniPaaS platform to end-users. In some regions, especially in Asia-Pacific, Eastern Europe, Spain, Italy, South America and a few countries in the Mediterranean area, we sell our products through regional distributors. We are dependent upon the acceptance of our products by our independent distributors and their active marketing and sales efforts. Typically, our arrangements with our independent distributors do not require them to purchase specified amounts of products or prevent them from selling non-competitive products. The independent distributors may not continue, or may not give a high priority to, marketing and supporting our products. Our results of operations could be adversely affected by changes in the financial condition, business, marketing strategies, local and global economic conditions, or results of our independent distributors.

We may lose independent distributors and we may not succeed in developing new distribution channels which could adversely affect our business, results of operations and financial condition.

If any of our distribution relationships are terminated, we may not be successful in replacing them on a timely basis, or at all. In addition, we will need to develop new sales channels for new products, and we may not succeed in doing so. Any changes in our distribution and sales channels, or our inability to establish effective distribution and sales channels for new markets, could adversely impact our ability to sell our products and result in a loss of revenues and profits.

Changes in the ratio of our revenues generated from different revenue elements may adversely affect our gross profit margins.

We derive our revenues from the sale of software licenses, related professional services, maintenance and technical support as well as from other IT professional services. Our gross margin is affected by the proportion of our revenues generated from the sale of each of those elements of our revenues. Our revenues from the sale of our software licenses, related professional services, maintenance and technical support have higher gross margins than our revenues from the sale of IT professional services. As a result of our acquisition of two IT consulting and staffing services businesses in 2010, the percentage of our revenues derived from IT professional services increased significantly compared to prior years. If the relative proportion of our revenues from the sale of IT professional services continues to increase as a percentage of our total revenues, our gross profit margins will decline in the future. Our software licenses revenues include the sale of third party software licenses, which have a lower gross margin than sales of our software products. Any increase in the portion of third party software license sales out of total license sales will

decrease our gross profit margin.

We derive a significant portion of our revenues from IT professional services. Our ability to attract and retain qualified computer professionals may adversely affect our business, results of operations and financial condition.

The success of three of our subsidiaries is dependent upon their ability to attract and retain qualified computer professionals to serve as temporary IT personnel. Competition for the limited number of qualified professionals with a working knowledge of certain sophisticated computer languages is intense. We compete for technical personnel with other providers of technical IT consulting and staffing services, systems integrators, providers of outsourcing services, computer systems consultants, clients and temporary personnel agencies. A shortage of, and significant competition for, software professionals with the skills and experience necessary to perform the services offered by these subsidiaries may adversely affect our business, results of operations and financial condition.

In addition, the ability of our subsidiaries to maintain and renew existing engagements and obtain new business for their contract IT professional services operations depends, in large part, on their ability to hire and retain technical personnel with the IT skills that keep pace with continuing changes in software evolution, industry

standards and technologies, and client preferences. Demand for qualified professionals conversant with certain technologies may outstrip supply as new and additional skills are required to keep pace with evolving computer technology or as competition for technical personnel increases. Increasing demand for qualified personnel could also result in increased expenses to hire and retain qualified technical personnel and could adversely affect our profit margins.

Our widespread operations may strain our management, operational and financial resources and could adversely affect our business, results of operations and financial condition.

Our widespread operations have significantly strained our management, operational and financial resources in the past. Any future growth may increase this strain. To manage future growth effectively, we must:

- Expand our operational, management, financial, marketing and research and development functions;
- Train, motivate, manage and retain qualified employees; and
- Hire additional personnel.

We may not succeed in managing future growth, which could adversely affect our business, results of operations and financial condition.

We may encounter difficulties with our international operations and sales which could adversely affect our business, results of operations and financial condition.

While our principal executive offices are located in Israel, 95% and 93% of our sales in 2010 and 2011, respectively, were generated in other countries. This subjects us to many risks inherent to international business activities, including:

- Limitations and disruptions resulting from the imposition of government controls;
- Changes in regulatory requirements;

- Export license requirements;
- Economic or political instability;
- Trade restrictions;
- Changes in tariffs;
- Currency fluctuations;
- Difficulties in the collection of receivables;
- Foreign tax consequences;
- Greater difficulty in safeguarding intellectual property;
- Difficulties in managing overseas subsidiaries and international operations; and

We may encounter significant difficulties in connection with the sale of our products and services in international markets as a result of one or more of these factors and our business, results of operations and financial condition could be adversely affected.

Natural disasters, terrorist attacks or breaches of network or information technology security could have an adverse effect on our business.

Natural disasters, terrorist acts, acts of war, cyber-attacks or other breaches of network or information technology (IT) security may cause equipment failures or disrupt our systems and operations. While we maintain

insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. Our inability to operate our facilities as a result of such events, even for a limited period of time, may result in significant expenses and/or loss of market share to other competitors in the SaaS market for our application platform as well as in the process and business integration technologies and IT services market. In addition, a failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. Any of these occurrences could adversely affect our results of operations and financial condition.

Currency exchange rate fluctuations in the world markets in which we conduct business could adversely affect our business, results of operations and financial condition.

Our financial statements are stated in U.S. dollars, our functional currency. However, in 2010 and 2011, over 44% and 46% of our revenues, respectively, were derived from sales outside the United States, particularly Europe, Japan, Israel, the United Kingdom and South Africa. We also maintain substantial non-U.S. dollar balances of assets, including cash and accounts receivable, and liabilities, including accounts payable. Therefore, fluctuations in the value of the currencies in which we do business relative to the U.S. dollar may adversely affect our business, results of operations and financial condition, by decreasing the U.S. dollar value of assets held in other currencies and increasing the U.S. dollar amount of liabilities payable in other currencies, or by decreasing the U.S. dollar value of our revenues in other currencies and increasing the U.S. dollar amount of our expenses in other currencies. Even if we use derivatives or other instruments to hedge part or all of our exposures from time to time, they may not effectively eliminate such risk, if at all.

The increasing amount of intangible assets and goodwill recorded on our balance sheet may lead to significant impairment charges in the future.

We regularly review our long-lived assets, including identifiable intangible assets and goodwill, for impairment. Goodwill and indefinite life intangible assets are subject to impairment review at least annually. Other long-lived assets are reviewed when there is an indication that impairment may have occurred. The amount of goodwill and identifiable intangible assets on our consolidated balance sheet has increased significantly as a result of our acquisitions, and may increase further following future acquisitions. Impairment testing under U.S. GAAP may lead to further impairment charges in the future.

Our future success will be largely dependent on the acceptance of future releases of our core technologies in the areas of application platforms, mobile development, such as cloud computing, and if we are unsuccessful with these efforts, our business, results of operations and financial condition will be adversely affected.

In 2008, we released a new generation of our eDeveloper application platform, branded uniPaaS. uniPaaS is compatible with previous versions of eDeveloper, adds cloud-based capabilities including rich internet applications, or RIAs, and mobile, and in the future will include PaaS capabilities. In 2011 we released a new release of uniPaaS with tighter integration with the .NET framework, and support for the BlackBerry mobile platform. Our future success will be in great measure dependent on the continued acceptance of uniPaaS. The continued acceptance of this product relies in part on the continued acceptance and growth of cloud markets including RIAs, mobile and SaaS, for which uniPaaS is particularly useful and advantageous. We will need to continue to enhance the uniPaaS product and if a new version of such product is not accepted, our business, results of operations and financial condition may be adversely affected.

Our efforts to increase our worldwide presence may not be profitable, which could adversely affect our business, results of operations and financial condition.

Our success in becoming a stronger competitor in the sale of application platforms and integration solutions is dependent upon our ability to increase our sales in all our markets, including, but not limited to the United States, Europe, Japan, APAC, India and South Africa. Our efforts to increase our penetration into these markets are subject to risks inherent to such markets, including the high cost of doing business in such locations. Our efforts may be costly and they may not result in profits, which could adversely affect our business, results of operations and financial condition.

Rapid technological changes may adversely affect the market acceptance of our products and services, and our business, results of operations and financial condition could be adversely affected.

We compete in a market that is characterized by rapid technological changes. Other companies are also looking to offer Internet-related solutions, such as cloud computing, to generate growth. These other companies may develop technological or business model innovations in the markets we seek to address that are, or are perceived to be, equivalent or superior to our services. In addition, our customers' business models may change in ways that we do not anticipate and these changes could reduce or eliminate our customers' needs for our services. Our operating results depend on our ability to adapt to market changes and develop and introduce new services into existing and emerging markets.

The introduction of new technologies and devices could render existing products and services obsolete and unmarketable and could exert price pressures on our products and services. Our future success will depend upon our ability to address the increasingly sophisticated needs of our customers by:

- Supporting existing and emerging hardware, software, databases and networking platforms; and

- Developing and introducing new and enhanced software development technology and applications that keeps pace with such technological developments, emerging new markets and changing customer requirements.

If release dates of any future products or enhancements are delayed or if, when released, they fail to achieve market acceptance, our business, financial condition and results of operations would be adversely affected.

Adapting to evolving technologies can require substantial financial investments, distract management and adversely affect the demand of our existing products or services.

Adapting to evolving technologies can require that we put a significant amount of resources into the development, integration and marketing of those technologies as we productize them. The acceptance and growth of cloud computing and enterprise mobility are examples of rapidly changing technologies that we have adapted and productized. This adaptation already required us to make a substantial financial investment to develop and implement cloud computing and enterprise mobility into our software solution model and has required significant attention from management to refine our business strategies to include the delivery of these solutions. As the market continues to adopt these new technologies, we expect to continue to make substantial investments in our service solutions and system integrations related to these changing technologies.

Even if we succeed in adapting to a new technology by developing attractive products and services and successfully bringing them to market, there is no assurance that the new product or service would have a positive impact on our financial performance and could even result in lower revenue, lower margins and/or higher costs and therefore could negatively impact our financial performance.

Our products have a lengthy sales cycle which could adversely affect our revenues.

Our customers typically use our technology to develop and deploy as well as integrate applications that are critical to their businesses. As a result, the licensing and implementation of our technology generally involves a significant commitment of attention and resources by prospective customers. Because of the long approval process that typically accompanies strategic initiatives or capital expenditures by companies, our sales process is often delayed, with little or no control over any delays encountered by us. Our sales cycle can be further extended for sales made through third party distributors.

Our products may contain defects that may be costly to correct, delay market acceptance of our products and expose us to difficulties in the collection of receivables and to litigation.

Despite our regular quality assurance testing, as well as testing performed by our partners and end-users who participate in our beta-testing programs, errors may be found in our software products or in applications

developed with our technology. This risk is exacerbated by the fact that a significant percentage of the applications developed with our technology were and are likely to continue to be developed by our ISV partners and system integrators over whom we exercise no supervision or control. If defects are discovered, we may not be able to successfully correct them in a timely manner or at all. Defects and failures in our products could result in a loss of, or delay in, market acceptance of our products, as well as difficulties in the collection of receivables and litigation, and could damage our reputation. The professional liability insurance that we maintain may not be sufficient against potential claims.

Our standard license agreement with our customers contains provisions designed to limit our exposure to potential product liability claims that may not be effective or enforceable under the laws of some jurisdictions. Accordingly, we could fail to realize revenues and suffer damage to our reputation as a result of, or in defense of, a substantial claim.

Our proprietary technology is difficult to protect and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

Our success and ability to compete depend in large part upon our ability to protect our proprietary technology. We rely on a combination of trade secret and copyright laws and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. We do not have any patents. Our policy is to require employees and consultants to execute confidentiality and non-compete agreements upon the commencement of their relationships with us. These measures may not be adequate to protect our technology from third-party infringement, and our competitors might independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection for intellectual property rights than that provided under U.S. or Israeli laws.

We are subject to litigation relating to intellectual property infringement. Third parties have in the past, and may in the future, claim that we infringe upon their intellectual property rights and could harm our business.

From time to time third parties have in the past, and may in the future, assert infringement claims against us or claim that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. Intellectual property litigation is expensive and any court ruling against us or infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend any such claims, which will adversely affect our financial condition and results of operations.

In February 2010, a U.S. company filed a lawsuit against us and one of our subsidiaries, claiming an alleged breach by us and by our subsidiary of its intellectual property rights in connection with one of our products. In July 2011, we signed a settlement agreement with the plaintiff according to which we paid it a lump sum for future maintenance and

support until 2018, subject to a complete release of all claims.

We may be unable to attract, train and retain qualified personnel, which could adversely affect our business, results of operations and financial condition.

In the event our business grows in the future, we will need to hire additional qualified personnel. The process of locating, training and successfully integrating qualified personnel into our operations can be lengthy and expensive. We may not be able to attract the personnel we need. Any loss of members of senior management or key technical personnel, or any failure to attract or retain highly qualified employees as needed, could have an adverse effect on our business, financial condition and results of operations.

Because we are controlled by Formula Systems (1985) Ltd. and Asseco Poland S.A., investors will not be able to affect the outcome of shareholder votes.

Formula Systems (1985) Ltd., or Formula Systems (symbol: FORTY), an Israeli company whose shares trade on the NASDAQ Global Select Market and the Tel Aviv Stock Exchange, directly owned 18,690,352 or 51.1%, of our outstanding ordinary shares as of March 19, 2012. Asseco Poland S.A., or Asseco, a Polish company listed on Warsaw Stock Exchange, owns 50.2% of the outstanding shares of Formula Systems. Although

transactions between us and our controlling shareholders are subject to special approvals under Israeli law (see Item 6C). “Directors, Senior Management and Employees - Board Practices - Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders”), Formula Systems and Asseco will be able to exercise control over our operations and business strategy and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Similarly, Formula Systems and Asseco will be able to control most matters requiring shareholder approval, including the election of our directors (subject to a special majority required for the election of external directors). Such concentration of ownership may have the effect of delaying or preventing an acquisition or a change in control of us.

If we are unable to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, the reliability of our financial statements may be questioned and our share price may suffer.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and on our executives and directors. Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 governing internal control and procedures for financial reporting, which started in connection with our 2007 Annual Report on Form 20-F, have resulted in increased general and administrative expenses and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. We may identify material weaknesses or significant deficiencies in our assessments of our internal controls over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities, and could adversely affect our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

Risks Related to Our Ordinary Shares

Our share price has been very volatile in the past and may continue to be susceptible to significant market price and volume fluctuations in the future.

Our ordinary shares have experienced significant market price and volume fluctuations in the past and may experience significant market price and volume fluctuations in the future. While in 2009 and in 2010 our share price increased by 78% and 170%, respectively, in 2011 our share price dropped by 20%. Our market price and volume may fluctuate in response to factors such as the following, some of which are beyond our control:

Quarterly variations in our operating results;

Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

- Announcements of technological innovations or new products by us or our competitors;

Announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

- Changes in the status of our intellectual property rights;

- Announcements by third parties of significant claims or proceedings against us;

- Additions or departures of key personnel;

The public's response to our press releases, our other public announcements and our filings with the Securities and Exchange Commission and the Israeli Securities Authority;

- Future sales of our ordinary shares by our directors, officers and significant shareholders;

Political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events;

Other events or factors in any of the markets in which we operate, including those resulting from war, incidents of terrorism, natural disasters or responses to such events; and

General trends of the stock markets.

Domestic and international stock markets often experience extreme price and volume fluctuations. The market prices of ordinary shares of software companies have been extremely volatile. Stock prices of many software companies have often fluctuated in a manner unrelated or disproportionate to the operating performance of such companies.

In the past, securities class action litigation has often been brought against registrants following periods of volatility in the market price of their securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources.

The trading volume of our shares has been low in the past and may be low in the future, resulting in lower than expected market prices for our shares.

Our shares have traded at low volumes in the past and may trade at low volumes in the future for reasons that may be related or unrelated to our performance. This may result in a lack of liquidity, which could negatively affect the market price for our ordinary shares

We have not established a dividend policy and may not pay cash dividends in the future.

We do not have a dividend distribution policy and did not pay any cash dividends on our ordinary shares in the last five years except in January 2010. Future dividend distributions are subject to the discretion of our board of directors and will depend on various factors, including our operating results, future earnings, capital requirements, financial condition and tax implications of dividend distributions on our income, future prospects and any other factors deemed relevant by our board of directors. The distribution of dividends also may be limited by Israeli law, which permits the distribution of dividends only out of profits (as defined by Israeli law) or otherwise upon the permission of the court. You should not rely on an investment in our company if you require dividend income from your investment.

Our ordinary shares are traded on more than one market and this may result in price variations.

Our ordinary shares are traded primarily on the NASDAQ Global Select Market and on the Tel Aviv Stock Exchange. Trading in our ordinary shares on these markets is made in different currencies (U.S. dollars on the NASDAQ Global Select Market and NIS on the Tel Aviv Stock Exchange), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Consequently, the trading prices of our ordinary shares on these two markets may differ. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.

If U.S. tax authorities were to treat us as a “passive foreign investment company,” that could have adverse consequences on U.S. holders.

Holders of our ordinary shares who are U.S. residents face income tax risks. There is a risk that we will be treated as a “passive foreign investment company,” commonly referred to as PFIC. Our treatment as a PFIC could result in a reduction in the after-tax return to the U.S. holders of our ordinary shares and would likely cause a reduction in the value of our shares. For U.S. federal income tax purposes, we will generally be classified as a PFIC for any taxable year in which either: (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average value of our assets for the taxable year produce or are held for the production of passive income. If we were determined to be a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. holders owning our ordinary shares and such U.S. holders could suffer adverse U.S. tax consequences. Accordingly, you are urged to consult your tax advisors regarding the application of such rules. United States residents should carefully read “Item 10E. Additional Information - Taxation, United States Federal Income Tax Consequences” for a

more complete discussion of the U.S. federal income tax risks related to owning and disposing of our ordinary shares.

Risks Related to Our Location in Israel

Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could adversely affect our business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying from time to time in intensity and degree, has led to security and economic