

FORMULA SYSTEMS (1985) LTD  
Form 20-F  
March 18, 2011

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

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2010

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: 000-29442

FORMULA SYSTEMS (1985) LTD.  
(Exact Name of Registrant as Specified in Its Charter)

Israel  
(Jurisdiction of Incorporation or Organization)

5 Haplada Street, Or Yehuda 60218, Israel  
(Address of Principal Executive Offices)

Guy Bernstein, CEO, 5 Haplada Street, Or Yehuda 60218, Israel  
Tel: 972 3 5389487, Fax: 972 3 5389645  
(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 1 par value	Tel Aviv Stock Exchange
American Depositary Shares	NASDAQ Global 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

As of December 31, 2010, the registrant had 13,596,000 outstanding ordinary shares, NIS 1 par value, of which 1,035,593 were represented by American Depositary Shares as of such date.

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



## TABLE OF CONTENTS

<b>PART I</b>	
ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS	4
ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE	4
ITEM 3. KEY INFORMATION	4
ITEM 4. INFORMATION ON THE COMPANY	23
ITEM 4A. UNRESOLVED STAFF COMMENTS	38
ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS	38
ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES	65
ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS	80
ITEM 8. FINANCIAL INFORMATION	83
ITEM 9. THE OFFER AND LISTING	85
ITEM 10. ADDITIONAL INFORMATION	87
ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	106
ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES	108
<b>PART II</b>	
ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES	109
ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS	109
ITEM 15. CONTROLS AND PROCEDURES	109
ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT	110
ITEM 16B. CODE OF ETHICS	111
ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES	111
ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES	112
ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS	112
ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT	112
ITEM 16G. CORPORATE GOVERNANCE	113
<b>PART III</b>	
ITEM 17. FINANCIAL STATEMENTS	115
ITEM 18. FINANCIAL STATEMENTS	115
ITEM 19. EXHIBITS	116

## INTRODUCTION

Some of the statements in this annual report, including those in “Item 3. Key Information— Risk Factors,” “Item 4. Information on the Company— Business Overview” and “Item 5. Operating and Financial Review and Prospects,” are forward-looking statements that involve risks and uncertainties. These forward-looking statements include statements about our plans, objectives, strategies, expectations, intentions, future financial performance and other statements that are not historical facts, and may be identified by the use of words like “anticipate,” “believe,” “expect,” “future,” “intend” and similar expressions. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. You should not unduly rely on these forward-looking statements, which apply only as of the date of this annual report. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including the risks described in “Item 3. Key Information— Risk Factors.” Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, commonly referred to as U.S. GAAP. In accordance with U.S. GAAP, we use the United States dollar as our reporting currency. In accordance with ASC 360 Property, Plant and Equipment and following the sale of our entire shareholdings in nextSource Inc., or nextSource, in October 2009, nextSource’s results of operations, assets and liabilities were classified as attributed to discontinued operations and as a result, we have reclassified certain figures in our financial statements relating to prior periods.

As used in this annual report, references to dollar refer to the United States dollar and references to NIS refer to New Israeli Shekels. References to the Israeli CPI refer to the Israeli consumer price index.

As used in this annual report, references to “we,” “our,” “ours” and “us” refer to Formula Systems (1985) Ltd. and its subsidiaries, unless otherwise indicated. References to “Formula” refer to Formula Systems (1985) Ltd. alone. Our operations are currently conducted through our three subsidiaries – Magic Software Enterprises Ltd., or Magic Software, Matrix IT Ltd., or Matrix, and Sapiens International Corporation N.V., or Sapiens.

All trademarks appearing in this annual report are the property of their respective holders.

This report reflects certain amendments to the Israeli Companies Law, 1999. Such amendments have been adopted and will go into effect over the course of 2011.

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 tables present our consolidated statement of operations and balance sheet data for the periods and as of the dates indicated. We derive the consolidated statement of operations data for the years ended December 31, 2008, 2009 and 2010, and the consolidated balance sheet data as at December 31, 2009 and 2010, from our audited consolidated financial statements included elsewhere in this annual report. The consolidated statement of operations data for the years ended December 31, 2006 and 2007 and the consolidated balance sheet data at December 31, 2006, 2007 and 2008 are derived from our audited consolidated financial statements not included in this annual report. You should read the selected consolidated financial data together with our consolidated financial statements included elsewhere in this annual report and with “Item 5. Operating and Financial Review and Prospects.”

Edgar Filing: FORMULA SYSTEMS (1985) LTD - Form 20-F

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(US\$ in thousands, except per share data)				
<b>Consolidated Statement of Operations Data:</b>					
Revenues	\$549,694	\$469,390	\$503,243	\$414,724	\$356,598
Cost of revenues	412,463	352,283	373,775	298,410	256,059
Gross profit	137,231	117,107	129,468	116,314	100,539
Research and development costs, net	5,503	4,430	6,564	6,547	5,508
Selling, general and administrative expenses	84,510	77,322	90,451	84,503	86,466
Other income, net	231	(1,668 )	580	750	1,102
Operating income	46,987	37,023	31,873	24,514	7,463
Financial expenses, net	(4,371 )	(231 )	(5,908 )	(3,619 )	(4,444 )
Gain (loss) on realization of investments, net	-	-	(337 )	2,039	3,724
Income before taxes on income	42,616	36,792	25,628	22,934	6,743
Taxes on income	(6,544 )	(8,305 )	(3,279 )	(1,891 )	(3,655 )
Equity in gains (losses) of affiliated companies, net	(1,070 )	(335 )	(216 )	(653 )	47
Income from continuing operations	35,002	28,152	22,133	20,390	3,135
Net income from discontinued operations	-	4,878	555	32,333	18,604
Net income	35,002	33,030	22,688	52,723	21,739
Net income attributable to non-controlling interests	16,623	13,954	10,819	15,464	11,724
Net income attributable to Formula's shareholders	18,379	19,076	11,869	37,259	10,015
<b>Earnings (losses) per share generated from continuing operations</b>					
Basic	1.37	1.08	0.84	0.82	(0.14 )
Diluted	1.36	1.04	0.84	0.80	(0.12 )
<b>Earnings (losses) per share generated from discontinued operations</b>					
Basic	-	0.37	0.04	2.00	0.94
Diluted	-	0.36	0.04	1.99	0.85
<b>Earnings per share:</b>					
Basic earnings	1.37	1.45	0.88	2.82	0.80
Diluted earnings	1.36	1.40	0.88	2.79	0.73
<b>Weighted average number of shares outstanding:</b>					
Basic	13,382	13,200	13,200	13,200	13,200
Diluted	13,523	13,564	13,200	13,200	13,298

	As of December 31,				
	2010	2009	2008	2007	2006
	(US\$ in thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Total assets	\$623,767	\$566,439	\$596,622	\$612,624	\$585,685
Total liabilities	289,383	271,125	319,252	306,321	352,746
Equity	334,384	295,314	277,370	306,303	232,939





## Dividends

In April 2010, Formula distributed to its shareholders a cash dividend of \$1.47 per share, previously announced in March 2010. The aggregate amount distributed by Formula was approximately \$20 million.

In January 2009, Formula distributed to its shareholders a cash dividend of \$2.27 per share. The aggregate amount distributed by Formula was approximately \$30 million.

In April 2008, Formula distributed to its shareholders a cash dividend of approximately \$0.76 per share. The aggregate amount distributed by Formula was approximately \$10 million.

In December 2006, Formula distributed to its shareholders a dividend consisting, in the aggregate, of 36,696,000 shares of Formula Vision Technologies (F.V.T) Ltd., or Formula Vision, that had been held by Formula, representing approximately 57% of the outstanding share capital of Formula Vision. Formula Vision shares were distributed at a ratio of 2.78 shares of Formula Vision for every one outstanding ordinary share of Formula, prior to withholding taxes.

In June 2005, Formula distributed to its shareholders a cash dividend of approximately \$4 per share. The aggregate amount distributed by Formula was approximately \$50.2 million.

Under Formula's dividend policy adopted by its board of directors, sums that are not planned to be used for investments in the near future may be distributed to the shareholders as a cash dividend, to the extent that our performance allows for such distribution and subject to applicable Israeli law.

Cash dividends may be declared and paid in New Israeli Shekels or dollars. Dividends to the holders of Formula's American Depositary Shares, or ADSs, are paid by the depositary of the ADSs, for the benefit of owners of ADSs. If a dividend is declared and paid in NIS in Israel, the NIS amount is converted into, and paid out in, dollars by the depositary of the ADSs.

### B. Capitalization and Indebtedness

Not applicable.

### C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Our business, operating results and financial condition could be seriously harmed due to any of the following risks. Additional risks and uncertainties that we are not aware of or that we currently believe are immaterial may also adversely affect our business, financial condition, and results of operations. The trading prices of our ordinary shares and ADSs could decline due to any of these risks, and you may lose all or part of your investment.

Risks Relating to Our Business

Unfavorable national and global economic conditions could have a material adverse effect on our business, operating results and financial condition.

The crisis in the financial and credit markets in the United States, Europe and Asia during 2008 and 2009 led to a global economic slowdown. Although global economic conditions have stabilized or improved, there is continuing economic uncertainty. If the economies in the countries in which we operate remain uncertain or weaken further, the level of information technology, or IT, capital spending and investment in IT projects by our existing and potential customers may decrease. 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. If global economic and market conditions, or economic conditions in the United States, Europe or Asia or other key markets remain uncertain or weaken further, our business, operating results and financial condition may be materially adversely affected.

The loss of, or significant reduction or delay in, purchases by our customers or impairment of our relationships with our largest customers could reduce our revenues and profitability.

The loss of any of our major customers or a decrease or delay in orders or anticipated spending by such customers could reduce our revenues and profitability, due to our reliance on such customers. Our customers could also engage in business combinations, which could increase their size, reduce their demand for our products and solutions as they recognize synergies or rationalize assets and increase or decrease the portion of our total sales concentration to any single customer.

For example, the largest customers of one of our three significant subsidiaries— Sapiens— and its subsidiaries in North America (three customers), the United Kingdom (one customer), Japan (one customer) and Israel (one customer) accounted for 9.5%, 6%, 15.8% and 25.8% of Sapiens' consolidated revenues, respectively, in 2010. One significant customer of another significant subsidiary—Magic Software— accounted for 29% of its consolidated revenues in 2010. There can be no assurance that the existing customers of our significant subsidiaries will enter into new project contracts with us or that they will continue using our enabling IT technologies.

If we are unable to effectively control our costs while maintaining our customer relationships, our business, results of operations and financial condition could be adversely affected.

It is critical for us to appropriately align our cost structure with prevailing market conditions, to minimize the effect of economic downturns on our operations, and in particular, to continue to maintain our customer relationships while protecting profitability and cash flow. If we are unable to align our cost structure in response to economic downturns (such as the downturn that commenced in late 2008, and any subsequent downturn that may recur in the current, uncertain global economic environment) on a timely basis, or if such implementation has an adverse impact on our business or prospects, then our financial condition, results of operations and cash flows may be negatively affected.

Conversely, adjusting our cost structure to fit economic downturn conditions may have a negative effect on us during an economic upturn or periods of increasing demand for our IT solutions. If we have too aggressively reduced our costs, we may not have sufficient resources to capture new IT projects and meet customer demand. If, for example, during periods of escalating demand for our products, which we experienced during the 2010 fiscal year, we are unable to add engineering and technical staff capacity quickly enough to meet the needs of our customers, they may turn to our competitors making it more difficult for us to retain their business. Similarly, if we are unable for any other reason to meet delivery schedules, particularly during a period of escalating demand, our relationships with our customers could be adversely affected. If we are unable to effectively manage our resources and capacity to capitalize on periods of economic upturn, there could be a material adverse effect on our business, financial condition, results of operations and cash flows.

Our success depends upon the development and maintenance of our strategic alliances.

We have established relationships with strategic partners to provide an international marketing presence and name recognition, as well as the resources necessary to implement many of our IT services. We are dependent upon our strategic partners for the marketing and sale of certain of our proprietary software solutions. If we cannot maintain our existing relationships with these partners, if our partners encounter financial difficulties, if we fail to establish effective, long-term relationships with additional partners, or if our partners enter into relationships with our competitors, our ability to market our proprietary software solutions in international markets may be limited. If this happens, our growth, if any, might be delayed or slowed. As a result, our business, financial condition, and results of operations could be seriously harmed.

If our products fail to compete successfully with those of our competitors, we may have to reduce the prices of our products, which in turn, may adversely affect our business.

We face competition, both in Israel and internationally, from a variety of companies, including companies with significantly greater resources than us who are likely to enjoy substantial competitive advantages, including:

- longer operating histories;

- greater financial, technical, marketing and other resources;
- greater name recognition;
- well-established relationships with our current and potential clients; and
- a broader range of products and services.

These competitors may be able to respond more quickly to new or emerging technologies or changes in customer requirements. They may also benefit from greater purchasing economies, offer more aggressive product and service pricing or devote greater resources to the promotion of their products and services. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase such competitors' ability to successfully market their tools and services. We also expect that competition will increase as a result of consolidation within the industry. Our further penetration of international markets may likewise cause us to face additional competition. As a result, we cannot assure you that the products and solutions that we offer will compete successfully with those of our competitors.

We may be unable to differentiate our tools and services from those of our competitors or successfully develop and introduce new tools and services that are less costly than, or superior to, those of our competitors. This could have a material adverse effect on our ability to compete.

Furthermore, several software development centers worldwide offer software development services at lower prices than we do. Due to the intense competition in the markets in which we operate, software products prices may fluctuate significantly. As a result, we may have to reduce the prices of our products, which in turn, may adversely affect our revenues and the gross margins for our products.

If we fail to locate, successfully compete for and consummate suitable acquisitions and investments, we may be unable to grow or maintain our market share.

As part of our strategy, we intend to pursue acquisitions of, and investments in, other companies, particularly companies offering products, technologies and services that are complementary to ours and are suitable for integration into our business. We cannot assure you that we will be able to locate suitable potential acquisition or investment opportunities in Israel or internationally, or if we do identify suitable candidates, that at the conclusion of related discussions and negotiations, we will be able to consummate the acquisitions or investments on terms which are favorable to us. If and when acquisition or investment opportunities arise, we expect to compete for these opportunities with other established and well-capitalized entities, and we cannot guarantee that we will succeed in such competition on terms which remain favorable to us. If we fail to consummate further acquisitions or investments in the future, our ability to grow or to even maintain our market share may be harmed.

Any future acquisitions of, or investments in, companies or technologies, especially those located outside of Israel, may distract our management, disrupt our business and may be difficult to finance on favorable terms.

As described above, our strategy includes selective acquisitions of, and investments in, companies offering products, technologies and services. If we or any of our subsidiaries acquires or invests in another company, the acquiring or investing entity could have difficulty assimilating the target company's personnel, operations, technology or products and service offerings into its own. 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 already developed and marketed products, there can be no assurance that product enhancements will be made in a timely fashion or that pre-acquisition due diligence will have identified all possible challenges that might arise with respect to such products. Furthermore, the key personnel of the acquired company may decide not to work for the acquirer. These difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and adversely affect our results of operations.

Any acquisition or investment in a company located outside of Israel poses additional risks, including risks related to the monitoring of a management team from a great distance and the need to integrate a potentially different business culture. Our failure to successfully integrate such a newly acquired business or such an investment could harm our business. In addition, the investigation of acquisition or investment candidates outside of Israel involves higher costs than those associated with pursuing domestic acquisitions or investments, and we cannot assure you that these investigations will successfully lead to the consummation of transactions.

We may furthermore need to raise capital in connection with any such acquisition or investment, which we would likely seek via public or private equity or debt offerings. The issuance of equity securities pursuant to any such financing could be dilutive to our existing shareholders. If we raise funds through debt offerings, we may be pressured in serving such debt. Our ability to raise capital in this manner also depends upon market and other conditions, many of which are beyond our control. Due to unfavorable conditions, we could be required to seek alternative financing methods, such as bank financings, which involve borrowing money on terms which are not favorable to us. Difficulties in raising equity capital or obtaining debt financing on favorable terms, or the unavailability of financing, including bank borrowings, may hinder our ability to implement our strategy for selective acquisitions and investments.

Our future results could be adversely affected by an impairment of the value of certain intangible assets.

The assets listed in our consolidated balance sheets as of December 31, 2010 include, among other things, goodwill amounting to approximately \$166 million, capitalized software development costs, net, amounting to approximately \$25 million and other intangible assets amounting to approximately \$8 million. The applicable accounting standards require that:

- goodwill not be amortized, but rather be subject to an annual impairment test. We perform an annual impairment test, as well as periodic impairment tests, if impairment indicators are present. Intangible assets that are not considered to have an indefinite useful life are amortized using the straight-line basis over their estimated useful lives. The carrying amount of these assets is reviewed whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value (usually discounted cash flow) of the impaired asset; and

- acquired technology and development costs of software that is intended for sale that were incurred after the establishment of technological feasibility of the relevant product be capitalized and tested for impairment on a regular basis and written down when capitalized costs exceed the product's net realizable value.

If our goodwill or capitalized software development costs are deemed to be impaired in whole or in part due to adverse changes in the value that we expect to realize from these assets, or if we fail to accurately predict the useful life of the capitalized software development costs, we could be required to reduce or write off such assets, which would require us to recognize additional expense in our statements of operations, thereby adversely affecting our operating results and causing a reduction in our shareholders' equity.

Certain amounts have been allocated to goodwill on our balance sheet as a result of acquisitions made by us from time to time, and should it become necessary to write-off a material part of this, our results of operations could be materially adversely affected.

We acquire businesses from time to time and as a result, certain amounts have been allocated to goodwill on our balance sheet. Goodwill and other intangible assets that have indefinite useful lives are tested at least annually for impairment. Should a test disclose that there has been a permanent impairment of a material part of the value of goodwill, it would be necessary to write-off such amount, and this could materially adversely affect our results of operations.

Our credit facility agreements contain a number of restrictive covenants which, if breached, could result in acceleration of our obligation to repay our debt.

The loan agreements to which certain of our subsidiaries are party contain a number of conditions and limitations on the manner in which they can operate their business, including limitations on their ability to incur debt and sell or acquire assets. These loan agreements also contain various covenants which require them to maintain certain financial ratios related to shareholders' equity and operating results that are customary for companies of comparable size. These limitations and covenants may force us to pursue less than optimal business strategies or forego business arrangements which could have been financially advantageous to us and, by extension, to our shareholders. In addition, a breach of the restrictive covenants could result in the acceleration of our obligations to repay our debt.

Marketing our products and services in international markets may require increased expenses and greater exposure to risks that we may not be able to successfully address.

We intend to continue to focus our efforts on selling proprietary software solutions in international markets and to devote significant resources to these efforts. If we are unable to continue achieving market acceptance for our solutions or continue to successfully penetrate international markets, our business will be harmed. In 2009 and 2010, we received approximately 22% and 25% of our consolidated revenues, respectively, from customers located outside of Israel. The expansion of our existing operations and entry into additional international markets will require significant management attention and financial resources. We are subject to a number of risks customary for international operations, including:

- changing product and service requirements in response to the formation of economic and marketing unions, such as the European Union;
- economic or political changes in international markets;
- greater difficulty in accounts receivable collection and longer collection periods;
- unexpected changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;
- the uncertainty of protection for intellectual property rights in some countries, particularly in southeast Asia;
- multiple and possibly overlapping tax structures; and
- currency and exchange rate fluctuations.

If we fail to address the strain on our resources caused by changes in our company, we will be unable to effectively manage our business.

Corporate organizational changes, as well as growth of our business, if any, have placed and will continue to place a strain on our personnel and resources. Our ability to manage any future changes or growth depends on our ability to continue to implement and improve our operational, financial and management information control and reporting systems on a timely basis and to expand, train, motivate and manage our work force. One of the challenges encountered by our subsidiaries is the need from time to time to, on the one hand, terminate the employment of certain employees, and, on the other hand, retain new employees for new, unexpected projects, each of which requires operational flexibility. If we cannot respond effectively to changing business conditions, our business, financial condition and results of operations could be materially adversely affected.

If we are unable to attract, train and retain qualified personnel, including senior management, we may not be able to achieve our objectives and our business could be harmed.

Our future success depends on our ability to attract, motivate and retain highly qualified professional employees, including senior management. In order to achieve our objectives, we may need to hire additional qualified software, administrative, operational, sales and technical support personnel. The process of attracting, training and successfully integrating qualified personnel into our operations can be lengthy and expensive. We expect to recruit most of our software and systems personnel in Israel, where the market for qualified personnel is quite competitive. We may not be able to compete effectively for the personnel that we need. In addition, our operations are dependent on the efforts of certain key management. Any loss of members of senior management or key technical personnel, or any failure to attract or retain highly qualified employees as needed, could materially adversely affect our business.

If we fail to estimate accurately the costs of fixed-price contracts, we may incur losses.

We derive a significant portion of our revenues from engagements on a fixed-price basis. We price these commitments based upon estimates of future costs. We bear the risk of faulty estimates and cost overruns in connection with these commitments. Our failure to accurately estimate the resources required for a fixed-price project, to accurately anticipate potential wage increases, or to complete our contractual obligations in a manner consistent with a project plan could materially adversely affect our business, operating results, and financial condition. In addition, we may agree to a price before design specifications are finalized, which could result in a fixed price that is too low, resulting in lower margins or losses to us.

If our tools or solutions do not function efficiently, we may incur additional expenses.

In the course of providing our software solutions, we conduct testing to detect the existence of failures, errors and bugs. In addition, we have instituted a quality assurance procedure for correcting errors and bugs in our tools. The amount of failures, errors and bugs detected to date, and the cost of correcting them, have not been significant. However, if our solutions fail to function efficiently or if errors or bugs are detected in our tools in the future, we might incur significant expenditures in an attempt to remedy the problem, and our reputation with users of our products and services may also be harmed. The adverse consequences of, and expenses related to, failures, errors, and bugs could have a material adverse effect on our business, operating results, and financial condition.

If we fail to satisfy our customers' expectations regarding our solutions or our solutions cause damage to our customers' information systems, our contracts may be cancelled and we may be the subject of legal claims.

Some of the products and services that we provide involve key aspects of customers' information systems. These systems are frequently critical to our customers' operations. As a result, our customers have a greater sensitivity to failures in these systems than do customers of other software products generally. If a customer's system fails during or following the provision of products or services by us, or if we fail to provide customers with proper support for our software products or do so in an untimely manner, we are exposed to the risks of cancellation of our contract with the customer and a legal claim for substantial damages being filed against us, regardless of whether or not we are responsible for the failure. Any cancellation of a contract could cause us to suffer damages, since we might not be paid for costs that we incurred in performing services prior to the date of cancellation. As to a legal claim for damages by the customer, while, when possible, we limit our liability under our product and service contracts, we cannot guarantee that such a limitation of liability, if any, would be sufficient to protect us. We maintain general liability and professional liability insurance coverage. However, we cannot assure you that our insurance coverage will be sufficient to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. If we lose one or more large claims against us that exceed available insurance coverage, our business, operating results and financial condition may be materially adversely affected. In addition, the filing of legal claims against us in connection with contract liability may cause us negative publicity and damage to our reputation.



If we are unable to accurately predict and respond to market developments or demands, our business will be adversely affected.

The IT business, in large part, is characterized by rapidly evolving technology and methodologies. This makes it difficult to predict demand and market acceptance for our services and products. In order to succeed, we need to adapt the products and services we offer to technological developments and changes in customer needs. We cannot guarantee that we will succeed in enhancing our products and services or developing or acquiring new products and services that adequately address changing technologies and customer requirements. We also cannot assure you that the products and services that we offer will be accepted by customers. If our products and services are not accepted by customers, our future revenues and profitability will be adversely affected. Changes in technologies, industry standards, the regulatory environment, customer requirements and new product introductions by existing or future competitors could render our existing products and services obsolete and unmarketable, or require us to enhance our current products or develop new products. This may require us to expend significant amounts of money, time and other resources to meet the demand. There can be no assurance that we will have sufficient resources to make such expenditures, especially in light of the worldwide financial and economic situation, or that these expenditures will bring the full advantages or any advantage as planned. These expenditures could strain our personnel and financial resources.

The economic impact in Japan of the devastation caused by the massive earthquake and tsunami of March 2011 would adversely affect our business and results of operations.

On March 11, 2011, a massive earthquake off the eastern coast of Japan triggered a tsunami tidal wave that devastated much of the city of Sendai and large areas of coastal north-eastern Japan, causing thousands of deaths, catastrophic damage and destruction of the local infrastructure, as well as a potential nuclear disaster. It is too early to predict the long-term impact of this disaster on the economy of Japan and elsewhere. Our net sales in Japan constituted approximately 4% of our total net revenues in 2010 and a slow-down in the Japanese economy resulting from such events would adversely affect our results of operations.

If we are unable to retain control of our subsidiaries, we would cease to consolidate them and our operating results may fluctuate significantly.

We currently hold a controlling interest in our subsidiaries through our direct equity holdings. As a result of our controlling interests in the subsidiaries, we consolidate their operating results with ours. If we are unable to maintain a controlling interest in our subsidiaries, as a result of equity issuances by subsidiaries to third parties that are unaffiliated with us or otherwise, we would cease to consolidate the operating results of those subsidiaries, based on relevant accounting guidelines. This, in turn, could result in significant fluctuations of our consolidated operating results.

### Risks Related to our Intellectual Property

If third parties assert claims of intellectual property infringement against us, we may suffer substantial costs and diversion of management's attention.

Substantial litigation over intellectual property rights exists in the software industry. We expect that software products will be increasingly subject to third-party infringement claims as the functionality of products in different industry segments overlaps, and we cannot predict whether third parties will assert claims of infringement against us based on our software products. Furthermore, our employees and contractors have access to software licensed by us from third parties, and a breach of the non-disclosure undertakings by any of our employees or contractors may lead to a claim of infringement against us. Any claim, with or without merit, could be expensive and time-consuming to defend, and would probably divert our management's attention and resources. In addition, such a claim may require us to enter into royalty or licensing agreements to obtain the right to use a necessary product or component. Such royalty or licensing agreements, if required, may not be available to us on acceptable terms, if at all. A successful claim of product infringement against us and our failure or inability to license the infringed or similar technology could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to adequately protect our proprietary rights, which may limit our ability to compete effectively.

Our success and ability to compete are substantially dependent upon our internally developed technology. Substantially all of our intellectual property consists of proprietary or confidential information that is not subject to patent or similar protection. In general, we have relied on a combination of technical leadership, trade secret, copyright and trademark law and nondisclosure agreements to protect our proprietary know-how. Unauthorized third parties may attempt to copy or obtain and use the technology protected by those rights. Any infringement of our intellectual property could have a material adverse effect on our business, financial condition and results of operations. Policing unauthorized use of our products is difficult and costly, particularly in countries where the laws may not protect our proprietary rights as fully as in the United States. We have placed, and in the future may place, certain of our software in escrow. The software may, under specified circumstances, be made available to our customers. From time to time, we also provide our software directly to customers. This may increase the likelihood of misappropriation or other misuse of our software.

Our largest shareholder, Asseco Poland S.A., owns the majority of the voting rights and controls the outcome of matters that require shareholder approval.

Asseco Poland S.A., or Asseco, owns approximately 50.2% of our outstanding ordinary shares and 51.2% of the voting rights. Therefore, Asseco has the power to control the outcome of those matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. This voting power may have the effect of delaying or preventing a change in control. In addition, potential conflicts of interest may arise in the event that we or any of our subsidiaries or other affiliates enter into agreements or transactions with affiliates of Asseco. Although Israeli law imposes certain procedures (including shareholder approval) for approval of certain related party transactions, we cannot assure you that these procedures will eliminate the possible detrimental effects of these conflicts of interest. If certain transactions are not approved in accordance with required procedures under applicable Israeli law, these transactions may be void or voidable.

Risks Related to our Traded Securities

The market price of our ordinary shares and American Depositary Shares may be volatile and you may not be able to resell your shares at or above the price you paid, or at all.

The stock market in general has experienced during recent years extreme price and volume fluctuations, including a sharp decline due to the global economic and financial crisis in late 2008 and in 2009, followed by an overall significant rebound in 2010 and 2011 to date. The market prices of securities of technology companies have been extremely volatile, and have experienced fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market fluctuations have affected and are expected to continue to affect the market price of our ordinary shares and ADSs.

The high and low closing market price of our ordinary shares traded on the Tel Aviv Stock Exchange, or the TASE, under the symbol “FORT,” and the high and low closing market price of our ADSs traded on the NASDAQ Global Market under the symbol “FORTY,” during each of the last three years, are summarized in the table below:

NASDAQ Global Market			TASE			
In US\$			In NIS		In US\$*	
High	Low	High	Low	High	Low	High