FORMULA SYSTEMS (1985) LTD
Form 20-F
May 15, 2012

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

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 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: 000-29442

FORMULA SYSTEMS (1985) 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)

Asaf Berenstin; 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
American Depositary Shares, each representing one Ordinary Share, NIS 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:

As of December 31, 2011, the registrant had 13,596,000 outstanding ordinary shares, NIS 1 par value, of which 768,559 were represented by American Depositary Shares.

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

Yes ¨ No x

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 x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant 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 o Accelerated filer x Non-accelerated filer o

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

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

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 o Item 18 o

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 x

TABLE OF CONTENTS

PART I

INTRODUCTION

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."

We prepare our consolidated financial statements in accordance with United States generally accepted accounting principles, 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 Accounting Standards Codification, or 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. For the period of time from our loss of control over Sapiens on August 21, 2011 until we regained a majority interest in Sapiens on January 27, 2012, we refer to Sapiens as an affiliated company.

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

3

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, 2009, 2010 and 2011, and the consolidated balance sheet data as at December 31, 2010 and 2011, from our audited consolidated financial statements included elsewhere in this annual report. The consolidated statement of operations data for the years ended December 31, 2007 and 2008 and the consolidated balance sheet data at December 31, 2007, 2008 and 2009 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."

Income Statement Data:

	Year ended December 31,				
	2007	2008	2009	2010	2011
	(U.S. dollars in thousands, except share and per share data)				
Revenues	$414,724	$503,243	$469,390	$549,694	$640,617

Cost of revenues	298,410	373,775	352,283	412,463	492,886
Gross profit	116,314	129,468	117,107	137,231	147,731
Research and development costs, net	6,547	6,564	4,430	5,503	5,148
Selling, general and administrative expenses	84,503	90,451	77,322	84,510	93,340
Other expenses (income), net	750	580	(1,668)	231	(207)
Operating income	24,514	31,873	37,023	46,987	49,450
Financial expenses, net	(3,619)	(5,908)	(231)	(4,371)	(6,500)
Gain (loss) on realization of investments, net	2,039	(337)	-	-	-
Income before taxes on income	22,934	25,628	36,792	42,616	42,950
Taxes on income	(1,891)	(3,279)	(8,305)	(6,544)	(5,689)
Gain derived from deconsolidation of subsidiary and equity in gains (losses) of affiliated companies, net	(653)	(216)	(335)	(1,070)	25,870
Income from continuing operations	20,390	22,133	28,152	35,002	63,131
Net income from discontinued operations	32,333	555	4,878	-	-
Net income	52,723	22,688	33,030	35,002	63,131
Net income attributable to non-controlling interests	15,464	10,819	13,954	16,623	20,169
Net income attributable to Formula's shareholders	37,259	11,869	19,076	18,379	42,962

4

	Year ended December 31,				
	2007	2008	2009	2010	2011
	(U.S. dollars in thousands, except share and per share data)				
Earnings per share generated from continuing operations:					
Basic	0.82	0.84	1.08	1.37	3.17
Diluted	0.8	0.84	1.04	1.36	3.11
Earnings per share generated from discontinued operations:					
Basic	2	0.04	0.37	-	-
Diluted	1.99	0.04	0.36	-	-
Total earnings per share:					
Basic earnings	2.82	0.88	1.45	1.37	3.17
Diluted earnings	2.79	0.88	1.4	1.36	3.11
Weighted average number of shares outstanding (in Thousands):					
Basic	13,200	13,200	13,200	13,282	13,514
Diluted	13,200	13,200	13,564	13,523	13,669

Balance Sheet Data:

	December 31,				
	2007	2008	2009	2010	2011
	(U.S. dollars in thousands)				
Total assets	$612,624	$596,622	$566,439	$623,767	$669,739
Total liabilities	306,231	319,252	271,125	289,383	317,012
Equity	306,303	277,370	295,314	334,384	352,727

Dividends

In June 2011, Formula distributed to its shareholders a cash dividend of $0.71 per share. The aggregate amount distributed by Formula was approximately $10 million.

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.

5

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 prospects, 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 prospects, 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 Related to Our Business and Our Industry

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

Our business depends on the overall demand for information technology, or IT, from, and on the economic health of, our current and prospective customers. In addition, the demand for our products and services is discretionary and may involve a significant commitment of capital and other resources. 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. Notwithstanding the recent recovery in some of the financial markets there is still continuing economic weakness and uncertainty, as adverse credit conditions, increased energy costs, renewed inflation, decreased consumer confidence, reduced capital spending, adverse business conditions, liquidity concerns and other factors have mitigated the strength of economic recovery from the global recession. Even if overall economic conditions continue to improve, continued challenging economic conditions in the markets in which we operate or a reduction in the level of IT, capital spending and investment in IT projects by our existing and potential customers, could adversely impact our business, results of operations and financial condition in a number of ways, including by resulting 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 with respect to any single customer.

For example, five customers of one of our three current significant subsidiaries— Sapiens— and its subsidiaries accounted for 33% of Sapiens' consolidated revenues (or 4% of our consolidated revenues), in 2011. One significant customer of another significant subsidiary—Magic Software— accounted for 25% of its consolidated revenues in 2011 (or 4% of our consolidated revenues). 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 and 2011 fiscal years, 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.

The software solutions market that we address through our subsidiaries is expected to continue to evolve, and if we are not able to accurately predict and rapidly respond to market developments or customer needs, our competitive position will be impaired.

The market for our solutions is characterized by changing business conditions and customer requirements. Nevertheless, estimates of the market's expected growth resulting from the changing conditions and requirements are inherently uncertain and are subject to many risks and assumptions. We may need to develop and introduce additional software and enhancements to our existing solutions to satisfy our current customers and maintain our competitive position in the marketplace. We may also need to modify our software so that it can operate with new or enhanced software that may be introduced by other software vendors. The failure to anticipate changes in technology, partner and customer requirements and successfully develop, enhance or modify our software solutions, or the failure to do so on a timely basis, could limit our revenue growth and competitive position.

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 ours who are likely to enjoy substantial competitive advantages, including:

- longer operating histories;
- closer proximity to future markets;
- greater financial, technical, marketing and other resources;
- cheaper costs, including labor cost;
- political leverage;
- 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. For example, in February 2010, Magic Software (via a subsidiary) acquired a consulting and staffing services business of a U.S.-based IT services company providing a comprehensive range of consulting and staffing services for telecom, network communications and the IT industry. As a further example, in August 2011, our current subsidiary Sapiens acquired IDIT I.D.I. Technologies Ltd., or IDIT, and FIS Software Ltd., or FIS, and in April 2010, it acquired Harcase Software Limited, or Harcase (Canada). If and when 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.

In the case of IDIT and FIS, Sapiens has commenced integrating them into its current business, including adding their solutions to Sapiens' product line and integrating their employees, including developers, technical support providers and sales and marketing personnel, into Sapiens' business. We expect that this process will continue into 2012, but there is no assurance that Sapiens will be successful and achieve anticipated synergies. In addition, while Sapiens has made significant progress towards the integration of Harcase (Canada)'s operations, technology and employees into its business, there can be no assurance that it will be able to successfully complete the integration and generate all anticipated synergies or operational improvements.

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, 2011 include, among other things, goodwill amounting to approximately $167 million, capitalized software development costs, net, amounting to approximately $12 million and other intangible assets (comprised mainly of customer related intangible assets and acquired technology) amounting to approximately $19 million. The applicable accounting standards require that:

- goodwill not be amortized, but rather be subject to an annual impairment test. We perform an annual goodwill impairment test with respect to our reporting units at December 31 of each year, or more often if indicators of impairment are present. As of December 31, 2010 and 2011, the estimated fair values of our reporting units ranged from 5% to 112% and from 10% to 28%, respectively, above their carrying values, thereby enabling us to avoid having to record any impairment. During the years ended December 31, 2009, 2010 and 2011, no imp