

FORMULA SYSTEMS (1985) LTD
Form 20-F
April 27, 2009

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, 2008

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: 0-29442

FORMULA SYSTEMS (1985) LTD.

(Exact Name of Registrant as Specified in Its Charter)

Israel

(Jurisdiction of Incorporation or Organization)

3 Abba Eban Boulevard, Herzlia 46725, Israel

(Address of Principal Executive Offices)

Guy Bernstein, CEO, 3 Abba Eban Boulevard, Herzliya 46725, Israel

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(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:

<u>Title of Each Class</u>	<u>Name of Each Exchange On Which Registered</u>
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, 2008, the registrant had 13,200,000 outstanding ordinary shares, NIS 1 par value, of which 388,274 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

Indicated 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 **PART I**

Some of the statements in this annual report, including those in the Risk Factors, 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. We use words like anticipates, believes, expects, future, intends and similar expressions to mean that the statement is forward-looking. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the 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 have based these forward-looking statements on our current expectations and projections about future events. 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.

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 FASB Statement of Financial Accounting Standards No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, and following the distribution of the shares held by Formula in Formula Vision Technologies (F.V.T.) Ltd., or Formula Vision, as a dividend to Formula's shareholders, in December 2006 and the sale of our entire shareholdings in BluePhoenix Solutions Ltd., or BluePhoenix, in June 2007, Formula Vision's and BluePhoenix's results of operations, assets and liabilities were classified as attributed to discontinued operations and as a result, we have restated 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 consumer price index refer to the Israeli CPI.

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.

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

2

TABLE OF CONTENTS

<u>ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>	4
<u>ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE</u>	4
<u>ITEM 3. KEY INFORMATION</u>	4
<u>ITEM 4. INFORMATION ON THE COMPANY</u>	23
<u>ITEM 4A. UNRESOLVED STAFF COMMENTS</u>	41
<u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	42
<u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	57
<u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	69
<u>ITEM 8. FINANCIAL INFORMATION</u>	72
<u>ITEM 9. THE OFFER AND LISTING</u>	73

<u>ITEM 10. ADDITIONAL INFORMATION</u>	75
<u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS</u>	90
<u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	91
<u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	91
<u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	91
<u>ITEM 15. CONTROLS AND PROCEDURES</u>	91
<u>ITEM 16. [RESERVED]</u>	92
<u>ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT</u>	92
<u>ITEM 16B. CODE OF ETHICS</u>	92
<u>ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	92
<u>ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES</u>	93
<u>ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	93
<u>ITEM 16F. CHANGE IN REGISTRANT CERTIFYING ACCOUNTANT</u>	93
<u>ITEM 16G. CORPORATE GOVERNANCE</u>	94
<u>ITEM 17. FINANCIAL STATEMENTS</u>	95
<u>ITEM 18. FINANCIAL STATEMENTS</u>	95
<u>ITEM 19. EXHIBITS</u>	95

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, 2006, 2007 and 2008, and the balance sheet data as of December 31, 2007 and 2008 from our consolidated financial statements included elsewhere in this annual report. Our consolidated financial statements have been audited by Ziv Haft registered public accounting firm, BDO member firm. The consolidated income statement data for the years ended December 31, 2004 and 2005 and the consolidated balance sheet data for the years ended December 31, 2004, 2005 and 2006 are derived from our audited 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. See Item 5. Operating and Financial Review and Prospects.

	Year Ended December 31,				
	2008	2007	2006	2005	2004
	\$				
	(In thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenues	\$ 590,807	\$ 493,350	\$ 416,807	\$ 365,841	\$ 332,279
Cost of revenues	452,263	369,110	309,447	266,234	228,216
Gross profit	138,544	124,240	107,360	99,607	104,063
Research and development costs, net	6,564	6,547	5,508	6,094	5,813
Selling, general and administrative expenses	98,607	90,458	88,844	86,682	82,548
Restructuring and non-recurring costs	-	-	2,911	1,455	-
Operating income	33,373	27,235	10,097	5,376	15,702
Financial expenses, net	(6,008)	(3,810)	(4,660)	(2,059)	(4,888)
Gain (loss) on realization of shareholdings, net	(337)	2,039	3,724	3,192	8,170
Other income (expenses), net	(580)	(750)	(1,102)	(341)	(1,054)
Income before taxes on income	26,448	24,714	8,059	6,168	17,930
Taxes on income	3,544	1,933	3,766	4,647	3,284
Equity in gains (losses) of affiliated companies, net	(216)	(653)	47	62	109
Minority interest in earnings of subsidiaries, net	(10,819)	(9,667)	(4,832)	189	(2,980)
Income (loss) from continuing operations	11,869	12,461	(492)	1,772	11,775
Income (loss) from discontinued operations, net	-	24,798	10,507	(1,589)	(3,675)
Net income	11,869	37,259	10,015	183	8,099
Earnings (losses) per share generated from continuing operations					
Basic	0.88	0.95	(0.04)	0.14	1.06
Diluted	0.88	0.93	(0.04)	0.14	0.94
Earnings (losses) per share generated from discontinued operations					
Basic	-	1.87	0.84	(0.13)	(0.33)
Diluted	-	1.86	0.77	(0.13)	(0.29)
Earnings per share:					
Basic earnings	0.88	2.82	0.8	0.01	0.73
Diluted earnings	0.88	2.79	0.73	0.01	0.65
Weighted average number of shares outstanding:					
Basic	13,200	13,200	13,200	12,800	10,800
Diluted	13,200	13,200	13,298	12,800	10,800
	As of December 31,				
	2008	2007	2006	2005	2004
	\$				
	(In thousands)				
Consolidated Balance Sheet Data:					
Total assets	\$ 596,622	\$ 612,624	\$ 597,487	\$ 360,141	\$ 378,084

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	As of December 31,				
Total liabilities	319,252	305,818	260,487	238,246	245,461
Shareholders' equity	169,937	198,388	153,290	163,449	186,778

5

Dividends

In January 2009, Formula distributed to its shareholders a cash dividend of \$2.27 per share, previously announced in December 2008. 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 of 36,696,000 shares of Formula Vision held by Formula and 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, will be distributed to the shareholders as a cash dividend, to the extent that our performance allows such distribution.

Cash dividends may be declared and paid in New Israeli Shekels or dollars. Dividends to the holders of the American Depositary Receipts, or ADRs, are paid by the depositary of the ADRs, for the benefit of owners of ADRs. If the dividend is declared and paid in NIS, the NIS amount is converted into dollars by the depositary of the ADRs.

Dividends paid by an Israeli company to shareholders residing outside Israel, holding less than 10% of the outstanding share capital of the company, are generally subject to withholding of Israeli income tax at a rate of up to 20%. Shareholders holding 10% or more of our outstanding share capital shall generally be subject to withholding of Israeli income tax at a rate of up to 25% on dividends. Such tax rates apply unless a lower rate is provided in a treaty between Israel and the shareholder's country of residence.

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, results of operations and our liquidity. In addition, the trading price of our ordinary shares could decline due to any of these risks, and you may lose all or part of your investment.

6

Risks Relating to Our Business

The recent global economic and financial crisis has had and will continue to have a negative effect on our business, financial condition and results of operations.

The recent global economic and financial market crisis has caused, among other things, a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, and reduced corporate profits and capital spending, all of which has had and will continue to have a negative effect on our business, results of operations and financial condition.

Demand for our products and services depends in large part upon the level of information technology, or IT, capital spending and investment in IT projects by our customers. The current economic conditions have reduced the willingness or ability of our customers and prospective customers to commit funds to IT projects, and may reduce their ability to pay for our products and services after purchase, whether as a result of possible customer insolvencies or otherwise. This has resulted in a longer sales cycles and increased pressure on pricing. Similarly, our suppliers may not be able to supply us with needed components on a timely basis, may increase prices or go out of business, which could result in our inability to meet customer demand, fulfill our contractual obligations or affect our gross margins. We cannot predict the timing or duration of the global economic crisis or the timing or strength of any subsequent economic recovery. Accordingly, we cannot know how the economic conditions will affect our business. As a result, we cannot assure you that we will be able to increase our revenues or keep our revenues at the same level as in 2008.

If the economy or markets in which we operate experience continued weakness at current levels or deteriorate further, our business, financial condition and results of operations will be materially and adversely impacted.

The loss of, or significant reduction or delay in, purchases by our 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. 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.

7

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 such downturns 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, we were 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.

We may experience significant fluctuations in our annual and quarterly results, which makes it difficult for investors to make reliable period-to-period comparisons and may contribute to volatility in the market price for our ordinary shares and American Depositary Shares.

Our quarterly and annual revenues, gross profits and results of operations have fluctuated significantly in the past, and we expect them to continue to fluctuate significantly in the future. The following events may cause fluctuations:

global economic trends, like the recent global economic crisis;

acquisitions and dispositions of companies and consolidation of our subsidiaries;

the size, time and recognition of revenue from significant contracts;

timing of product releases;

timing of contracts;

timing of completion of specified milestones and delays in implementation;

changes in the proportion of service and license revenues;

price and product competition;

increases in selling and marketing expenses, as well as other operating expenses;

8

currency fluctuations; and

consolidation of our customers.

A substantial portion of our expenses, including most product development and selling and marketing expenses, must be incurred in advance of when revenue is generated. If our projected revenue does not meet our expectations, we are likely to experience an even larger shortfall in our operating profit relative to our expectations. The gross margins of our subsidiaries also will vary both among themselves and over time. As a result, changes in the revenue mix from these subsidiaries may affect quarterly operating results. In addition, we may derive a significant portion of our net income from transactions which involve equity issuances by our subsidiaries, the sale of equity securities of our subsidiaries or the sale of proprietary software technology. These events do not occur on a regular basis and their timing is difficult to predict. As a result, we believe that period-to-period comparisons of our historical results of operations are not necessarily meaningful and that you should not rely on them as an indication for future performance. Also, it is possible that our quarterly and annual results of operations may be below the expectations of public market analysts and investors. If this happens, the price of our ordinary shares will likely decrease.

Many of our customers are financial institutions. A negative impact of the recent global economic and financial crisis on their business may cause a negative effect on our business, financial condition and results of operations.

A portion of our revenues in 2008 was derived from financial institutions. The recent global economic and financial market crisis had an adverse affect on various financial institutions and the banking sector. Lower levels of liquidity, increases in the rates of default and bankruptcy, and reduced corporate profits and capital spending, may have an adverse effect on our business, results of operations and financial condition.

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

We 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 selling of certain of our proprietary software solutions. If we cannot maintain our existing relationships with these partners, if our partners encounter financial difficulties, or 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-down. As a result, our business, financial condition, and results of operations could be seriously harmed.

9

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.

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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.

As a result, they 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. We also face additional competition as we continue to penetrate international markets. As a result, we cannot assure you that the products and solutions 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 business.

If we fail to compete for acquisitions and investments, we may be unable to grow.

As part of our strategy, we intend to pursue acquisitions of, and investments in, other companies. If and when acquisition or investment opportunities occur, we expect to compete for these opportunities with other established and well-capitalized entities. We cannot assure you that we will be able to locate potential acquisition or investment opportunities in Israel or internationally on terms which are favorable to us. If we fail to consummate further acquisitions or investments in the future our ability to grow may be harmed.

10

Any future acquisitions of companies or technologies may distract our management and disrupt our business.

Our strategy includes selective acquisitions of, and investments in, companies offering products and services suitable for integration into our business. We may acquire or make investments in complementary businesses, technologies, services or products if appropriate opportunities arise. We may engage in discussions and negotiations with companies about our acquiring or investing in those companies' businesses, products, services or technologies. We cannot assure you that we will be able to identify future suitable acquisition or investment candidates, or if we do identify suitable candidates, that we will be able to make the acquisitions or investments on commercially acceptable terms or at all. If we acquire or invest in another company, or if any of our subsidiaries acquires control in another subsidiary or affiliate, the acquirer could have difficulty assimilating that company's personnel, operations, technology or products and service offerings into its own. 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. We may incur indebtedness or issue equity securities to pay for any future acquisitions. The issuance of equity securities could be dilutive to our existing shareholders.

We intend to pursue acquisitions outside of Israel as part of our expansion strategy. These acquisitions, as well as any future acquisitions of companies located outside of Israel, would pose additional risks, including monitoring a management team from a great distance and integrating a potentially different business culture. Our failure to successfully integrate these new businesses could harm our business. In addition, the investigation of acquisition candidates outside of Israel involves higher costs than those associated with pursuing domestic acquisitions, and we cannot assure you that these investigations will result in transactions.

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

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The assets listed in our consolidated balance sheet include, among other things, goodwill, capitalized research and development costs and intangible assets related to customers' relations. The applicable accounting standards require that:

goodwill is not amortized, but rather is 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 assets 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 its net realizable value.

11

If our goodwill or capitalized research and development costs were deemed to be impaired in whole or in part due to our failure to achieve our goals, or if we fail to accurately predict the useful life of the capitalized research and development costs, we could be required to reduce or write off such assets, thus adversely affecting our operating results.

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.

If we fail to raise capital for our subsidiaries, we may be required to borrow money on unfavorable terms.

Our business strategy involves raising capital for our subsidiaries through public or private offerings. Our ability to raise capital for our subsidiaries depends upon market and other conditions which are beyond our control. If we fail to raise capital for our subsidiaries, it may hinder their growth. We may therefore be required to seek alternative capital raising methods, including borrowing money on terms which are not favorable to us. In the last few years, due to difficulties we encountered in raising capital for our subsidiaries, we were required to borrow monies from banks. Difficulties in raising capital on favorable terms or unavailability of financing may materially and adversely affect our business, operating results and financial condition.

The terms of our credit facilities contain a number of restrictive covenants which, if breached, could result in acceleration of our obligation to repay our debt.

The loan agreements of our subsidiaries contain a number of conditions and limitations on the way in which they can operate their business, including limitations on their ability to raise 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 or to our shareholders.

12

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. We expect to continue devoting significant resources to these efforts. If we are unable to continue achieving market acceptance for our solutions or otherwise continue to successfully penetrate international markets, our business will be harmed. In 2007 and 2008, we received approximately 35% and 32% of our

total 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, including 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;

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. 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, we may not be able to achieve our objectives and our business could be harmed.

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 may not be able to compete effectively for the personnel we need. Our future success depends on our ability to absorb and retain senior employees and to attract, motivate and retain highly qualified professional employees. We expect to recruit most of our software and systems personnel in Israel. 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 portion of our revenues from engagements on a fixed-price basis. We price these commitments 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 the project plan could materially adversely affect our business, operating results, and financial condition. In addition, we may agree to a price before the 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, we might incur significant expenditures in an attempt to remedy the problem. The consequences of 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, our contracts may be cancelled and we may be the subject of damages claims.

In the event that we fail to satisfy our customers' expectations from the results of the implementation of our solutions, or if we fail to timely deliver our solutions to our customers, these customers may suffer damages. When and if this occurs, customers may have the ability to cancel our contracts. 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. In addition, from time to time we may be subject to claims as a result of not delivering our products on time or in a satisfactory manner. Such claims may lead to material damages.

14

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

The IT business 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 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. This could strain our personnel and financial resources.

If we are unable to retain control in 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. From time to time, if and when required, we enter into voting agreements with other shareholders of the companies, in order to retain control of our subsidiaries. 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, failure to reach voting agreements or otherwise, we would cease to consolidate the operating results of these subsidiaries. This may result in significant fluctuations of our consolidated operating results.

15

We are exposed to significant claims for damage caused to our customers' information systems.

Some of the products and services 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, we are exposed to the risk of a claim for substantial damages being filed against us, regardless of our responsibility for the failure. When possible, we limit our liability under our product and service contracts. We cannot guarantee that these limitations of liability, if any, would be sufficient to protect us against legal claims. 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 third parties assert claims of 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 may be increasingly subject to third-party infringement claims as the functionality of products in different industry segments overlaps. We cannot predict whether third parties will assert claims of infringement against us. In addition, our employees and contractors have access to software licensed by us from third parties. 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 if submitted 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, Emblaze Ltd., owns the majority of our ordinary shares and controls the outcome of matters that require shareholder approval.

Emblaze Ltd., or Emblaze, owns approximately 51.7% of our outstanding ordinary shares. Therefore, Emblaze 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 share ownership 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 enter into agreements or transactions with affiliates of Emblaze. 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.

Fluctuations in foreign currency values affect the prices of our products, which in turn may affect our business and results of operations.

A significant portion of our worldwide sales is currently denominated in dollars and euros, while a substantial portion of our expenses, principally salaries and related personnel expenses, is in New Israeli Shekels (NIS). As a result, a decrease in the value of the dollar or euro relative to other foreign currencies, in particular the NIS, would increase our operating costs and, therefore, could adversely affect our results and harm our competitive position in the markets. In recent periods, the value of the dollar and the euro was decreased significantly in relation to the NIS. We cannot know whether this trend will continue in the future. If the dollar or euro value in relation to the NIS continues to decrease, our operating costs would increase, and in turn, our results of operation may be harmed. To date, we have not engaged in significant hedging transactions. In the future, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of the dollar or euro against the NIS. However, we cannot assure you that these measures will adequately protect us from material adverse effects arising from the impact of inflation in Israel. For additional information relating to the exchange rates between different relevant currencies, see Item 5. Operating and Financial Review and Prospects Overview Our Functional and Reporting Currency.

We may be adversely affected if the market prices of our publicly traded subsidiaries decrease.

A significant portion of our assets is comprised of equity securities of publicly and non-publicly traded companies. Our publicly traded subsidiaries are Magic Software Enterprises Ltd., or Magic Software, Matrix IT Ltd., or Matrix, and Sapiens International Corporation N.V., or Sapiens. The stock prices of these publicly traded companies have been extremely volatile, and have experienced fluctuations due to market conditions and other factors which are beyond our control. Fluctuations in the market price and valuations of our holdings in these companies may affect the value of our assets. In addition, the stock prices of many technology companies fluctuate significantly for reasons that may be unrelated to operating results. If the value of our assets decreases significantly as a result of the above, our business, operating results and

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financial condition, may be materially and adversely affected.

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, and in particular, during recent year, a sharp decline as part of the global economic and financial crisis. 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 American Depositary Shares, or ADSs.

The high and low 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 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 In \$		TASE In NIS	
	High	Low	High	Low
2008	14.14	4.99	47.78	17.53
2007	14.46	11.69	60.59	44.97
2006	14.00	9.15	60.15	39.99

The market price of the ordinary shares and the ADSs may fluctuate substantially due to a variety of factors, including:

- any actual or anticipated fluctuations in our or our competitors' quarterly revenues and operating results;
- shortfalls in our operating results from levels forecast by securities analysts;

- public announcements concerning us or our competitors;
- results of integrating investments and acquisitions;
- the introduction or market acceptance of new service offerings by us or our competitors;
- changes in product pricing policies by us or our competitors;
- public announcements concerning distribution of dividends and payment of dividends;
- changes in security analysts' financial estimates;
- changes in accounting principles;
- sales of our shares by existing shareholders; and
- the loss of any of our key personnel.

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In addition, global and local economic, political and market conditions and military conflicts and in particular, those specifically related to the State of Israel, may affect the market price of our shares and ADSs.

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

Our ordinary shares are traded on the TASE and our ADRs are traded on the NASDAQ Global Market. Trading in our ordinary shares and ADRs on these markets takes place in different currencies (dollars on the NASDAQ Global Market and NIS on the TASE), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). The trading prices of our ordinary shares and ADRs on these two markets may differ due to these and other factors. Any decrease in the trading price of our ordinary shares or ADRs, as applicable, on one of these markets could cause a decrease in the trading price on the other market.

Our United States investors could suffer adverse tax consequences if we are characterized as a passive foreign investment company.

Although we do not believe that we were a passive foreign investment company, or PFIC, for U.S. federal income tax purposes during 2008, we cannot assure you that we will not be treated as a PFIC in 2009 or in future years. We would be a PFIC if 75% or more of our gross income in a taxable year is passive income. We would also be a PFIC if at least 50% of our assets in a taxable year produce, or are held for the production of, passive income. Passive income includes interest, dividends, royalties, rents and annuities. If we are or become a PFIC, United States investors could be subject to adverse tax consequences, including having gain realized on the sale of our ordinary shares or ADSs being treated as ordinary income, as opposed to capital gain income, and having potentially punitive interest charges apply to such sale proceeds. Rules similar to those applicable to gains derived from the disposition of our ordinary shares also apply to certain excess distributions. A decline in the value of our ordinary shares or ADSs could result in our company being classified as a PFIC. United States investors should consult with their own tax advisors with respect to the United States tax consequences of investing in our ordinary shares.

19

For a discussion of how we might be characterized as a PFIC and related tax consequences, see Item 10. Additional Information Taxation United States Federal Income Tax Considerations.

Risks Relating to Operations in Israel

Political, economic, and military conditions in Israel could negatively impact our business.

Our headquarters and principal research and development facilities are located in Israel. Although we generated approximately 32% of our revenues in 2008 from international markets, we are, nonetheless, directly influenced by the political, economic and military conditions affecting Israel. Over the past several decades, a number of armed conflicts have occurred between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity has led to security and economic problems for Israel. Since 2000, there have been ongoing hostilities between Israel and the Palestinians, which have adversely affected the peace process and at times have negatively influenced Israel's economy as well as its relationship with several other countries. In 2006, Israel experienced a war with Hezbollah militants in Lebanon. Hamas, an Islamist movement responsible for many attacks, including missile strikes, against Israelis, won the majority of the seats in the Parliament of the Palestinian Authority in 2006 and took control of the entire Gaza Strip by force in 2007. In January 2009, Israel engaged in a military action against Hamas in Gaza to prevent continued rocket attacks against Israel. These developments have further strained relations between Israel and the Palestinians. The current political situation between Israel and its neighbors may not improve. These political, economic and military conditions in Israel could have a material adverse effect on our business, financial condition, results of operations and future growth.

In addition, nonexempt male adult citizens of Israel, including some of our officers and employees, are obligated to perform military reserve duty until the age of 40 or 45 depending on their function in the army, and are subject to being called for active duty under emergency circumstances. While we have operated effectively under these requirements since our incorporation, we cannot predict the full impact of such conditions on it in the future, particularly if emergency circumstances occur. If many of our employees are called for active duty, our operations in Israel and our business may be adversely affected.

20

Political relations could limit our ability to sell or buy internationally.

We could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli firms and others doing business with Israel or with Israeli companies. Also, over

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the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. There can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on our business.

The tax benefits available to us from government programs may be discontinued or reduced at any time, which would likely increase our taxes.

Certain of our subsidiaries received grants in the past and receive tax benefits under Israeli government programs, particularly as a result of the Approved Enterprise status of certain operations in Israel. Approved Enterprise status is granted by the Israeli Investment Center of the Ministry of Industry and Trade and entitles the grantee to a variety of tax incentives. The incentives awarded to certain of our subsidiaries include reduced tax rates and a tax holiday. Subject to compliance with applicable requirements, the portion of our subsidiary's undistributed income derived from our Approved Enterprise programs was exempt from income tax during the first two years, followed by a five year tax reduced tax rate of 25% instead of 26% on income derived from Approved Enterprise investment programs. In order to qualify for these incentives, the Approved Enterprise is required to provide minimum paid-in-capital (30% of the investment), to show an increase in its export activities, and to meet other general investing criteria. As of April 20, 2009, our subsidiaries have met those criteria and received tax benefits from their Approved Enterprise programs, as presented in Note 16 to our financial statements. To maintain the eligibility for these programs and benefits, we must meet the conditions mentioned above. We cannot assure you that these programs and tax benefits will continue at the same level in the future. If these tax benefits and programs are terminated or reduced, we could pay increased taxes in the future, which could decrease our profits.

It may be difficult to serve process and enforce judgments against our directors and officers in Israel.

We are organized under the laws of the State of Israel. All of our executive officers and directors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to:

effect service of process within the United States on us or any of our executive officers or directors;

enforce court judgments obtained in the United States including those predicated upon the civil liability provisions of the United States federal securities laws, against us or against any of our executive officers or directors, in the United States or Israel; and

bring an original action in an Israeli court against us or against any of our executive officers or directors to enforce liabilities based upon the United States federal securities laws.

Provisions of Israeli law may delay, prevent or make more difficult an acquisition of us.

The Israeli Companies Law generally requires that a merger be approved by the board of directors and a majority of the shares voting on the proposed merger. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if shares representing a majority of the voting power present at the shareholders meeting, and which are not held by the other party to the merger (or by any person who holds 25% or more of the shares or the right to appoint 25% or more of the directors of the other party or its general manager) have voted against the merger. Upon the request of any creditor of a party to the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of the surviving company. Finally, a merger may generally not be completed unless at least (i) 50 days have passed since the filing of a merger proposal signed by both parties with the Israeli Registrar of Companies; and (ii) 30 days have passed since the merger was approved by the shareholders of each of the parties to the merger. Also, in certain circumstances an acquisition of shares in a public company must be made by means of a tender offer. Lastly, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than U.S. tax laws. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or make more difficult an acquisition of or merger with us, which may adversely affect its ability to engage in a business combination and could depress our share price.

As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.

As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. A foreign private issuer that elects to follow a home country practice instead of such requirements, must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer

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must disclose in its annual reports filed with the Securities and Exchange Commission, or the SEC, or on its website each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. As a foreign private issuer listed on the NASDAQ Global Market, we may follow home country practice with regard to, among other things, composition of our board of directors, director nomination procedure, compensation of officers, and quorum at shareholders' meetings. In addition, we may follow our home country law, instead of the NASDAQ Marketplace Rules, which require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Both our legal name and our commercial name is Formula Systems (1985) Ltd. We were incorporated in Israel on April 2, 1985. We maintain our principal executive offices at 3 Abba Eban Boulevard, Herzlia 46725, Israel and our telephone number is 011-972-9-959-8800. Our agent in the United States is Corporation Service Company and its address is 2711 Centerville Road, Suite 400, Wilmington, DE 19808. In 1991, we completed our initial public offering of ordinary shares on the Tel Aviv Stock Exchange, or the TASE. In October 1997, we completed the listing of our ADSs on the NASDAQ Global Market.

Since our inception, we have acquired controlling interest and have invested in companies which are engaged in the IT solutions and services business. We, together with our subsidiaries and affiliates, are known as the Formula Group.

We have adopted a strategy of seeking opportunities to realize gains through the selective sale of investments and minority interest in our subsidiaries and affiliates to outside investors. We believe that this strategy provides us with capital to support the growth of our subsidiaries, as well as increasing shareholder value. We expect to continue to develop and enhance the products, services and solutions of our subsidiaries, and to continue to pursue additional acquisitions of, or investments in, companies that provide IT services and proprietary software solutions.

Capital Expenditures and Divestitures

Certain of our investment and financing activities are described below. For additional information relating to our investment and financing activities during 2007 and 2008, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

Purchase of TACT. In 2008, our subsidiary, Matrix, purchased all the shares of TACT Computers and Systems Ltd., or TACT, for an aggregate consideration of \$12.5 million. The sellers are entitled to an additional consideration to be calculated based on the difference between (x) TACT's value in 2008 to be calculated pursuant to an agreed upon formula (based on a multiple of the operating profit), subject to the application of agreed upon adjustments and calculations, and (y) the consideration paid on the date of completion. As of the date of this annual report, a commitment has been incurred for additional consideration of approximately \$6.5 million.

Sale of AAOD. On December 30, 2007, our subsidiary, Magic Software, sold its wholly-owned subsidiary, Advanced Answers on Demand Holding Corporation, or AAOD, a Florida corporation that develops and markets application software targeted at the long-term care industry, to Fortissimo Capital for \$17 million. Fortissimo paid Magic Software \$1 million of the sale price in December 2007 and the remaining \$16 million in March 2008. In addition, as part of the transaction, Magic Software entered into a three-year license agreement with AAOD according to which AAOD will continue to sell Magic Software's products, as an OEM partner, in consideration for \$3 million, to be paid to AAOD quarterly over the three years starting in 2008.

Debenture Offering by Matrix. On August 19, 2007, our subsidiary, Matrix, completed an offering of debentures in an aggregate principal amount of approximately \$62 million (NIS 250 million). The debentures were sold to institutional and other investors in Israel. The debentures bear an interest at an annual rate of 5.15%. The principal will be paid in four equal installments on December 31 of each of the years 2010 through 2013. The principal and interest are linked to the Israeli consumer price index. On February 21, 2008, Matrix listed the debentures for trading on the TASE.

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Sale of BluePhoenix shares. On June 20, 2007, we completed the sale of an aggregate of 8,038,526 shares of our subsidiary BluePhoenix Solutions Ltd., or BluePhoenix, constituting our entire holdings in BluePhoenix, to international institutional investors for aggregate consideration of approximately \$64 million.

Private Placement by Sapiens. In June 2007, our subsidiary, Sapiens, entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20 million (excluding finders' fees and out of pocket expenses), \$6.5 million of which was by Formula. Sapiens issued to the investors an aggregate of 6,666,667 common shares (of which 2,166,666 common shares were issued to Formula), at a price per share of \$3.00, which reflected a premium of approximately 25% above the trading price of Sapiens' common shares (as of the date Sapiens' board of directors approved the investment).

Spin-Off of Formula Vision. On December 26, 2006, we distributed to our shareholders a dividend consisting of 36,696,000 shares of Formula Vision, held by us and 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. As a result, we no longer hold an interest in Formula Vision. For more information, see Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Spin-off of the Investment in Formula Vision Discontinued Operation.

Repayment of Formula Vision Debt. On December 31, 2006, Formula Vision paid approximately \$51 million to us, as a full repayment of the principal of the debentures issued by Formula Vision to Formula in 2001 and 2002, including interest accrued thereon. In January 2004, Formula exchanged approximately \$35 million of the aggregate amount of the debentures for 38,000,000 shares of Formula Vision and constituting 59.4% of the outstanding share capital of Formula Vision at that time. In December 2005, the general meeting of shareholders approved an amendment to the debentures, pursuant to which the repayments due in 2005 and 2006 would be deferred to December 31, 2006, provided, however that the amount of cash and cash equivalents that Formula Vision held did not exceed the amount of its bank loans (including the amount of guarantees made by Formula Vision to banks in relation to loans granted to its subsidiaries).

24

Repayment of the Debenture to FIMI and IDB. In December 2005 and April 2006, we repaid to First Israel Mezzanine Investors Ltd., or FIMI, and Israel Discount Bank, or IDB, a debenture in the aggregate principal amount of \$4.7 million issued by Formula in 2002.

B. Business Overview

General

We are a global IT solutions and services company based in Israel. We are principally engaged in providing software consulting services, developing proprietary software products and providing computer-based business solutions. We deliver our solutions in over 50 countries worldwide to customers with complex IT services needs, including a number of "Fortune 1000" companies. We operate in two principal business areas, IT services and proprietary software solutions. Following is a description of our business areas:

IT Services

We design and implement IT solutions which improve the productivity of our customers' existing IT assets. In delivering our IT services, we at times use proprietary software developed by members of the Formula Group. We provide our IT services across the full system development life cycle, including definition of business requirements, system analysis, technical specifications, coding, testing, training, implementation and maintenance. We perform our projects on-site or at our own facilities.

Proprietary Software Solutions

We design, develop and market proprietary software solutions for sale in selected niche markets worldwide. We regularly seek opportunities to invest in or acquire companies with attractive proprietary software solutions under development which we believe to have market potential. The majority of our investments and acquisitions in this area have been in companies with products beyond the prototype stage. In addition, from time to time, we selectively invest in companies with proven technology where we believe we can leverage our experience to enhance product positioning and increase market penetration. We provide our management and technical expertise, marketing experience and financial resources to help bring these products to market. We also assist the members of our group to form teaming agreements with strategic partners to develop a presence in international markets.

The Formula Group

Formula is the parent company of subsidiaries and affiliates, referred to collectively as the Formula Group. We currently hold a controlling interest in our subsidiaries through our equity holdings. From time to time, if and when required, we enter into voting agreements with other shareholders of the companies, in order to retain control of our subsidiaries. At present, we have no voting agreements in effect. We appoint a majority of the boards of directors of our subsidiaries through our equity holdings and, if required, through voting agreements with shareholders who are often members of our management or of our subsidiaries' management. We provide our subsidiaries with our management, technical expertise and marketing experience to help them to penetrate their respective markets.

We direct the overall strategy of our subsidiaries. While the subsidiaries each have independent management, we monitor the growth of our subsidiaries through the active involvement in the following matters:

- strategic planning;
- marketing policies;
- senior management recruitment;
- investment and budget policy;
- financing policies; and
- overall ongoing monitoring of each subsidiary's performance.

We promote the synergy and cooperation among our subsidiaries by encouraging the following:

- transfer of technology and expertise;
- leveling of human resources demand;
- combining skills for specific projects;
- formation of critical mass for large projects; and
- marketing and selling the group's products and services to the group's customer base.

We, through our subsidiaries, offer a wide range of integrated IT solutions and services, and design, develop and market proprietary software solutions for sale in selected niche markets, both in Israel and worldwide.

Our Subsidiaries

Matrix

Matrix IT Ltd. is one of Israel's leading integration and information technology services companies, based on STKI.INFO and IDC annual surveys. Matrix employs over 4,000 software, hardware, integration and training personnel, which provide advanced IT services to more than 500 customers in the Israeli market. Matrix also markets in Israel software and hardware products manufactured by a broad range of international manufacturers.

The solutions, services and products supplied by Matrix are designed to improve Matrix's customers' competitive capabilities, by providing a response to their unique IT needs in all levels of their operation.

Areas of Operation

Matrix is active in four principal areas: software solutions and services, software products, infrastructure solutions and hardware products, and training and assimilation.

Software solutions and services. Matrix provides software services, software development projects, outsourcing, integration of software systems and services all in accordance with its customers' specific needs. Matrix also provides upgrading and expansion of existing software systems. Matrix software solutions and services include the following components: (i) development of dedicated customer software systems; (ii) customization of software developed by Matrix or by third parties to provide a response to customers' requirements; (iii) systems assimilation; (iv) offshore and domestic services, mainly for software developments and quality assurance and software testing; and (v) integration of all or part of these components. The scope of work invested in each individual component varies from one customer to the other, based on each customer's specific requirements.

Software Products. Matrix's operations in this area include sales and support of software products in various categories, mainly customer relationship management, referred to as CRM, systems management and business service management products, software products for content management, software products for business intelligence (BI), data warehouses and extract/transform/load (ETL), software products for integration, database systems, open-code operating systems, software products for knowledge management and software development and testing tools.

Infrastructure solutions and hardware products. Matrix's operations in this area include: (i) supply of infrastructure solutions for computer and communication systems; (ii) sale and marketing of PCs, laptops, Intel servers, peripheral equipment, operating systems, servers and workstations operating on Unix and Linux operating systems, and sales and marketing of storage and backup systems for mainframe computers such as HP and IBM; and (iii) maintenance for computers and peripheral equipment, lab services and a help desk.

Training and assimilation. Matrix operates technological training and qualification centers providing advanced professional courses for hi-tech personnel, training and assimilation of computer systems, applications courses, professional training and training for capital market operations.

Matrix provides solutions, services and products primarily to the following four market sectors (or verticals): banking and finance, telecommunications, commerce and manufacturing, and the public and security forces sector.

27

Matrix offers to each market sector a broad range of solutions and services, customized for the specific needs of that sector. Matrix operates dedicated departments, each of which specializes in a particular sector. Each such department supplies customers in that sector with a product basket providing a response to most of its IT requirements, based on an in-depth business understanding of the challenges which are typical to that sector. Matrix established separate headquarters for each particular market sector, which manages the operations relating to that sector.

Specialization in the various sectors is reflected in the applications, professional and marketing aspects of each sector. Accordingly, the professional and marketing infrastructure required to support each market sector is developed to address such sector's specific needs.

In addition to the four sector-based areas of operations, Matrix operates two horizontal divisions providing specialist services for all of the different sectors of operations. These entities include:

Expertise centers Matrix operates about 20 expertise centers, in areas such as: SOA (service oriented architecture), Mobility (Mobile Technology), CRM, Open Source, J2EE and M/F. These expertise centers are based on market concept, which is targeted to yield significant added value to the company's customers, including: group of professionals that are focused and have expertise in the related technologies, hands-on experience and expertise in the related technologies, methodologies, and best practices; and

A strategic consulting center that provides customers with diverse consultation services on topics such as organization, strategy, business development and technological development.

Customers

Matrix's customers include large enterprises in Israel, including commercial banks (such as Bank Leumi, Bank Hapoalim, The First International Bank, Discount Bank, United Mizrahi Bank and Igud Bank), loan and mortgage banks (such as Leumi Mortgage Bank),

telecommunications services providers (Bezeq, Bezeq International and Barak), cellular operators (Cellcom, Orange and Pelephone), credit card companies (Visa Cal, Isracard and Leumicard), leasing companies, insurance companies (such as Harel Hamishmar, Phoenix, Clal, Migdal), security agencies, satellite operators (YES), hi-tech companies (such as Comverse, Motorola and Amdocs), the Israeli Defense Force and government ministries and public agencies such as Israel Electric Company, Social Security, Mekorot, and media and publishing entities.

Magic Software

Magic Software Enterprises Ltd., develops, markets, sells and supports application platforms and business and process integration solutions. Magic Software's products and services are available through a global network of regional offices, independent software vendors, or ISVs, system integrators, value-added distributors, value-added resellers as well as OEM and consulting partners in approximately 50 countries and supported by an extensive global services organization. In addition to technology, Magic Software provides its customers with maintenance and technical services, as well as professional services and training.

Magic Software Core Technology

With over 25 years of experience and thousands of customers and partners, Magic Software's technology enables enterprises to accelerate the process of building, deploying and integrating business software applications that can be rapidly customized to meet current and future needs.

Magic Software's technology gives partners and customers the power to create any type of business applications, leverage existing IT resources, enhance business ability, and focus on core business priorities to gain maximum return on their existing and new IT investments.

Magic Software is known for its code-free approach, allowing users to focus on business logic rather than technological requirements. This approach forms the driving principle of both the uniPaaS application platform (the next generation of eDeveloper) and the iBOLT business and process integration suites. Both uniPaaS and iBOLT enable enterprises to accelerate the process of building and deploying applications that can be rapidly customized and integrated with existing systems:

uniPaaS Application Platform (the next generation of eDeveloper) is a comprehensive application platform that supports all deployment models including Full Client, Rich Internet Applications (RIA) and Software-as-a-Service (SaaS). It uses a single development paradigm to handle all client and server partitioning and offers customers the choice in how they deploy their applications, whether full client or web; on-premise or on-demand; in the cloud or behind the corporate firewall; software or SaaS; or global or local, and complies with event-driven and service-oriented architectural principles.

By offering technology transparency, uniPaaS allows customers to focus on their business requirements rather than technological means. uniPaaS's single development paradigm significantly reduces the time and costs associated with the development and deployment of RIAs. Application owners can leverage their initial investment when moving from full client mode to RIA and SaaS, and eventually modify these choices as the situation requires. Furthermore, enterprises can use cloud based uniPaaS applications in a SaaS model and still have their databases in the privacy of their own data centers. It also supports most hardware and operating system environments such as Windows, Unix, Linux and AS/400, as well as multiple databases. uniPaaS is interoperable with .NET and Java technologies.

iBOLT Business and Process Integration Suite provides business integration and process management solutions with a particular focus on enterprise applications. iBOLT allows integration and interoperability of diverse solutions, including legacy applications, in a quick and efficient manner.

Increasing the usability and life span of existing legacy and other IT systems, iBOLT allows fast enterprise application integration (EAI), development and customization of diverse applications, systems and databases, assuring rapid return on invested capital and time-to-market, increased profitability, and customer satisfaction. Magic Software offers special editions of iBOLT targeted at specific enterprise application vendor ecosystems, such as SAP Business One, SAP R/3, SAP Business All in One, JD Edwards, IBM i, Salesforce.com, Lotus Notes, and HL7. These special editions contain specific features and pricing tailored for these market segments.

Magic Software's technologies adhere to open standards and deliver high levels of portability and scalability, crucial for today's dynamic business environment, and operate as a uniform application paradigm independent of architecture (Internet, client/server, mobile, LAN/WAN), operating systems (Windows, Linux, UNIX, iSeries), database (DB2, Oracle, Informix, MS SQLServer, Pervasive and others), or platform (.NET, J2EE).

Enabling Business

Magic Software's technology enables enterprises to accelerate the process of building and deploying business software applications that can be rapidly customized to meet current and future needs.

Magic Software's technology and solutions are particularly in demand when time-to-market considerations are critical, budgets are tight, integration is required with multiple platforms or applications, databases or existing systems and business processes, as well as for RIA, cloud computing and SaaS.

A wide variety of developers use Magic Software's products, including in-house corporate development teams and software houses and independent software vendors. Large and medium sized system integrators use Magic Software's products in large customized system integration projects and for developing industry-specific vertical applications.

Professional Services

Magic Software provide a broad range of consulting and software development project management services to customers developing, deploying and integrating distributed applications.

30

Magic Software offers fee-based consulting services in connection with installation assurance, application audits and performance enhancement, application migration and application prototyping and design. Consulting services are aimed at both generating additional revenues and ensuring successful implementation of uniPaaS and iBOLT projects through knowledge transfer.

Services are offered as separately purchased add-on packages or as part of an overall software development and deployment technology framework. Over the last several years, Magic Software has built upon its established global presence to form joint ventures with its MSPs (Magic Software providers) who use Magic Software technology to develop solutions for their customers, and distributors to deliver successful solutions in focused market sectors.

Partner Alliances

Magic Software forms partner alliances to help deliver complete solutions to customers. These solutions encompass application integration, development, vertical domain expertise and hardware implementation. Magic Software maintains strategic alliances with leading vendors, like SAP, IBM, Oracle and Salesforce.com. Magic Software's partnership with SAP, entered into in 2004, focuses on providing a special edition of iBOLT which extends the value of SAP Business One, SAP Business All in One and SAP R/3 implementations with capabilities such as extended workflows, composite applications, multi-channel access, interoperability and integration with other systems and platforms, as well as business activity and performance monitoring. Magic Software applies the same marketing concept to other leading enterprise application ecosystems, with special editions of iBOLT for Salesforce.com, Oracle's JD Edwards, IBM i, Lotus Notes and HL7. In addition, Magic Software has alliances with system integrators, software and hardware vendors and consulting organizations. These partnerships enable Magic Software to better serve its customers worldwide.

Vertical Solutions

Magic also develops, markets, and supports, through its subsidiaries and affiliates, vertical applications, including long-term care, cargo handling and inventory control solutions.

Cargo handling Hermes (formerly Magic eCargo) is a comprehensive solution for cargo handling and inventory control that is designed to increase productivity, improve efficiency, and reduce costs. Hermes handles many aspects of a cargo operation including inventory control, automated build-up of flights/manifesting, messaging to CARGO-IMP standards, customs clearance, weight and balance departure control systems, interfacing, scanning and verification of cargo, secured tracking and a comprehensive financial package for all aspects of charging,

collecting fees and invoicing.

Banking Nextstep Infotech PVT Ltd. develops and markets Cheq Mate, a banking application that provides most of the functionality needed to run a retail branch, including support for various deposit types, advances, time deposits, bank guarantees, letters of credit and portfolio management.

31

Professional Services CoreTech is an information technology consulting firm offering flexible and creative solutions in the areas of infrastructure design and delivery, application development, technology planning and implementation services, and supplemental staffing.

Markets and Customers

Magic Software markets and sells its products and services in approximately 50 countries worldwide. Industries that are significantly represented in the Magic Software's community include finance, retail, media, telecommunications, manufacturing, healthcare and government agencies. Among the thousands of end-users running their business systems with Magic Software's technology, are the following:

adidas-Canada, Administar Services Group, AFC Worldwide Express, Allstate, Anglo-Canadian Housewares, Anritsu, Athlon Group, Boeing, Burger King, Carey International, City of Phoenix Police Department, Club Med, CBIA, Charlotte Country Court System, Compass Group PLC, Danish Ministry of Economic, Deka Bank, Deutsche Bank, DHL, Electricité de Strasbourg, Electra, Esmee Fairbairn Foundation, Fortis Assurances, Fujitsu-Ten, Euroclear, Europ Assistance Netherlands, Financial Times, FMRP, Fraport AG, GAP, GGD Amsterdam, Grange Insurance, Heller Bank AG, Hitachi, ING Commercial Finance, Johnson & Johnson, John Menzies, Kodak, LORD Corporation, Marconi Mobile, Merrill Lynch, Matsushita, Minolta, NEC, Nestle Nespresso, Nintendo, New York State Public Defenders Association, Online Trading Academy, OTOR, Paris Nord Villepinte Exhibition Center, Philip Morris, Primagas, Prestwick House, Rosenbauer, San Francisco Courts, Semeru, Sharp System Products, Sklar Peppler TEVA, Title Solutions, Titan Software, Vadim Software, Vodafone, the United Nations, UPS, Victorinox, Vodafone, W3Com, Warren Board, and Washington State.

Sapiens

Sapiens International Corporation N.V. is a global provider of IT solutions that modernize business processes to enable insurance and other leading companies to quickly adapt to changes. Sapiens' solutions, sold as customizable software modules, align IT with business demands for speed, flexibility and efficiency. Sapiens' solutions are supplemented by its technology, methodology and consulting services, which address the complex issues related to the life-cycle of enterprise business applications. Sapiens' solutions include scalable insurance applications developed for leading organizations such as AXA, Norwich Union, Liverpool Victoria, IAT Group, ING, OneBeacon, Principal Financial Group, Texas Farm Bureau Insurance Companies, Menora Mivtachim Insurance and Santam. Sapiens' service offerings include a standard consulting offering that helps customers make better use of IT in order to achieve their business objectives.

32

Sapiens' core technology, *Sapiens eMerge*, is a rules-based application development suite which enables rapid solution development for complex mission-critical enterprises to deliver new functionality, achieve legacy modernization and enterprise application integration. The primary building block of Sapiens' solution offerings is Sapiens eMerge, Sapiens' business rules engine. The use of Sapiens eMerge reduces the complexity of programming so that new applications and modifications of existing ones can be produced in a much shorter time than through conventional programming.

Another key advantage of Sapiens eMerge is the ability to extend the productive life of older computer systems, while at the same time providing the basis for using new generation Internet and service-oriented technologies. The use of rapid application development allows enterprise-specific enhancements to be made in a shorter time and with a greatly reduced maintenance burden when compared to other technologies.

Development, deployment, integration and administration of applications are all accomplished through the technology components of Sapiens eMerge, providing customers with flexible, scalable and feature-rich systems. Sapiens eMerge, which serves over 100 of Sapiens customers worldwide, reduces the cost of business software development and maintenance.

Sapiens markets its solutions globally through its direct sales force and through marketing alliances with global IT providers, such as IBM Corporation and Electronic Data Systems Corporation. Sapiens is a Premier Business Partner of IBM and works with IBM on solutions, joint

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development, testing, validation and marketing. Through this and other business alliances, Sapiens has developed extensive knowledge in mainframe and mid-range systems, including CICS, DB2, MQ and the WebSphere e-business platform. Sapiens is also a member of IBM's Insurance Application Architecture (IAA) group and the ISV Advantage Program for the small and medium business insurance market segment.

Sapiens Business Solutions for the Insurance Industry

Sapiens has formulated Sapiens INSIGHT, a suite of modular business software solutions that make use of existing assets to quickly and cost-effectively modernize business processes that are the key to survival in the current, challenging insurance landscape. Sapiens insurance solutions, which include the Sapiens INSIGHT family, are based on Sapiens eMerge.

Sapiens INSIGHT is designed for the general (property and casualty) and life insurance markets. These solutions can be customized to match specific legacy systems and business requirements, while providing pre-configured functionality. These solutions can be used independently or together as follows:

Sapiens INSIGHT for Property & Casualty is a fully functional, general insurance policy administration solution that makes it easier for brokers and agents to do business with carriers. By automating the process, this web-enabled solution reduces the cost of doing business and optimizes risk selection through the use of rules based underwriting.

33

Sapiens INSIGHT for Life & Pensions is a powerful and comprehensive framework-based life and pensions solution that serves companies administering life insurance, pension funds, health insurance and saving plans. Sapiens INSIGHT for Life & Pensions is dynamic, is highly customizable and can be easily accommodated to administer changes in processes. It is fully web-enabled, prepared to utilize the advantages of the Internet and intranet.

Sapiens INSIGHT for Closed Books, also known as LifeLite, is a solution for life insurance companies and pension funds seeking ways to reduce the cost of maintaining long-term closed books of business, that is, lines of business that are no longer current. Sapiens provides customizable solutions that enable companies to efficiently and more effectively administer policies and claims relating to closed books.

Sapiens INSIGHT for Reinsurance is a functional-rich solution for the insurance market, designed to support insurance carriers in the management of all types of reinsurance for the general (property and casualty) and life insurance markets, according to the rapidly changing requirements of the international reinsurance market. This state-of-the-art, web-enabled solution streamlines and reduces the cost of handling all reinsurance functions through automation, is based on ACORD standards and B2B XML technology, and is designed for a multi-language, multi-currency and multi-company environment.

Sapiens INSIGHT for Underwriting (formerly MediRisk INSIGHT) is an underwriting solution for life, health and disability insurance. It reduces a customer's costs by automating a larger portion of the process of evaluating the risks of new business and by streamlining the procedures for handling new business. By using this solution, an insurance company can make underwriting assessments on new cases earlier in the business cycle and achieve greater consistency in its decision-making. Sapiens markets INSIGHT for Underwriting on the basis of licensing and distribution agreements with MediRisk Solutions Ltd. which developed the solution and holds the intellectual property rights to it.

Sapiens collaborates with its customers to tailor the Sapiens INSIGHT solutions to achieve the unique operational performance goals of each organization. In addition, Sapiens has executed independent projects for the insurance market, providing enhanced information access and visibility to empower the sales, agent and broker community, thus accelerating transaction processing for improved customer service and business efficiency. Sapiens insurance solutions are compatible with a variety of platforms including IBM zSeries and iSeries, HP UNIX at the host-side and Windows 2000/XP Web servers. They are also compatible with open architecture standards such as .NET, Java EE, XML, Web Services and application server platforms such as IBM's WebSphere.

34

Services

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Outsourcing of application maintenance. Sapiens' outsourcing services were developed from its strong, long-term relationships with its customers. Sapiens is currently servicing multi-year outsourcing contracts with blue-chip customers involving mission-critical systems. The outsourcing projects are performed either on or off the customers' premises. Sapiens' asset discovery solution contributes to the maintenance and management of an enterprise's IT environment.

IT Services. Sapiens provides customers with specialized IT services in many areas, including project management and technical assistance. Sapiens' personnel work with the customer for the duration of the entire project, collectively undertaking design, development and deployment tasks, coupled with hands-on-training, to achieve a rapid software solution that matches the customer's business and IT goals.

Customers

Sapiens INISGHT. Sapiens markets the Sapiens INISGHT suite of solutions to insurance carriers in four main categories: Property & Casualty (known as General Insurance in Europe); Life and Pensions (known as Life and Health in the US), Reinsurance and Medical Underwriting. Sapiens' customers and target markets have direct written premiums in the range of \$80 million to \$5 billion per year. However, given the flexibility and modularity of the Sapiens INISGHT suite of solutions, its offerings can accommodate most situations and budgets.

Sapiens eMerge. Sapiens markets Sapiens eMerge primarily to corporate customers and government entities with large information technology budgets and ongoing maintenance and development needs. Sapiens' corporate customers include, among others, insurance companies, banks and other companies offering financial services and companies in the manufacturing and transportation sectors. The principal markets in which Sapiens competes are located in North America, Europe, Israel and Japan.

nextSource Inc.

nextSource Inc., or nextSource, operates in the field of workforce management solutions by developing and delivering an innovative and comprehensive suite of services and products. This model allows customers to engage nextSource for one or any combination of capabilities that address the challenges imposed by today's global and complex workforce issues. nextSource offers customers the ability to manage their present and future workforce needs with a high degree of flexibility, proven best practices and proprietary technology as a single source. This positions nextSource as the workforce solutions provider of choice.

35

nextSource's wheel of integrated solutions include:

Vendor Management Talent Acquisition Management Solution (TAMS)

One of nextSource's key products is its intuitive, web-based vendor management system named Talent Acquisition Management Solution, or TAMS. TAMS is a scalable, 8th generation vendor management software application. TAMS automates the process of acquiring and managing a customer's workforce consisting of temporary staffing, contract workers, consultants and direct hires. TAMS also facilitates the competitive sourcing and tracking of fixed price, deliverable-based projects.

TAMS introduces process improvements resulting in the elimination of inefficiencies, reducing the amount of time HR managers and procurement teams spend in acquiring and tracking contingent workforces. The application provides timekeeping, invoicing, online requisitioning, online purchase orders and all approvals associated with each function. nextSource is able to configure the application to fit its customers' specifications with minimal implementation time through nextSource's highly experienced implementation team.

Salary & Rate Benchmarking The PeopleTicker

nextSource's key product in this area, The People Ticker, is the industry's only web-based, real-time rate and salary benchmarking tool for full-time and contingent compensation. The People Ticker replaces the antiquated salary survey approach by providing users with real time rate and salary data specific to an industry, geographic region and job description. With this powerful application, customers are able to assess and react to the cost of specific labor market fluctuations on a real-time basis. The application takes the guesswork out of establishing geography and position specific, hourly rates and full-time salaries for employees based on current market supply and demand. Armed with this information, customers are now able to hire and retain employees, procure contingent labor and budget for project-based initiatives in a cost effective manner. Currently, The PeopleTicker is in its third generation and covers the United States, Canada, United Kingdom and India.

Payrolling Services/Third-Party Employer of Record Services

nextSource offers a comprehensive payrolling and risk mitigation service. nextSource payrolling services protect its customers and mitigate risks and the many legal issues surrounding the acquisition of 1099s or independent contractors. nextSource serves as the employer of record for these resources providing customers with the ability to maintain flexible workforce capabilities. nextSource complements its payrolling services offering with People Time, a web-based, time and attendance tracking application enabling hiring managers to collect and report worker time and cost data.

36

Staffing

Through ConsultingDirect, nextSource creates an efficient web-enabled labor market/reverse auction through which a pool of pre-screened and pre-qualified members of its Registry of Certified Consultants (ROCC), have the opportunity to bid for open positions. ROCC members provide their requested hourly rate or project fee and the customer is able to make an informed decision in a highly competitive, transparent auction-type market for each job posting. nextSource believes that this system provides a very efficient process for customers to reach a wide group of pre-screened, pre-negotiated candidates.

Agency Exchange

In 2003, nextSource created The Multiple Listing Staffing Association (MLSA), an industry-wide network of independent, nextSource-qualified staffing agencies. The MLSA brings together staffing agencies working cooperatively with one another under the nextSource umbrella. Members of the MLSA can post an unlimited number of openings of any type on nextSource's web-based portal and increase their own qualified candidate pool by accessing the nextSource database of candidates, in addition to accessing new customers and additional openings from other agencies.

HR/Procurement Consulting

nextSource provides HR and procurement consulting, including assisting customers with the negotiation of rates and supplier agreements and the establishment of agency performance metrics. nextSource also offers salary and compensation analysis, assessment of co-employment risks, review of on-boarding and off-boarding procedures and other HR policies and processes.

Pre-Employment Screened Applicants Certified Person

The newest addition to nextSource's offerings is the *Certified Person* platform; a sourcing tool that integrates background screening services. Certified Person removes the uncertainty of whether or not a candidate passes employment pre-screening requirements. All members of Certified Person will be put through a background screening process that will ensure they meet our customer's specific background and on-boarding requirements prior to being engaged for any opportunities. Once they pass these requirements, these candidates will be introduced in the appropriate recruiting cycle. This solution was created to streamline the time to hire process by only sourcing and recruiting candidates who have already passed the required on-boarding requirements.

Sales and Marketing

Our subsidiaries conduct sales and marketing efforts primarily through division or product managers. In certain cases, the companies devote sales managers who, aided by their staffs, are responsible for ongoing customer relationships, as well as sales to new customers. In addition, the IT services companies participate in competitive bidding processes, primarily for turnkey and government projects, as well as large IT services contracts. Our subsidiaries attend trade shows and exhibitions in the high technology markets, while further supplementing their sales efforts with space advertising and products and services listing in appropriate directories. In addition, our subsidiaries organize user group meetings for their customers, where new products and services are highlighted. We typically enter into strategic alliances and intend to pursue acquisitions in order to penetrate various international markets and promote sales of our proprietary software solutions in international markets.

37

The following table summarizes our revenues by operating segments for the periods indicated:

	Software Services	Proprietary Software Products	Total
\$ in thousands			
Year ended December 31,			
2008	485,354	105,453	590,807
2007	392,527	100,823	493,350
2006	319,939	96,868	416,807

The following table summarizes the revenues from our IT products and services by geographic regions of our customers, for the periods indicated:

	Year ended December 31,		
	2008	2007	2006
\$ in thousands			
Israel	399,474	319,444	264,293
International:			
United States	134,662	120,051	93,479
Other	56,671	53,855	59,035
	191,333	173,906	152,514
Total	590,807	493,350	416,807

Competition

The markets for the IT products and services we offer are rapidly evolving and highly competitive. Our ability to compete successfully in IT services markets depends on a number of factors, like breadth of service offerings, sales and marketing efforts, service, pricing, and quality and reliability of services. The principal competitive factors affecting the market for the proprietary software solutions include product performance and reliability, product functionality, availability of experienced personnel, price, ability to respond in a timely manner to changing customer needs, ease of use, training and quality of support.

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.

As a result, they 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. In addition, in the future, we may face further competition from new market entrants and possible alliances between existing competitors. We also face additional competition as we continue to penetrate international markets. As a result, we cannot assure you that the products and solutions we offer will compete successfully with those of our competitors. Furthermore, several software development centers worldwide offer software development services at much 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.

Matrix's principal competitors in the domestic Israeli market are Israeli IT services companies and systems integrators, the largest of which are Ness Technologies Inc., Team-Malam, Taldor and One1. Matrix's international competitors in the Israeli marketplace include HP, EDS, IBM and Microsoft. These international competitors often use local subcontractors to provide personnel for contracts performed in Israel. Most of these international entities are also business partners of Matrix.

Magic Software's principal competitors in the market for the uniPaaS technology are Cordys, IBM, Microsoft, Oracle, Pegasystems, Progress, Fiorano, Intersystems, Sun, TIBCO, Ultimius and Unify. The principal competitors in the market for Magic Software's iBOLT Business and Process Integration Suite are Tibco, Informatica, Microsoft BizTalk and Software AG.

Sapiens' competitors in the market for solutions offered to the insurance industry fall into several categories: vendors of complete systems, vendors of insurance software products, large multinational integrators and local integrators in the various territories where Sapiens operates.

39

Examples of Sapiens' competitors are: CSC, Camilion, SOLCORP, Fineos, SAP, SunGard, Navisys, Fiserv, OneShield, Ascendant One, Insurity, IDP, The Innovation Group, Duck Creek and AQS in the United States; Unisys, SunGard, FIS Software and RebusIs in the United Kingdom; Falmeyer (FJA), COR AG Insurance Technologies and IDIT IDI Technologies in Europe. Examples of large integrators in the insurance field are Electronic Data Systems and CSC (companies that also have customer or alliance relationships with Sapiens in other fields). An example of a competitor that is a local integrator is Ness Technologies in Israel.

In addition, Sapiens faces competition from its customers' and potential customers' internal IT departments, who often prefer to develop solutions in-house.

Sapiens' competitors in the business rule engines and management marketplace include Fair Isaac (Blaze), Pegasystems, ILOG, Computer Associates, Haley, Corticon, Versata, RuleBurst and ESI.

Software Development

The software industry is characterized by rapid technological developments. In order to maintain technological leadership, we engage in ongoing software development activity through our subsidiaries, aimed at both creating new proprietary software and services, as well as enhancing and customizing existing products and services. This effort includes introducing new supported programming languages and database management systems; improving functionality and flexibility and enhancing ease of use. We work closely with current and potential end-users, our strategic partners and leaders in certain industry segments to identify market needs and define appropriate product enhancements and specifications.

Intellectual Property Rights

We rely on a combination of trade secret, copyright and trademark laws and non-disclosure agreements, to protect our proprietary know-how. Some members of our group have patents and patent applications pending. Our proprietary technology incorporates processes, methods, algorithms and software that we believe are not easily copied. Despite these precautions, it may be possible for unauthorized third parties to copy aspects of our products or to obtain and use information that we regard as proprietary. We believe that, because of the rapid pace of technological change in the industry, patent and copyright protection are less significant to our competitive position than factors such as the

knowledge, ability and experience of our personnel, new product development and ongoing product maintenance and support.

C. Organizational Structure

Formula is the parent company of the Formula Group.

The following table presents certain information regarding the control and ownership of our significant subsidiaries, as of April 20, 2009.

Subsidiary	Country of Incorporation	Percentage Of Ownership
Matrix IT Ltd.	Israel	50.0%
Magic Software Enterprises Ltd.	Israel	58.2%
Sapiens International Corporation N.V.	Netherlands Antilles Islands	70.6%
nextSource Inc.	United States	100.00%

The ordinary shares of Magic Software and Sapiens are traded on the NASDAQ Global Market and on the TASE, and the ordinary shares of Matrix are traded on the TASE.

D. Property, Plants and Equipment

Our corporate headquarters, as well as the research and development and sales and marketing headquarters of a majority of our subsidiaries, are located in Herzlia, Israel. We lease approximately 103,000 square feet of office space in Herzlia, pursuant to a lease which expires on October 31, 2013. We also lease an aggregate of approximately 194,000 square feet of office space in several other locations in Israel.

We own a 39,300 square feet facility in Or-Yehuda, Israel used for office space of Magic.

In addition, Sapiens leases approximately 45,000 square feet of office space in Rechovot, Israel, 4,700 square feet in the United States and 13,800 square feet in Great Britain, Magic Software leases approximately 5,100 square feet of office space in the United States and several of our subsidiaries lease some additional office space and sales and support premises in the United States, Europe and Asia.

We believe that our properties are adequate for our present uses. If in the future we require additional space to accommodate our growth, we believe that we will be able to obtain this additional space without difficulty and at commercially reasonable prices.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Overview

Formula is the parent company of subsidiaries and affiliates, referred to collectively as the Formula Group. We are principally engaged in providing software consulting services, developing proprietary software products and providing computer-based business solutions. We currently hold a controlling interest in three publicly traded subsidiaries: Magic Software, Matrix and Sapiens. In addition, we wholly own nextSource. We consolidate the results of operations of our subsidiaries in which we hold a controlling interest with ours. Our operating results are, and have been, directly influenced by the consolidation and cessation of consolidation of our subsidiaries. This could cause significant fluctuations of our consolidated operating results. As a result, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and you should not rely on these comparisons as indications of our future performance.

We recognize revenues in two categories: the delivery of software services and the delivery of proprietary software solutions. All of our subsidiaries, including IT services companies and proprietary software solutions companies, recognize revenues from the delivery of software services, and most of them recognize revenues in both revenue categories. We have separated our subsidiaries into these categories in accordance with the category in which each subsidiary has earned most of its revenues.

We recognize, in non-operating income, gains and losses arising from the sale of previously un-issued capital stock by a subsidiary or an affiliate to outside investors, if the sale changes our ownership percentage in this entity. We measure the gain or loss by the difference between our share in the proceeds from the stock offering and the carrying amount, on an equity basis, of the proportionate reduction in our investment. Transactions of this nature do not occur on a regular basis and it is difficult for us to predict their timing.

Our functional and reporting currency

Beginning in 2007, Formula changed its functional currency from NIS to the dollar since most of its assets are denominated in dollars and Formula has no outstanding NIS loans. This, according to indicators as mentioned in Financial Accounting Standards Board Statement no. 52 Foreign Currency Translation, referred to SFAS 52. Prior to 2007, Formula operated primarily in the economic environment of the New Israeli Shekel (NIS) and its functional currency was the NIS. The functional currencies of Formula's subsidiaries are the NIS and the dollar. Formula has elected to use the dollar as its reporting currency.

Formula translates the financial statements of its subsidiaries whose functional currency is the NIS, into dollars, under the principles described in SFAS 52. Assets and liabilities have been translated at period-end exchange rates. Results of operations have been translated at the exchange rate at the dates on which those transactions occurred or at an average rate. We present differences resulting from translation under shareholders' equity in the item accumulating other comprehensive income (loss). In the consolidation, Formula presents the financial statements of subsidiaries whose functional currency is the dollar, at the original amounts.

The comparative figures for 2006 have been measured under the assumption that Formula's functional currency was the NIS. The financial statements of prior years of Formula and most of its subsidiaries whose functional currency is the NIS have been translated into dollars under the principles described in SFAS 52.

Critical Accounting Policies

In preparation of our financial statements, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

The revenue recognition policy of each of our significant subsidiaries is material because our revenue is a key component of our results of operations. Our revenue recognition determines the timing of certain expenses, such as commissions and royalties. We follow very specific and detailed guidelines in measuring revenue; however, certain judgments affect the application of our revenue policy. Revenue results are difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in future operating losses. Should changes in conditions cause our subsidiaries' managements to determine that these guidelines are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

Revenues derived from direct software license agreements are recognized in accordance with Statement of Position (SOP) 97-2 Software Revenue Recognition (as amended by SOP 98-4 and SOP 98-9), upon delivery of the software when collection is probable, the license fee is

otherwise fixed or determinable and persuasive evidence of an arrangement exists.

SOP No. 97-2 generally requires revenue earned from software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements determined by the vendor's specific objective evidence, or VSOE, of fair value. Revenue is recognized under the residual method when VSOE of fair value exists for all undelivered elements and VSOE of fair value does not exist for all of the delivered elements, and when all SOP No. 97-2 criteria for revenue recognition are met, as described above. The VSOE of the undelivered elements -PCS (post contract support) is based on the price charged on PCS sold separately or renewed.

43

Generally there are no rights of return, price protection or similar contingencies in our subsidiaries' contracts. Accordingly, they do not establish a provision due to the lack of warranties' claims in the past. Some of our subsidiaries' contracts include customer acceptance clauses. In determining whether revenue can be recognized, when an acceptance clause exists, they consider their history with similar arrangements, the customer's involvement in the progress, the existence of other service providers and the payments terms.

We recognize revenues from projects based on SOP 81-1 Accounting for Performance of Construction Type and Certain Production Type Contracts, using contract accounting on a percentage of completion method, based on the relationship of actual costs incurred to total costs estimated to be incurred over the duration of the contract. Provision for estimated losses on uncompleted contracts is made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract. If our subsidiaries do not accurately estimate the resources required or the scope of work to be performed, or do not manage their projects properly within the planned periods of time or satisfy their obligations under the contracts, then future margins may be significantly and negatively affected or losses on existing contracts may need to be recognized. Any such resulting reductions in margins or contract losses could be material to our results of operations. Our subsidiaries recognize contract losses, if any, in the period in which they first become evident.

We recognize revenues from consulting fees with respect to projects billed on a time and material basis, based on the number of hours performed. The VSOE for consulting services in multiple element arrangements is established based on the price charged when the consulting services are sold separately based on a time and material basis.

Revenues from contractual maintenance contract and training are recognized ratably over the contract period.

Revenues from sales of hardware are recognized when the merchandise is delivered to the customer, provided no significant vendor obligations remain.

Capitalized Software Research and Development Costs

Development costs of software that is intended for sale that were incurred after the establishment of technological feasibility of the relevant product, are capitalized. Technological feasibility is determined by our subsidiaries when detailed program design is completed and verified in accordance with the provisions of the FASB Statement of Financial Accounting Standards No. 86 (SFAS 86). Software development costs incurred by our subsidiaries before technological feasibility is established are charged to the statement of operations as incurred net of participation of the Office of the Chief Scientist (OCS). Our subsidiaries' policy on capitalized software costs determines the timing of our recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or capitalized costs. Our subsidiaries' management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. Amortization of capitalized software development costs begins when the product is available for general release to customers. Annual amortization is computed by the straight-line method, over the remaining useful life of the product, or based on the ratio of current gross revenues to current and anticipated future gross revenues, whichever is higher. Currently, amortization is computed by the straight-line method over a period of 3 to 5 years. Our subsidiaries' failure to accurately predict the useful life of capitalized software could cause a one-time amortization, which could adversely affect our operating results.

44

Impairment of Goodwill and Intangible Assets

Our business acquisitions resulted in goodwill and other intangible assets. We periodically evaluate our goodwill, intangible assets, and investments in affiliates for potential impairment indicators. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of our acquired businesses and investments.

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In accordance with FASB Statement of Financial Accounting Standards No. 142 Goodwill and Other intangible Assets, or SFAS 142, indefinite life intangible assets and goodwill are not amortized but rather subject to annual impairment testing.

Goodwill is tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is generally determined using discounted cash flows, market multiples and market capitalization. Significant estimates used in the fair value methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples of the reportable unit. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our goodwill and intangible assets. These write downs, if any, may have an adverse affect on our operating results. Future events could cause us to conclude that impairment indicators exist and that additional intangible assets associated with our acquired businesses are impaired.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

Long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-lived Assets, or SFAS 144, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of assets held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

45

Spin-off of the Investment in Formula Vision

According to APB No. 29 Accounting for Nonmonetary Transactions, a spin off is accounted as a decrease in the company's retained earnings and measured according to the book value of the investment as of the spin-off date.

Discontinued Operation

Under SFAS 144, when a component of an entity, as defined in SFAS 144, has been disposed of or is classified as held for sale, the results of its operations, including the gain or loss on its disposal should be classified as discontinued operations and the assets and liabilities of such component should be classified as assets and liabilities attributed to discontinued operations. The operations, assets and liabilities of the component would be eliminated from the company's consolidated operations and the company will no longer have any significant continuing involvement in the operations of the component.

Share-Based Payments

Effective January 1, 2006, we adopted Statement of Financial Accounting Statement No. 123 (revised 2004), Share-Based Payment, referred to as SFAS 123(R), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation, or SFAS 123, which requires the measurement and recognition of compensation expense based on estimated fair values for all shared based payments awards made to employees and directors. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or SAB 107, relating to SAFS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

SFAS 123(R) requires us to estimate the fair value equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the awards that is ultimately expected to vest is recognized as an expense over the requisite service periods in our consolidated statement of operations. Prior to the adoption of SFAS 123(R), we accounted for equity based awards under the fair value recognition provisions of SFAS 123.

We adopted SFAS 123(R) using the Modified Prospective Method. Under that transition method, compensation cost recognized in the year ended December 31, 2007 included: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of the SFAS 123(R).

Beginning on the date of adoption of SFAS 123(R), we estimate forfeitures based on historical experience and other factors.

A. Operating Results***Year Ended December 31, 2008 Compared to Year Ended December 31, 2007***

Revenues. Revenues increased 20% from \$493.4 million in 2007 to \$590.8 million in 2008. Revenues from the two categories of our operation were as follows: Revenues from the delivery of software services increased 24% from \$392.5 million in 2007 to \$485.4 million in 2008. This increase was attributable to the growth in Matrix's and nextSource's revenues due to an increased demand for their services. Revenues from the sale of proprietary software solutions in 2008 were \$105.4 million compared to \$100.8 million in 2007. This increase was attributable primarily to increase in Magic Software's revenues.

Cost of Revenues. Cost of revenues consists primarily of wages and related expenses and hardware and other materials costs. Cost of revenues increased 23% from \$369.1 million in 2007 to \$452.3 million in 2008. As a percentage of revenues, cost of revenues were relatively at the same level in 2007 and in 2008, 75% and 76%, respectively. Our software services sales are generally characterized by a lower gross margin than sales of proprietary software solutions. Cost of revenues for proprietary software solutions were \$53.5 million in 2008 and \$52.9 million in 2007. Cost of revenues for software services increased 26% from \$316.1 million in 2007 to \$398.9 million in 2008, primarily due to the increase in the cost of revenues of our subsidiaries Matrix and nextSource.

Software Development Costs, net. Software development costs consist primarily of wages and related expenses and, to a lesser degree, consulting fees we pay to independent contractors engaged in research and development. Software development costs, net, consist of software development costs, gross, less capitalized software costs. Software development costs, gross, in 2008 and 2007 were \$13.2 million and \$12.6 million, respectively. In 2008, we capitalized software costs of \$6.7 million compared to \$6.2 million in 2007. Capitalization of software costs in 2008 was attributable to our proprietary software solutions subsidiaries. Software development costs, net, were \$6.6 million and \$6.5 million, in 2008 and 2007, respectively. As a percentage of revenues, software development costs, net decreased from 1.3% in 2007 to 1.1% in 2008. Software development costs in 2008 were attributable primarily by Magic Software and Sapiens which had research and development expenditures of approximately \$2.3 million and \$3.9 million, respectively. Amortization of capitalized software costs was \$7.2 million in 2008 and \$6.4 million in 2007, which amounts were included in cost of revenues.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of salaries, severance and related expenses, travel expenses, selling expenses, rent, utilities, depreciation, amortization and professional fees. Selling, general and administrative expenses in 2008 and 2007 were \$98.7 million and \$90.5 million, respectively. As a percentage of revenues, selling, general and administrative expenses were 16.7% in 2008 and 18.3% in 2007. The increase in selling, general and administrative expenses was attributable to an increase in selling, general and administrative expenses of all of our subsidiaries.

Operating Income. Our operating income increased from \$27.2 million in 2007 to \$33.4 million in 2008. The operating income in 2008 was attributable to the improvement in the operating results of all of our subsidiaries, and in particular Matrix which had operating income of \$27.9 million, Magic Software which had operating income of \$4.3 million and Sapiens which had operating income \$2.5 million. The operating income in 2007 was attributable to the improvement in the operating results of our subsidiaries, and in particular Matrix which had operating income of \$24.5 million, Magic Software which had operating income of \$1.3 million and Sapiens which had operating income of \$800,000.

Financial Expenses, net. Financial expenses, net increased from \$3.8 million in 2007 to \$6.0 million in 2008. Financial expenses, net, is influenced by various factors, including our cash balances, loan balances, changes in the exchange rate of the NIS against the dollar, changes in the exchange rate of the dollar against the euro and changes in the Israeli CPI. Financial expenses, net in 2008 are attributable to interest expenses incurred by our subsidiaries, Matrix and Sapiens, which had financial expenses of \$6.6 million and \$2.0 million, respectively, resulting from issuance of debentures. These expenses were primarily offset by financial income in Formula which resulted from interest derived from short-term and long-term deposits and exchange rate differentials.

Other expenses, net. Other expenses, net in 2008 and 2007 were \$580,000 and \$750,000, respectively.

Gain (Loss) on Realization of Shareholdings. Loss on realization of shareholdings in 2008 was \$337,000 compared to a gain of \$2.0 million in 2007.

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Taxes on Income. Taxes on income in 2008 were \$3.5 million compared to \$1.9 million in 2007. The increase in taxes on income in 2008 was mainly attributable to the increase in taxes of Matrix.

Company's Equity in Results of Affiliates, net. Our equity in losses of affiliates, net were \$216,000 in 2008 compared to \$653,000 in 2007. Equity in losses of affiliates in 2007 was attributable primarily to equity in losses of affiliates of Matrix.

Minority Interest, net. Minority interest, net, includes the minority interest in companies which are not wholly owned by the Formula Group during each of the periods indicated. Minority interest in profits of subsidiaries in 2008 was \$10.8 million compared to \$9.7 million in 2007. This increase was primarily attributable to the improvement in the results of Magic Software and Sapiens.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Revenues. Revenues increased 18% from \$416.8 million in 2006 to \$493.4 million in 2007. Revenues from the two categories of our operation were as follows: Revenues from the delivery of software services increased 23% from \$320.0 million in 2006 to \$392.5 million in 2007. This increase was attributable to the growth in Matrix's and nextSource's revenues due to an increased demand for their services. Revenues from the sale of proprietary software solutions in 2007 were \$100.8 million compared to \$96.9 million in 2006. This increase was attributable to increase in Magic Software's revenues which were offset by a decrease in Sapiens's revenues.

48

Cost of Revenues. Cost of revenues increased 19% from \$309.4 million in 2006 to \$369.1 million in 2007. As a percentage of revenues, cost of revenues were relatively at the same level in 2006 and in 2007, 74% and 75%, respectively. Cost of revenues for proprietary software solutions were \$52.9 million in 2007 and \$53.8 million in 2006. Cost of revenues for software services increased 24% from \$255.6 million in 2006 to \$316.1 million in 2007, primarily due to the increase in the cost of revenues of our subsidiaries Matrix and nextSource.

Software Development Costs, net. Software development costs, gross, in 2007 and 2006 were \$12.6 million and \$14.0 million, respectively. In 2007, we capitalized software costs of \$6.2 million compared to \$8.5 million in 2006. Capitalization of software costs in 2007 was attributable to our proprietary software solutions subsidiaries. Software development costs, net, increased from \$5.5 million in 2006 to \$6.5 million in 2007. As a percentage of revenues, software development costs, net remained at the same level of 1.3% in 2006 and 2007. The increase in software development costs was attributable primarily to Magic Software and Sapiens which had research and development expenditures of approximately \$2.7 million and \$3.5 million, respectively. Amortization of capitalized software costs was \$6.4 million in 2007 and \$8.9 million in 2006, which amounts were included in cost of revenues.

Selling, General and Administrative Expenses. Selling, general and administrative expenses in 2007 and 2006 were \$90.5 million and \$88.8 million, respectively. As a percentage of revenues, selling, general and administrative expenses were 18.3% in 2007 and 21.3% in 2006. The increase in selling, general and administrative expenses was primarily attributable to an increase in selling, general and administrative expenses of Matrix which was offset by a decrease in selling, general and administrative expenses of Sapiens and Magic Software.

Restructuring Costs. We had no restructuring costs in 2007. Restructuring costs in 2006 were \$2.9 million and were primarily attributable to restructuring activities of Magic Software, which had restructuring costs of \$2.1 million, and Sapiens which had restructuring costs of \$758,000. The restructuring costs of Magic Software resulted mainly from severance payments paid in connection with the restructuring and impairment plan announced by Magic Software in the third quarter of 2006, which aimed to reduce costs and improve profitability.

Operating Income. Our operating income increased from \$10.1 million in 2006 to \$27.2 million in 2007, a 59% increase. The operating income in 2007 was attributable to the improvement in the operating results of all of our subsidiaries, and in particular Matrix which had operating income of \$24.5 million, Magic Software which had operating income of \$1.3 million and Sapiens which had operating income \$800,000. The operating income in 2006 was attributable to the improvement in the operating results of our subsidiaries, and in particular Matrix which had operating income of \$19.2 million and a decrease in the net operating loss of Sapiens, which had operating loss of \$1.3 million. This improvement was offset by the operating loss of \$6.7 million of Magic Software.

Financial Expenses, net. Financial expenses, net decreased from \$4.6 million in 2006 to \$3.8 million in 2007. Financial expenses, net in 2007 were attributable to interest expenses incurred by our subsidiaries, Matrix and Sapiens, which had financial expenses of \$2.1 million and \$2.8 million, respectively, resulting from issuance of debentures. These expenses were offset by financial income in Formula which resulted from interest derived from short-term deposits and exchange rate differentials.

49

Other income (expenses), net. Other expenses, net in 2007 and 2006 were \$750,000 and \$1.1 million, respectively.

Gain on Realization of Shareholdings. Gain on realization of shareholdings in 2007 was \$2.0 million compared to \$3.7 million in 2006. Gain on realization of shareholdings in 2007 was primarily attributable to a gain from a decrease in our shareholding in Sapiens due to a private placement consummated by Sapiens. Gain on realization of shareholdings in 2006 was attributable primarily to the sale by Matrix of its holdings in Matrix-1 One Ltd. and the decrease in the percentage of shareholdings by Matrix of its subsidiary, Tiltan, which resulted in aggregate consideration of approximately \$4.0 million.

Taxes on Income. Taxes on income in 2007 were \$1.9 million compared to \$3.8 million in 2006. The decrease in taxes on income in 2007 was mainly attributable to the decrease in taxes of Matrix.

Company's Equity in Results of Affiliates, net. Our equity in losses of affiliates, net were \$653,000 in 2007 compared to a gain of \$47,000 in 2006. Equity in losses of affiliates in 2006 was attributable primarily to equity in losses of affiliates of Matrix.

Minority Interest, net. Minority interest in profits of subsidiaries in 2007 was \$9.7 million compared to \$4.8 million in 2006. This increase was primarily attributable to the improvement in the results of all of our subsidiaries, and, in particular, Matrix, Magic and Sapiens.

Impact of Inflation and Currency Fluctuations on Results of Operations

A significant portion of our worldwide sales is currently denominated in dollars and euros, while a substantial portion of our expenses, principally salaries and related personnel expenses, is in New Israeli Shekels (NIS). As a result, a decrease in the value of the dollar or euro relative to other foreign currencies, in particular the NIS would increase our operating costs and, therefore, could adversely affect our results and harm our competitive position in the markets. In recent periods, the value of the dollar and the euro decreased significantly in relation to the NIS. We cannot know whether this trend will continue in the future. If the dollar or euro value in relation to the NIS continues to decrease, our operating costs would increase, and in turn, our results of operation may be harmed. To date, we have not engaged in significant hedging transactions. In the future, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of the dollar or euro against the NIS. However, we cannot assure you that these measures will adequately protect us from material adverse effects arising from the impact of inflation in Israel.

50

Following is a summary of the most relevant monetary indicators for the reported periods:

For the year ended December 31,	Inflation rate in Israel	Devaluation of NIS against the US\$	Devaluation of euro against the US\$
	%	%	%
2006	(0.1)	(8.2)	(11.3)
2007	3.4	(8.7)	(11.7)
2008	3.8	(1.1)	5.6

B. Liquidity and Capital Resources

Since inception, we have financed our growth and business primarily through cash provided by operations and through public debt and equity offerings, as well as through private and public debt and equity offerings of our subsidiaries. In addition, we finance our business through short-term and long-term loans and borrowings available under our credit facilities.

Cash

At December 31, 2008 we had cash and cash equivalents and short-term investments of \$156.8 million and at December 31, 2007, we had cash and cash equivalents and short-term investments of \$201.8 million. At December 31, 2008, we had indebtedness to banks and others of \$27.4 million, of which \$10.7 million were current liabilities and \$16.6 million were long-term liabilities. At December 31, 2007, we had indebtedness to banks and others of \$50.6 million, of which \$27.0 million were current liabilities and \$23.7 million were long-term liabilities.

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Formula received a loan of approximately \$3 million from the First International Bank of Israel Ltd which is secured by a pledge on a portion of our shareholdings in one of our subsidiaries. Our subsidiaries maintain credit facilities with banks in accordance with their cash requirements. These credit facilities include, inter alia, certain covenants related to their operations, such as maintaining a minimum level of shareholders' equity and reaching certain operating results targets. Some of our subsidiaries' assets are pledged to the lender banks. If any of our subsidiaries does not meet the covenants specified in its credit agreement, and a waiver with respect to the fulfillment of such covenant has not been received from the lender bank, the lender bank may foreclose on the pledged assets to satisfy the debt.

Cash flow provided by operating activities in 2008 was \$47.4 million compared to cash flow provided by operating activities of \$43.2 million in 2007. Cash flow provided by operating activities in 2008 was primarily comprised of \$27.9 million provided by Matrix, \$9.8 million by Sapiens and \$7.7 million by Magic Software. Cash flow provided by operating activities in 2007 was primarily comprised of \$23.2 million provided by Matrix, \$7.1 million by Sapiens and \$7.9 million by Magic Software.

Financing activities

Cash flow used by financing activities in 2008 was \$59.8 million compared to cash flow provided in financing activities of \$12.9 million in 2007. This was mainly the result of the following transactions:

51

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 2008, Matrix distributed to its shareholders a cash dividend in the aggregate amount of approximately \$11.3 million, of which \$5.6 million was received by Formula.

During 2008, Matrix repaid long-term loans to banks of approximately \$10.2 million.

During 2008, certain of our subsidiaries repaid short-term loans to banks of approximately \$15.2 million, of which \$6.7 million was repaid by Matrix, and \$5.0 million was repaid by Sapiens and \$3.4 million was repaid by Magic Software.

In 2008, Sapiens re-purchased an aggregate amount of NIS 7.6 million nominal value of its debentures, representing approximately \$2.1 million. In addition, Sapiens paid to its debenture holders \$3.5 million, representing the third payment of the principal of the debentures (Series A).

In August 2007, Matrix completed an offering of debentures to institutional and other investors in Israel, in an aggregate principal amount of approximately \$62.0 million (NIS 250 million). In 2008, Matrix re-purchased an aggregate amount of NIS 47.7 million nominal value of its debentures, representing approximately \$12.6 million.

In June 2007, Sapiens entered into a private placement investment transaction with several institutional investors, private investors and Formula for an aggregate gross investment amount of \$20 million (excluding finders' fees and out of pocket expenses), \$6.5 million of which was by Formula.

In 2007, Matrix distributed to its shareholders a cash dividend in the aggregate amount of approximately \$14.1 million, of which \$6.4 million was received by Formula.

During 2007, Formula and certain of our subsidiaries repaid long-term loans to banks of approximately \$61.6 million, of which \$50.9 million was repaid by Formula and \$9.4 million was repaid by Matrix.

During 2007, Formula and certain of our subsidiaries repaid short-term loans to banks of approximately \$16.9 million, of which \$5.4 million was repaid by Formula, \$4.8 million was repaid by Matrix and \$4.6 million was repaid by Sapiens.

In 2007, Sapiens re-purchased an aggregate amount of NIS 15 million nominal value of its debentures, representing approximately \$3.5 million. In addition, Sapiens paid to its debentures holders \$4.4 million representing the second payment of the principal of the debentures (Series A).

52

Recent financing activities

In January 2009, Formula distributed to its shareholders a cash dividend of \$2.27 per share, previously declared in December 2008. The aggregate amount distributed by Formula was \$30 million.

Investing activities

In 2008, net cash used in investing activities was \$41.0 million and in 2007, net cash used by investing activities was \$18.8 million. These investing activities were comprised of the following transactions:

In 2008, we purchased in the open market shares of several of our subsidiaries as follows: 217,127 shares of Matrix for aggregate consideration of \$800,000, 2,392,531 shares of Magic Software for aggregate consideration of \$4.5 million and 3,442,836 shares of Sapiens for aggregate consideration of \$6.3 million.

In 2008, Matrix purchased 25% of the outstanding shares of its subsidiary Tangram Soft Ltd. for an aggregate consideration of \$4.7 million.

In 2008, our subsidiaries capitalized software development costs and other costs in an aggregate amount of \$6.7 million.

In 2008, Matrix and Magic Software purchased marketable securities for aggregate consideration of \$7.2 million and \$1.0 million, respectively.

On December 30, 2007, Magic Software entered into an agreement, to sell its wholly-owned subsidiary, AAOD, a Florida corporation, to Fortissimo Capital, for \$17 million. Magic Software received \$1.0 million of the sale proceeds in December 2007 and \$16.0 million in March 2008.

In 2008, our subsidiary Matrix purchased all the shares of TACT Computers and Systems Ltd. for an aggregate consideration of \$12.5 million.

In June 2007, we completed the sale of our entire shareholdings in BluePhoenix to international institutional investors for aggregate consideration of approximately \$64 million.

In 2007, we purchased in the open market shares of several of our subsidiaries as follows: 1,231,563 shares of Matrix for aggregate consideration of \$4.3 million, 503,473 shares of Magic Software for aggregate consideration of \$1.0 million and 195,107 shares of Sapiens for aggregate consideration of \$326,535.

In 2007, Matrix purchased marketable securities for aggregate consideration of \$26.3 million.

In 2007, our subsidiaries capitalized software development costs and other costs in an aggregate amount of \$8.5 million.

We believe that our available cash revenues, together with cash flows from operating activities, will be sufficient to meet our cash needs for at least the next 12 months at the current level of operations. We will consider in the future additional equity issuances, debt issuances or borrowings from banks if necessary to meet cash needs for our growth. Should we require additional financing in the future, we cannot assure you that such financing will be available on favorable terms or at all.

Commitments and Contingent Liabilities

Formula received a loan of approximately \$3 million from the First International Bank of Israel Ltd which is secured by a pledge on a portion of our shareholdings in one of our subsidiaries. Some of our subsidiaries have floating charges in favor of banks and other financial institutions. In addition, some of our subsidiaries have liens on leased vehicles, leased equipment and other assets in favor of the leasing companies.

Other Contractual Commitments

We entered into an undertaking to indemnify our office holders in specified limited categories of events and in specified amounts, subject to certain limitations. For more information, see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Indemnification of Office Holders.

Effective Corporate Tax Rates in Israel

Law for the Encouragement of Capital Investments, 1959

Certain of the companies in the Formula Group have been granted Approved Enterprise status under the Law for the Encouragement of Capital Investments, 1959, known as the Investment Law. Accordingly, if these companies comply with certain requirements, they are eligible for certain tax benefits for the first seven years in which they generate taxable income. Income derived from these companies' Approved Enterprise programs will be tax exempt for a period of two years after the companies have taxable income. They will also be subject to a 25% company tax rate for the following five years. Under certain circumstances, if the percentage of the share capital that foreign shareholders hold in subsidiaries and affiliates of these companies exceeds 25%, future Approved Enterprises of the applicable subsidiary or affiliate would qualify for reduced tax rates for an additional three years, after the seven years mentioned above. We cannot assure you that these companies will obtain approval for additional Approved Enterprises, that the provisions of the Investment Law will not change, or that the above-mentioned shareholding portion will be reached or maintained for each subsequent year.

On April 1, 2005, the Israeli Parliament passed an amendment to the Investment Law, in which it revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment will qualify for benefits as a privileged enterprise (rather than the previous terminology of approved enterprise). Among other things, the amendment provides tax benefits to both local and foreign investors and simplifies the approval process. If the investment programs of the Formula Group companies comply with the requirements of the law, they will be entitled to certain tax benefits. We cannot assure you that any additional investment program adopted by any of these companies in the future will comply with the requirements of the law or that the tax benefits for investment programs continue at current levels.

54

Corporate Tax

Following the tax reform enacted in 2003, an Israeli company is subject to tax on its worldwide income. An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid by the subsidiary in its country of residence. Israeli tax payers are also subject to tax on income from a controlled foreign corporation, according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary, if such subsidiary's primary source of income is a passive income (such as interest, dividends, royalties, rental income, or capital gains).

On January 1, 2006, an additional tax reform took place relating primarily to profits from investments. The main goal of the reform was to unify the tax rates applicable to profits from investments, such as interest, capital gains, and dividends. In addition, under the new reform, the tax rates applicable to companies were reduced to 27% in 2008, 26% in 2009, and 25% from 2010 and on.

Our international operations are taxed at the local effective corporate tax rate in the countries of our subsidiaries' residence. In the future we may derive an increasing percentage of our income from operations outside of Israel. If that occurs, our effective tax rate may increase. However, we expect that this increase will be offset by carried forward accumulated losses of consolidated companies.

C. Research and Development, Patents and Licenses

The net amount we spent on research and development activities in 2008 and 2007 remain at the same level and totaled \$6.6 and \$6.5 million, respectively. In 2006, we spent \$5.5 million. The increase in the amount spent on research and development activities in 2007 compared to 2006 relates primarily to an increase in research and development expenditures of Sapiens. For more information about our research and development activities, see Item 4. Information on the Company Business Overview Software Development.

For information concerning our intellectual property rights, see Item 4. Information on the Company Business Overview Intellectual Property Rights.

D. Trend Information

The recent global economic and financial market crisis has caused, among other things, a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, and reduced corporate profits and capital spending, all of which have had and will continue to have a negative effect on our business, results of operations and financial condition.

55

Demand for our products and services depends in large part upon the level of IT capital spending and investment in IT projects by our customers. The current economic conditions have reduced the willingness or ability of our customers and prospective customers to commit funds to IT projects, and may reduce their ability to pay for our products and services after purchase, whether as a result of possible customer insolvencies or otherwise. This has already resulted in a longer sales cycles and increased pressure on pricing. We cannot predict the timing or duration of the global economic crisis or the timing or strength of any subsequent economic recovery. We also cannot know how the economic conditions will affect our business. As we continue to market new products and penetrate international markets, we expect our selling, general and administrative expenses to continue to be relatively high.

E. Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our contractual obligations and commitments as of December 31, 2008.

	Payments due by period					Other (1)
	Total	Less than 1 year	1-3 years	3-5 Years	More than 5 years	
\$ in thousands						
Long-term debt obligations (2)	84,995	13,290	40,867	30,838	-	-
Lease obligations	42,039	18,419	19,408	2,122	-	-
Liability in respect of the acquisition of activities	7,964	6,954	420	420	170	-
Other long-term liabilities reflected on our balance sheet under U.S. GAAP	11,712	-	-	-	-	11,712
Total	\$ 146,710	\$ 38,663	\$ 60,695	\$ 35,470	\$ 170	\$ 11,712

- (1) Other obligations include severance pay which was not funded by the Company, the due date of which is unknown.
(2) Does not include interest.

56

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**A. Directors and Senior Management**

The following table describes information about our directors and senior management as of April 20, 2009.

Name	Age	Position
Guy Bernstein	41	Chief Executive Officer
Naamit Salomon	44	Chief Financial Officer
Naftali Shani	59	Chairman of the Board
Shimon Laor	42	Director
Tal Barnoach	46	Director
Hadas Gazit Kaiser	33	Director
Dr. Shlomo Nass	49	Director
Dr. Ronnie Vinkler ⁽¹⁾	63	Director
Ofer Lavie ⁽¹⁾	64	Director

(1) Outside director under the Companies Law. See Item 6. Directors, Senior Management and Employees Board Practices Outside Directors; Audit Committee; Internal Auditor; Approval of Certain Transactions Under the Companies Law, below.

Guy Bernstein was appointed our chief executive officer in January 2008. Mr. Bernstein served as a member of our board of directors from November 2006 to December 2008. Since December 2006, Mr. Bernstein has served as chief executive officer of Emblaze, our controlling shareholder, a publicly-traded company listed on the AIM, the London Stock Exchange. Mr. Bernstein also serves as a director of Sapiens and he is the chairman of the board of Matrix and Magic Software. From April 2004 to December 2006, Mr. Bernstein served as the chief financial officer of Emblaze. He has served as a director of Emblaze since April 2004. Prior thereto, Mr. Bernstein served as the chief financial and operations officer of Magic Software, a position he held since 1999. He joined Magic Software from Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, where he acted as senior manager from 1994 to 1997. Mr. Bernstein holds a B.A. degree in accounting and economics from Tel Aviv University and is a certified public accountant in Israel.

Naamit Salomon has served as our chief financial officer since 1997. Ms. Salomon also serves as a director of Magic Software and Sapiens. From 1990 through August 1997, Ms. Salomon was a controller of two large, privately-held companies in the Formula Group. Ms. Salomon holds a B.A. degree in economics and business administration from Ben Gurion University and an LL.M. degree from the Bar-Ilan University.

Naftali Shani has served as chairman of our board of directors since January 2009. Mr. Shani also serves as the chairman of the board of directors of Emblaze, our controlling shareholder. Prior to founding Emblaze, Mr. Shani served as general manager of Bartrade Ltd., a subsidiary of Bank Leumi, one of Israel's leading banks and as general manager of the Israeli Chemical Company, Pazchem. Prior thereto, Mr. Shani was the treasurer and controller of the Israeli Prime Minister's office. Mr. Shani holds a B.A. degree in economics.

Shimon Laor has served as one of our directors since November 2006. He also served as a director of Emblaze and as its chief financial officer from 1995 to 2000. Since then, he has been engaged in private business initiatives. Mr. Laor also serves as a director of Emblaze VCON Ltd., a partially-owned subsidiary of Emblaze. Prior to joining Emblaze in August 1995, Mr. Laor served as an economist at the head office foreign currency division of the First International Bank of Israel. Mr. Laor holds a B.A. degree in economics and accounting from Tel Aviv University.

Tal Barnoach has served as one of our directors since November 2006. Since 1994, Mr. Barnoach has served as chairman and chief executive officer of S.E.A. Multimedia. In addition, from 2002 to 2006, he served as the chief executive officer of BeInSync, a company he co-founded in 2002. Mr. Barnoach also serves as the executive vice chairman of zone IP of Emblaze. Since 1999, Mr. Barnoach has served as chairman of Orca Interactive Ltd. Mr. Barnoach holds a B.A. degree in economics from Tel Aviv University.

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Hadas Gazit Kaiser has served as one of our directors since March 2007. Ms. Gazit Kaiser also serves as the chief financial officer of Magic Software since January 2009. Ms. Gazit Kaiser has served as the chief financial officer and finance director of Emblaze from December 2006 until December 2008. During 2005 and 2006, she served as the vice president, finance of Emblaze and the chief financial officer of Emblaze Mobile. From 2003 to 2005, Ms. Gazit Kaiser served as the budget control manager of TTI Team Telecom International Ltd., a NASDAQ-listed company. Prior thereto, Mrs. Gazit Kaiser acted as a manager at Kost, Forer Gabbay & Kasierer. Mr. Gazit Kaiser is a director of Magic Software, Sapiens, Matrix and Rad View Software Ltd. Ms. Gazit Kaiser holds a B.A. degree in economics and accounting and an M.B.A. degree in finance, both from Tel Aviv University, and she is a certified public accountant in Israel.

Dr. Shlomo Nass has served as one of our directors since April 2003. Dr. Nass is a senior partner at Dr. Shlomo Nass and Co. Ltd., and a president of and a partner in I.G.B. Israel Global Business, an investment group. Mr. Nass performed various public duties and serves as a director of I.G.B., IRS-TKB International Consultants Ltd., Mivnei Taasiya Ltd., TAO, N.M.C., Yuli Shukei Hon Ltd., The Azure Beach Development Company (Tel Aviv-Herzliya) Ltd., Shir Lak Ltd., M.D.K. Touch Ltd. and Haniman Enterprises Ltd. Mr. Nass holds a B.Sc. degree in economics and accounting, an LL.B. degree, and a Ph.D degree in law, all from Bar-Ilan University. He is a certified public accountant in Israel and a member of the Israel Bar.

Dr. Ronnie Vinkler has served as one of our outside directors since March 2007. Dr. Vinkler is an independent business development and management analysis consultant. Dr. Vinkler also serves as a director of Kaman Capital Ltd. In 2002 and 2003, Dr. Vinkler served as general manager of Icom Mobile (Israel). From 2000 to 2002, he served as general manager of B.I.S. Advanced Software Solutions Ltd. Since 2003, Dr. Vinkler has been in charge of business development with several companies like Tesnet, Aman Computers and more. Dr. Vinkler holds a B.Sc. degree in aeronautical engineering and industrial engineering and management from the Technion, Israel Institute of Technology, and a M.Sc. and Ph.D in aeronautical engineering from Caltech, California Institute of Technology.

Ofar Lavie has served as one of our outside directors since March 2007. Mr. Lavie is an independent financial business development consultant. From 1999 to 2005, Mr. Lavie served as the chief financial officer of Metalink Ltd., a public company listed on the NASDAQ Global Market and the TASE. Mr. Lavie also serves as a director of Yozma Pension Fund for Self Employed Ltd., a Migdal Group fund, and of Alpa Cosmetics Ltd. Mr. Lavie also serves as an outside director of Procognia (Israel) Ltd., a public company traded on the TASE and Shaniv Paper Industries Ltd. In addition, Mr. Lavie serves as the chief executive officer of the Education Center in the CFO Forum in Israel. Mr. Lavie holds a B.Sc. degree in economics from Tel Aviv University.

58

B. Compensation

In 2008, Formula paid to its directors and officers (nine persons) aggregate direct remuneration of approximately \$804,000. This amount includes amounts set aside or accrued to provide post-employment benefits.

This amount does not include the following:

amounts expended by us for automobiles made available to Formula's officers;

expenses, including business travel, professional and business association dues and expenses, that Formula reimburses its officers for; and

other fringe benefits that companies in Israel commonly reimburse or pay to their officers.

The amount also includes payment of director's fees to Formula's outside directors and Mr. Shlomo Nass. Formula compensates its outside directors in accordance with the regulations promulgated under the Israeli Companies Law, 1999, referred to as the Companies Law. Formula compensates Mr. Shlomo Nass in such amounts specified in the regulations.

Formula's employee directors do not receive fees for their services as directors. In 2008, Formula paid an aggregate amount of \$26,960 for post-employment benefits for Formula's executive officers and directors. Under Israeli law, Formula is not required to disclose, and has not otherwise disclosed, the compensation of its senior management and directors on an individual basis.

Generally, we enter into written employment agreements with our executive officers pursuant to which, among other things, we pay them a monthly salary in an agreed amount. The salary is linked to the Israeli CPI. Each party may terminate the agreement upon up to 6 months prior

notice. If we terminate any of these employment agreements, we will have to pay the usual severance pay required under Israeli law for all employees.

In December 2008, our chief executive officer, Mr. Guy Bernstein, ceased to serve as a member of our board of directors. His service agreement with us was terminated and replaced by a new agreement, the terms of which have been approved by our board of directors, as required under Israeli law.

59

Under his new service agreement, Mr. Guy Bernstein continues to be entitled to an annual bonus, previously approved by our audit committee, board of directors and shareholders, in an amount equal to 3.3% of our net profit (including capital gains) after tax. An advance of 70% of the bonus is paid quarterly, based on our quarterly financial statements, subject to final adjustment at the end of each year.

Under his former service agreement, Mr. Bernstein was granted, for his services as a director, options to purchase 198,000 ordinary shares, each exercisable at an exercise price of NIS 60 per share (not linked to the CPI) (approximately \$16.35). In June 2008, Mr. Bernstein waived his right to receive such options. For information regarding additional options to purchase ordinary shares granted to Mr. Bernstein, see Item 6.E. Share Ownership below.

C. Board Practices

Pursuant to our articles of association, directors are elected at the annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented at the meeting. Our board is comprised of 7 persons, of which the following three have been determined by the board to be independent within the meaning of the applicable NASDAQ requirements: Shlomo Nass, Ronnie Vinkler and Ofer Lavie. The board includes two outside directors mandated under Israeli law and subject to additional criteria to help ensure their independence. See Outside Directors below. Each director, except for the outside directors, holds office until the next annual general meeting of shareholders. Officers are appointed by our board of directors. For information regarding the employment agreements of our officers, see Item 6. Directors, Senior Management and Employees Compensation.

Companies trading on The NASDAQ Global Market are generally required to have a majority of their board members be independent. We are exempt from this requirement under the controlled company exemption because more than 50% of our voting power is held by Emblaze.

Under a recent amendment to the Companies Law, a person who lacks the necessary qualifications and the ability to devote an appropriate amount of time to the performance of his or her duties as a director shall not be appointed director of a publicly traded company and shall not serve as a director of such company. While determining a person's compliance with such provisions, the company's special requirements and its scope of business shall be taken into consideration. Where the agenda of a shareholders meeting of a publicly traded company includes the appointment of directors, each director nominee should submit a declaration to the company confirming that he or she has the necessary qualifications and he or she is able to devote an appropriate amount of time to performance of his duties as a director. In the declaration, the director nominee should specify his or her qualifications and confirm that the restrictions set out in the Companies Law, do not apply.

60

Under the Companies Law, if a director ceases to comply with any of the requirements provided in the Companies Law, such director must notify the company immediately about it, and his term of service shall terminate on the date of the notice.

Outside Directors under the Companies Law

Under the Companies Law, companies incorporated under the laws of Israel whose shares have been offered to the public in or outside of Israel, are required to appoint at least two outside directors. This law provides that a person may not be appointed as an outside director if the person or the person's relative, partner, employer, another person to whom he was directly or indirectly subject, or any entity under the person's control, has, as of the date of the person's appointment to serve as outside director, or had, during the two years preceding that date, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term affiliation includes:

an employment relationship;

a business or professional relationship maintained on a regular basis;

control; and

service as an office holder.

No person may serve as an outside director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as an outside director or may otherwise interfere with the person's ability to serve as an outside director or if the person is an employee of the Israel Securities Authority or of an Israeli stock exchange. If, at the time of election of an outside director, all other directors are of the same gender, the outside director to be elected must be of the other gender. Outside directors are to be elected by a majority vote at a shareholders' meeting, provided that either:

the majority of shares voted at the meeting, including at least one-third of the shares of non-controlling shareholders voted at the meeting, vote in favor of election of the director; or

the total number of shares of non-controlling shareholders voted against the election of the director does not exceed one percent of the aggregate voting rights in the company.

Pursuant to the Companies Law, all outside directors must have financial and accounting expertise or professional qualifications, and at least one outside director must have financial and accounting expertise. The terms "financial and accounting expertise" and "professional qualifications" are defined in regulations promulgated under the Companies Law. Our audit committee member, Ronnie Vinkler, is considered to have the required professional qualifications and Shlomo Nass has financial and accounting expertise.

61

If an outside director ceases to comply with any of the requirements provided in the Companies Law with respect to the appointment of outside directors, such outside director must notify the company immediately about it, and his term of service shall terminate on the date of the notice.

The initial term of an outside director is three years and may be extended by the general meeting of shareholders, for an additional three years. In March 2007, Mr. Ronnie Vinkler and Mr. Ofer Lavie were appointed as our outside directors, each to hold office until March 2010. In accordance with the Israeli Companies Regulations (Alleviation for Public Companies Whose Shares are Listed on a Stock Exchange Outside of Israel) 2000, dual listed companies, like us, may re-appoint an outside director for additional three-year terms, above the maximum six-year term permitted under the Companies Law, if the audit committee and the board of directors confirm that due to the expertise and special contribution of the outside director to the work of the board and its committees, his re-appointment is in the best interests of the company.

Each committee of a company's board of directors is required to include at least one outside director and the audit committee must include all the outside directors.

An outside director is entitled to compensation as provided in regulations promulgated under the Companies Law and is otherwise prohibited from receiving any compensation, directly or indirectly, in connection with services provided as an outside director.

Independent Directors Under the Companies Law

Under a recent amendment to the Companies Law, a publicly traded company may prescribe in its articles of association that its board of directors shall include independent directors in such number or such percentage as to be provided in the articles. An "independent director" is defined as a director who meets all of the following:

the audit committee confirms that he or she meets the qualifications for being appointed as an outside director, except for the requirement for financial and accounting expertise or professional qualifications; and

he or she has not served as a director of the company for a period exceeding nine consecutive years. For this purpose, a break of up to two years in the service shall not be deemed to interrupt the continuation of the service.

The Companies Law provides that if the company has no controlling shareholder or a shareholder that holds at least 25% of the voting rights in the company, most of the members of the board shall be independent directors. If the company has a controlling shareholder or a shareholder that holds at least 25% of the voting rights therein, at least one-third of the directors shall be independent directors.

As of the date of this annual report, our articles of association have not yet been amended to include the new provisions of the Companies Law relating to independent directors.

Qualifications of Other Directors Under the Companies Law

Under the Companies Law, the board of directors of a publicly traded company is required to make a determination as to the minimum number of directors who must have financial and accounting expertise according to criteria that is defined in regulations promulgated under the Companies Law, effective as of January 2006. In accordance with the Companies Law, the determination of the board should be based on, among other things, the type of the company, its size, the volume and complexity of its activities and the number of directors. Based on the foregoing considerations, our board determined that the number of directors with financial and accounting expertise in our company shall not be less than one.

Audit Committee

The Companies Law requires public companies to appoint an audit committee, comprised of at least three directors, including all of the outside directors. The chairman of the board of directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee.

In addition, under applicable NASDAQ rules, we are currently required to have at least three independent directors and to maintain an audit committee, whose members are independent of management. We have established an audit committee, consisting of our two outside directors, Ronnie Vinkler and Ofer Lavie, as well as Shlomo Nass. Each audit committee member qualifies as an independent director under the applicable NASDAQ rules and those of the SEC. The board has determined that Shlomo Nass is an audit committee financial expert as defined by applicable SEC regulations. See Item 16. Audit Committee Financial Expert.

Under the Companies Law, the audit committee is responsible for overseeing the business management practices of the company in consultation with the company's internal auditor and the independent auditor, making recommendations to the board to improve such practices and approving related party transactions as required by the Companies Law. In accordance with the Sarbanes-Oxley Act and NASDAQ requirements, our audit committee is directly responsible for the appointment, compensation, retention and oversight of our independent auditors, subject to shareholder approval as required under Israeli law. In addition, the audit committee is responsible for assisting the board in monitoring our financial statements and the effectiveness of our internal controls. We have adopted a formal audit committee charter that we have implemented, embodying these responsibilities.

Internal Auditor

Under the Companies Law, the board of directors must appoint an internal auditor, nominated by the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Companies Law, the internal auditor may be an employee of the company but not an office holder, or an interested party (*i.e.*, a holder of 5% or more of the voting rights in the company or of the issued share capital, the chief executive officer of the company or any of its directors, or a person who has the authority to appoint the company's chief executive officer or any of its directors), or a relative of an office holder or of an interested party. In addition, the company's independent auditor or its representative may not serve as the company's internal auditor.

Exculpation, Insurance and Indemnification of Directors and Officers

Under the Companies Law, an Israeli company may not exempt an office holder from liability with respect to a breach of his duty of loyalty, but may exempt in advance an office holder from his liability to the company, in whole or in part, with respect to a breach of his duty of care, provided, however, that such a breach is not related to a distribution of a dividend or any other distribution by the company.

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Office Holders Insurance. Our articles of association provide that, subject to the provisions of the Companies Law, we may enter into a contract for the insurance of the liability of any of our office holders imposed on the office holder in respect of an act performed in his or her capacity as an office holder, with respect to:

a breach of his duty of care to us or to another person;

a breach of his duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his act would not prejudice our interests; or

a financial liability imposed upon him in favor of another person.

We have obtained an insurance policy covering the Formula Group's directors' and officers' liability. Our subsidiaries participate in the premium payments of the insurance, on a proportional basis. The total premium we paid during 2008 was approximately \$200,000.

Indemnification of Office Holders. Our articles of association provide that we may indemnify an office holder in respect of an obligation or expense imposed on or expended by an office holder in respect of an act performed in his capacity as an office holder as specified below:

- (i) a financial liability imposed on him in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court;
- (ii) reasonable litigation expenses, including attorney's fees, expended by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against him, and either (i) concluded without the imposition of any financial liability in lieu of criminal proceedings; or (ii) concluded with the imposition of a financial liability in lieu of criminal proceedings but relates to a criminal offense that does not require proof of criminal intent; and

64

- (iii) reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him by a court, in proceedings instituted against him by another person, or in a criminal charge from which he was acquitted or in any criminal proceedings of a crime which does not require proof of criminal intent in which he was convicted.

We may undertake to indemnify an office holder as aforesaid, (a) prospectively, provided that in respect of (i) above, the undertaking is limited to categories of events that in the opinion of our board of directors are foreseeable in light of the company's operations at the time that the undertaking to indemnify is given, and for an amount or criteria that our board has determined as reasonable under the circumstances, and further provided that such events and amount or criteria are indicated in the indemnification undertaking, but in any event no more than 25% of Formula's shareholders equity according to its most recent financial statements as of the date of the actual payment of indemnification; and (b) retroactively.

Limitations on Exemption, Insurance and Indemnification. The Companies Law provides that a company may not indemnify an office holder, enter into an insurance contract which would provide coverage for any monetary liability, or exempt an office holder from liability, with respect to any of the following:

a breach by the office holder of his duty of loyalty unless the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;

a breach by the office holder of his duty of care if the breach was done intentionally or recklessly, except for a breach that was made in negligence;

any act or omission done with the intent to derive an illegal personal benefit; any fine levied against the office holder; or

a counterclaim made by the company or in its name in connection with a claim against the company filed by the office holder.

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In addition, under the Companies Law, indemnification of, and procurement of insurance coverage for, our office holders must be approved by our audit committee and our board of directors and, in specified circumstances, by our shareholders.

We have entered into an undertaking to indemnify our office holders in specified limited categories of events and in specified amounts, subject to the limitations set by the Companies Law and our articles of association, as described above. For more information, see Item 7.B. Related Party Transactions – Indemnification of Office Holders.

Approval of Certain Transactions Under the Companies Law

The Companies Law codifies the fiduciary duties that office holders, including directors and executive officers, owe to a company. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of loyalty includes (i) avoiding any conflict of interest between the office holder's position in the company and his personal affairs, (ii) avoiding any competition with the company, (iii) avoiding exploiting any business opportunity of the company in order to receive personal advantage for himself or others, and (iv) revealing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder. Each person listed in the table under Directors and Senior Management above is an office holder. Under the Companies Law, arrangements regarding the compensation of directors require the approval of the audit committee, the board of directors and shareholder approval.

65

The Companies Law requires that an office holder of a company promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction as defined under the Companies Law, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing. In addition, the office holder must also disclose any interest held by any corporation in which the office holder owns 5% or more of the share capital, is a director or general manager or in which he or she has the right to appoint at least one director or the general manager. An extraordinary transaction is defined as a transaction other than in the ordinary course of business, otherwise than on market terms, or that is likely to have a material impact on the company's profitability, assets or liabilities.

Under the Companies Law, after the office holder complies with the disclosure requirements described above, only board approval is required for any transaction which is not an extraordinary transaction, unless the articles of association of the company provide otherwise, and provided the transaction is not adverse to the company's interest. If the transaction is an extraordinary transaction, the company must receive any approval stipulated by the articles of association, the approval of the company's audit committee and the approval of the board of directors, as well as, under certain circumstances, approval by a meeting of the shareholders of the company. An office holder who has a personal interest in a matter which is considered at a meeting of the board of directors or the audit committee may not be present at this meeting or vote on this matter unless the majority of the board members or members of the audit committee, as applicable, have a personal interest in such matter and in such case, the matter should also be approved by the shareholders of the company.

The Companies Law applies the same disclosure requirements to a controlling shareholder of a public company, which includes a shareholder that holds 25% or more of the voting rights in the company if no other shareholder owns more than 50% of the voting rights in the company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and the terms of compensation of a controlling shareholder or its relative who is an office holder or an employee of the company, require the approval of the audit committee, the board of directors and the shareholders of the company. The shareholder approval must include at least one-third of the shareholders who have no personal interest in the transaction and are voting on the subject matter or, alternatively, the total shareholdings of those who have no personal interest in the transaction who vote against the transaction must not represent more than one percent of the voting rights in the company. In certain cases provided in regulations promulgated under the Companies Law, shareholder approval is not required.

66

The approvals of the board of directors and shareholders is required for a private placement of securities (or a series of related private placements during a 12-month period or that are part of one continuous transaction or transactions conditioned upon each other) in which:

the securities issued represent at least 20% of the company's actual voting power prior to the issuance of such securities, and such issuance increases the relative holdings of a 5% shareholder or causes any person to become a 5% shareholder, and the consideration in the transaction (or a portion thereof) is not in cash or in securities listed on a recognized stock exchange, or is not at a fair market value;
or

a person would become, as a result of such transaction, a controlling shareholder of the company.

D. Employees

We have approximately 5,500 full-time employees, of whom approximately 4,730 are software professionals. Most of our employees are located in Israel and the other in the United States, Europe and other places abroad. In 2007, we had approximately 4,950 full-time employees, of whom approximately 4,260 were software professionals. In 2006, we had approximately 5,290 full-time employees, of whom approximately 4,550 were software professionals. The increase in the number of employees in 2008 compared to 2007 related primarily to the increase in the number of employees in Matrix and nextSource, which was offset by a decrease in the number of employees in Magic Software and Sapiens. The decrease in the number of employees in 2007 compared to 2006 related primarily to the decrease in the number of employees in Magic Software, Sapiens and ,in particular, nextSource, which was offset by an increase in the number of employees in Matrix.

With respect to our employees in Israel, we are subject to various Israeli labor laws and labor practices, and to administrative orders extending certain provisions of collective bargaining agreements between the Histadrut (Israel's General Federation of Labor) and the Coordinating Bureau of Economic Organizations (the Israeli federation of employers' organizations) to all private sector employees. For example, mandatory cost of living adjustments, which compensate Israeli employees for a portion of the increase in the Israeli consumer price index, are determined on a nationwide basis. Israeli law also requires the payment of severance benefits upon the termination, retirement or death of an employee. We meet this requirement by (i) contributing on an ongoing basis towards managers' insurance funds that combine pension, insurance and, if applicable, severance pay benefits and (ii) payment of differences, if applicable. In addition, Israeli employers and employees are required to pay specified percentages of wages to the National Insurance Institute. Other provisions of Israeli law or regulation govern matters such as the length of the workday, minimum wages, other terms of employment and restrictions on discrimination. We are also subject to the labor laws and regulations of other jurisdictions in the world where we have employees.

67

E. Share Ownership

As of April 20, 2009, none of our directors and officers had a share ownership in our company, nor did they hold options to purchase shares, except for Mr. Guy Bernstein, our chief executive officer, as described below.

Mr. Bernstein was granted, for his services as a director, options to purchase 198,000 ordinary shares, each exercisable at an exercise price of NIS 60 per share (approximately \$16.35). In June 2008, Mr. Bernstein waived his right to receive such options.

In January 2009, we granted to Mr. Bernstein, in connection with his new service agreement, options to purchase 396,000 ordinary shares. These options vest over a three-year period, commencing on December 17, 2008, on a quarterly basis. The exercise price of the options is NIS 0.01 per share. The options shall expire six years of the date of grant. As of April 20, 2009, Mr. Bernstein is the beneficial owner of less than 1% of our outstanding share capital (including options exercisable within 60 days of this annual report).

Arrangements Involving the Issue or Grant of Options to Purchase Shares

Formula's 2008 Share Option Plan

In March 2008, our shareholders approved the adoption of Formula's 2008 Employee and Office Holders Share Option Plan, referred to as the plan. Pursuant to the plan, we may grant from time to time to our and our subsidiaries' employees and office holders (which are not Formula's controlling shareholders) options to purchase up to 400,000 ordinary shares of Formula. The plan is administered by our board of directors. The plan provides that options may be granted, from time to time, to such grantees to be determined by the board, at an exercise price and under such terms to be determined at their sole and absolute discretion. Options may be granted under the plan through January 2018.

Of the options available for grant under the plan, we granted in January 2009, options to purchase 396,000 ordinary shares to our chief executive officer, each exercisable at an exercise price of NIS 0.01. For more information, see Item 6.B. Compensation.

Option Plans of Our Subsidiaries

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Our operating subsidiaries generally have share option plans pursuant to which qualified directors, employees and consultants may be granted options for the purchase of securities in these subsidiaries. In addition, these subsidiaries may from time to time grant options to third parties as part of a business transaction.

68

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

The following table presents information regarding the ownership of Formula's ordinary shares at April 20, 2009 by each person known to us to be the beneficial owner of more than 5% of Formula's ordinary shares based on information provided to us by the holders or disclosed in public filings with the SEC. None of the holders of the ordinary shares listed in this table have voting rights different from other holders of Formula's ordinary shares. Except where indicated otherwise, we believe, based on information furnished by these owners, that the beneficial owners of Formula's shares listed below have sole investment and voting power with respect to the shares.

Name and Address	Shares Beneficially Owned	Percent of Class ⁽¹⁾
Emblaze Ltd. ⁽²⁾	6,820,091	51.7%
Menora Mivtachim Holdings Ltd. ⁽³⁾	1,141,360 ⁽⁴⁾	8.6%
Clal Insurance Enterprises Holdings Ltd. ⁽⁵⁾	1,202,967 ⁽⁶⁾	9.12%

- (1) Ordinary shares deemed beneficially owned by virtue of the right of any person or group to acquire these ordinary shares within 60 days of April 20, 2009, are treated as outstanding only for the purposes of determining the percent owned by this person or group. Percentages in the above table are based on 13,200,000 ordinary shares outstanding as of April 20, 2009.
- (2) In November 2006, Emblaze Ltd., referred to as Emblaze, purchased from FIMGold LP all of its shareholdings in Formula, *i.e.* 33.4% of our outstanding share capital. Since then and until April 20, 2009, Emblaze purchased additional shares of Formula in the open market and in privately negotiated transactions, bringing its holdings in Formula to 51.7%. Emblaze is a public company traded on the main list of the London Stock Exchange. The major shareholders of Emblaze, based on publicly available and other information (*i.e.*, persons that hold 5% or more of the share capital of the Emblaze) are Naftali Shani, the chairman of the board of directors of Emblaze (who holds approximately 13.9% of the outstanding share capital of Emblaze) and Eli Reifman, vice-chairman of the board of directors of Emblaze (who holds approximately 13.55% of the outstanding share capital of Emblaze), Fortissimo Capital Management Ltd. (that holds approximately 16% of the outstanding share capital of Emblaze), Schroders Plc (that holds approximately 15% of the outstanding share capital of Emblaze) and Donald Sturm (who holds approximately 8.9% of the outstanding share capital of Emblaze).
- (3) Menora Mivtachim Holdings Ltd. is a holding company publicly-traded on the TASE. 61.86% of Menora Mivtachim Holdings' outstanding shares are held, directly and indirectly, by Menachem Gurevitch, and 38.14% are publicly held.
- (4) Pursuant to Amendment No. 2 to Schedule 13D filed on March 19, 2009.
- (5) Clal Insurance Enterprises Holdings Ltd., referred to as Clal Insurance, is publicly traded on the TASE. The controlling shareholder of Clal Insurance is IDB Development Corporation Ltd. (57.53%) and Bank Hapoalim Ltd. holds a 9.95% interest in Clal Insurance.
- (6) Pursuant to Schedule 13G/A filed on February 13, 2009, of the 1,202,967 shares reported as beneficially owned by Clal Insurance (i) 1,202,265 shares are held for members of the public through, among others, provident funds, mutual funds, pension funds and insurance policies, which are managed by subsidiaries of Clal Insurance, each of which subsidiaries operates under independent management and makes independent voting and investment decisions; and (ii) 702 shares are held by third-party client accounts managed by Clal Finance Batucha Investment Management Ltd., a wholly owned subsidiary of Clal Finance Ltd., as portfolio managers, which operates under independent management and makes investment decisions independent of Clal Insurance and Clal Finance.

69

As of April 20, 2009, 13,200,000 ordinary shares were issued and outstanding, excluding 24,780 ordinary shares that we purchased during 2002. On April 20, 2009, we had approximately 2 shareholders of record. All of our ordinary shares have equal voting rights. However, under applicable Israeli law, the shares we hold have no voting rights and, therefore, are excluded from the number of our outstanding shares.

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As of April 20, 2009, 564,066 ADSs were issued and outstanding pursuant to a depositary agreement with The Bank of New York, representing 564,066 of our ordinary shares. As of that date, there were approximately 25 registered holders of ADSs in the United States.

B. Related Party Transactions

Indemnification of Office Holders

In December 2005, the general meeting of shareholders approved the grant of new indemnification letters to office holders following the amendment of the Companies Law adopted in March 2005 and the changes in articles of association approved by the general meeting in December 2005.

The indemnification letters provide, among other things, that will indemnify each of office holders to the maximum extent permitted by articles of association. Advance payments for coverage of legal expenses in criminal proceedings will be required to be repaid by office holders to the company if such office holder is found guilty of a crime which requires proof of criminal intent, or if it is determined that the office holder is not lawfully entitled to such indemnification.

All of the indemnification letters granted to office holders are identical, including indemnification letters granted to office holders who are or may be considered controlling persons under the Companies Law.

The indemnification is limited to the expenses and matters detailed in the indemnification letters insofar as they result from the office holder's actions which includes, among other things, the following matters: the offering of securities by us to the public or to private investors; the offer by us to purchase securities from the public, private investors or other holders, whether pursuant to a prospectus, agreement, tender or any other proceeding; occurrences resulting from being a public company, or from the fact that our securities were offered to the public and traded on the NASDAQ and on the TASE; and occurrences in connection with investments.

Our undertaking for indemnification is limited to up to 25% of our shareholders' equity as it appears in our latest financial statements known at the date of indemnification.

70

Our undertaking for indemnification shall not apply to a liability incurred as a result of any of the following:

- (i) a breach by the office holder of his or her duty of loyalty, unless the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- (ii) a breach by the office holder of his or her duty of care if the breach was done intentionally or recklessly;
- (iii) any act or omission done with the intent to derive an illegal personal benefit; or
- (iv) any fine levied against the office holder.

We shall not be required to indemnify an office holder, if the office holder, or anyone on its behalf, already received payment in respect of a liability subject to indemnification, under an effective insurance coverage or an effective indemnification arrangement with a third party, provided, however, that if such payment made to the office holder does not cover the entire liability subject to the indemnification, we shall indemnify the office holder in respect of the difference between the amount paid to the office holder and the liability subject to the indemnification.

Office Holders Insurance

We have obtained an insurance policy covering the Formula Group's directors' and officers' liability. Our subsidiaries participate in the premium payments of the insurance, on a proportional basis. The total premium Formula paid during 2008 was approximately \$200,000.

Other Transactions

From time to time, in our ordinary course of business, we engage in transactions with our subsidiaries and affiliates. We believe that these agreements are made on an arms length basis upon terms and conditions no less favorable to us, our subsidiaries and affiliates, as we could obtain from unaffiliated third parties. If we engage with our subsidiaries and affiliates in transactions which are not in the ordinary course of business, we receive the approvals required under the Companies Law. These approvals include audit committee approval, board approval and, in certain circumstances, shareholder approval. See Item 6.C. Board Practices.

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

Financial Statements

Our consolidated financial statements and other financial information are incorporated herein by reference to Item 18. Financial Statements below.

Legal Proceedings

We are not involved in any proceedings in which any of our directors, members of our senior management or any of our affiliates is either a party adverse to us or to our subsidiaries or has a material interest adverse to us or to our subsidiaries. We are also not involved in any legal proceedings which may have, or have had in the recent past, significant effects on our financial position or profitability.

Dividend policy

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, will be distributed to the shareholders as a cash dividend, to the extent that our performance allows such distribution. In recent years, Formula has made the following distributions:

In January 2009, Formula distributed to its shareholders a cash dividend of \$2.27 per share, previously announced in December 2008. 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 of 36,696,000 shares of Formula Vision held by Formula and 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 in the amount of approximately \$4 per ordinary share, or approximately \$50.2 million in the aggregate.

B. Significant Changes

There has been no material change in our financial position since December 31, 2008.

ITEM 9. THE OFFER AND LISTING**A. Offer and Listing Details***Price Range of Ordinary Shares*

The following table sets forth the high and low closing price for our ordinary shares on the TASE, for the periods indicated. The exchange rate reported by the Bank of Israel on April 20, 2009 was NIS 4.207 = \$1.00.

Period	Closing Price Per Share	
	High	Low
	in NIS	
2004	98.40	61.83
2005	89.65	46.84
2006	60.15	39.99
2007	60.59	44.97
First Quarter	54.39	46.99
Second Quarter	60.07	52.05
Third Quarter	60.59	48.85
Fourth Quarter	57.68	44.97
2008	47.78	17.53
First Quarter	47.78	37.30
Second Quarter	34.69	24.08
Third Quarter	28.58	22.52
Fourth Quarter	36.09	17.53
October	36.19	27.39
November	27.85	20.17
December	23.88	17.53
2009		
First Quarter	31.05	16.16
January	31.05	16.76
February	18.55	16.22
March	19.17	16.16
April (through April 20)	20.19	19.10

73

Price Range of American Depositary Shares

The following table sets forth, for the periods indicated, the high and low closing sale prices for the ADSs, as reported by the NASDAQ Global Market.

Period	Closing Price Per Share	
	High	Low
	in \$	
2005	20.44	11.00

Period	Closing Price Per Share	
2006	14.00	9.15
2007	15.42	9.02
First Quarter	12.80	11.43
Second Quarter	15.27	12.69
Third Quarter	14.75	11.78
Fourth Quarter	15.42	9.02
2008	14.14	4.99
First Quarter	14.14	10.9
Second Quarter	13.32	9.48
Third Quarter	10.78	9.20
Fourth Quarter	11.01	4.99
October	11.01	7.44
November	7.60	5.40
December	6.53	4.99
2009		
First Quarter	8.00	3.59
January	8.00	4.02
February	4.65	3.90
March	4.62	3.59
April (through April 20)	4.89	4.55

B. Plan of Distribution

Not applicable.

C. Markets

Since our initial public offering in 1991, our ordinary shares have been traded in Israel on the TASE under the symbol FORT. No U.S. trading market exists for the ordinary shares. Since October 1997, our ADSs have been traded on the NASDAQ Global Market, under the symbol FORTY.

Pursuant to NASDAQ Marketplace Rule 4350(a), we notified NASDAQ that with respect to the quorum for shareholders meetings, we follow Israeli law and practice and accordingly do not follow NASDAQ rules. The quorum for a shareholders meeting, as stipulated in our articles of association, complies with the provisions of the Israeli law, and requires the presence, in person or by proxy of holders of 25% of our outstanding ordinary shares, in lieu of the requirement specified in NASDAQ Marketplace Rule 4350(e) pursuant to which the quorum for any shareholders meeting shall not be less than 33% of the outstanding voting shares of the company.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We are registered with the Israeli Companies Register under the number 52-003669-0. Our objects are specified in our memorandum of association. These objects include:

operating within the field of informational and computer systems;

providing management, consulting and sale services for computers, computer equipment, software for computers and for information systems;

the business of systems analysis, systems programming and computer programming; and

establishing facilities for instruction and training for computers and digital systems.

Description of Our Share Capital

Our company's share capital consists of ordinary shares. Our articles of association do not restrict in any way the ownership of our ordinary shares by non-residents, except that these restrictions may exist with respect to citizens of countries which are in a state of war with Israel.

75

Dividend and Liquidation Rights

Our board of directors is authorized to declare dividends, subject to the provisions of the Companies Law. Dividends on our ordinary shares may be paid only out of profits and other surplus, as defined in the Companies Law, as of the end date of the most recent financial statements or as accrued over a period of two years, whichever is higher. Alternatively, if we do not have sufficient profits or other surplus, then permission to effect a distribution can be granted by order of an Israeli court. In any event, our board of directors is authorized to declare dividends, provided there is no reasonable concern that the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. Dividends may be paid in cash or in kind. We may invest or use for our own benefit all unclaimed dividends. If dividends remain unclaimed for seven years from the date we declared the dividend they lapse and revert back to us. Our board of directors can cause us to pay the dividend to a holder who would have been entitled if the dividend had not reverted back to us. In case of liquidation, after satisfying liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to their holdings. This right may be affected by the grant of a preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future. Under the Companies Law, the declaration of a dividend does not require the approval of the shareholders of the company, unless the company's articles of association require otherwise. Our articles of association provide that our board of directors may declare and pay dividends without any further action of our shareholders.

Redemption Provisions

In accordance with our articles of association, we may issue redeemable shares and accordingly redeem those shares.

Voting, Shareholder Meetings and Resolutions

Holders of our ordinary shares have one vote for each ordinary share held on all matters submitted to the vote of shareholders. These voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future. Under the Companies Law, shares held by the company are not entitled to any rights so long as they are held by the company.

We must hold an annual general meeting once a year with a maximum period of fifteen months between the meetings. All other meetings of shareholders other than annual general meetings are considered special general meetings. Our board of directors may call a special general meeting whenever it decides it is appropriate. In addition, shareholders representing 5% of the outstanding share capital may require the board of directors to call a special general meeting. The quorum required for a general meeting of shareholders consists of two or more holders present in person or by proxy who hold or represent at least 25% of the voting power. A meeting adjourned for a lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the chairman of the meeting may decide with the consent of the holders of a majority of the voting power represented at the meeting in person or by proxy and voting on the question of adjournment. At the reconvened meeting, if a quorum is not present within half an hour from the time appointed for holding the meeting, the required quorum will consist of two shareholders present in person or by proxy.

Under the Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority, except in certain circumstances provided for under the Israeli law, which require a majority of at least 75% of the shares present at the meeting.

Shareholder Duties

Under the Companies Law, a shareholder has a duty to act in good faith towards the company in which he holds shares and towards other shareholders and to refrain from abusing his power in the company including voting in the general meeting of shareholders on:

- any amendment to the articles of association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of some of the acts and transactions which require shareholder approval.

A shareholder has the general duty to refrain from depriving rights of other shareholders. Any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder that, under the provisions of the articles of association, has the power to appoint an office holder in the company, is under a duty to act in fairness towards the company. The rules pertaining to a breach of contract apply to a breach of the duty to act in fairness, mutatis mutandis, bringing into account the shareholder's position in the company. The Companies Law does not describe the substance of this duty.

Transfer of Shares

Fully paid ordinary shares are issued in registered form and may be freely transferred under our articles of association unless the transfer is restricted or prohibited by another instrument.

Modification of Class Rights

Under our articles of association, the rights attached to any class unless otherwise provided by the terms of the class including voting, rights to dividends and the like, may be varied by adoption of the necessary amendment to the articles of association, provided that the affected shareholders approve the change by a class meeting in which a simple majority of the voting power of the class represented at the meeting and voting on the matter approves the change.

Election of Directors

Our ordinary shares do not have cumulative voting rights in the election of directors. As a result, the holders of ordinary shares that represent more than 50% of the voting power represented at a shareholders meeting, have the power to elect all of our directors, other than the outside directors which are appointed by a special majority of shareholders. For a summary of those provisions in our articles of association with respect to the directors, see Item 6. Directors, Senior Management and Employees.

Anti-Takeover Provisions; Mergers and Acquisitions Under Israeli Law

Mergers

The Companies Law permits merger transactions if approved by each party's board of directors and shareholders. In determining whether the required majority has approved the merger in the event of cross ownership between the merging companies, namely, if the merging company's shares are held by the other party to the merger, or by any person holding at least 25% of the means of control of the other party to the merger, then a vote against the merger by holders of the majority of the shares present and voting, excluding shares held by the other party to the merger or by such person, or anyone acting on behalf of either of them, including any of their affiliates, is sufficient to reject the merger transaction. In the event that the merger transaction has not been approved by the special majority described above, the holders of at least 25% of the voting rights of such company may apply to the court for approval of the merger. The court may approve the merger if it is found that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger. A merger may not be consummated unless at least 50 days have passed from the time that a proposal for approval of the merger has been filed with the Israeli Registrar of Companies and 30 days have passed from the date of the approval of the shareholders of the merging companies.

The Companies Law further provides that the foregoing approval requirements will not apply to shareholders of a wholly-owned subsidiary in a rollup merger transaction, or to the shareholders of the acquirer if:

the transaction does not involve an amendment to the acquirer's memorandum or articles of association;

the transaction does not contemplate the issuance of more than 20% of the voting rights of the acquirer which would result in any shareholder becoming a controlling shareholder; and

there is no cross ownership of shares of the merging companies, as described above.

Tender Offers

The Companies Law provides that an acquisition of shares of a public company must be made by means of a tender offer if as a result of the acquisition, the purchaser would become a holder of 25% or more of the voting rights in the company. This rule does not apply if there is already another holder of 25% or more of the voting rights in the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of more than 45% of the voting rights of the company, if there is no other holder of more than 45% of the voting rights of the company.

78

The foregoing provisions do not apply to:

a private placement in which the company's shareholders approved such holder owning 25% or more of the voting rights in the company (if there is no other shareholder that holds 25% or more of the voting rights in the company); or more than 45% of the voting rights in the company (if there is no other shareholder that holds 45% or more of the voting rights in the company); or

a purchase from an existing holder of 25% or more of the voting rights in the company that results in another person becoming a holder of 25% or more of the voting rights in the company or a purchase from an existing holder of more than 45% of the voting rights in the company that results in another person becoming a holder of more than 45% of the voting rights in the company.

Regulations adopted under the Companies Law provide that these tender offer requirements do not apply to companies whose shares are listed for trading outside of Israel if, according to the law in the country in which the shares are traded, including the rules and regulations of the stock exchange on which the shares are traded, there is either a limitation on acquisition of any level of control of the company, or the acquisition of any level of control requires the purchaser to do so by means of a tender offer to the public.

The Companies Law also provides that if following any acquisition of shares, the acquirer holds 90% or more of the company's shares or of a class of shares, the acquisition must be made by means of a tender offer for all the target company's shares or all the shares of the class, as applicable. An acquirer who wishes to eliminate all minority shareholders must do so by way of a tender offer and acquire 95% of all shares not held by or for the benefit of the acquirer before the acquisition. If, however, the tender offer to acquire 95% is not successful, the acquirer may not acquire shares tendered if by doing so the acquirer would own more than 90% of the shares of the target company.

C. Material Contracts

We consider the sale of our shareholdings of BluePhoenix as a material contract. For more information about this transaction, see Item 4. Information on the Company History and Development Capital Expenditures and Divestitures.

79

D. Exchange Controls

Under current Israeli regulations, we may pay dividends or other distributions in respect of our ordinary shares either in non-Israeli or Israeli currencies. If we make these payments in Israeli currency, they will be freely transferred in non-Israeli currencies at the rate of exchange prevailing at the time of conversion. We expect therefore, that dividends, if any, that we pay to holders of ADSs, will be paid in dollars, net of conversion expenses, expenses of the depositary, the Bank of New York, and Israeli income taxes. Because exchange rates between the NIS and the dollar fluctuate continuously, a U.S. shareholder will be subject to the risk of currency fluctuations between the date when we declare NIS-denominated dividends and the date when we pay them in NIS. See Item 3. Key Information Risk Factors.

Non-residents of Israel may freely hold and trade our ADSs or ordinary shares pursuant to the general permit issued under the Israeli Currency Control Law, 1978. Neither our articles of association nor the laws of the State of Israel restrict in any way the ownership of our ordinary shares by non-residents, except that these restrictions may exist with respect to citizens of countries which are in a state of war with Israel.

E. Taxation

Israeli Taxation

The following is a description of material tax consequences regarding the ownership and disposition of our ordinary shares and ADSs under Israeli tax laws to which U.S. and other non-Israeli shareholders may be subject. The information below does not apply to specified persons or cover specified situations. Therefore, you are advised to consult your own tax advisor as to particular tax consequences unique to you related to an investment in our ordinary shares or ADSs, including the effects of applicable Israeli or foreign or other tax laws and possible changes in the tax laws.

To the extent that the discussion is based on legislation yet to be judicially or administratively interpreted, we cannot assure you that the views we express herein will accord with any such interpretation in the future.

Tax Consequences Regarding Disposition of Our ADSs or Ordinary Shares

In general, Israel imposes capital gains tax on the sale of capital assets, including shares of Israeli companies by both Israeli residents and non-Israeli resident shareholders, unless a specific exemption is available or unless a tax treaty between Israel and the shareholders' country of residence provide otherwise. Shareholders that are not Israeli residents are generally exempt from Israeli capital gains tax on any gain derived from the sale of our ADSs or ordinary shares, provided that (i) such shareholders did not acquire the shares prior to our initial public offering; and (ii) such gains did not derive from a permanent establishment of such shareholders in Israel. However, non-Israeli corporations will not be entitled to the foregoing exemption if an Israeli resident (a) has a controlling interest of 25% or more in such non-Israeli corporation; or (b) is the beneficiary of or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

80

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In certain instances where our non-Israeli shareholders may be liable to Israeli tax on the sale of our ADSs or ordinary shares, the payment of the consideration may be subject to Israeli withholding tax.

In addition, in the case when the sale, exchange or disposition of our ADSs or ordinary shares by shareholders who are U.S. residents (within the meaning of the U.S.-Israel Tax Treaty) holding the ADSs or ordinary shares as a capital asset will be also exempt from Israeli capital gains tax under the U.S.-Israel Tax Treaty, unless, either (i) the shareholders hold, directly or indirectly, shares representing 10% or more of our voting shares during any part of the 12-month period preceding such sale, exchange or disposition; or (ii) the capital gains arising from such sale, exchange or disposition are attributable to a permanent establishment of the shareholders located in Israel. In such case, the shareholders would be subject to Israeli capital gains tax, to the extent applicable, as mentioned above. However, under the U.S.-Israel Tax Treaty, the U.S. resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed on the sale, exchange or disposition, subject to the limitation in the U.S. law applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

Taxes Applicable to Dividends

Nonresidents of Israel are generally subject to Israeli income tax on the receipt of dividends paid on our ADSs or ordinary shares at the rate of 20%, or 15% for dividends or income generated by an approved enterprise, which tax will be withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence.

However, the tax rate on dividends paid to a substantial shareholder (which is someone who alone, or together with another person, holds, directly or indirectly, at least 10% in one or all of any of the means of control in the corporation) is 25%.

Under Israeli tax law, a distribution of dividends from income attributable to an Approved Enterprise will be subject to tax in Israel at the rate of 15%, which is withheld and paid by the company paying the dividend, if the dividend is distributed during the benefits period or within the following 12 years (but the 12-year limitation does not apply to a Foreign Investors Company). Any distribution of dividends from income that is not attributable to an Approved Enterprise after January 1, 2006, will be subject to tax in Israel at the rate of 20%.

Under the U.S.-Israel Tax Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ADSs or ordinary shares who is a U.S. resident (within the meaning of the U.S.-Israel Tax Treaty) is 25%. However, dividends paid from income derived from our Approved Enterprise are subject to withholding at the rate of 15%, although we cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders' tax liability according to the U.S.-Israel Tax Treaty. Furthermore, the maximum rate of withholding tax on dividends not generated by our Approved Enterprise, that are paid to a U.S. corporation holding 10% or more of our outstanding voting capital during the part of the tax year that precedes the date of the payment of the dividend and during the whole of its prior tax year, is 12.5%. This reduced rate will not apply if more than 25% of our gross income consists of interest or dividends, other than dividends or interest received from a subsidiary corporation, 50% or more of the outstanding voting shares of which are owned by the company.

81

A nonresident of Israel who receives dividends with respect of which tax was fully paid, is generally exempt from the duty to file returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer and the taxpayer has no other taxable sources of income in Israel.

United States Federal Income Tax Considerations

Subject to the limitations described herein, this discussion summarizes certain United States federal income tax consequences of the purchase, ownership and disposition of our ordinary shares or ADSs to a United States holder. A United States holder is a holder of our ordinary shares or ADSs who is:

an individual who is a citizen or resident of the United States for United States federal income tax purposes;

a corporation (or another entity taxable as a corporation for United States federal income tax purposes) created or organized under the laws of the United States, any political subdivision thereof, or the District of Columbia;

an estate, the income of which is subject to United States federal income tax regardless of its source; or

a trust (i) if, in general, a United States court is able to exercise primary supervision over its administration and one or more United States persons have the authority to control all of its substantial decisions, or (ii) that has in effect a valid election under

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applicable United States Treasury Regulations to be treated as a United States person.

Unless otherwise specifically indicated, this discussion does not consider the United States tax consequences to a person that is not a United States holder (a non-United States holder) and considers only United States holders that will own the ordinary shares or ADSs as capital assets (generally, for investment).

82

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the Code), current and proposed Treasury Regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with retroactive effect. This discussion does not address all aspects of United States federal income taxation that may be relevant to any particular United States holder based on the United States holder's individual circumstances. In particular, this discussion does not address the United States federal income tax consequences to United States holders who are broker-dealers, insurance companies, tax-exempt organizations, financial institutions, financial service entities, real estate investment trusts, regulated investment companies, grantor trusts, individual retirement and tax-deferred accounts, or who own, directly, indirectly or constructively, 10% or more of our outstanding voting shares, United States holders holding the ordinary shares or ADSs as part of a hedging, straddle or conversion transaction, United States holders whose functional currency is not the United States dollar, United States holders who acquired their shares upon the exercise of employee stock options or otherwise as compensation, certain former citizens or long-term residents of the United States and United States holders subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, the tax treatment of persons who are, or hold the ordinary shares or ADSs through, a partnership or other pass-through entity is not considered, nor is the possible application of United States federal estate or gift taxes or any aspect of state, local or non-United States laws.

You are advised to consult your tax advisor with respect to the specific United States federal, state, local and foreign tax consequences of purchasing, holding or disposing of our ordinary shares or ADSs.

83

Taxation of Distributions on the Ordinary Shares or ADSs

Subject to the discussion below under Tax Consequences if We Are a Passive Foreign Investment Company, a distribution paid by us with respect to the ordinary shares or ADSs to a United States holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for United States federal income tax purposes. The amount of the distribution with respect to the ordinary shares or ADSs will equal the amount of cash and the fair market value of any property distributed and will also include the amount of any non-U.S. taxes withheld from such distribution. Dividends that are received by United States holders that are individuals, estates or trusts will be taxed at the rate applicable to long-term capital gains (a maximum rate of 15% through taxable years beginning on or before December 31, 2010), provided that such dividends meet the requirements of qualified dividend income. For this purpose, qualified dividend income generally includes dividends paid by a non-U.S. corporation if certain holding period and other requirements are met and either (a) the stock of the non-U.S. corporation with respect to which the dividends are paid is readily tradable on an established securities market in the United States (e.g., the NASDAQ Global Market) or (b) the non-U.S. corporation is eligible for benefits of a comprehensive income tax treaty with the United States which includes an information exchange program and is determined to be satisfactory by the United States Secretary of the Treasury. The United States Internal Revenue Service (IRS) has determined that the United States-Israel income tax treaty is satisfactory for this purpose. Dividends that fail to meet such requirements, and dividends received by corporate United States holders, are taxed at ordinary income rates. No dividend received by a United States holder will be a qualified dividend (1) if the United States holder held the ordinary share or ADS with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code Section 246(c), any period during which the United States holder has an option to sell, is under a contractual obligation to sell, has made (and not closed) a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share or ADS (or substantially identical securities); or (2) to the extent that the United States holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share or ADS with respect to which the dividend is paid. If we were to be a passive foreign investment company (as such term is defined in the Code), or PFIC, for any taxable year, dividends paid on our ordinary shares or ADSs in such year or in the following taxable year would not be qualified dividends. See the discussion below regarding our PFIC status under Tax Consequences if We Are a Passive Foreign Investment Company. In addition, a non-corporate United States holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend income will be taxed at ordinary income rates.

The amount of any distribution which exceeds the amount treated as a dividend will be treated first as a non-taxable return of capital, reducing the United States holder's tax basis in its ordinary shares or ADSs to the extent thereof, and then as capital gain from the deemed disposition of the ordinary shares or ADSs. Corporate holders will not be allowed a deduction for dividends received in respect of the ordinary shares or ADSs.

84

Dividends paid by us in NIS generally will be included in the income of United States holders at the dollar amount of the dividend (including any non-U.S. taxes withheld therefrom), based upon the spot rate of exchange in effect on the date the distribution is received. United States holders will have a tax basis in NIS for United States federal income tax purposes equal to that dollar value. A United States holder that converts a dividend paid in NIS into United States dollars subsequent to receipt may have foreign exchange gain or loss arising from exchange rate fluctuations, which will generally be taxable as United States source ordinary income or loss.

Subject to the limitations set forth in the Code and the Treasury Regulations thereunder, United States holders may elect to claim as a foreign tax credit against their United States federal income tax liability, the non-U.S. income tax withheld from dividends received in respect of the ordinary shares or ADSs. The limitations on claiming a foreign tax credit include, among others, computation rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the United States federal income taxes otherwise payable with respect to each such class of income. In this regard, dividends paid by us generally will be foreign source passive income for U.S. foreign tax credit purposes. United States holders that do not elect to claim a foreign tax credit may instead claim a deduction for the non-U.S. income tax withheld if they itemize deductions. The rules relating to foreign tax credits are complex, and you should consult your tax advisor to determine whether and to what extent you would be entitled to this credit. A United States holder will be denied a foreign tax credit for non-U.S. income tax withheld from a dividend received on the ordinary shares or ADSs (i) if the United States holder has not held the ordinary shares or ADSs for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend or (ii) to the extent the United States holder is under an obligation to make related payments with respect to positions in substantially similar or related property. Any days during which a United States holder has substantially diminished its risk of loss on the ordinary shares or ADSs are not counted toward meeting the required 16-day holding period.

Taxation of the Disposition of the Ordinary Shares or ADSs

Subject to the discussion below under *Tax Consequences if We Are a Passive Foreign Investment Company*, upon the sale, exchange or other disposition of our ordinary shares or ADSs, a United States holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the United States holder's tax basis in the ordinary shares or ADSs. The gain or loss recognized on the disposition will be long-term capital gain or loss if the United States holder held the ordinary shares or ADSs for more than one year at the time of the disposition and non-corporate United States holders may be eligible for a reduced rate of taxation (currently a maximum rate of 15% for taxable years beginning on or before December 31, 2010). Capital gain from the sale, exchange or other disposition of ordinary shares or ADSs held for one year or less is short-term capital gain and taxed as ordinary income. Gain or loss recognized by a United States holder on a sale, exchange or other disposition of ordinary shares or ADSs generally will be treated as U.S. source income or loss for United States foreign tax credit purposes. The deductibility of capital losses is subject to certain limitations.

85

A United States holder that uses the cash method of accounting calculates the dollar value of the proceeds received on the sale as of the date that the sale settles. However, a United States holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A United States holder that uses the accrual method may avoid realizing foreign currency gain or loss by electing to use the settlement date to determine the proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a United States holder that receives foreign currency upon disposition of ordinary shares or ADSs and converts the foreign currency into dollars after the settlement date or trade date (whichever date the United States holder is required to use to calculate the value of the proceeds of sale) may have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the dollar, which will generally be United States source ordinary income or loss.

Tax Consequences if We Are a Passive Foreign Investment Company

We will be a passive foreign investment company, or PFIC, for a taxable year if either (1) 75% or more of our gross income in the taxable year is passive income; or (2) the average percentage (by value determined on a quarterly basis) in a taxable year of our assets that produce, or are held for the production of, passive income is at least 50%. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation's assets and as directly earning our proportionate share of the other corporation's income. If we are a PFIC, a United States holder must determine under which

of three alternative taxing regimes it wishes to be taxed:

The QEF regime applies if the United States holder elects to treat us as a qualified electing fund (QEF) for the first taxable year in which the United States holder owns our ordinary shares or ADSs or in which we are a PFIC, whichever is later, and if we comply with certain reporting requirements. If the QEF regime applies, then each year that we are a PFIC, such United States holder will include in its gross income a proportionate share of the our ordinary earnings (which is taxed as ordinary income) and net capital gain (which is taxed as long-term capital gain), subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. These amounts would be included in income by an electing United States holder for its taxable year in which our taxable year ends, whether or not such amounts are actually distributed to the United States holder. A United States holder's basis in our ordinary shares or ADSs for which a QEF election has been made would be increased to reflect the amount of any taxed but undistributed income. Generally, a QEF election allows an electing United States holder to treat any gain realized on the disposition of his ordinary shares or ADSs as capital gain.

86

Once made, the QEF election applies to all subsequent taxable years of the United States holder in which it holds our ordinary shares or ADSs and for which we are a PFIC, and can be revoked only with the consent of the IRS. The QEF election is made by attaching a completed IRS Form 8621, including the PFIC annual information statement, to a timely filed United States federal income tax return. Even if a QEF election is not made, a U.S. person who is a shareholder in a PFIC must file a completed IRS Form 8621 every year.

If a QEF election is made after the first taxable year in which a United States holder holds our ordinary shares or ADSs and we are a PFIC, then special rules would apply.

A second regime, the mark-to-market regime, may be elected so long as our ordinary shares or ADSs are marketable stock (e.g., regularly traded on the NASDAQ Global Market). Pursuant to this regime, an electing United States holder's ordinary shares or ADSs are marked-to-market for each taxable year that we are a PFIC and the United States holder recognizes as ordinary income or loss an amount equal to the difference as of the close of the taxable year between the fair market value of our ordinary shares or ADSs and the United States holder's adjusted tax basis therein. Losses are allowed only to the extent of net mark-to-market gain previously included by the United States holder under the election for prior taxable years. An electing United States holder's adjusted basis in our ordinary shares or ADSs is increased by income recognized under the mark-to-market election and decreased by the deductions allowed under the election.

Under the mark-to-market election, in a taxable year that we are a PFIC, gain on the sale of our ordinary shares or ADSs is treated as ordinary income, and loss on the sale of our ordinary shares or ADSs, to the extent the amount of loss does not exceed the net mark-to-market gain previously included, is treated as ordinary loss (losses in excess of net mark-to-market gain previously included are generally capital losses). The mark-to-market election applies to the taxable year for which the election is made and all later taxable years, unless the ordinary shares or ADSs cease to be marketable or the IRS consents to the revocation of the election.

If the mark-to-market election is made after the first taxable year in which a United States holder holds our ordinary shares or ADSs and we are a PFIC, then special rules would apply.

A United States holder making neither the QEF election nor the mark-to-market election is subject to the excess distribution regime. Under this regime, excess distributions are subject to special tax rules. An excess distribution is either (1) a distribution with respect to ordinary shares or ADSs that is greater than 125% of the average distributions received by the United States holder from us over the shorter of either the preceding three years or such United States holder's holding period for our ordinary shares or ADSs, or (2) gain from the disposition of our ordinary shares or ADSs (including gain deemed recognized if the ordinary shares or ADSs are used as security for a loan).

87

Excess distributions must be allocated ratably to each day that a United States holder has held our ordinary shares or ADSs. A United States holder must include amounts allocated to the current taxable year and to any period prior to the first day of the first

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taxable year for which we are a PFIC in its gross income as ordinary income for the current taxable year. All amounts allocated to other years of the United States holder would be taxed at the highest tax rate for each such prior year applicable to ordinary income. The United States holder also would be liable for interest on the deferred tax liability for each such other year calculated as if such liability had been due with respect to each such other year. A United States person who inherits shares or ADSs in a non-U.S. corporation that was a PFIC in the hands of the decedent is generally denied the otherwise available step-up in the tax basis of such shares or ADSs. Instead, such United States holder's basis would be equal to the lesser of the decedent's basis or the fair market value of the ordinary shares or ADSs.

We believe that in 2008 we were not a PFIC and currently we expect that we will not be a PFIC in 2009. However, PFIC status is determined as of the end of the taxable year and is dependent on a number of factors, including the value of our assets, the amount and type of our gross income and the market value of our ordinary shares. Therefore, there can be no assurance that we will not become a PFIC for the current taxable year ending December 31, 2009 or in a future taxable year. We will notify United States holders in the event we conclude that we will be treated as a PFIC for any taxable year to enable United States holders to consider whether or not to elect to treat us as a QEF for United States federal income tax purposes or to "mark to market" the ordinary shares or ADSs or to become subject to the "excess distribution" regime.

United States holders are urged to consult their tax advisors regarding the application of the PFIC rules, including eligibility for and the manner and advisability of making, the QEF election or the mark-to-market election.

Information Reporting and Backup Withholding

A United States holder generally is subject to information reporting and may be subject to backup withholding (currently at rate of up to 28% through 2010) with respect to dividend payments on, or receipt of the proceeds from the disposition of, the ordinary shares or ADSs. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations, or if a United States holder provides a correct taxpayer identification number, certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the United States federal income tax liability of a United States holder, or alternatively, the United States holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the IRS.

88

Non-United States holders of Ordinary Shares or ADSs

Except as provided below, a non-United States holder of ordinary shares or ADSs will not be subject to United States federal income or withholding tax on the receipt of dividends on, and the proceeds from the disposition of, an ordinary share or ADS, unless, in the case of United States federal income taxes, that item is effectively connected with the conduct by the non-United States holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, that item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized by an individual non-United States holder upon the disposition of our ordinary shares or ADSs will be subject to tax in the United States if the non-United States holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

Non-United States holders generally will not be subject to information reporting or backup withholding with respect to the payment of dividends on, or the proceeds from the disposition of, ordinary shares or ADSs, provided that the non-United States holder provides its taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

Formula is subject to the reporting requirements of the Exchange Act that are applicable to a foreign private issuer. In accordance with the Exchange Act, we file with the SEC reports, including annual reports on Form 20-F by June 30 each year. In addition, we furnish interim financial information on Form 6-K on a quarterly basis. We also furnish to the SEC under cover of Form 6-K certain other material information required to be made public in Israel, filed with and made public by any stock exchange or distributed by us to our shareholders. You may inspect without charge and copy at prescribed rates such material at the public reference facilities maintained by the SEC, at 100 F Street, N.E., Washington, D.C. 20549. You may also obtain copies of such material from the SEC at prescribed rates by writing to the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

The SEC maintains an Internet site at <http://www.sec.gov> that contains reports and other material that are filed through the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system. Formula began filing through the EDGAR system beginning in October 2002.

89

Formula's ADSs are quoted on the NASDAQ Global Market. You may inspect reports and other information concerning Formula at the offices of the National Association of Securities Dealers, Inc., 9513 Key West Avenue, Rockville, Maryland 20850. You may also find our reports filed with the ISA on the Magna site whose address is <http://www.magna.isa.gov.il>.

Our Internet address is <http://www.formulasystems.com>. A copy of each report submitted in accordance with applicable United States law is available for public review at our principal executive offices.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Currency Exchange Rate Fluctuations and Impact of Inflation

In light of the nature of our activities, we invest our cash and cash equivalents primarily in short-term and long-term deposits. As of December 31, 2008, we invested substantially all of the cash we held in dollar accounts bearing interest based on LIBOR, euro accounts and NIS accounts bearing interest based on the Israeli prime rate.

An increase in value of the NIS against the dollar or euro may have a negative impact on our operating results and financial condition. Depending upon the circumstances, we will consider entering into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of the dollar or euro against the NIS. There can be no assurance that these activities, or others that we may use from time to time, will eliminate the negative financial impact of currency fluctuations and inflation.

We do not engage in currency speculation. Generally, we do not hold nor have we issued, to any material extent, any derivatives or other financial instruments for trading purposes.

Fluctuations in Market Price of Securities We Hold

We hold securities of several publicly traded companies on the NASDAQ Global Market and the TASE. These companies include Magic Software, Matrix and Sapiens. We consider these holdings as long-term holdings. We are exposed to the risk of fluctuation of the price of these companies' securities. All of these publicly traded companies have experienced significant historical volatility in their stock prices. Fluctuations in the market price of our holdings in these companies may result in the fluctuation of the value of our assets. We typically do not attempt to reduce or eliminate our market exposure on these securities.

90

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

(a) *Disclosure Controls and Procedures.* Based on management's evaluation (with the participation of our chief executive officer and chief financial officer), as of December 31, 2008, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Commission rules and forms, and is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Management's Annual Report on Internal Control over Financial Reporting.* Our board of directors and audit committee are responsible for establishing and maintaining adequate internal control over financial reporting. Formula's internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of our consolidated financial statements.

Our chief executive officer and chief financial officer assessed the effectiveness of Formula's internal control over financial reporting as of December 31, 2008. In making this assessment, they used the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our chief executive officer and chief financial officer have concluded that, as of December 31, 2008, Formula's internal control over financial reporting is effective based on those criteria.

91

Notwithstanding the foregoing, all internal control systems no matter how well designed have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(c) *Attestation Report of the Registered Public Accounting Firm.* This annual report includes an attestation report of our registered public accountant assessing our internal control over financial reporting.

(d) *Changes in Internal Control Over Financial Reporting.* During the period covered by this report, there were no changes in Formula's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, Formula's internal control over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Shlomo Nass, a member of our audit committee and an independent member of our board of directors pursuant to the NASDAQ requirements, is an audit committee financial expert, as defined by applicable SEC regulations.

ITEM 16B. CODE OF ETHICS

Formula has adopted a code of business conduct and ethics applicable to its executive officers, directors and all other employees. A copy of the code is available to all Formula's employees, investors and others upon request to the following address: Formula Systems (1985) Ltd., 3 Abba Eban Boulevard, Herzliya 46725, Israel, Attn: Chief Financial Officer. Any waiver of this code for executive officers or directors will be disclosed through the filing of a Form 6-K.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES*Policy on Pre-Approval of Audit and Non-Audit Services of Independent Auditors*

Our audit committee is responsible for the oversight of our independent auditor's work. The audit committee's policy is to pre-approve all audit and non-audit services provided by Ziv Haft independent registered public accounting firm, BDO member firm. These services may include audit services, audit-related services, tax services and other services, as further described below. The audit committee sets forth the basis for its pre-approval in detail, listing the particular services or categories of services which are pre-approved, and setting forth a specific budget for such services. Additional services may be pre-approved by the audit committee on an individual basis. Once services have been pre-approved, Ziv Haft independent registered public accounting firm, BDO member firm and our management then report to the audit committee on a periodic basis regarding the extent of services actually provided in accordance with the applicable pre-approval, and regarding the fees for the services performed.

92

Principal Accountant Fees and Services

We paid the following fees for professional services rendered by Ziv Haft independent registered public accounting firm, BDO member firm, for the years ended December 31:

	2008	2007
	(\$ in thousands)	
Audit Fees	669	617
Audit-Related Fees	100	150
Tax Fees	77	96
All Other Fees	-	-
Total	846	863

The Audit Fees for the years ended December 31, 2008 and 2007 were for professional services rendered for the audits of our annual consolidated financial statements, review of our consolidated quarterly financial statements, statutory audits of Formula and certain subsidiaries, issuance of comfort letters, consents and assistance with review of documents filed with the SEC.

The audit-related fees for the years ended December 31, 2008 and 2007 were primarily related to internal control review.

Tax Fees for the years ended December 31, 2008 and 2007 were for services related to tax compliance, including the preparation of tax returns and claims for refund, and tax advice.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

ITEM 16F. CHANGE IN REGISTRANT CERTIFYING ACCOUNTANT

Not applicable.

93

ITEM 16G. CORPORATE GOVERNANCE

The NASDAQ Global Market requires companies with listed shares to comply with its corporate governance standards. As a foreign private issuer, we are not required to comply with all of the rules that apply to listed U.S. companies. However, except for certain instances described below, we have generally chosen to comply with the NASDAQ Global Market's corporate governance rules as though we were a U.S. company. Accordingly, except for such difference described below, we do not believe there are any significant differences between our corporate governance practices and those that would typically apply to a U.S. domestic issuer under the NASDAQ Global Market corporate governance rules.

Pursuant to NASDAQ Marketplace Rule 4350(a), we notified NASDAQ that with respect to the quorum for shareholders meetings, we follow Israeli law and practice and accordingly do not follow NASDAQ rules. The quorum for a shareholders meeting, as stipulated in our articles of association, complies with the provisions of the Israeli law, and requires the presence, in person or by proxy of holders of 25% of our outstanding ordinary shares, in lieu of the requirement specified in NASDAQ Marketplace Rule 4350(e) pursuant to which the quorum for any shareholders meeting shall not be less than 33% of the outstanding voting shares of the company.

94

PART III

ITEM 17. FINANCIAL STATEMENTS

We have responded to Item 18 in lieu of this item.

ITEM 18. FINANCIAL STATEMENTS

Our consolidated financial statements and the reports of independent registered public accounting firm in connection therewith are filed as part of this annual report, as noted on the pages below:

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets at December 31, 2008 and 2007	F-5
Consolidated Statements of Operations for the Years Ended December 31, 2008, 2007 and 2006	F-7
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2008, 2007 and 2006	F-8
Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006	F-9
Notes to Consolidated Financial Statements	F-14

ITEM 19. EXHIBITS

Exhibit No.

- 1.1 Memorandum of Association ⁽¹⁾
- 1.2 Articles of Association as amended on December 28, 2005 ⁽²⁾
- 4.1 Form of Letter of Indemnification, dated December 28, 2005 ⁽²⁾
- 4.2 International Securities Purchase Agreement dated June 15, 2007 between the Registrant and each of the purchasers identified on the signature pages of the agreement ⁽³⁾
- 4.3 English translation of Formula Systems (1985) Ltd. Employees and Office Holders Share Option Plan (2008)*

95

Exhibit No.

- 8 List of Subsidiaries*
- 12.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
- 12.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
- 13.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
- 13.2 Certification of the Chief Financial Officer pursuant to Section. 906 of the Sarbanes-Oxley Act of 2002*
- 15.1 Consent of Ziv Haft registered certified public accountants (Isr.) BDO member firm*
- 15.2 Consent of Levy Cohen and Co.*
- 15.3 Consent of Levy Cohen and Co.*
- 15.4 Consent of Kost, Forer, Gabbay & Kaiserer*
- 15.5 Consent of Kost, Forer, Gabbay & Kaiserer*
- 15.6 Consent of Verstegen accountants en belastingadviseurs*
- 15.7 Consent of KDA Audit Corporation*
- 15.8 Consent of Maria Negyessy*

*Filed herewith.

- (1) Incorporated by reference to the Registration Statement on Form F-1 (File No. 333-8858).
(2) Incorporated by reference to the Annual Report on Form 20-F filed with the Securities and Exchange Commission on June 29, 2006.
(3) Incorporated by reference to the Annual Report on Form 20-F filed with the Securities and Exchange Commission on June 29, 2007.

FORMULA SYSTEMS (1985) LTD.

(An Israeli corporation)

2008 Annual Report

FORMULA SYSTEMS (1985) LTD.

(An Israeli Corporation)

2008 CONSOLIDATED FINANCIAL STATEMENTS

TABLE OF CONTENTS

	<u>Page</u>
<u>REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM:</u>	F-1-F-3
CONSOLIDATED FINANCIAL STATEMENTS:	
<u>Balance Sheets</u>	F-4-F-5
<u>Statements of Operations</u>	F-6
<u>Statements of Changes in Shareholders' Equity</u>	F-7
<u>Statements of Cash Flows</u>	F-8-F-12
<u>Notes to Financial Statements</u>	F-13-F-67

The amounts are stated in U.S. dollars (\$).

ZIV HAFT
Certified Public Accountants (Isr.)

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46-48 Menachem Begin Road, Tel-Aviv 66184
Tel: +972 3 638 6868, Fax: +972 3 639 4320
E-mail: zivhaft@bdo.co.il www.bdo.co.il

**Report of Independent Registered Public Accounting Firm
To the Shareholders and Board of Directors of
FORMULA SYSTEMS (1985) LTD.**

We have audited the accompanying consolidated balance sheets of Formula Systems (1985) Ltd. and its subsidiaries (the Company) as of December 31, 2008 and 2007 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, whose consolidated assets constitute approximately 21% and 22% of total consolidated assets as of December 31, 2008 and 2007, respectively, and whose consolidated revenues constitute approximately 18%, 20% and 23% of total consolidated revenues for the years ended December 31, 2008, 2007 and 2006, respectively. The financial statements of those subsidiaries were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included in respect of those subsidiaries is based solely on the reports of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2008 and 2007, and the related consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 27, 2009 expressed an unqualified opinion thereon.

Tel Aviv, Israel
April 27, 2009

Ziv Haft
Certified Public Accountants (Isr.)
BDO Member Firm

Haifa Tel: 04-8680600, Fax: 04-8620866
Jerusalem Tel: 02-6546200, Fax: 02-6526633

Kiryat Shmona Tel: 04-6951389, Fax: 04-6951360
Beer Sheva Tel: 08-6654432, Fax: 08-6270008

F - 1

ZIV HAFT
Certified Public Accountants (Isr.)

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**Report of Independent Registered Public Accounting Firm
To the Shareholders and Board of Directors of
FORMULA SYSTEMS (1985) LTD.**

We have audited Formula Systems (1985) Ltd. (the Company) internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Tread way Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 15b Management Report Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Beer Sheva Tel: 08-6654432, Fax: 08-6270008

F - 2

ZIV HAFT
Certified Public Accountants (Isr.)

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and subsidiaries as of December 31, 2007 and 2008, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008 and our report dated April 27, 2009 expressed an unqualified opinion thereon.

Tel Aviv, Israel

April 27, 2009

Ziv Haft
 Certified Public Accountants (Isr.)
 BDO Member Firm

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F - 3

FORMULA SYSTEMS (1985) LTD.

(An Israeli Corporation)

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2008	2007
	(U.S. \$ in thousands)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	110,602	161,504
Short-term investments (Note 3)	46,158	40,276
Trade receivables (net of allowances for doubtful debts of \$4,326 and \$4,678 as of December 31, 2008 and 2007, respectively)	158,166	139,478
Other current assets (Note 17A)	16,104	34,822
Inventories	2,772	3,157
Total assets attributed to discontinued operations	31	41
	<u>333,833</u>	<u>379,278</u>
LONG-TERM INVESTMENTS, LOANS AND RECEIVABLES:		
Loans and other investments (Note 5)	15,844	14,849
Investments in affiliates (Note 6)	3,694	3,792
	<u>19,538</u>	<u>18,641</u>
SEVERANCE PAY FUND	38,105	36,851
	<u>15,228</u>	<u>15,794</u>
PROPERTY AND EQUIPMENT, NET (Note 7)	15,228	15,794
	<u>143,352</u>	<u>119,014</u>
GOODWILL (Note 1J and Note 8)	143,352	119,014
	<u>46,566</u>	<u>43,046</u>
OTHER ASSETS, NET (Note 9)	46,566	43,046

December 31,	
596,622	612,624

F - 4

FORMULA SYSTEMS (1985) LTD.

(An Israeli Corporation)

December 31,	
2008	2007
(U.S. \$ in thousands)	

LIABILITIES AND SHAREHOLDERS' EQUITY
CURRENT LIABILITIES: