MAGIC SOFTWARE ENTERPRISES LTD
Form 20-F
March 18, 2011

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
FORM 20-F

OR
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

OR
¨ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report

Commission file number: 0-19415

MAGIC SOFTWARE ENTERPRISES LTD.
(Exact name of Registrant as specified in its charter
and translation of Registrant's name into English)
Israel
(Jurisdiction of incorporation or organization)

5 Haplada Street, Or Yehuda 60218, Israel
(Address of principal executive offices)

Amit Birk; +972 (3) 538 9322; abirk@magicsoftware.com
5 Haplada Street, Or Yehuda 60218, Israel
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person

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

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:
Ordinary Shares, par value NIS 0. 1 per share…………..35,909,606 (as of December 31, 2010)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ¨ No x

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ¨ No ¨

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

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer x

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

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

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

INTRODUCTION

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

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

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

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

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

This annual report on Form 20-F contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. Statements which use the terms “anticipate,” “believe,” “expect,” “plan,” “intend,” “estimate” and similar expressions are intended to identify forward looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3D. “Key Information - Risk Factors.”

TABLE OF CONTENTS

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following table presents selected consolidated financial data as of the dates and for each of the periods indicated. For the years ended December 31, 2006 and 2007, this data includes discontinued operations. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. "Operating and Financial Review and Prospects" and our consolidated financial statements and notes thereto included elsewhere in this annual report.

We have derived the following consolidated income statement data for the years ended December 31, 2008, 2009 and 2010 and the consolidated balance sheet data as of December 31, 2009 and 2010 from our audited consolidated financial statements and notes included elsewhere in this annual report. We have derived the consolidated income statement data for the years ended December 31, 2006 and 2007 and the consolidated balance sheet data as of December 31, 2006, 2007 and 2008 from our audited consolidated financial statements that are not included in this annual report, with the relevant adjustments for the years ended December 31, 2006 and 2007due to the discontinued operations.

Income Statement Data:

	Year ended December 31,				
	2006	2007	2008	2009	2010
	(U.S. dollars in thousands, except share and per share data)				
Revenues:					
Software	$18,788	$17,707	$20,913	$17,261	$20,111
Maintenance and technical support	11,531	12,605	14,530	13,821	14,407
Consulting services	22,252	28,116	26,537	24,268	54,060
Total revenues	52,571	58,428	61,980	55,350	88,578
Cost of revenues:					
Software	5,433	4,557	4,898	5,388	5,320
Maintenance and technical support	2,873	1,602	2,263	2,189	2,070
Consulting services	16,862	21,181	19,978	18,687	44,058
Total cost of revenues	25,168	27,340	27,139	26,264	51,448
Gross profit	27,403	31,088	34,841	29,086	37,130
Operating costs and expenses:					
Research and development, net	2,462	2,716	2,350	1,310	2,072
Selling and marketing	15,712	15,558	17,357	15,308	17,526
General and administrative	13,784	11,532	10,867	8,210	8,194
Other income, net	-	-	-	1,972	-

Restructuring and impairment	2,157	-	-	-	-
Operating income (loss)	(6,712)	1,282	4,267	6,230	9,338
Financial income (expense), net	332	161	448	238	(224)
Other income, net	278	170	-	42	159

1

	Year ended December 31,				
	2006	2007	2008	2009	2010
	(U.S. dollars in thousands, except share and per share data)				
Income (loss) before taxes on income	(6,102)	1,613	4,715	6,510	9,273
Tax benefit (taxes on income)	(310)	(362)	(199)	(334)	102
Income (loss) after taxes on income	(6,412)	1,251	4,516	6,176	9,375
Equity in earnings (losses) of affiliates	15	(86)	(8)	-	-
Net income (loss) from continued operations	$(6,397)	$1,165	$4,508	$6,176	$9,375
Net income from discontinued operations	1,320	11,465	-	-	-
Net income (loss)	(5,077)	12,630	4,508	6,176	9,375
Less: Net income (loss) allocated to non-controlling interest	71	(22)	-	-	-
Net income attributable to Magic's Shareholders	5,006	12,608	4,508	6,176	9,375
Basic net income (loss) per share	$(0.16)	$0.40	$0.14	$0.19	$0.29
Diluted net income (loss) per share	$(0.16)	$0.39	$0.14	$0.19	$0.29
Shares used to compute basic income (loss) per share	31,184	31,443	31,769	31,899	32,140
Shares used to compute diluted income (loss) per share	31,184	32,023	32,032	32,107	32,731
Dividends	-	-	-	15,974	-

Balance Sheet Data:

	December 31,				
	2006	2007	2008	2009	2010
	(U.S. dollars in thousands)				
Working capital	$15,584	$28,737	$33,851	$28,021	$48,815
Cash, cash equivalents, short term deposits and marketable securities	11,653	16,446	32,588	41,868	46,542
Total assets including discontinued operations	71,172	82,298	81,164	87,551	111,950
Total equity	47,644	61,244	66,755	57,188	88,865

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

2

Risks Related to Our Business and Our Industry

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

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

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

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

- The size and timing of orders;
- The high level of competition that we encounter;
- The timing of our product introductions or enhancements or those of our competitors or of providers of complementary products;
- Market acceptance of our new products, applications and services;
- The purchasing patterns and budget cycles of our customers and end-users;
- The mix of product sales;
- Exchange rate fluctuations;
- General economic conditions; and
- The integration of newly acquired businesses.

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

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

During periods of slowing economic activity our customers may reduce their demand for our products, technology and professional services, which would reduce our sales, and our business, operating results and financial condition may be materially adversely affected. In addition, this could result in longer sales cycles, slower adoption of new technologies and increased price competition for our products and services. We could also be exposed to credit risk and payment delinquencies on our accounts receivable, which are not covered by collateral. Any of these events would likely harm our business, operating results and financial condition.

Our revenues from Japan, which accounted for 12% of our total revenues for the year ended December 31, 2010, may be adversely affected as result of the recent national disaster in Japan and pending or future purchases may be delayed or cancelled as a result.

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

In January 2010, we purchased a consulting and staffing services business of a U.S.-based IT services company for approximately $13.7 million to be paid over a three year period. The acquired business provides a comprehensive range of consulting and staffing services for telecom, network communications and the IT industry. The business employs approximately 233 persons with offices located in Dallas, Texas.

We may make additional acquisitions in the future. We intend to continue to address the need to develop new products and enhance existing products through acquisitions of other companies, product lines, technologies, and personnel. Acquisitions involve numerous risks, including the following:

- Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired companies;
- Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;
- Potential difficulties in completing projects associated with in-process research and development;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- Initial dependence on unfamiliar supply chains or relatively small supply partners;
- Insufficient revenue to offset increased expenses associated with acquisitions; and
- The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

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

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

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

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

We sell our products through our direct sales representatives, as well as through third parties that use our technology to develop and sell solutions for their customers, referred to as ISVs or Magic Software Providers, or MSPs, and also through SIs. These independent distributors then resell our products to end-users. We are dependent upon the acceptance of our products by our independent distributors and their active marketing and sales efforts. Typically, our arrangements with our independent distributors do not require them to purchase specified amounts of products or prevent them from selling non-competitive products. The independent distributors may not continue, or may not give a high priority to, marketing and supporting our products. Our results of operations could be materially adversely affected by changes in the financial condition, business, marketing strategies, local and global economic conditions, or results of our independent distributors.

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

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

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

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

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

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

In addition, the ability of our subsidiaries to maintain and renew existing engagements and obtain new business for their contract IT professional services operations depends, in large part, on their ability to hire and retain technical personnel with the IT skills that keep pace with continuing changes in software evolution, industry standards and technologies, and client preferences. Demand for qualified professionals conversant with certain technologies may outstrip supply as new and additional skills are required to keep pace with evolving computer technology or as competition for technical personnel increases. Increasing demand for qualified personnel could also result in increased expenses to hire and retain qualified technical personnel and could adversely affect our profit margins.

Our widespread operations may strain our management, operational and financial resources and could have a material adverse affect on our business, results of operations and financial condition.

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

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

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

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

While our principal executive offices are located in Israel, 92% of our sales in 2008, 93% of our sales in 2009 and 95% of our sales in 2010 were generated in other countries. This subjects us to many risks inherent to international business activities, including:

- Limitations and disruptions resulting from the imposition of government controls;
- Changes in regulatory requirements;
- Export license requirements;
- Economic or political instability;
- Trade restrictions;
- Changes in tariffs;
- Currency fluctuations;
- Difficulties in the collection of receivables;
- Foreign tax consequences;
- Greater difficulty in safeguarding intellectual property; and
- Difficulties in managing overseas subsidiaries and international operations.

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

Currency exchange rate fluctuations in the world markets in which we conduct business could have a material adverse affect on our business, results of operations and financial condition.

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

Declines in our share price and/or operating performance could result in a future impairment of our goodwill or long-lived assets.

We assess potential impairments of goodwill annually and whenever there is evidence that events or changes in circumstances indicate that an impairment condition may exist. We assess potential impairments of our long-lived assets, including property and equipment, customer relationships and capitalized software, whenever there is evidence that events or changes in circumstances indicate that the carrying value may not be recoverable. In the past, our share price, and consequently our market capitalization, have experienced significant fluctuations and may experience significant fluctuations in the future. During 2008, our share price dropped by 32%, while in 2009 and in 2010, it increased by 78% and 170%, respectively. If the value of our market capitalization falls below the value of our shareholders' equity, it might indicate that an impairment of goodwill is required. We determine the value of each of our reporting units using the income approach, which utilizes a discounted cash flow model, as we believe that this approach best approximates our fair value at this time. Our ability to reconcile the gap between our market capitalization and aggregate fair value of the reporting units depends on various factors, some of which are qualitative, such as estimated control premium that an investor would be willing to pay for a controlling interest in us, while others involve management judgment. If our market capitalization falls below our shareholders' equity, or actual results of operations materially differ from our modeling estimates, we may be required to record a non-cash impairment charge of our goodwill and/or other long-lived assets. A significant impairment loss could have a material adverse effect on our operating results and on the carrying value of our goodwill and/or our long-lived assets on our balance sheet.

We face intense competition in the software as a service, or SaaS, market for our application platform as well as in the process and business integration technologies and IT services market. This competition could adversely affect our business, results of operations and financial condition.

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

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

7

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

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

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

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

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

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

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

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

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

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

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

We compete in a market that is characterized by rapid technological change. The introduction of new technologies and devices could render existing products and services obsolete and unmarketable and could exert price pressures on our products and services. Our future success will depend upon our ability to address the increasingly sophisticated needs of our customers by:

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

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

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

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

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

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

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

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

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

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

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

From time to time third parties have in the past, and may in the future, assert infringement claims against us or claim that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. Any infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend any such claims. In February 2010, a U.S. company filed a lawsuit against us and one of our subsidiaries, claiming an alleged breach by us and the subsidiary of its intellectual property rights in connection with one of our products. Intellectual property litigation is expensive and any court ruling against us could have a material adverse affect on our financial condition and results of operations.

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

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

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

Formula Systems (1985) Ltd., or Formula Systems (symbol: FORTY), an Israeli company whose shares trade on the NASDAQ Global Select Market and the Tel Aviv Stock Exchange, directly owns 18,560,352, or 51.3%, of our outstanding ordinary shares. Asseco Poland S.A., or Asseco, a Polish company listed on Warsaw Stock Exchange, owns 50.2% of the outstanding shares of Formula Systems. Although transactions between us and our controlling shareholders are subject to special approvals under Israeli law (see Item 6C. “Directors, Senior Management and Employees - Board Practices - Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders”), Formula Systems and Asseco will be able to exercise control over our operations and business strategy and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Similarly, Formula Systems and Asseco will be able to control most matters requiring shareholder approval, including the election of our directors (subject to a special majority required for the election of outside directors). Such concentration of ownership may have the effect of delaying or preventing an acquisition or a change in control of us.

10

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

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

Risks Related to Our Ordinary Shares

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

Our ordinary shares have experienced significant market price and volume fluctuations in the past and may experience significant market price and volume fluctuations in the future. During 2008, our share price dropped by 32%, while in 2009 and in 2010 it increased by 78% and 170%, respectively. Our market price and volume may fluctuate in response to factors such as the following, some of which are beyond our control:

- Quarterly variations in our operating results;
- Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- Announcements of technological innovations or new products by us or our competitors;
- Announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Changes in the status of our intellectual property rights;
- Announcements by third parties of significant claims or proceedings against us;
- Additions or departures of key personnel;
- The public's response to our press releases, our other public announcements and our filings with the Securities and Exchange Commission and the Israeli Securities Authority;
- Future sales of our ordinary shares by our directors, officers and significant shareholders;
- Political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events;
-

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

- General trends of the stock markets.

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

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

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

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

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

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

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

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

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

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

Risks Related to Our Location in Israel

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

We are incorporated under the laws of, and our executive offices and research and development facilities are located in, the State of Israel. Although most of our sales are made to customers outside Israel, we are influenced to a limited extent by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by any major hostilities involving Israel, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Major hostilities between Israel and its neighbors may hinder Israel’s international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business. In recent years, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups. Ongoing or future violence between Israel and the Palestinians, armed conflicts, terrorist activities, tension along Israel’s northern borders, or political instability in the region would likely negatively affect business conditions and could significantly harm our results of operations.

Recent popular uprisings in various countries in the Middle East are affecting the political stability of those countries. Such instability may lead to a deterioration in the political and trade relationships that exist between the State of Israel and these countries. In addition, such instability may affect the global economy and marketplace as a result of changes in oil and gas prices. Since our executive offices and research and development facilities are located in the State of Israel, any such events that affect the State of Israel may impact us in unpredictable ways. If our operations are significantly impacted by such events, our results of operations may be adversely affected.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

Our results of operations may be negatively affected by the obligation of our personnel to perform military service.

Many of our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

We currently have the ability to benefit from government tax benefits, which may be cancelled or reduced in the future.

We are eligible to receive tax benefits under Government of Israel programs. In order to maintain our eligibility for these tax benefits, we must continue to meet specific conditions. If we fail to comply with these conditions in the future, the tax benefits we could receive may be cancelled.

Service and enforcement of legal process on us and our directors and officers may be difficult to obtain.

We are incorporated in Israel and some of our directors, executive officers and the Israeli experts named in this annual report reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, most of our assets and the assets of some of our executive officers and some of the experts named in this annual report are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel. For more information regarding the enforceability of civil liabilities against us, our directors and executive officers and the Israeli experts named in this prospectus, including the terms under which certain judgments may be enforced by an Israeli court, please see "Enforceability of Civil Liabilities."

Provisions of Israeli law may delay, prevent or make difficult an acquisition of us, which could prevent a change of control and therefore depress the price of our shares.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or complicating a merger with, or other acquisition of, us. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes at the general meeting with respect to, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and actions and transactions involving interests of officers, directors or other interested parties which require the shareholders' general meeting's approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that he or she possesses the power to determine the outcome of a vote at a meeting of our shareholders, or who has, by virtue of the company's articles of association, the power to appoint or prevent the appointment of an office holder in the company, or any other power with respect to the company, has a duty of fairness toward the company. The Israeli Companies Law does not establish criteria for determining whether or not a shareholder has acted in good faith. Moreover, the law is relatively new and there is no case law available on the duty of a non-controlling shareholder to act in good faith.

As a foreign private issuer whose shares are listed on the NASDAQ Global Select 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 Select Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Listing Rules. We follow Israeli law and practice instead of The NASDAQ Listing Rules regarding the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present. As a foreign private issuer listed on the NASDAQ Global Select Market, we may also follow home country practice with regard to, among other things, the composition of the 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 Listing 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. 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 must disclose in its annual reports filed with the Securities and Exchange Commission each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were incorporated under the laws of the State of Israel in February 1983 as Mashov Software Export (1983) Ltd. and we changed our name to Magic Software Enterprises Ltd. in 1991. We are a public limited liability company and operate under the Israeli Companies Law 1999 and associated legislation. Our registered offices and principal place of business are located at 5 Haplada Street, Or Yehuda 60218, Israel, and our telephone number is +972-3-538-9292. Our U.S. subsidiary, Magic Software Enterprises Inc., is located at 23046 Avenida de la Carlota, Laguna Hills, CA 926653. Our address on the Internet is www.magicsoftware.com. The information on our website is not incorporated by reference into this annual report.

We develop, market and support uniPaaS, an application platform for developing and deploying business applications, and iBOLT, a platform for business and process integration. We also offer IT professional services in the areas of infrastructure design and delivery, application development, technology planning and implementation services, and supplemental staffing services. The uniPaaS and iBOLT platforms enable enterprises to accelerate the process of building and deploying applications that can be rapidly customized and integrated with existing systems. As an IT technology innovator, we have over 25 years of experience in assisting software and enterprise companies worldwide to produce and integrate their business applications. Our application platform, uniPaaS, is used by thousands of enterprises and ISVs to develop solutions for their users and customers in approximately 50 countries. We also refer to these ISVs as MSPs. We also provide maintenance and technical support as well as professional services to our enterprise customers and MSPs. In addition, we sell our iBOLT technology for business integration to customers using specific popular software applications, such as SAP, Salesforce.com, IBM i (AS/400) or Oracle JD Edwards or other business applications. We refer to these vendor-centered market sectors as eco-systems.

On January 17, 2010, we purchased the consulting and staffing services business of a U.S.-based IT services company for approximately $13.7 million to be paid over a three year period. The acquired business provides a comprehensive range of consulting and staffing services for telecom, network communications and the IT industry. The business employs approximately 233 persons with offices located in Dallas, Texas in the United States. The acquisition had a positive effect on the growth of our IT professional services revenues in 2010 and we believe that the acquired business will enable us to continue to expand our presence in the U.S. market and leverage our relationships with top tier customers.

On October 31, 2010, we purchased an 88% interest in a consulting and staffing services company and have an option to increase our holdings to 100%. We paid a cash purchase price of $ 1.6 million. The acquired company provides a comprehensive range of consulting and staffing services for the IT industry in the areas of infrastructure design and delivery, application development, technology planning and implementation services.

On January 1, 2011, we acquired 51% of our South African distributor, Magix Integration (Proprietary) Ltd., with an option to increase our holdings to 75%, for a total investment of up to $2.5 million. Magix Integration (Proprietary) Ltd. specializes in the software integration and application development of our platforms as well as the support of large-scale and complex systems in the public and financial sectors in South Africa. We believe that this acquisition will contribute to our growth and further strengthen our presence in the region.

In 2010, we continued to work closely with IBM as an Advanced Partner of the IBM Partnerworld for Developer Business Partner program and as a Member Partner of IBM Partnerworld for Software. IBM has awarded us with its ServerProven® certification for our uniPaaS and iBOLT products following a rigorous testing and evaluation process. Only those products that are validated by IBM to install quickly, start up easily and run reliably on IBM servers are awarded this certification, designed by IBM to assist its customers to easily identify complete solutions for their business-critical e-business needs. We are also part of IBM's System i Tools Innovation Program. As part of our activities with IBM's customers and business partners, we released a special edition of iBOLT for Oracle JD Edwards, targeted at users of JD Edwards Enterprise One Oracle enterprise resource planning, or ERP, software on the IBM System i platform.

In November 2010, we signed a global alliance agreement with MicroStrategy® Incorporated (NASDAQ: MSTR), a leading worldwide provider of business intelligence software, enabling us to deliver an integrated business intelligence solution to our uniPaaS and iBOLT customers worldwide. MicroStrategy Incorporated was positioned in the 'Leaders' Quadrant of the "Gartner 2010 Magic Quadrant for Business Intelligence Platforms Report."

Our capital expenditures for the years ended December 31, 2008, 2009 and 2010, were approximately $0.7 million, $0.6 million and $0.6 million, respectively. These expenditures were principally for network equipment and computers, furniture and office equipment and leasehold improvements.

B. Business Overview

Industry Overview

In recent years the multiplication of enterprise applications has lead to a level of complexity of an enterprise's information system that is obstructing business progress and evolution, reducing business agility and often resulting in multiple versions of similar data objects, such as customer records. We believe that one of the main challenges modern enterprises face today is "creating a single view of the truth," which is the better way to make effective and relevant business decisions. Business integration is employed to facilitate this. Traditionally, given their cost and complexity, business integration solutions were targeted at large enterprises. Consequently, business integration tools are mostly complex, require significant implementation resources, take a long time to implement and are costly. Given the critical need for business integration across the demand and supply chain, enterprises of all sizes require such solutions. We recognized this trend and emerging need when we designed iBOLT.

Another major evolution in enterprises is the trend of reusing IT assets, such as enterprise applications, which is driving the move towards service oriented architecture, or SOA. Due to the large investments in enterprise applications, such as ERP and CRM, on the one hand, and the accelerating business change, on the other hand, organizations need to find a way to continue to leverage their IT investments while increasing their ability to change business processes and support new ones. The software industry's response is a new SOA, a new paradigm of application development, service oriented development architecture, and composite applications. Most of these involve metadata (which is data that describes other data, similar to a table of content describing a book), rather than traditional programming. We have developed and enhanced this paradigm over the last 25 years, and we believe that we have one of the largest installed-base of products employing such technology.

Additionally, mobile, cloud and SaaS are each becoming a well-established phenomenon in some areas of enterprise IT. These are growing into mainstream options for software-based business solutions and will affect most of enterprise IT departments in the next three years in one way or another. It appears that SaaS and cloud enabled application platforms are becoming dominant players in the growing SaaS application industry. We are developing our technology to provide the functionality of a cloud-enabled application platform as a result of the growing demand from application vendors to repackage their applications as a SaaS offering.

General

Our 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. Our development, deployment and integration products empower customers to dramatically improve their business performance and return on investment by enabling the affordable and rapid delivery and integration of business applications, systems and databases. Our technology and solutions are especially 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 RIAs, cloud computing and SaaS.

We address the critical business needs of companies so that they are able to quickly respond to changing market forces and demands. Robust business solutions are created, deployed and maintained with unrivaled productivity and time-to-market results. Our development paradigm is aligned with modern application development theories and enables developers to create better solutions in less time and with fewer resources.

Our technology, comprised of the iBOLT and uniPaaS solutions, is comprehensive and industry proven. These technologies can be applied to the entire software development market, from the implementation of micro-vertical solutions, through tactical application renovation and process automation solutions, to enterprise spanning SOA migrations and composite applications initiatives. Unlike most competing platforms, we offer a coherent and unified toolset stemming from the same proven metadata driven and rules-based declarative technology. Metadata platforms consist of pre-compiled and pre-written technical and administrative functions, which are essentially ready-made business application coding that enables developers to bypass the intensive technical code-writing stage of application development and integration and move quickly and efficiently to deployment. Through the use of metadata-driven platforms such as uniPaaS and iBOLT, software vendors and enterprise customers can experience unprecedented cost savings through fast and easy implementation and reduced project risk.

Development communities are facing high complexity, cost and extended pay-back periods in order to deliver cloud, RIAs, mobile and SaaS applications. uniPaaS and iBOLT provide ISV's with the ability to rapidly build integrated applications in a more productive manner, deploy them in multiple modes and architectures as needed, lower IT maintenance costs and decreasing time-to-market.

With the launch of iBOLT, we started a process of expanding from the application development field to the business integration and process management fields, which are presently converging, from a technology perspective, into the composite application field. Products for these fields require SOA, application integration capabilities, process management, orchestration capabilities and information delivery capabilities. We believe that our technology and products provide all of these capabilities.

With the impending introduction of our cloud-enabled application platform, we expect to strengthen our position as a leading application platform provider opening the path for us to address the top-tier sector of the market. The increasing adoption of the SaaS delivery and business model within the overall cloud environment requires the use of a new generation of application platforms, which support the relevant functions required for SaaS and cloud deployment. We are one of the first vendors to offer such a platform. By leveraging the easy migration of applications between the different versions of our products, our MSPs have the potential to be among the first and most versatile sources of SaaS applications. Industry analysts as well as several of our major MSPs have recognized this, and we have begun to work with some of them in this context.

Our Products

The underlying principles and purpose of our technology are to provide:

- Simplicity – the use of code-free development tools instead of hard coding and multiple programming languages.
-

Business focus – the use of pre-compiled business logic and components eliminates repetitive, low level technical and coding tasks.

- Comprehensiveness – the use of a comprehensive development and deployment platform offers a full end-to-end development, deployment and integration capability.

- Automation of mundane tasks - to accelerate development and maintenance and reduce risk; and
- Interoperability - to support business logic across multiple hardware and software platforms, operating systems and geographies.

We offer two complementary products that address the wide spectrum of composite applications.

uniPaaS Application Platform

The uniPaaS application platform was released during 2008 as the next generation of eDeveloper. uniPaaS was released in recognition of the growing market demand for cloud based offerings including RIAs, mobile applications and SaaS. It features new functionality and extensions to our application platform, with the objective of enabling the development of RIAs, SaaS, mobile and cloud enabled applications. SaaS is a relatively new business and technical model for delivering software applications, similar to a phone or cable TV model, in which the software applications are installed and operated in dedicated data centers and users subscribe to these centers and use the applications over an internet connection. This model requires the ability to deliver RIAs.

uniPaaS is a comprehensive RIA platform. It uses a single development paradigm that handles all ends of the application development and deployment process including client and server partitioning and the inter-communicating layers.

uniPaaS offers customers the power to choose 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 mobile or SaaS; global or local. Our uniPaaS application platform complies with event driven and service oriented architectural principles. By offering technology transparency, this product allows customers to focus on their business requirements rather than technological means. The uniPaaS single development paradigm significantly reduces the time and costs associated with the development and deployment of cloud-based applications, including RIAs, mobile and SaaS. In addition, application owners can leverage their initial investment when moving from full client mode to cloud mode, 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. In addition, uniPaas is interoperable with .NET and Java technologies.

uniPaaS can be applied to the full range of software development, from the implementation of micro-vertical solutions, through tactical application renovation and process automation solutions, to enterprise spanning SOA migrations and composite applications initiatives. Unlike most competing platforms, we offer a coherent and unified toolset stemming from the same proven metadata driven and rules based declarative technology, resulting in unprecedented cost savings through fast and easy implementation and reduced project risk.

In April 2010, we released version 1.9 of uniPaaS, which includes new RIA deployment capabilities and additional enhancements and improvements.

Our uniPaaS application platform was acknowledged in Gartner’s 2010 Magic Quadrant for Application Infrastructure for Systematic SOA-Style Application Projects and Gartner placed in the Visionaries quadrant. In its report, Gartner presents uniPaaS as an easy-to-develop platform with substantial support for various nonfunctional requirements built in, and notes that it is emerging as a highly capable cloud-enabled application platform.

iBOLT Business and Process Integration

The iBOLT business integration suite is a graphical, wizard-based code-free solution delivering fast and simple integration and orchestration of business processes and applications. iBOLT allows businesses to more easily view, access, and leverage their mission-critical information, delivering true enterprise application integration, or EAI, BPM, and SOA, infrastructure.

iBOLT allows the integration and interoperability of diverse solutions, including legacy applications, in a quick and efficient manner. In January 2010, we released iBOLT Version 3.2 and since then we have continued to develop the iBOLT channel and entered into agreements with additional SIs, consultancies and service providers, who acquired iBOLT skills and offer iBOLT licenses and related services to their customers. Increasing the usability and life span of existing legacy and other IT systems, iBOLT allows fast 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. We also offer special editions of iBOLT targeted at specific enterprise application vendor ecosystems, such as SAP, JD Edwards or Salesforce.com. These special editions contain specific features and pricing tailored for these market sectors. In addition, during 2010, we released special editions for Microsoft Sharepoint.

Our Value Proposition

Our technology and solutions are especially in demand when budgets are tight and time-to-market considerations are critical. Our 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. Our development and integration products empower customers to dramatically improve their business performance and return on investment by enabling the affordable and rapid integration of diverse applications, systems and databases to streamline business processes from within one comprehensive framework.

We address the critical business needs of companies so that they are able to quickly respond to changing market forces and demands. Robust business solutions are created, deployed and maintained with unrivaled productivity and time-to-market results.

uniPaaS, our metadata driven application platform, is aligned with modern application development theories and enables developers to create better solutions in less time and with fewer resources. uniPaaS offers our customers - ISVs, SIs and enterprises - the following benefits:

- Faster Time to Market. uniPaaS eliminates the difficulties and costs of developing distinct client and server paradigms and partitioning.

- Lower Total Cost of Ownership. When deployment is required uniPaaS automatically instructs the business logic to the various technical components, saving the need for human intervention or planning and enabling deployment at an unprecedented low cost of ownership.

- Deployment Flexibility. Unique to the market, uniPaaS gives users the power to choose how they deploy their applications, whether full client or web, on-premise or on-demand, software or SaaS.

- Scalability and Adaptability. uniPaaS enables application owners to move from full client mode to RIAs, mobile and SaaS and back again as business situations and demands change.

- Portability. uniPaaS can be used with most hardware platforms, operating systems and databases. Applications developed with our technology for one platform can also be deployed on other supported platforms.

- Database Access and Technology Independence. Our technology can easily move data across platforms and convert the data from one database format to another.

- Comprehensiveness. uniPaaS incorporates all aspects of the development and deployment process, which usually requires organizations to buy and integrate multiple and diverse server and client paradigms.

- Global Experience and Expertise. uniPaaS leverages 25 years of research and development, including applied customer experience and feedback.

We believe that iBOLT offers our customers and partners the following benefits:

- Time to Market. Based on our customers' experience and feedback, we believe that iBOLT's services, components and wizards allow for faster project delivery.

- Cost Effectiveness. Many vendors design their business logic in a way that's so complex; customers can barely use it. iBOLT's graphical business flow editor allows users to easily and intuitively configure their business processes, ensuring that their end project is practical, usable and gives value for their investment.

- Comprehensiveness. iBOLT is a comprehensive integration technology stack, guaranteeing powerful and cost-effective integration for any business scenario.

- Deployment Flexibility. iBOLT has a significant range of built-in certified and optimized adaptors to maximize the integration flexibility and intuitive use.

- Scalability and Adaptability. iBOLT is used by hundreds of companies of every size in almost every industry sector worldwide and is responsible for tens of millions of transactions daily.

- Global Experience and Expertise. iBOLT leverages 25 years of research and development, including applied customer experience and feedback. uniPaaS stands at the core of the iBOLT integration suite, from studio to its actual deployment.

Special editions of iBOLT with optimized adaptors are available to expand the capabilities of the most commonly used ERP and CRM packages, including SAP Business One, SAP Business All-in-One, SAP R/3, Salesforce.com, Oracle JD Edwards, IBM i Series, Lotus Notes and Lotus Domino, HL7,Microsoft Dynamics CRM and Microsoft Sharepoint.

Our Strategy

Our goal is to achieve a leadership position in the application platform and business integration markets. We focus on providing technology, applications and IT consulting and staffing services that enable enterprises to meet their business needs on time and budget. The key elements of our strategy to achieve this goal are to:

- Develop and up-sell to our installed base and partner community by leveraging our solutions (uniPaaS, iBOLT and professional services);

- Utilize connectivity/integration solutions (iBOLT based) in existing ecosystems (SAP, Salesforce.com, JD Edwards, Lotus Notes and Lotus Domino, HL7, Microsoft Dynamics CRM and OEMs) to enlarge our installed base;

- Strengthen our alliances with SAP, Salesforce.com, Oracle JD Edwards and IBM i;

- Develop additional alliances with leading application vendors and develop offerings and partner programs for their ecosystems, such as Oracle's JD Edwards and Salesforce.com;

- Focus on recruiting OEM partners that will incorporate our iBOLT integration technology into their product offerings;

- Promote uniPaaS (RIAs, mobile and SaaS platforms) into the mid- and upper-markets of both enterprises and ISVs;

- Increase the number of software houses and ISVs that use uniPaaS to build their applications;

- Focus our sales efforts on our core products, uniPaaS and iBOLT; and
- Focus our efforts on further building a strong partner base of SIs, ISVs, distributors, resellers, OEMs and consulting partners of our core technologies.

20

Product Development

The software industry is characterized by rapid technological changes and is highly competitive with respect to timely product innovation. We must maintain compatibility and competitiveness in the face of ongoing changes in industry standards.

We place considerable emphasis on research and development in order to improve and expand the functionality of our technology and to develop new applications. We believe that our future success depends upon our ability to maintain our technological leadership, to enhance our existing products and to introduce new commercially viable products addressing the needs of our customers on a timely basis. We also intend to support emerging technologies as they are introduced in the same way we have supported new technologies in the past. We will continue to devote a significant portion of our resources to research and development. We believe that internal development of our technology is the most effective means of achieving our strategic objective of providing an extensive, integrated and feature-rich development technology.

During 2010, our research and development focused on the following products:

- uniPaaS: In April 2010, in response to customers' needs and service requests, we released uniPaaS version 1.9 and subsequent service packs for uniPaaS 1.9.

- RIA Technology: We continued to develop our RIA capabilities with an enhanced version of uniPaaS and RIA client module. We are currently working on developing new RIAs for additional mobile phone platforms such as BlackBerry, Android and iPhone.

- In January 2010, we released iBOLT 3.2. This release includes enhancements in all iBOLT capabilities, including connectors, stability, monitoring, etc.

- Hermes software. We continued to develop the Hermes software solution for air cargo handling. HERMES Release 4.0 incorporates new and advanced functionality. During 2010, HERMES Release 4.0 was deployed by additional several customers across the globe, and its deployment to new and existing customers will continue throughout 2011. We expect to begin development of HERMES Release 5.0 in the second half of 2011, which will focus on a technology platform migration.

Product Services

Professional Services. We offer 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. As part of management efforts to focus on license sales, our goal is to provide such activities as a complementary service to our customers and partners. We believe that the availability of effective consulting services is an important factor in achieving widespread market acceptance.

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, we have built upon our established global presence to form business alliances with our MSPs that use our technology to develop solutions for their customers, and distributors to deliver successful solutions in focused market sectors.

Maintenance. We offer our customers annual maintenance contracts providing for upgrades and new versions of our products for an annual fee.

Technical Support. We believe that a high level of customer support is important to the successful marketing and sale of our products. Our in-house technical support group provides training and post-sale support. We believe that effective technical support during product evaluation as well as after the sale has substantially contributed to product acceptance and customer satisfaction and will continue to do so in the future.

We offer an online support system for our MSPs, providing them with the ability to instantaneously enter, confirm and track support requests via the Internet. This system supports MSPs and end-users worldwide.

As part of this online support, we offer a Support Knowledge Base tool providing the full range of technical notes and other documentation including technical papers, product information, and answers to most common customer queries and known issues that have already been reported.

Training. We conduct formal and organized training on our development tools. We develop courses, pertaining to our principal products, uniPaaS and iBOLT and provide trainer and student guidebooks. Course materials are available both in traditional, classroom courses and as web-based training modules, which can be downloaded and studied at the student's own pace and location. The courses and course materials are designed to accelerate the learning process, using an intensive technical curriculum in an atmosphere conducive to productive training.

IT Strategic Consulting and Staffing Services

We provide a broad range of consulting services in the areas of infrastructure design and delivery, application development, technology planning and implementation services, as well as supplemental staffing services. Our wholly-owned subsidiaries, Coretech Consulting Group LLC and Fusion Solutions LLC, and our 88%-owned subsidiary, Xsell Resources Inc., provide IT consulting and staffing services to a wide variety of companies including Fortune 1000 companies. The technical personnel we provide generally supplement the in-house capabilities of our clients. Our approach is to make available to our clients a broad range of technical personnel to meet their requirements rather than focusing on specific specialized areas. We have extensive knowledgeable of and have worked with virtually all types of telecom infrastructure technologies in wireless and wireline as well as in the areas of infrastructure design and delivery, application development, project management, technology planning and implementation services. With an experienced team of recruiters in the telecom and other IT areas and with a substantial and a growing database of telecom talent, we can rapidly respond to a wide range of requirements with well qualified candidates. Our client list includes major global telecoms, OEM's and engineering, furnish and installation service companies. We have built long-term relationships with our clients by providing expert telecom talent. We provide individual consultants for contract and contract-to-hire assignments as well as candidates for full time placement. In addition, we configure teams of technical consultants for assigned projects at our clients' sites.

Customers, End-Users and Markets

We market and sell our products and services in more than 50 countries worldwide. The following table presents our revenues by revenue type and geographical market for the periods indicated:

	Year ended December 31,		
	2008	2009	2010
	(In thousands)		
Software sales	$ 20,913	$ 17,261	$ 20,111
Maintenance and technical support	14,530	13,821	14,407
Consulting services	26,537	24,268	54,060
Total revenues	$ 61,980	$ 55,350	$ 88,578

	Year ended December 31, 2008	2009	2010
		(In thousands)	
Israel	$ 4,760	$ 3,614	$ 4,405
Europe	25,359	22,516	21,788
United States.	20,096	18,485	48,888
Japan	10,110	8,895	10,806
Other	1,655	1,840	2,691
Total revenues	$ 61,980	$ 55,350	$ 88,578

Industries that are significantly represented by our partners include finance, insurance, government, health care, logistics, manufacturing media, retail and telecommunications. Our uniPaaS and iBOLT technologies are used by a wide variety of developers, integrators and solution providers, which can generally be divided into two sectors: in the first sector are those performing in-house development (corporate IT departments) and in the second sector are MSPs (ISVs), including large SIs and smaller independent developers, and VARs that use our technology to develop or provide solutions to their customers. MSPs who are packaged software publishers use our technology to write standard packaged software products that are sold to multiple clients, typically within a vertical industry sector or a horizontal business function.

Among the thousands of customers running their business systems with our technology are the following:

Adecco Nederland, Allstate Life Insurance, Anritsu, Auchan, Bank Leumi, Bank of Cyprus UK, BNP Paribas, BSkyB, Carrefour, CBS Outdoor, CCV, Club Med, Eldan, Electra, Ekro, Euroclear, Factory Master, Finanz Informatik, Franken Brunnen, Fujitsu-ten, Gakken, GGD Amsterdam, Groupe Flo, Hebrew University of Jerusalem, HONDA, Immobilier, ING Commercial Finance, Industry, Japan Chamber of Commerce, Menzies (John Menzies plc), Nespresso, Nintendo, RDC Datacentrum, Rosenbauer, Staff Development Management Systems (SDMS Ltd), SECOM Techno Service, Symbra, Tecan, Total and Vinci.

Sales, Marketing and Distribution

We market, sell and support our products through our own direct sales force as well as through a global channel-network of ISVs, SIs, value-added distributors and resellers, as well as OEM and consulting partners. Our own sales force is based in our regional offices in the United States, Japan, the United Kingdom, France, South Africa, Germany, the Netherlands, Hungary, India and Israel, and through local distributors elsewhere, our channel-network is present in about 50 countries worldwide.

Direct Sales. For uniPaaS, our direct sales force pursues enterprise accounts and software solution providers. Our sales personnel carry out strategic sales with a direct approach to decision makers, managing a constantly monitored consultative type of sales cycle. iBOLT is mostly sold via indirect channels and through our ecosystem business relationships, but we have some direct customers with integration needs.

At December 31, 2010, we had approximately 107 sales personnel including a team of sales engineers who provide pre-sale technical support, presentations and demonstrations in order to support our sales force.

Indirect Sales. We maintain an indirect sales channel for iBOLT, through our ecosystem business relationships, as well as via SIs, value added distributors and resellers, OEM partners, as well as consultancies and service providers. We maintain an indirect sales channel for uniPaaS through ISVs and SIs, who use our application platform to develop and deploy different applications selling them to their end-user customers. We carry out marketing activities with our indirect channels and increased the number of new channel partners for both uniPaaS and iBOLT during 2010.

23

Distributors. In general, we distribute our products through local distributors in those countries where we do not have a sales office. A local distributor is typically a software marketing organization with the capability to add value with consulting, training, and support. Distributors that are also MSPs are generally responsible for the implementation of both our application platform and business and process integration suite and localization into their native languages. The distributors also translate our marketing literature and technical documentation. Distributors must undergo our program of sales and technical training. Marketing, sales, training, consulting, product and client support are provided by the local distributor. We are available for backup support for the distributor and for end-users. In coordination with the local subsidiaries and distributors, we also provide sales support for large and multinational accounts. We have approximately 25 distributors in Europe, Latin America and Asia, many of whom are also MSPs.

VARs. In general, we resell our products through VARs that extend their capabilities with our offerings. These include SAP VARs.

Global Marketing Activities. We carry out a wide range of marketing activities aimed at generating awareness of our solutions offerings. Among our activities, we focus on online communication on social networks, including corporate blogs, public relations and media coverage, case studies, industry analyst relations, an extensive program of Internet-based webcasts, search engine optimization campaigns, on-line advertising, exhibitions, attendance at trade shows, lead generation campaigns, and end-user and distributor conferences and seminars. We conduct distributor and user conferences to update our worldwide affiliates and user base on our new product offerings, marketing activities, pricing, good practices, technical information and the like.

In order to foster improved relationships with our channel partners, we periodically sponsor local events and other regional marketing activities. On our corporate Internet website, we host an online solutions directory, which highlights applications developed and offered by our partners. Furthermore, in 2009 we introduced an effective partner portal, which includes all updated marketing materials and campaigns we developed and in April 2010, we launched our developers' network where all developers using our software can exchange ideas, learn best practices and hear recent tips for more effective use of our technology and more.

iBOLT Ecosystems. The important ecosystem businesses pursued by us to date include:

- SAP. During 2004, we entered into a partnership with SAP that focused on providing a special edition of iBOLT as a collaboration platform for the SAP Business One product, an integrated business management solution designed specifically for small and midsize businesses. Our iBOLT Special Edition was accepted by the SAP community, and our company was awarded by SAP the ISV Partner Leadership in Innovation 2005 award, in 2006 we were awarded the SAP Software Solution Partner Quality Excellence Award, and in 2007 we were awarded the SAP global award for SAP Business One Global Solution Partner Award for Leadership in Innovation. Our iBOLT Special Edition partner program is endorsed by over 230 SAP Business One partners across the globe which have signed a partnership agreement with us and have become a significant new addition to the our partner community. In the beginning of 2007, we announced a new iBOLT Special Edition for SAP R/3 ERP software and we received SAP's xAPPS certification. iBOLT is also certified for SAP All-in-One special edition. In addition to the direct economic impact of iBOLT sales, we are experiencing the following benefits that arise from our partnership with SAP: (i) recognition and validation of our technology as a mainstream player in the business integration and composite application development domains; (ii) privileged access to a pre-qualified partner community that can also employ iBOLT in non-SAP related projects; and (iii) revitalization of our partner community, by offering them access to the SAP Partner Program and branding of their existing applications.

- IBM. In March 2007, we qualified for the IBM Business Partner SOA Specialty. For this specialty, IBM selects business partners who market SOA content, services, or both that demonstrate compatibility with or complement the IBM SOA Foundation products, who endorse the IBM SOA strategy, and whose marketing activities IBM determines to be in agreement with its own. We offer SOA capabilities in the System i (iSeries / AS/400) market and we qualified for this specialty with respect to one of our SOA projects. Our technology allows IBM System i users to better utilize the value of their legacy systems and integrate them with different applications in their organization to maximize the return on their existing investments.

- Salesforce.com. In late 2007, we joined the partners' program of Salesforce.com and became AppExchange certified. This enables us to address the Salesforce.com ecosystem and introduce our iBOLT for Salesforce.com to its partners and customers. Since then, we have participated in Salesforce.com's regional Success Tours, Tour-de-Force events, as well as launched our iBOLT for Salesforce.com at Dreamforce Europe 2008 in May in London, and participated at Dreamforce U.S. in November 2008, where we released the advanced version of iBOLT for Salesforce.com. During 2009, we participated in Salesforce.com's U.S. and EMEA cloud events. We have signed partnerships and already implemented our solutions with customers in the United Kingdom, the United States, Germany and Israel. Together with nefos GmbH, we won the integration award at the 2010 Cloudforce event in Munich, Germany. Cloudforce Munich is one of the largest cloud computing events in Europe. We and nefos received the award (the only award of the event) for our outstanding achievements in integrating Salesforce.com and SAP in a customer project.

- Oracle JD Edwards. Since late 2006 we have been actively marketing iBOLT to users of Oracle's JD Edwards ERP Systems. We are Platinum Sponsors of the Quest International Users Group and promote our solutions to users of JD Edwards Enterprise One and JD Edwards World at Oracle Collaborate, Oracle Open World and UKOUG events. We have recruited more than a dozen partners and continue to win new customer deals related to our JD Edwards business.

Competition

The markets for our uniPaaS and iBOLT technologies and applications are characterized by rapidly changing technology, evolving industry standards, frequent new product introductions and rapidly changing customer requirements. These markets are therefore highly competitive, and we expect competition to intensify in the future. The enhancement of the SaaS market increases the competition in these areas, and one of our competitors, even claims to offer a fully automated eDeveloper conversion process, converting eDeveloper based applications to .NET based applications. We constantly follow and analyze the market trends and our competitors in order to effectively compete in these markets and avoid losing market share to other players and to our competitors.

With the introduction of uniPaaS in mid-2008, we further shifted our activities from the integrated development environment market, in which we were competing with eDeveloper in the past, towards the application platform and web oriented architecture market. Our current competitors include Cordys, IBM, Microsoft, Adobe, Oracle, Pegasystems, Progress, Fiorano, Intersystems, Sun, Ultimus and Unify. In the iBOLT integration market, our competitors include Microsoft BizTalk, Informatica, TIBCO and Software AG. Additional competitors may enter each of our markets at any time. Moreover, our customers may seek to develop internally the products that we currently sell to them and thereafter they may also compete with us.

Our goal is to maintain our technology superiority, time to market and worldwide channel network, as well as our constant market analysis to quickly address changing market dynamics. We believe that the principal competitive factors affecting the market for our products include developer productivity, rapid results, product functionality, performance, reliability, portability, interoperability, ease-of-use, demonstrable economic benefits for developers and users relative to cost, quality of customer support and documentation, ease of installation, vendor reputation and experience, financial stability as well as intuitive and out of the box solutions to extend the capabilities of ERP and/or CRM and other application vendors for enterprise integration.

Intellectual Property

We do not hold any patents and rely upon a combination of copyright, trademark, trade secret laws and contractual restrictions to protect our rights in our software products. Our policy has been to pursue copyright protection for our software and related documentation and trademark registration of our product names. Also, our key employees and independent contractors and distributors are required to sign non-disclosure and secrecy agreements.

We provide our products to customers under a non-exclusive, non-transferable license. Usually, we have not required end-users of our products to sign license agreements. However, in some instances license agreements are required to be signed by the end-users. Generally, a "shrink wrap" license agreement is included in the product packaging, which explains that by opening the package seal, the user is agreeing to the terms contained therein. It is uncertain whether license agreements of this type are legally enforceable in all of the countries in which the software is marketed.

Our trademark rights include rights associated with our use of our trademarks and rights obtained by registration of our trademarks. We have obtained trademark registrations in South Africa, Canada, China, Israel, the Netherlands (Benelux), Switzerland, Thailand, Japan, the United Kingdom and the United States. The initial terms of the registration of our trademarks range from 10 to 20 years and are renewable thereafter. Our use and registration of our trademarks do not ensure that we have superior rights to others that may have registered or used identical or related marks on related goods or services. We do not believe that patent laws are a significant source of protection for our products. We have registered a copyright for our software in the United States and Japan. Also, we have registered copyrights for some of our manuals in the United States and have acquired an International Standard Book Number (ISBN) for some of our manuals. Our copyrights expire 70 years from date of first publication.

Since the software industry is characterized by rapid technological changes, the policing of the unauthorized use of software is a difficult task and software piracy is expected to continue to be a persistent problem for the packaged software industry. As there can be no assurance that the above-mentioned means of legal protection will be effective against piracy of our products, and since policing unauthorized use of software is difficult, software piracy can be expected to be a persistent potential problem.

We believe that because of the rapid pace of technological change in the software industry, the legal protections for our products are less significant factors in our success than the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of our support services.

C. Organizational Structure

Asseco, a Polish company listed on the Warsaw Stock Exchange, has a 50.2% controlling interest in our controlling shareholder Formula Systems, an Israeli company (NASDAQ: FORTY). Formula Systems beneficially owns 51.3% of our outstanding ordinary shares. Formula Systems is an international IT company principally engaged, through its subsidiaries, in providing software consulting services, developing proprietary software products and producing computer-based solutions.

The following table sets forth the legal name, location and country of incorporation and percentage ownership of each of our subsidiaries:

Subsidiary/Affiliate Name	Country of Incorporation	Ownership Percentage	
Magic Software Japan K.K	Japan	100	%
Magic Software Enterprises Inc	Delaware	100	%
Magic Software Enterprises (UK) Ltd	United Kingdom	100	%
Hermes Logistics Technologies Limited	United Kingdom	100	%
Magic Software Enterprises Spain Ltd	Spain	100	%
Coretech Consulting Group, Inc	Pennsylvania	100	%
Coretech Consulting Group LLC	Delaware	100	%
Magic Software Enterprises (Israel) Ltd	Israel	100	%
Magic Software Enterprises Netherlands B.V	Netherlands	100	%
Magic Software Enterprises France	France	100	%

Magic Beheer B.V	Netherlands	100	%
Magic Benelux B.V	Netherlands	100	%
Magic Software Enterprises GMBH	Germany	100	%

Subsidiary/Affiliate Name	Country of Incorporation	Ownership Percentage	
Magic Software Enterprises India Pvt. Ltd	India	100	%
Onyx Magyarorszag Szsoftverhaz	Hungary	100	%
CarPro Systems Ltd	Israel	90.48	%
Fusion Solutions, LLC	Delaware	100	%
Xsell Resources Inc.	Pennsylvania	88	%
Magix Integration (Proprietary) Ltd	South Africa	51	%

D. Property, Plants and Equipment

Our headquarters and principal administrative, finance, sales, marketing and research and development office is located in a 39,321 square feet of space that we lease in Or Yehuda, Israel, a suburb of Tel Aviv. We pay an aggregate annual rent of $0.3 million for the facilities under a lease agreement expiring in December, 2014. We have an option to terminate the lease agreement upon six months prior written notice.

Our subsidiaries lease office space in Laguna Hills, California; King of Prussia, Pennsylvania; Dallas, Texas; Paris, France; Munich, Germany; Pune, India; Bangalore, India; Tokyo, Japan; Budapest, Hungary; Houten, the Netherlands; Johannesburg; South Africa; and Bracknell, the United Kingdom. The aggregate annual cost for such facilities was $1,487 in the year ended December 31, 2010.

ITEM 4 A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

The following discussion of our results of operations should be read together with our consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.

Background

We were incorporated under the laws of Israel in February 1983 and began operations in 1986. Our ordinary shares were listed on the NASDAQ Global Market (symbol: MGIC) from our initial public offering in the United States on August 16, 1991 until January 3, 2011, at which date the listing of our ordinary shares was transferred to the NASDAQ Global Select Market. Since November 16, 2000, our ordinary shares have also traded on the Tel Aviv Stock Exchange. We develop market, sell and support an application platform and business and process integration solutions. We have 16 wholly-owned subsidiaries, incorporated in the United States, Europe, Asia, and Israel. Our subsidiaries are engaged in developing, marketing and supporting vertical applications, as well as in selling and supporting our products, and three of our subsidiaries provide IT consulting and staffing services.

Overview

We develop market, sell and support uniPaaS, an application platform for software development and deployment, and iBOLT, a platform for business integration and BPM. Both uniPaaS and iBOLT enable enterprises

27

to accelerate the process of building and deploying applications that can be rapidly customized and integrated with existing systems.

As an IT technology innovator, we have over 25 years of experience in assisting software companies and enterprise software companies worldwide to produce and integrate their business applications. Our application platform, uniPaaS, is used by thousands of enterprises and ISVs to develop solutions for their users and customers in approximately 50 countries. We also refer to these ISVs as MSPs. We also provide maintenance and technical support as well as professional services to our enterprise customers and to MSPs. In addition, we sell our iBOLT technology for business integration to customers using specific popular software applications, such as SAP, Salesforce.com, IBM i (AS/400) or Oracle JD Edwards or other business applications. We refer to these vendor-centered market sectors as ecosystems.

On December 23, 2010, we raised approximately $21.4 million before costs ($20.3 million, net of issuance expenses) in a private placement to institutional investors in the United States and abroad. We issued an aggregate of 3,287,616 ordinary shares at a price of $6.50 per share in the offering. Certain of the purchasers also received warrants to purchase up to an aggregate of 1,134,231 ordinary shares at an exercise price of $8.26 per share. The warrants are exercisable as of six months from the date of issuance, have a term of three years, and the exercise price is subject to future adjustment for various events, such as stock splits or dividend distributions. If the warrants are exercised in full, we will receive additional proceeds of approximately $9.4 million.

During 2010, we generated cash flows from operations of $14.4 million, compared to $7.5 million in the previous year. Our cash and cash equivalents, together with our investments, were $46.5 million as of December 31, 2010, compared with $41.9 million as of December 31, 2009.

We believe that our strong cash position, our solid balance sheet and our financing capabilities all provide a key competitive advantage and collectively will enable us to be well positioned to manage our business.

Strategy and Focus Areas

Our vision of how the industry will evolve is being driven by the change in enterprise mobility, RIA and cloud computing. This transition appears to be occurring as we expected. We believe that our technology will allow us to expand our offerings into the cloud and mobile enterprise markets with speed, scale and flexibility. We intend to remain focused on both the technology and business architectures that will enable our customers to take advantage of the cost efficiencies and competitive advantages conveyed by these technologies. We intend to continue to prudently take advantage of opportunities to capture market transitions and to put our assets to use in existing and new markets as the recovery occurs. We believe that our strategy and our ability to innovate and execute may enable us to improve our competitive position in difficult business conditions and may continue to provide us with long-term growth opportunities.

Segments

Historically, we reported our results on the basis of one reportable segment, which was comprised of two reporting units. During 2010, as a result of a change in our management structure associated with the acquisition of a U.S.-based IT consulting and staffing services business in January 2010, we began to report our results on the basis of two reportable business segments: proprietary software technology and IT professional services, each of which has one reporting unit. The reporting unit of our IT professional services segment is comprised of our three IT consulting and staffing subsidiaries, Coretech Consulting Group LLC, Fusion Solutions LLC and Xsell Resources Inc., and the reporting unit of our proprietary software technology segment is comprised of all of our other subsidiaries. Set forth below is segment information for the years ended December 31, 2008, 2009 and 2010.

	Proprietary software products	IT professional services	Unallocated expense	Total
	(U.S. dollars in thousands)			
2008				
Total revenues	$49,087	$12,893	$-	$61,980
Expenses	40,000	11,754	5,959	57,713
Operating income (loss)	$9,087	$1,139	$(5,959)	$4,267
2009				
Total revenues	$43,120	$12,230	$-	$55,350
Expenses	36,448	11,048	3,596	51,092
Operating income (loss)	$6,672	$1,182	$(3,596)	$4,258
2010				
Total revenues	$46,262	$42,316	$-	$88,578
Expenses	36,556	39,249	3,435	79,240
Operating income (loss)	$9,706	$3,067	$(3,435)	$9,338

General

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

Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are converted into dollars in accordance with the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 830 "Foreign Currency Matters." The majority of our sales are made outside of Israel and a substantial part of them is in dollars. In addition, a substantial portion of our costs is incurred in dollars. Since the dollar is the primary currency of the economic environment in which we and certain of our subsidiaries operate, the dollar is our functional and reporting currency and accordingly, monetary accounts maintained in currencies other than the dollar are remeasured using the foreign exchange rate at the balance sheet date. Operational accounts and non monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. For certain foreign subsidiaries whose functional currency is other than the U.S. dollar, all balance sheet accounts have been translated using the exchange rates in effect at each balance sheet date. Operational accounts have been translated using the average exchange rate prevailing during each year. The resulting translation adjustments are reported as a component of accumulated other comprehensive income (loss) in equity.

Critical Accounting Policies and Estimations

We have identified the policies below as critical to the understanding of our financial statements. The preparation of our consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in certain circumstances that affect the amounts reported in the accompanying financial statements and the related footnotes. Actual results may differ from these estimates. To facilitate the understanding of our business activities, certain of our accounting policies that we believe are the most important to the portrayal

29

of our financial condition and results of operations and that require management's subjective judgments are described below. We base our judgments on our experience and various assumptions that we believe are reasonable.

Revenue Recognition

We derive our revenues from licensing the rights to use our software, related professional services maintenance and technical support as well as from other IT professional services. We sell our products primarily through direct sales force and indirectly through distributors.

As required by ASC 985-605, "Software Revenue Recognition," we determine the value of the software component of our multiple-element arrangements using the residual method when vendor specific objective evidence, or VSOE, of fair value exists for the undelivered elements of the support and maintenance agreements. VSOE is based on the price charged when an element is sold separately or renewed. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

We account for our software sales in accordance with ASC 985-605, "Software Revenue Recognition." Software license revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the vendor's fee is fixed or determinable, no further obligation exists and collectability is probable. Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement.

We generally do not grant a right of return to our customers. When a right of return exists, we defer revenue until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria are met.

Revenue from professional services consists of billable hours for services provided, recognized as the services are rendered.

Arrangements that include professional services bundled with licensed software and other software related elements, are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When services are considered essential to the software, revenues under the arrangement are recognized using contract accounting based on ASC 605-35, "Construction-Type and Production-Type Contracts," on a percentage of completion method based on inputs measures. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss for the entire contract. During the years ended December 31, 2008, 2009 and 2010, no such estimated losses were identified.

When professional services are not considered essential to the functionality of other elements of the arrangement, revenue allocable to the consulting services is recognized as the services are performed, using the VSOE fair value. In most cases, we have determined that the services are not considered essential to the functionality of other elements of the arrangement.

Deferred revenue includes unearned amounts received under maintenance and support contracts, and amounts received from customers but not yet recognized as revenues.

Research and development costs

Research and development costs incurred in the process of software development before establishment of technological feasibility are charged to expenses as incurred. Costs incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in ASC 985-20, "Costs of Software to be

Sold, Leased or Marketed."

We establish technological feasibility upon completion of a detailed program design or working model.

Capitalized software costs are amortized on a product by product basis, by the greater of the amount computed using the: (i) ratio of current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product (three to five years). We assess the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. As of December 31, 2008, 2009 and 2010], no impairment losses have been identified.

Business Combinations

Effective January 1, 2009, we adopted the amended ASC 805, "Business Combinations." ASC 805 requires recognition of assets acquired, liabilities assumed, and non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. ASC 805 also requires the fair value of acquired in-process research and development to be recorded as intangibles with indefinite lives, contingent consideration to be recorded on the acquisition date, and restructuring and acquisition-related deal costs to be expensed as incurred. Any excess of the fair value of net assets acquired over purchase price and any subsequent changes in estimated contingencies are to be recorded in earnings. In addition, changes in valuation allowance related to acquired deferred tax assets and in acquired income tax position are to be recognized in earnings.

ASC 805 is applied prospectively for all business combinations occurring after January 1, 2009, except for changes in valuation allowance related to deferred tax assets and changes in acquired income tax position originating from business combinations that occurred prior to the effective date of ASC 805, which are recognized in earnings following the adoption date.

Variable Interest Entities

ASC 810, "Consolidation," provides a framework for identifying variable interest entities, or VIEs, and determining when a registrant should include the assets, liabilities, non-controlling interests and results of activities of a VIE in its consolidated financial statements.

The assessment of whether an entity is a VIE and the determination of the primary beneficiary requires judgment and involves the use of significant estimates and assumptions. Those include, among others, forecasted cash flows, their respective probabilities and the economic value of certain preference rights. In addition, such assessment also involves estimates of whether a group entity can finance its current activities, until it reaches profitability, without additional subordinated financial support.

Effective January 1, 2010, we adopted an updated guidance for the consolidation of VIEs. The new guidance replaces the prior quantitative approach for identifying which enterprise should consolidate a VIE, which was based on which enterprise was exposed to a majority of the risks and rewards, with a qualitative approach, based on which enterprise has both (1) the power to direct the economically significant activities of the entity and (2) the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the variable interest entity. Determination about whether an enterprise should consolidate a VIE is required to be evaluated continuously as changes to existing relationships or future transactions. The adoption of this standard did not have a material impact on our financial position or results of operations.

The U.S.-based consulting and staffing services business that we acquired through one of our wholly-owned subsidiaries on January 17, 2010 is considered to be a VIE. The subsidiary is the primary beneficiary of the VIE, as a result of the fact that it holds the power to direct the activities of the acquired business, which significantly impacts its economic performance, and has the right to receive the benefits accruing from the acquired business.

Goodwill

We have recorded goodwill as a result of past acquisitions. Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired.

We operate in two operating segments, each of which is comprised of one reporting unit. Goodwill was allocated to the reporting units at acquisition. We follow ASC 350, "Intangibles – Goodwill and Other" and perform our goodwill annual impairment test for our two reporting units at December 31 of each year, or more often if indicators of impairment are present.

As required by ASC 350, we compare the fair value of each reporting unit to its carrying value ('step 1'). If the fair value exceeds the carrying value of the reporting unit net assets, goodwill is considered not impaired, and no further testing is required. If the carrying value exceeds the fair value of the reporting unit, then the implied fair value of goodwill is determined by subtracting the fair value of all the identifiable net assets from the fair value of the reporting unit. An impairment loss is recorded for the excess, if any, of the carrying value of goodwill over its implied fair value ('step 2').

Effective January 1, 2009, as required by ASC 820, "Fair Value Measurements and disclosures," we apply assumptions that market place participants would consider in determining the fair value of each reporting unit.

In order to determine the fair value of our two reporting units, we implemented an 'income approach'. Under the income approach expected future cash flows are discounted to their present value using an appropriate rate of return. Judgments and assumptions related to future cash flows (projected revenues, operating expenses and capital expenditures), future short-term and long-term growth rates, and weighted average cost of capital, which are based on our internal assumptions, and believed to be similar to those of market participants and to represent both the specific risks associated with the business, and capital market conditions, are inherent in developing the discounted cash flow model.

In addition, we compared our market capitalization, including an estimated control premium that an investor would be willing to pay for a controlling interest in our company to the fair value of our reporting units, based on a third-party valuation study. The determination of a control premium requires the use of judgment and is based primarily on comparable industry and deal-size transactions, related synergies and other benefits. Our reconciliation of the gap between our market capitalization and the aggregate fair value of our company depends on various factors, some of which are qualitative and involve management judgment, including stable relatively high backlog coverage and experience in meeting operating cash flow targets.

Since the fair value of our two reporting units exceeded their carrying amount, no impairment losses were recognized in 2008, 2009 and 2010

Impairment of long-lived assets and intangible assets subject to amortization

We review our long-lived assets for impairment in accordance with ASC 360, "Property, Plant and Equipment," whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset 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 value of the assets exceeds the fair value of the assets. During the years ended December 31, 2008, 2009 and 2010, no impairment indicators have been identified.

As required by ASC 820, "Fair Value Measurements," effective January 1, 2009, we apply assumptions that marketplace participants would consider in determining the fair value of long-lived assets (or asset groups).

Intangible assets with finite lives are comprised of distribution rights, acquired technology and customer relationships, and are amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. We recorded an intangible asset attributable to customer relationships that we acquired in connection with the acquisition of a U.S.-based IT consulting and staffing services business in January 2010 and such customer relationships have been amortized since such time on a cash generating basis, over a period of four to 15 years. Distribution rights and acquired technology are being amortized on a straight line basis over a period of four to 15 years.

Marketable Securities

We account for investments in marketable securities in accordance with ASC 320 "Investments – Debt and Equity Securities." Our management determines the appropriate classification of its investments in marketable debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Our marketable securities consist mainly of debt securities which are designated as available-for-sale and are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in financial income, net, together with accretion (amortization) of discount (premium), and interest or dividends.

We recognize an impairment charge when a decline in the fair value of an investment that falls below its cost basis is determined to be other-than-temporary.

Declines in fair value of available-for-sale equity securities that are considered other-than-temporary, based on criteria described in SAB Topic 5M, "Other Than Temporary Impairment of Certain Investments in Equity Securities," are charged to earnings (based on the entire difference between fair value and amortized cost). Factors considered in making such a determination include the duration and severity of the impairment, the financial condition and near-term prospects of the issuer, and the intent and ability of the company to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value.

For declines in value of debt securities, effective January 1, 2009, we apply an amendment to ASC 320. Under the amended impairment model, an other-than-temporary impairment (OTTI) loss is deemed to exist and recognized in earnings if management intends to sell or if it is more likely than not that it will be required to sell, a debt security, before recovery of its amortized cost basis.

If the criteria mentioned above, does not exist, we evaluate the collectability of the security in order to determine if the security is other than temporary impaired.

For debt securities that are deemed other-than-temporary impaired, the amount of impairment recognized in the statement of operations is limited to the amount related to "credit losses" (the difference between the amortized cost of the security and the present value of the cash flows expected to be collected), while impairment related to other factors is recognized in other comprehensive income.

During 2008, we recorded a $131,000 other-than-temporary impairment of marketable securities. We did not record any impairment of marketable securities in 2009 and 2010.

Stock-based compensation

We account for stock-based compensation in accordance with ASC 718 "Compensation – Stock Compensation." ASC 718 requires registrants to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in our consolidated statement of operation. We recognize compensation expenses for the value of our awards, which have graded vesting based on the accelerated method over the requisite service period of each of the awards, net of estimated forfeitures. To measure and recognize compensation expense for share-based awards we use the Binomial option-pricing model. The Binomial model for option pricing requires a number of assumptions, of which the most significant are the suboptimal exercise factor and expected stock price volatility. The suboptimal exercise factor is estimated based on employees' historical option exercise behavior. The suboptimal exercise factor is the ratio by which the stock price must increase over the exercise price before employees are expected to exercise their stock options. Expected volatility is based upon actual historical stock price movements and was calculated as of the grant dates for different periods, since the Binomial model can be used for different expected volatilities for different periods. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term to the contractual term of the options. Although we paid a cash dividend in January 2010, we have no foreseeable plans to pay dividends and therefore we use an expected dividend yield of zero in the option pricing model. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. Estimated forfeitures are based on actual historical pre-vesting forfeitures. For awards with performance conditions, compensation cost is recognized over the requisite service period if it is 'probable' that the performance conditions will be satisfied, as defined in ASC 450-20-20, “Loss Contingencies.”

Contingencies

From time to time, we are subject to claims arising in the ordinary course of our business, including claims relating to product liability, employees, suppliers and public authorities. In determining whether liabilities should be recorded for pending litigation claims, we assess the allegations made and the likelihood that we will be able to defend against the claim successfully. When we believe that it is probable that we will not prevail in a particular matter, we estimate the amount of liability based, in part, on advice of legal counsel.

Fair Value Measurements

We account for certain assets and liabilities at fair value under ASC 820, “Fair Value Measurements and Disclosures.” Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 - significant other observable inputs based on market data obtained from sources independent of the reporting entity;

Level 3 - Unobservable inputs which are supported by little or no market activity (for example cash flow modeling inputs based on assumptions).

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. We categorized each of our fair value measurements in one of these three levels of hierarchy.

Assets and liabilities measured at fair value on a recurring basis are comprised of marketable securities foreign currency forward contracts and contingent consideration (See Note 5 to the consolidated financial statements).

The carrying amounts reported in the balance sheet for cash and cash equivalents, trade receivables, other accounts receivable, short-term bank credit, trade payables and other accounts payable approximate their fair values due to the short-term maturities of such instruments.

Accounting for income tax

We account for income taxes in accordance with ASC 740, “Income Taxes.” ASC 740 prescribes the use of the “asset and liability” method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value. Deferred tax assets are classified as current or non-current according to the expected reversal dates.

Effective as of January 1, 2007, we utilize a two-step approach in recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. Under the first step we evaluate a tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, based on technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement with the tax authorities. We have accrued interest and penalties related to unrecognized tax benefits in our provisions for income taxes. The total amount of gross unrecognized tax benefits (taxes on income) for the years ended December 31, 2008, 2009 and 2010 were $16,000, $(217,000) and $874,000, respectively.

Significant Revenues and Expenses

Revenues. Revenues are derived from sales of software licenses, related professional services, maintenance and technical support and other IT professional services. Revenues may continue to be affected by factors including market uncertainty, which can result in cautious spending in our global markets; changes in the geopolitical environment; sales cycles; high fluctuation of exchange rates; changes in the mix of direct sales and indirect sales and variations in sales channels.

Cost of Revenues. Cost of revenues for software sales consist primarily of software production costs, royalties and licenses payable to third parties, as well as amortization of capitalized software. Cost of revenues for maintenance and technical support and professional services consists primarily of personnel expenses, subcontracting and other related costs. Cost of revenues is affected by changes in the mix of revenues sold; price competition; sales discounts; currency fluctuation; and increases in labor costs. Service gross margin may be impacted by various factors such as the change in mix between technical support services and advanced services, the timing of technical support service contract initiations and renewals and the timing of our strategic investments in headcount and resources to support this business.

Research and Development Expenses, Net. Research and development costs consist primarily of salaries of employees engaged in on-going research and development activities and other related expenses. The capitalization of software development costs is applied as reductions to gross research and development costs to calculate net research and development expenses.

The following table sets forth the gross research and development costs, capitalized software development costs, and the net research and development expenses for the periods indicated:

	Year ended December 31		
	2008	2009	2010
	(U.S. dollars in thousands)		
Gross research and development costs	$ 4,927	$ 4,438	$ 5,667
Less capitalized software development costs	(2,577)	(3,128)	(3,595)
Research and development expenses, net	$ 2,350	$ 1,310	$ 2,072

Selling and Marketing Expenses. Selling and marketing expenses consist primarily of salaries and related expenses for sales and marketing personnel, sales commissions, marketing programs, website related expenses, public relations, promotional materials, travel expenses and trade show exhibit expenses.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related expenses for executive, accounting, human resources and administrative personnel, professional fees, provisions for doubtful accounts, and other general corporate expenses.

Financial income (expenses), net. Net financial income (expenses) consists primarily of interest earned on cash equivalents and marketable securities, interest paid on loans received and currency translation adjustments.

Results of Operations

The following table presents selected consolidated statement of operations data for the periods indicated as a percentage of total revenues:

	Year ended December 31,					
	2008		2009		2010	
Revenues:						
Software	33.7	%	31.2	%	22.7	%
Maintenance and technical support	23.5		25.0		16.3	
Consulting services	42.8		43.8		61.0	
Total revenues	100.0	%	100.0	%	100.0	%
Cost of revenues:						
Software	7.9		9.7		6.0	
Maintenance and technical support	3.7		4.0		2.3	
Consulting services	32.2		33.8		49.7	
Total cost of revenues	43.8		47.5		58.0	
Gross profit	56.2		52.5		42.0	
Operating costs and expenses:						
Research and development, net	3.8		2.4		2.3	
Selling and marketing,	28.0		27.7		19.8	
General and administrative	17.5		14.8		9.2	
Other income, net	-		3.6		-	
Total operating expenses, net	49.3		41.3		31.3	
Operating income	6.9		11.2		10.7	
Financial income (expenses), net	0.7		0.4		(0.3	)
Other income, net	-		0.1		0.2	
Income before taxes on income	7.6		11.7		10.6	
Tax benefit (taxes on income)	(0.3	)	(0.6	)	-	
Net income attributable to Magic's shareholders	7.3		11.1		10.6	

Year Ended December 31, 2010 Compared With Year Ended December 31, 2009

Revenues. Revenues in 2010 increased by 60% from \$55.4 million in 2009 to \$88.6 million in 2010. Revenues from proprietary software products increased by 7% from \$43.1 million in 2009 to \$46.3 million in 2010, as a result of increased sales of licenses due to the recovery from the global economic downturn in Japan, the United States and United Kingdom. Revenues from IT professional services increased by 246% from \$12.2 million in 2009 to \$42.3 million in 2010, primarily as a result of the acquisition of a U.S.-based IT professional services business on January 17, 2010.

Revenues from sales of licenses increased by 13% from \$14.7 million in 2009 to \$16.6 million in 2010. Revenues from sales of applications increased by 35% from \$2.6 million in 2009 to \$3.5 million in 2010. The increase in license and applications sales was primarily due to the recovery from the global economic downturn in Japan, the United States and United Kingdom. Revenues from maintenance and technical support increased by 4.3% from \$13.8 million in 2009 to \$14.4 million in 2010, primarily as a result of the increase in licenses revenues. Revenues from IT consulting services increased by 123% from \$24.3 million in 2009 to \$54.1 million in 2010, primarily as a result of the acquisition of a U.S.-based IT professional services business on January 17, 2010.

The following table presents our revenues by geographical market for the years ended December 31, 2009 and 2010:

	Year ended December 31, 2009	2010
	(In thousands)	
Israel	$ 3,614	$ 4,405
Europe	22,516	21,788
United States	18,485	48,888
Japan	8,895	10,806
Other	1,840	2,691
Total revenues	$ 55,350	$ 88,578

Cost of Revenues. Cost of revenues increased by 95% from $26.3 million in 2009 to $51.4 million in 2010. Cost of revenues for licenses decreased by 10% from $4.1 million in 2009 to $3.7 million in 2010, primarily due to a decrease in the amortization of capitalized software expenses in 2010 due to the full amortization of older releases prior to the 2010 period, which decrease was offset by the amortization of new releases. Cost of revenues for applications increased by 23% from $1.3 million in 2009 to $1.6 million in 2010, mainly due to the increase in application revenues. Cost of revenues for maintenance and technical support decreased by 5% from $2.2 million in 2009, to $2.1 million in 2010. Cost of revenues for IT consulting services increased by136% from $18.7 million in 2009 to $44.1 million in 2010, as a result of the acquisition of a U.S.-based IT professional services business on January 17, 2010. Cost of revenues for each of the years ended December 31, 2009 and 2010 includes $2,000 of stock-based compensation recorded under ASC 718.

Gross Profit. Gross profit in 2010 was 42% compared to gross profit of 52.5% in 2009. The decrease in gross profit was mainly due to the change in the ratio of our revenues primarily as a result of the increase in IT consulting services revenues, which have lower margins than our revenues from licenses and maintenance and technical support.

Research and Development Expenses, Net. Gross research and development costs increased by 30% from $4.4 million in 2009 to $5.7 million in 2010. Net research and development expenses increased by 62% from $1.3 million in 2009 to $2.1 million in 2010. In 2010, we capitalized $3.6 million of software development costs compared to $3.1 million in 2009. The increase in gross research and development costs and capitalization costs is due to increased research and development activity in 2010. The increase in gross research and development costs in 2010 was also due to the depreciation of the U.S. dollar against the NIS, which increased the U.S. dollar value of our NIS denominated costs. Net research and development costs as a percentage of revenues was 2.3% in 2010 compared to 2.4% in 2009. Research and development expenses for the years ended December 31, 2009 and 2010 include $26,000 and $61,000, respectively, of stock-based compensation recorded under ASC 718.

Selling and Marketing Expenses. Selling and marketing expenses increased by 14% from $15.3 million in 2009 to $17.5 million in 2010. The increase in selling and marketing expenses is primarily due to the acquisition of a U.S.-based IT professional services business on January 17, 2010 as well as from increased worldwide selling and marketing activities and increased bonuses and commissions to our sales personal as a result of increased sales. Selling and marketing expenses as a percentage of revenues was 20% in 2010 as compared to 28% in 2009. Selling and marketing expenses for the years ended December 31, 2009 and 2010 include $32,000 and $75,000, respectively, of stock-based compensation recorded under ASC 718.

General and Administrative Expenses. General and administrative expenses remained constant at $8.2 million both in 2009 and 2010. General and administrative expenses for the years ended December 31, 2009 and 2010 include $70,000 and $162,000, respectively, of stock-based compensation recorded under ASC 718.

Other Income, Net. We recorded other income, net of $2.0 million in 2009 compared to $0.2 million in 2010. Other income, net in 2009 is attributable to the capital gain that we recorded from the sale of our Israel-based

headquarters' office building in December 2009 in consideration of $5.2 million, of which $4.9 million was received in December 2009 and the remaining $0.3 million was received in 2010 following the receipt of certain approvals from the Israeli tax authorities and local municipality that we have no outstanding obligations. Other income, net in 2009 is also attributable to the capital gain that we recorded from the sale of our Hungarian office building facility in June 2009 for total consideration of $0.5 million. Other income in 2010 is attributable to proceeds from the sale of the assets of CarPro Systems Ltd. in December 2006.

Financial Income (Expenses), Net. We had financial expenses, net of $0.2 million in 2010 compared to financial income, net of $0.2 million in 2009. Our financial income, net in 2009 consists of interest income on deposits and marketable securities. Our financial expenses, net in 2010 was primarily due to the depreciation of the Euro against the U.S. dollar, which adversely affected the U.S. dollar value of Euro denominated assets, including cash and accounts receivable.

Tax Benefit (Taxes on Income). We recorded taxes on income of $0.3 million in 2009 compared to a tax benefit of $0.1 million in 2010. Taxes on income are primarily attributable to taxes incurred in Europe and the United States. The tax benefit in 2010 was derived from an increase in a deferred income tax asset recorded with respect to carryforward tax losses in Israel, reversing a previous valuation allowance on a deferred income tax asset.

Net Income. We recorded net income of $9.4 million in 2010 compared to net income of $6.2 million in 2009. The increase in net income in 2010 is attributable to the increase in our operations, mainly in the Japanese and U.S. markets, as well as to the revenues generated from the U.S.-based IT professional services business that we acquired in January 2010. Our net income in 2009 benefited from approximately $2.2 million capital gains that we record as a result of the sale of our Hungarian facility in June 2009 and our Israel-based headquarters' office building in December 2009.

Year Ended December 31, 2009 Compared With Year Ended December 31, 2008

Revenues. Revenues in 2009 decreased by 11% from $62.0 million in 2008 to $55.4 million in 2009. Revenues from proprietary software products decreased by 12% from $49.1 million in 2008 to $43.1 million in 2009, as a result of the economic downturn during 2009, which led to a significant reduction in ongoing orders for our products, particularly in the Japanese and European markets. Revenues from IT professional services revenues decreased by 5% from $12.9 million in 2008 to $12.2 million in 2009. License revenues decreased by 18% from $17.9 million in 2008 to $14.7 million in 2009, primarily attributable to the generally lower demand for our products caused by the global economic downturn. As a result of this economic downturn during 2009, we experienced a significant reduction in ongoing orders for our products, particularly in the Japanese and European markets. Revenues from sales of applications decreased by 13% from $3.0 million in 2008 to $2.6 million in 2009, primarily due to a reduction in orders in the Japanese market and exchange rate differences attributed to the depreciation of the British Pound against the U.S. dollar, which adversely affected the U.S. dollar value of our British Pound denominated revenues from sales of applications. Revenues from maintenance and technical support decreased by 5% from $14.5 million in 2008 to $13.8 million in 2009, primarily as a result of the depreciation of the Euro and British Pound against the U.S. dollar, which adversely affected the U.S. dollar value of our Euro and British Pound denominated revenues from maintenance and technical support. Revenues from consulting and other services decreased by 9% from $26.6 million in 2008 to $24.3 million in 2009, primarily as a result of the advancement of a number of customers' projects to production stage, consequently reducing the technology consulting needs of these customers, and the lower demand caused by the global economic downturn.

The following table presents our revenues by geographical market for the years ended December 31, 2008 and 2009:

	Year ended December 31,	
	2008	2009
	(In thousands)	
Israel	$ 4,760	$ 3,614
Europe	25,359	22,516
United States	20,096	18,485
Japan	10,110	8,895
Other	1,655	1,840
Total revenues	$ 61,980	$ 55,350

Cost of Revenues. Cost of revenues decreased by 3% from $27.1 million in 2008 to $26.3 million in 2009. Cost of revenues for licenses increased by 28% from $3.2 million in 2008 to $4.1 million in 2009, primarily due to an increase in amortization of capitalized software development expenses from $2.4 million in 2008 to $3.7 million in 2009. Cost of revenues for applications decreased by 24% from $1.7 million in 2008 to $1.3 million in 2009, due to the decrease in application revenues and increased margins on sales of applications. Cost of revenues for maintenance and technical support were $2.2 in 2009, the same as in 2008. Cost of revenues for consulting and other services decreased by 7% from $20.0 million in 2008 to $18.7 million in 2009, consistent with the decrease in consulting and other services revenues. Cost of revenues for the years ended December 31, 2008 and 2009 includes $20,000 and $2,000, respectively, of stock-based compensation recorded under ASC 718.

Gross Profit. Gross profit in 2009 was 52.5% compared to gross profit of 56.2% in 2008. The decrease in gross profit was mainly a result of the decrease in the license sales and maintenance and technical support, which maintain high gross profit margins.

Research and Development Expenses, Net. Gross research and development costs decreased by 10% from $4.9 million in 2008 to $4.4 million in 2009. Net research and development expenses decreased by 44% from $2.3 million in 2008 to $1.3 million in 2009. In 2009, we capitalized $3.1 million of software development costs compared to $2.6 million in 2008 due to an increase in product enhancements. The decrease in gross research and development costs in 2009 was primarily due to a reduction in salary costs that we implemented in 2009 and the depreciation of the NIS against the U.S. dollar, which decreased the U.S. dollar value of our NIS denominated salary costs. Net research and development costs as a percentage of revenues in 2009 was 2.4% compared to 3.8% in 2008. Research and development expenses for the years ended December 31, 2008 and 2009 include $13,000 and $26,000, respectively, of stock-based compensation recorded under ASC 718.

Selling and Marketing Expenses. Selling and marketing expenses decreased by 12% from $17.4 million in 2008 to $15.3 million in 2009. The decrease in selling and marketing expenses is consistent with the decrease in total sales and is also attributable to expense control initiatives implemented by management in 2009. Selling and marketing expenses for the years ended December 31, 2008 and 2009 include $112,000 and $32,000, respectively, of stock-based compensation recorded under ASC 718.

General and Administrative Expenses. General and administrative expenses decreased by 25% from $10.9 million in 2008 to $8.2 million in 2009. The decrease in general and administrative expenses is primarily attributable to a reduction in salary costs that we implemented in 2009 together with other expense control initiatives. General and administrative expenses for the years ended December 31, 2008 and 2009 include $99,000 and $70,000, respectively, of stock-based compensation recorded under ASC 718.

39

Other Income, Net. We recorded other income of $2.0 million in 2009, which is mainly attributable to the sale of our Israel-based headquarters' office building in December 2009 in consideration of $5.2 million, of which $4.9 million was received in December 2009 and the remaining $0.3 million was received in 2010 following the receipt of certain approvals from the Israeli tax authorities and local municipality that we have no outstanding obligations. We did not record other income in 2008.

Financial Income, Net. Financial income, net decreased from $0.4 million in 2008 to $0.2 million in 2009. The decrease in financial income, net was primarily due to lower prevailing interest rates on deposits and marketable securities and the effect of changes in currency rates.

Taxes on Income. We recorded taxes on income of $0.2 million in 2008 compared to $0.3 million in 2009. Taxes on income are primarily attributable to taxes incurred in Europe and the United States. Most of our subsidiaries have accumulated carryforward losses for tax purposes.

Equity in Earnings (Losses) of Affiliates. Prior to the sale of our 40% ownership interest in Nextstep in June 2008, we recognized income and loss from the operations of Nextstep. In 2008, we recorded equity in losses of affiliates of $8,000. As a result of the sale of our interest in Nextstep in June 2008, we recorded a loss of $61,000. We did not record equity in losses of affiliates in 2009.

Net Income (Loss). We recorded net income of $4.5 million from continued operations in 2008 compared to net income of $6.2 million from continued operations in 2009. The increase in net income in 2009 is mainly attributable to the capital gain of approximately $2 million that we recorded from the sale of our Israel-based headquarters' office building as well as expense control initiatives implemented by management in 2009.

Impact of Currency Fluctuations and of Inflation

Our financial statements are stated in U.S. dollars, our functional currency. However, a substantial portion of our revenues and costs are incurred in other currencies, particularly NIS, Euros, Japanese yen, and the British pound. We also maintain substantial non-U.S. dollar balances of assets, including cash, accounts receivable, and liabilities, including accounts payable. Therefore, fluctuations in the value of the currencies in which we do business relative to the U.S. dollar may have a material adverse effect on our business, results of operations and financial condition. The depreciation of such other currencies in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our liabilities which are payable in those other currencies (unless such costs or payables are linked to the U.S. dollar). Such depreciation also has the effect of decreasing the U.S. dollar value of any asset that is denominated in such other currencies or receivables payable in such other currencies (unless such receivables are linked to the U.S. dollar). In addition, the U.S. dollar value of revenues and expenses denominated in such other currencies would increase. Conversely, the appreciation of any currency in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked assets and the U.S. dollar amounts of any unlinked liabilities and increasing the U.S. dollar value of revenues and expenses denominated in other currencies.

In addition, while we incur a portion of our costs in NIS, the U.S. dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is (or is not) offset, or is offset on a lagging basis, by a devaluation of the NIS in relation to the U.S. dollar.

Because exchange rates between the NIS, Euro, Japanese Yen and the British pound and the U.S. dollar fluctuate continuously, exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

The following table sets forth, for the periods indicated, (i) depreciation or appreciation of the U.S. dollar against the most important currencies for our business, the NIS, Euro, Japanese yen, the British pound; and (ii) inflation as reflected in changes in the Israeli consumer price index.

	Year Ended December 31,				
	2006	2007	2008	2009	2010
New Israeli Shekel	2.0 %	9.9 %	1.2 %	0.7 %	6.4 %
Euro	4.2 %	11.7 %	(5.3)%	3.5 %	(7.4)%
Japanese Yen	(7.6)%	6.2 %	23.1 %	(1.4)%	13.4 %
British Pound	6.4 %	2.2 %	(27.2)%	10.9 %	(4.4)%
Israeli Consumer Price Index	(0.1)%	3.4 %	3.8 %	4.0 %	2.6 %

Conditions in Israel

We are incorporated under the laws of Israel, and our principal executive offices and most of our research and development facilities are located in the State of Israel. See Item 3.D. “Key Information - Risk Factors - Risks Relating to Our Location in Israel” for a description of governmental, economic, fiscal, monetary or political polices or factors that have materially affected or could materially affect our operations.

Corporate Tax Rate

Israeli companies are subject to corporate tax at the rate of 25% in the 2010 tax year. In accordance with a recent amendment to the Income Tax Ordinance (Amendment No. 171 dated July 23, 2009), the corporate tax rate declined to 24% in 2011 and is scheduled to further decline to 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015 and 18% in 2016 and thereafter. However, the effective tax rate payable by a company that derives income from an “approved enterprise” (as further discussed below), may be considerably less.

Eight investment programs at our facility in Or Yehuda have been granted “approved enterprise” status under the Law for Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law, and we are, therefore, eligible for certain tax benefits. Subject to compliance with applicable requirements, the portion of our income derived from the approved enterprise programs will be tax-exempt for a period of two to four years commencing in the first year in which an approved enterprise generates taxable income and will be subject, for a period of five to eight years, to a reduced corporate tax (such reduced tax rates are dependent on the level of foreign investments in the company). However, these benefits will not be available to us with respect to any income derived by our non-Israeli subsidiaries.

On April 1, 2005, an amendment to the Investment Law, or the Amendment, came into effect that has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which are eligible to receive tax benefits, such as generally requiring that at least 25% of the enterprise’s income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. Such an enterprise is a Privileged Enterprise, rather than the previous terminology of Approved Enterprise. The period of tax benefits for a new Privileged Enterprise commences in the "Year of Commencement,” which is the later of: (1) the year of election, or (2) the year in which taxable income is first generated by the company after the election year.

However, the amendment to the Investment Law provides that terms and benefits included in any certificate of approval granted prior to the Amendment will remain subject to the provisions of the Investment Law as they were on the date of such approval. Therefore, our existing approved enterprise programs will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income will subject us to taxes upon distribution or liquidation and we may be required to record deferred tax liability with respect to such tax-exempt income. As of December 31, 2010, we did not generate income under the provision of the Amendment.

In December 2010, the Israeli Parliament passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), which, among other things, amends the Investment Law, effective as of January 1, 2011. According to the new legislation, the benefit tracks under the Investment Law were modified and a uniform tax rate will apply to all of the income of a Privileged Enterprise. We may elect to irrevocably implement the amendment (while waiving benefits provided under the Investment Law as currently in effect) and subsequently would be subject to the amended tax rates that are: 2011 and 2012 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%).

As of December 31, 2010, our net operating loss carry-forwards for Israeli tax purposes was approximately $35.1 million. Under current Israeli tax laws, operating loss carry-forwards do not expire and may be offset against future taxable income. As of December 31, 2010, our subsidiaries in Europe had estimated total available tax loss carry-forwards of $6.6 million, which may be offset against future taxable income for 15 to 20 years, respectively.

We have received final tax assessments through the year 2005 from the Israeli tax authorities.

Recently Issued Accounting Standards

In October 2009, the FASB issued amendments to the accounting and disclosure for revenue recognition of multiple deliverable revenue arrangements codified in ASC 605-25. The amendments modify the criteria for recognizing revenue in multiple element arrangements and require companies to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. Additionally, the amendments eliminate the residual method for allocating arrangement considerations. The amendments establish a selling price hierarchy for determining the selling price of a deliverable, which is based on: a) vendor-specific objective evidence; b) third-party evidence; or c) estimates. In addition, the guidance significantly expands required disclosures related to a vendor’s multiple-deliverable revenue arrangements. ASC 605-25 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We have not early adopted the guidance. We do not believe that the adoption of the new guidance will have material impact on our consolidated financial statements.

In January 2010, the FASB updated the “Fair Value Measurements Disclosures” codified in FASB ASC 820. More specifically, the update requires (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. to present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). The update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value, and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. The update became effective as of the first quarter ended December 31, 2010, except for the gross presentation of the Level 3 roll forward information, which is required for annual reporting of December 31, 2010. The adoption of the new guidance did not have a material impact on our consolidated financial statements.

In February 2010, the FASB issued Accounting Standard Update, or ASU, 2010-09 - amendments to certain recognition and disclosure requirements of “Subsequent Events” codified in ASC 855. The update removes the requirement to disclose the date through which subsequent events were evaluated in both originally issued and reissued financial statements for "SEC Filers." ASU 2010-09 still requires our company to evaluate subsequent events through the date that the financial statements are issued. The adoption of the new guidance did not have a material impact on our consolidated financial statements.

In December 2010, the FASB Emerging Issues Task Force issued ASU 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations codified in ASC 805, “Business Combinations.” ASU 2010-29 responds to diversity in practice about the interpretation of the pro forma disclosure requirements for business combinations. When a public entity's business combinations are material on an individual or aggregate basis, the notes to its financial statements must provide pro forma revenue and earnings of the combined entity as if the acquisition date(s) had occurred as of the beginning of the annual reporting period. The ASU clarifies that if comparative financial statements are presented, the pro forma disclosures for both periods presented (the year in which the acquisition occurred and the prior year) should be reported as if the acquisition had occurred as of the beginning of the comparable prior annual reporting period only and not as if it had occurred at the beginning of the current annual reporting period. The ASU also expands the supplemental pro forma disclosure requirements to include a description of the nature and amount of any material non-recurring adjustments that are directly attributable to the business combination. We have determined not to early adopt the new guidance.

B. Liquidity and Capital Resources

Historically, we have financed our operations through cash generated by operations, funds generated by our public offerings in 1991 (approximately \$8.5 million), 1996 (approximately \$5.0 million) and 2000 (approximately \$79.6 million), private equity investments in 1998 (approximately \$12.2 million), as well as from research and development and marketing grants primarily from the Government of Israel. In addition, we have also financed our operations through short-term loans and borrowings under available credit facilities.

In June 2008, we sold our 40% interest in Nextstep in consideration of \$150,000 and recorded a capital loss of \$61,000.

In December 2009, we sold our Israel-based headquarters' office building in consideration of \$5.2 million, of which \$4.9 million was received in December 2009 and the remaining \$0.3 million was received in 2010 following the receipt of certain approvals from the Israeli tax authorities and local municipality that we have no outstanding obligations. We recorded a capital gain of \$2.0 million as a result of the transaction in 2009.

On January 17, 2010, we purchased a consulting and staffing services business of a U.S.-based IT services company for approximately \$13.7 million to be paid over a three year period, of which \$8.6 million was paid in 2010, \$1.9 million was paid in 2011 and the remainder will be paid in 2012 and 2013. The acquisition had a positive effect on the growth of our IT professional services revenues in 2010.

On October 31, 2010, we purchased an 88% interest in a consulting and staffing services company, and have an option to increase our holdings to 100%. We paid a cash purchase price of \$1.6 million. The acquired company provides a comprehensive range of consulting and staffing services for IT industry in the areas of infrastructure design and delivery, application development, technology planning and implementation services.

In order to strengthen our presence in Southern Africa, on January 1, 2011, we acquired 51% of our South African distributor, Magix Integration (Proprietary) Ltd., with an option to increase out holdings to 75%, for a total investment of up to \$2.5 million. Magix Integration (Proprietary) Ltd. specializes in the software integration and application development of our platforms as well as the support of large-scale and complex systems in the public and financial sectors in South Africa.

On December 23, 2010, we raised approximately \$21.4 million before costs (\$20.3 million net of issuance expenses) in a private placement to institutional investors in the United States and abroad. We issued an aggregate of 3,287,616 ordinary shares at a price of \$6.50 per share in the offering. Certain of the purchasers also received warrants to purchase up to an aggregate of 1,134,231 ordinary shares at an exercise price of \$8.26 per share. The warrants are exercisable as of six months from the date of issuance, have a term of three years, and the exercise price is subject to future adjustment for various events, such as stock splits or dividend distributions. If the warrants are exercised in full, we will receive additional proceeds of approximately \$9.4 million.

As of December 31, 2010, we had approximately \$46.5 million in cash and cash equivalents and working capital of approximately \$48.8 million, compared to approximately \$41.9 million in cash and cash equivalents and working capital of approximately \$28.0 million at December 31, 2009.

As of December 31, 2010, our total debt was approximately \$11,000 compared to approximately \$53,000 as of December 31, 2009, comprised solely of long-term loans (including current maturities).

In December 2009, we announced that our board of directors had declared a cash dividend of $0.50 per share and the payment of the dividend in the aggregate amount of approximately $16.0 million was made on January 25, 2010.

We do not currently have significant capital spending or purchase commitments; however we anticipate a moderate increase in capital expenditures and lease commitments during 2011 consistent with the anticipated growth in our operations, infrastructure and personnel. We believe that our accumulated cash, in conjunction with cash generated from operations and available funds, will be sufficient to meet our cash requirements for working capital and capital expenditures for at least the next 12 months. We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, accounts receivable collections, and the timing and amount of tax and other payments.

We invested the proceeds from our December 2010 private placement in short-term deposit accounts that bear annual interest of 1%-2%. We believe the overall credit quality of our portfolio is strong, with our cash equivalents and fixed income portfolio invested in securities with a weighted-average credit rating exceeding A. Our fixed income and publicly traded equity securities are classified as either Level 1 or Level 2 investments, as measured under ASC 820, "Fair Value Measurements and Disclosures," as these vendors either provide a quoted market price in an active market or use observable inputs.

Cash Flows

The following table summarizes our cash flows for the periods presented:

	Year ended December 31,		
	2008	2009	2010
	(U.S. dollars in thousands)		
Net income from continuing operations	$ 4,508	$ 6,176	$ 9,375
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities from continuing operations:	3,186	1,358	5,022
Net cash provided by operating activities from continuing operations	7,694	7,534	14,397
Net cash used in operating activities from discontinued operations	(21)	-	-
Net cash provided by operating activities	7,673	7,534	14,397
Net cash provided by (used in) investing activities	11,266	(10,376)	(391)
Net cash provided by (used in) financing activities	(3,371)	(62)	4,915
Effect of exchange rate changes on cash and cash equivalents	(458)	(55)	390
Increase (decrease) in cash and cash equivalents from continuing operation	15,131	(2,959)	19,311

Net cash provided by operating activities was $14.4 million for the year ended December 31, 2010, compared to $7.5 million and $7.7 million for the year ended December 31, 2009 and 2008, respectively. Net cash provided by operations in 2010 consists primarily of our ongoing operations activity and of net income adjusted for non-cash activity, including depreciation and amortization of our capitalized research and development assets and customer relations and an increase in accrued expenses and other accounts payable, offset by an increase in deferred income taxes assets. Net cash provided by operations in 2009 consists primarily of our ongoing operations activity and of net income adjusted for non cash activity, including depreciation and amortization of our capitalized research and development assets and a decrease in trade receivables, which was offset by gain on sale of property and equipment, a decrease in accrued expenses and other accounts payable and an increase in deferred income taxes. Net cash provided by operations in 2008 consists primarily of our ongoing operations activity and of net income adjusted for non cash activity, including depreciation and amortization of our capitalized research and development assets and an increase in accrued expenses and other accounts payable.

Net cash used in investing activities was approximately $0.4 million for the year ended December 31, 2010, compared to net cash used in investing activities of approximately $10.4 million for the year ended December 31, 2009 and net cash provided by investing activities of approximately $11.3 million for the year ended December 31,

2008. Net cash used in investing activities in 2010 is primarily attributable to $10.2 million used for the acquisition of two U.S.-based IT services businesses, $3.6 million of capitalized software development costs, $1.2 million prepayment on investment, $0.6 million for investment in property and $0.4 million for investment in marketable securities, which was offset by $13.8 million net proceeds from short-term and long-term deposits, $1.2 million proceeds from sale and maturity of marketable securities and $0.4 million proceeds from the sale of property and equipment. Net cash used in investing activities in 2009 is primarily attributable to $12.0 million net investments in short-term and long-term deposits, $3.1 million capitalized software development costs and $1.6 million investment in marketable securities, which was offset by $4.9 million proceeds received from the sale of our Israel-based headquarters' office building in December 2009. Net cash provided by investing activities in 2008 is primarily attributable to $15.3 million net proceeds received from the sale of our wholly-owned AAOD subsidiary, as well as $150,000 proceeds from the sale of Nextstep, offset by $2.6 million capitalized software development costs, $0.7 million for the purchase of property and equipment and $1.3 million investment in marketable securities and short term bank deposits.

Net cash provided by financing activities was approximately $4.9 million for the year ended December 31, 2010, primarily attributable to $20.3 million net proceeds from a private placement of our ordinary shares that we completed in December 2010, which was offset by a $16.0 million aggregate dividend paid in January 2010. Net cash used in financing activities was approximately $0.1 million and $3.4 million for the years ended December 31, 2009 and 2008, respectively, primarily attributable to the repayment of short-term loans.

C. Research and Development, Patents and Licenses

Our research and development and support personnel work closely with our customers and prospective customers to determine their requirements and to design enhancements and new releases to meet their needs. We periodically release enhancements and upgrades to our core products. In the years ended December 31, 2008, 2009 and 2010, we invested $4.9 million, $4.4 million and $5.7 million in research and development, respectively. Research and development activities take place in our facilities in Israel, India and Japan.

As of December 31, 2010, we employed 96 employees in research and development activities, of which 40 persons were located in Israel, 51 persons in India and five persons in Japan. Our product development team includes technical writers who prepare user documentation for our products. In addition, we have also entered into arrangements with subcontractors for the preparation of product user documentation and certain product development work.

For additional information regarding product development see Item 4. "Information on the Company - Business Overview - Product Development."

D. Trend Information

In 2010, we experienced growth in our revenues and profitability as market conditions improved mainly in the U.S. and Japanese markets, and our principal products received wider market acceptance. With our most recent acquisitions, we expect this trend to continue into 2011.

For more information on trends in our industry, please see Item 4. "Information on the Company-Business Overview-Industry Background and Trends" and Item 5. "Operating and Financial Review and Prospects - Results of Operations."

E. Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our minimum contractual obligations as of December 31, 2010 and the effect we expect them to have on our liquidity and cash flow in future periods.

Contractual Obligations	Payments due by period			
	Total	less than 1 year	1-3 years	3-5 years
Operating lease obligations	$ 2,735,000	$ 1,437,000	$ 1,143,000	$ 155,000
Liabilities due to acquisition activities	5,106,000	1,906,000	3,200,000	
Severance payments, net*	211,000	-	-	-
Uncertainties in income taxes (ASC 740)	1,253,000			