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

F O R M 20 – F

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

OR

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

For the fiscal year ended December 31, 2009

OR

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

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.....

For the transition period from _____ to _____

Commission file number: 005-52583

BLUEPHOENIX SOLUTIONS LTD.

(Exact Name of Registrant as Specified in its Charter)

Israel

(Jurisdiction of Incorporation or Organization)

8 Maskit Street, Herzliya 46733, Israel

(Address of Principal Executive Offices)

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Tel: 972 9 9526110, Fax: 972 9 952611

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

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Ordinary shares, NIS 0.01 par value	NASDAQ Global Market

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

None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None
(Title of Class)

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.

23,223,112 Ordinary shares, NIS 0.01 per share

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

Yes No

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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

Item 17 Item 18

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

Yes No

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PART I

Some of the statements in this annual report, including those in the Risk Factors, Operating and Financial Review and Prospects, and Business Overview sections, are forward-looking statements that involve risks and uncertainties. These forward-looking statements include statements about our plans, objectives, strategies, expectations, intentions, future financial performance, and other statements that are not historical facts. We use words like “anticipates,” “believes,” “expects,” “future,” “intends,” and similar expressions to mean that the statement is forward-looking. You should not unduly rely on these forward-looking statements, which apply only as of the date of this annual report. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including the risks described under Risk Factors.

As used in this annual report, references to “we,” “our,” “ours,” and “us” refer to BluePhoenix Solutions Ltd. and its subsidiaries, unless otherwise indicated. References to “BluePhoenix” refer to BluePhoenix Solutions Ltd.

The name BluePhoenix™ and the names BluePhoenix™ IT Discovery, BluePhoenix™ LogicMiner, BluePhoenix™ DBSMigrator, BluePhoenix™ PlatformMigrator, BluePhoenix™ Rehosting, BluePhoenix™ LanguageMigrator, BluePhoenix™ DataMigrator, BluePhoenix™ FieldEnabler, BluePhoenix™ StandardsEnabler, , BluePhoenix™ AppBuilder, ASNA Monarch™, ASNA Visual RPG® (AVR) ASNA DataGate®, DSK4SP™ and DSK2SMB™, appearing in this annual report are trademarks of our company. Other trademarks in this annual report are owned by their respective holders.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT, AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following tables present our consolidated statement of operations and balance sheet data for the periods and as of the dates indicated. We derived the statements of operations data for each of the years ended December 31, 2007, 2008 and 2009 and the balance sheet data as of December 31, 2008 and 2009 from our consolidated financial statements included in Item 18 of this annual report, which have been prepared in accordance with generally accepted accounting principles as applied in the United States, or U.S. GAAP. Our consolidated financial statements have been audited by Ziv Haft, independent registered public accounting firm, BDO member firm. The selected consolidated financial data as of December 31, 2005, 2006 and 2007 and for the years ended December 31, 2005 and 2006 is derived from our audited financial statements not included in this annual report, which have been prepared in accordance with U.S. GAAP. You should read the selected consolidated financial data set forth below together with our consolidated financial statements included elsewhere in this annual report. See “Item 5. Operating and Financial Review and Prospects.”

	Year Ended December 31,				
	2009	2008	2007	2006	2005
	\$				
(in thousands, except per share data)					
Consolidated Statements of Operations Data:					
Revenues	\$ 77,778	\$ 91,745	\$ 81,222	\$ 61,375	\$ 50,642
Cost of revenues	44,885	46,032	36,529	26,066	22,782
Gross profit	32,893	45,713	44,693	35,309	27,860
Research and development costs	11,420	18,378	12,653	8,595	7,214
Selling, general, and administrative expenses	30,406	32,359	28,370	19,338	16,938
Goodwill impairment	5,670	13,328	-	-	-
Restructuring costs	-	-	694	-	-
Total operating expenses	47,496	64,065	41,717	27,933	24,152
Operating income (loss)	(14,603)	(18,352)	2,976	7,376	3,708
Financial expenses, net	(779)	(2,237)	(4,343)	(3,553)	(2,092)
Other income, net	-	398	892	282	104
Income (loss) before taxes on income	(15,382)	(20,191)	(475)	4,105	1,720
Income tax (expense) benefit	117	330	(68)	407	(112)
	(15,265)	(19,861)	(543)	4,512	1,608
Equity in earnings (losses) of affiliated companies, net	(10)	(49)	35	-	-
Net profit (loss) from continued operation	(15,275)	(19,910)	(508)	4,512	1,608
Discontinued operation	-	(8,512)	(7,489)	273	186
Net income (loss)	(15,275)	(28,422)	(7,997)	4,785	1,794
Net income attributed to non-controlling interests	(295)	(179)	(199)	(113)	(5)
Net income (loss) attributed to BluePhoenix' shareholders	\$ (15,570)	\$ (28,601)	\$ (8,196)	\$ 4,672	\$ 1,789
Total earning (loss) per share:					
Basic	\$ (0.72)	\$ (1.35)	\$ (0.48)	\$ 0.34	\$ 0.13
Diluted	\$ (0.72)	\$ (1.35)	\$ (0.48)	\$ 0.33	\$ 0.13
Weighted average number of shares outstanding	21,500	21,196	17,145	13,889	13,557
Weighted average number of shares outstanding assuming dilution	21,500	21,196	17,145	14,371	13,973

	December 31,				
	2009	2008	2007	2006	2005
	\$				
(in thousands)					
Consolidated Balance Sheet Data:					
Working capital	\$ 27,638	\$ 32,360	\$ 32,008	\$ 31,401	\$ 17,954
Total assets	\$ 122,554	\$ 139,987	\$ 146,858	\$ 127,466	\$ 99,691
Total liabilities	\$ 39,880	\$ 46,665	\$ 34,388	\$ 66,961	\$ 47,482
Equity	\$ 82,674	\$ 93,322	\$ 112,470	\$ 60,512	\$ 52,324

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

Risks Related to Our Business

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

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

Demand for our tools and services, depends in large part upon the level of information technology, or IT, capital spending and investment in IT projects by our customers. The current economic conditions have reduced the willingness or ability of our customers and prospective customers to commit funds to IT projects, and may reduce their ability to pay for our tools and services after purchase, whether as a result of possible customer insolvencies or otherwise. This has resulted in longer sales cycles and increased pressure on pricing. Similarly, our suppliers may not be able to supply us with needed components on a timely basis, may increase prices or may go out of business, which could result in our inability to meet customer demand, fulfill our contractual obligations or affect our gross margins.

Our revenues have decreased by 15% from \$91.7 million in 2008 to \$77.8 million in 2009. This decrease is mainly attributable to the global economic and financial crisis which caused a decrease in demand from existing customers for our consulting services and pricing pressure in attracting new customers for our legacy modernization projects. We cannot predict the duration of the global economic crisis or the timing or strength of any subsequent economic recovery. As a result, we cannot assure you when or if our revenues will return to previous levels, or whether our revenues will remain at the current level or decrease further.

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

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

A small number of customers has accounted for a substantial portion of our current and historical net revenues. In 2009, no individual customer accounted for more than 10% of our revenues. However, in 2008, sales to The Capita Group Plc accounted for 10% of our revenues and in 2007, sales to SDC Udvikling A/S and EDS accounted for 12% and 11% of our revenues, respectively.

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

Our acquisition of existing businesses and our failure to successfully integrate these businesses could disrupt our business, dilute your holdings in us, and harm our financial condition and operating results.

In recent years, we acquired and increased our investment in several businesses. We intend to make future strategic acquisitions of complementary companies, products, or technologies, depending on market conditions and available financing. Such acquisitions could disrupt our business by diverting the attention of management from day-to-day operations and may result in other disruptions (described below) and possibly losses as a result of our failure to successfully integrate the acquired businesses with our existing business. For example, in 2007, an impairment loss of \$7 million related to goodwill in Mainsoft Corporation, or Mainsoft, was identified and charged to loss from discontinued operation. In 2008, we sold our entire holdings in Mainsoft and a loss of approximately \$8.5 million was charged to loss from discontinued operation.

Acquisitions involve numerous risks, including:

- problems combining the acquired operations, technologies, or products;
- unanticipated costs or liabilities;
- diversion of management's attention;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- potential loss of key employees, particularly those of the acquired organizations; and
- impairment of intangible assets related to acquisitions.

Further, products that we acquire from third parties often require significant expenditures of time and resources to upgrade and integrate with our existing product suite. We may not be able to successfully integrate any business, technologies or personnel that we have acquired or that we might acquire in the future, and this could harm our financial condition and operating results.

In addition, your holdings would be diluted if we issue equity securities in connection with any acquisition, as we did in the acquisition of CodeStream Software Ltd. For more information about these transactions, see “Item 4.B. Business Overview-Investments and Acquisitions.”

Many of our customers are financial institutions, and the negative impact of the recent global economic and financial crisis on their businesses has and could continue to cause a negative effect on our business, financial condition and results of operations.

Approximately 44% of our revenues in 2009 and approximately 60% of our revenues in 2008 were derived from financial institutions. The recent global economic and financial market crisis had an adverse effect on various financial institutions and the banking sector. Lower levels of liquidity, increases in the rates of default and bankruptcy, and reduced corporate profits and capital spending, may have an adverse effect on our business, results of operations and financial condition, as occurred in 2009.

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

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

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

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

The IT modernization business is characterized by rapidly evolving technology and methodologies. This makes it difficult to predict demand and market acceptance for our modernization tools and services. In order to succeed, we need to adapt the tools and services we offer to keep up with technological developments and changes in customer needs. We cannot guarantee that we will succeed in enhancing our tools and services, or developing or acquiring new modernization tools and services that adequately address changing technologies and customer requirements. We also cannot assure you that the tools and services we offer will be accepted by customers. If our tools and services are not accepted by customers, our future revenues and profitability will be adversely affected. Changes in technologies, industry standards, the regulatory environment and customer requirements, and new product introductions by existing or future competitors, could render our existing solutions obsolete and unmarketable, or require us to enhance our current tools or develop new tools. This may require us to expend significant amounts of money, time, and other resources to meet the demand. This could strain our personnel and financial resources.

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

Our quarterly and annual results of operations have fluctuated significantly in the past, and we expect them to continue to fluctuate significantly in the future. These fluctuations are the result of risks related to the introduction of new products and any of the following events:

- global economic trends, such as the recent global economic crisis;
- adverse economic conditions in various geographic areas where our customers and potential customers operate;
- acquisitions and dispositions of companies;
- timing of completion of specified milestones and delays in implementation;
- timing of product releases;
- timing of contracts;
- increases in selling and marketing expenses, as well as other operating expenses; and
- currency fluctuations and financial expenses related to our financial instruments.

In addition, unexpected events that do not occur on a regular basis and that are difficult to predict may cause fluctuations in our operating results. In 2009, as a result of unexpected extension of a delivery of a large project, we charged additional \$2.8 million of costs incurred by us, of which the majority of the amount related to subcontractors. In 2009 and 2008, we had losses from continuing operations of approximately \$15.3 million and \$19.9 million, respectively. These losses were attributable to a number of factors including impairment tests of goodwill performed by us on overall IT modernization reporting resulting in impairment losses of \$5.7 million in 2009 and \$13.3 million in 2008, and which were charged to operations. Additional losses were attributable to costs incurred with regard to our cost saving plan, changes in foreign currencies that affected our financial expenses and to a decrease in our gross margin.

As a result of the foregoing, we believe that period-to-period comparisons of our historical results of operations are not necessarily meaningful and that you should not rely on them as an indication for future performance. Also, it is possible that our quarterly and annual results of operations may be below the expectations of public market analysts and investors.

A delay in collecting our fees could result in cash flow shortages, which in turn may significantly impact our financial results.

Typical modernization projects which deploy our solutions are long-term projects. Therefore, payment for these projects or a substantial portion of our fees may be delayed until the successful completion of specified milestones. In addition, the payment of our fees is dependent upon customer acceptance of the completed work and our ability to collect the fees. Further, although the timing of receipt of our fees varies, we incur the majority of our expenses on a current basis. As a result, a delay in the collection of our fees could result in cash flow shortages.

If we are unable to invest in new products and markets or to manage the effects of changes in our offering portfolio, our results will be adversely affected.

We specialize in the development and implementation of sophisticated software modernization and porting tools and products. We leverage our know-how, experience, and generic technologies to develop and introduce new software tools that enable the modernization of legacy systems. The need for our modernization solutions changes over time, and recent regulations or newly introduced technologies may create new needs for modernization solutions. As part of our growth strategy, as new needs evolve, we typically conduct a market analysis to qualify and quantify the market opportunity. If the results justify the investment required for the development of new products or tools, then we begin the development process of the new product. In order to maintain our position in the market, and our ability to address the constantly changing needs of the marketplace, we continually invest in the development of new products.

In order to properly introduce a new product to the marketplace or to introduce our current products into new markets, we continuously update our marketing materials, educate our sales force, and make changes to our operations. If these activities are not completed in a timely or satisfactory manner, or we limit our capital spending on these activities, our new product introduction may be delayed or harmed and our business, financial condition, and results of operations could be materially adversely affected.

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

The assets listed in our consolidated balance sheet as of December 31, 2009 include, among other things, goodwill valued at approximately \$52 million, research and development costs valued at approximately \$12.1 million, intangible assets related to customers' relations valued at approximately \$2.6 million and other intangible assets valued at approximately \$2.9 million. The applicable accounting standards require that:

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

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

For example, in 2009 and 2008, we performed impairment tests and identified losses of \$5.7 million and \$13.3 million, respectively, related to goodwill of our overall IT modernization reporting unit which were charged to operations. Our ability to reconcile the gap between our market capitalization and the aggregate fair value of our assets as reported depends on various factors, some of which are quantitative, such as an estimated control premium that an investor would be willing to pay for a controlling interest in us, and some of which are qualitative and involve management judgment, including stable relatively high backlog and growing pipe line of anticipated business. In that regard, we based our assumption on an effective control premium rate of 30% in 2009 and 42% in 2008 which was based on various mergers and acquisitions in Israel and abroad involving similar companies, that took place during the six-month period preceding December 31, 2009. If our market capitalization stays below the value of our equity, or actual results of operations differ materially from our modeling estimates and related assumptions, or if any of our qualitative reconciliation factors changes in the future, we may be required to record additional impairment charges for our goodwill. If our goodwill or capitalized research and development costs were deemed to be impaired in whole or in part due to our failure to achieve our goals, or if we fail to accurately predict the useful life of the capitalized research and development costs, we could be required to reduce or write off such assets, thus adversely affecting our operating results.

If we are unable to attract, train, and retain qualified personnel for our worldwide facilities at competitive prices, we may not be able to achieve our objectives and our business could be harmed.

In order to achieve our objectives, we hire from time to time software, administrative, operational, sales, and technical support personnel. The process of attracting, training, and successfully integrating qualified personnel can be lengthy and expensive. We may not be able to compete effectively for the personnel we need. As part of our growth strategy, we developed offshore centers in Cyprus, Romania and St. Petersburg, Russia. We hired professional consultants for these development centers, leveraging the lower employer costs that existed in these countries. In recent years, professional work in these countries became more expensive and professional fees may continue to increase in the future. The establishment of additional offshore facilities may result in significant capital expenses, which may affect our cash position. We cannot assure you that our offshore facilities will continue to be cost effective. Our future success depends on our ability to absorb and retain senior employees and to attract, motivate, and retain highly qualified professional employees worldwide at competitive prices.

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

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

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

In the course of providing our modernization solutions, the project team conducts testing to detect the existence of failures, errors, and bugs. If our modernization solutions fail to function efficiently or if errors or bugs are detected in our tools, we may incur significant expenditures in an attempt to remedy the problem. The consequences of failures, errors, and bugs could have a material adverse effect on our business, operating results, and financial condition.

If we fail to satisfy our customers' expectations regarding our solutions, or if we fail to timely deliver our solutions to our customers, we may be required to pay penalties, our contracts may be cancelled and we may be the subject of damages claims.

In the event that we fail to satisfy our customers' expectations from the results of the implementation of our solutions, or if we fail to timely deliver our solutions to our customers, these customers may suffer damages. When and if this occurs, we may be required under the customer agreement to pay penalties to our customers or pay their expenses (as occurred in 2009) and our customers may have the ability to cancel our contracts. Payments of penalties or a cancellation of a contract could cause us to suffer damages. In addition, we might not be paid for costs that we incurred in performing services prior to the date of cancellation. In addition, from time to time we may be subject to claims as a result of not delivering our products on time or in a satisfactory manner. Such disputes or others may lead to material damages.

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

Some of the products, tools, and services we provide involve key aspects of our customers' information systems. These systems are frequently critical to our customers' operations. As a result, our customers have a greater sensitivity to failures in these systems than do customers of other software products generally. If a customer's system fails during or following the provision of modernization solutions or services by us, or if we fail to provide customers with proper support for our modernization solutions, we are exposed to the risk of a claim for substantial damages against us, regardless of our responsibility for the failure. We cannot guarantee that the limitations of liability under our product and service contracts, if any, would be sufficient to protect us against legal claims. We cannot assure you that our insurance coverage will be sufficient to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. If we lose one or more large claims against us that exceed available insurance coverage, it may have a material adverse effect on our business, operating results, and financial condition. In addition, the filing of legal claims against us in connection with contract liability may cause us negative publicity and damage to our reputation.

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

Substantial litigation over intellectual property rights exists in the software industry. Software products may be increasingly subject to third-party infringement claims as the functionality of products in different industry segments overlaps. We cannot predict whether third parties will assert claims of infringement against us. In addition, our employees and contractors have access to software licensed by us from third parties. A breach of the nondisclosure undertakings by any of our employees or contractors may lead to a claim of infringement against us.

Any claim, with or without merit, could be expensive and time-consuming to defend, and would probably divert our management's attention and resources. In addition, such a claim, if submitted, may require us to enter into royalty or licensing agreements to obtain the right to use a necessary product or component. Such royalty or licensing agreements, if required, may not be available to us on acceptable terms, if at all.

A successful claim of product infringement against us and our failure or inability to license the infringed or similar technology could have a material adverse effect on our business, financial condition, and results of operations.

We may experience greater than expected competition that could have a negative effect on our business.

We operate in a highly competitive market. Competition in the modernization field is, to a large extent, based upon the functionality of the available automated tools and personnel expertise. Our competitors may be in a better position to devote significant funds and resources to the development, promotion and sale of their modernization tools and services, thus enabling them to respond more quickly to emerging opportunities and changes in technology or customer requirements. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase such competitors' ability to successfully market their tools and services. We also expect that competition will increase as a result of consolidation within the industry. As we develop new tools and services, we may begin to compete with companies with which we have not previously competed. Our competitors include:

- small vendors who may provide a single solution for a particular area of modernization, such as Cast, Ateras, Anubex, Migrationware, Alchemy solutions, HTWC, Speedware and Softmaint;
- large system integrators such as IBM, HP, SUN, Accenture, Cap Gemini and EDS, some of whom we also partner with;

- software houses such as Micro Focus and Metaware; and
- Indian system integrators such as Tata, WIPRO, Infosys and Patni.

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

Many of our existing and potential competitors may have or acquire more extensive development, marketing, distribution, financial, technological and personnel resources than we do. This increased competition may result in our loss of market share and pricing pressure which may have a material adverse effect on our business, financial condition and results of operations. We cannot assure you that competition with both competitors within our industry and with the in-house IT departments of certain of our customers or prospective customers will not result in price reductions for our tools and services, fewer customer orders, deferred payment terms, reduced revenues or loss of market share, any of which could materially adversely affect our business, financial condition, and results of operations.

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

Our success and ability to compete are substantially dependent upon our internally developed technology. Our intellectual property consists of proprietary or confidential information that is not subject to patent or similar protection. Our employees and contractors have direct access to our technology. In general, we have relied on a combination of technical leadership, trade secret, copyright and trademark law, and nondisclosure agreements to protect our proprietary know-how. Unauthorized third parties may attempt to copy or obtain and use the technology protected by those rights. Any infringement of our intellectual property could have a material adverse effect on our business, financial condition, and results of operations. Policing unauthorized use of our products is difficult and costly, particularly in countries where the laws may not protect our proprietary rights as fully as in the United States.

Pursuant to agreements with certain of our customers, we have placed, and in the future may be required to place, in escrow, the source code of certain of our software. Pursuant to the escrow arrangements, the software may, under specified circumstances, be made available to our customers. From time to time, we also provide our software directly to customers. These factors may increase the likelihood of misappropriation or other misuse of our software.

We are exposed to litigation that could result in considerable financial liabilities.

In June 2003, a former Liraz shareholder filed an application with the Tel-Aviv-Jaffa District Court to approve a claim filed by him against us, as a class action. The claim relates to the acquisition of Liraz shares, which we completed in March 2003. The shareholder alleges that the share price we paid to Liraz's shareholders in the tender offer and in a subsequent mandatory purchase was lower than the fair price of Liraz shares. The maximum amount of the claim is approximately NIS 37.1 million (\$9.9 million) in the aggregate. Under Israeli law, the court's approval is required for the plaintiff to represent all of the shareholders of Liraz who sold their shares to us pursuant to the tender offer and the mandatory acquisition. The plaintiff has applied for such approval in the lawsuit. Since the critical issue in our case concerns the basis upon which the fair price of shares purchased within the context of a tender offer is to be determined, and due to the fact that this particular issue has come before the Supreme Court of Israel in an appeal concerning another separate case, the plaintiff in our claim has agreed to postpone the proceedings until the Supreme Court has given its decision in the appeal. In December 2009, the Supreme Court held that, as a general rule, the fair price of shares purchased within the context of a full tender offer shall be determined in accordance with the discounted cash flow method. The plaintiff in our case is expected to notify the court whether he wishes to renew the proceedings. As of the date of this annual report, the plaintiff has not yet applied to the court. Based on our analysis of the statement of claim, including an evaluation of the fair value of the Liraz shares, and the price paid for Liraz in a previous transaction immediately prior to the tender offer, we believe that the allegations against us in this proceeding are without merit and we intend to vigorously defend the claim and contest the allegations made therein. If we are not successful in defending this claim, we could be exposed to considerable financial liabilities and, as a result, our financial condition could be materially adversely harmed.

See also “Item 8.A. Consolidated Statements and Other Financial Information – Legal Proceedings.”

Our existing credit facilities contain a number of restrictions and obligations that limit our operating and financial flexibility, and there is no assurance that credit facilities will be available in the future.

As of March 22, 2010, we had an aggregate of \$15 million of outstanding loans under our credit facilities. Our credit facilities contain a number of restrictive covenants that limit our operating and financial flexibility. These covenants restrict, among other things, our ability to pledge our assets, dispose of assets, make loans or give guarantees, make certain acquisitions, and engage in mergers or consolidations. Our credit facilities also contain covenants regarding maintaining certain financial ratios. Our ability to continue to comply with these and other obligations depends in part on the future performance of our business. There can be no assurance that such obligations will not materially adversely affect our ability to finance our future operations or the manner in which we operate our business. In particular, any noncompliance with performance-related covenants and other undertakings of our credit facilities could result in an acceleration of our outstanding debt under our credit facilities and restrict our ability to obtain additional funds, which could have a material adverse effect on our business, financial condition, and results of operations. In addition, there is no assurance that banks will continue to provide us with credit facilities in the future.

Risks Relating to International Operations

Marketing our tools and solutions in international markets may cause increased expenses and greater exposure to risks that we may not be able to successfully address.

We intend to continue to expand our international operations, which will require significant management attention and financial resources. In order to continue to expand worldwide sales, we need to establish additional marketing and sales operations, hire additional personnel, and recruit additional resellers internationally. To the extent that we are unable to do so effectively, our growth is likely to be limited and our business, operating results, and financial condition will be materially adversely affected.

Risks inherent in our worldwide business activities generally include:

- currency exchange fluctuations;
- unexpected changes in regulatory requirements;
- tariffs and other trade barriers;
- costs of localizing products for foreign countries;
- lack of acceptance of localized products;
- longer accounts receivable payment cycles;
- difficulties in operations of management;
- potentially adverse tax consequences, including restrictions on the repatriation of earnings; and
- the burdens of complying with a wide variety of local legislation.

We cannot assure you that these factors will not have a material adverse effect on our future international sales and, consequently, on our business, operating results, and financial condition.

Inflation, devaluation, and fluctuation of various currencies may adversely affect our results of operations, liabilities, and assets.

We run our operations in various countries. As a result, we enter into transactions with customers and suppliers in local currencies. The reporting currency of our consolidated financial statements and the functional currency of our business is the U.S. dollar. The fluctuations in foreign currency exchange rates in countries where we operate can adversely affect the reflection of these activities in our consolidated financial statements. Fluctuations in the value of our non-dollar revenues, costs, and expenses measured in dollars could materially affect our results of operations. In addition, our balance sheet reflects non-dollar denominated assets and liabilities, which can be adversely affected by fluctuations in the currency exchange rates.

We enter, from time to time, into forward currency exchange contracts or other arrangements in order to hedge this foreign currency exposure. Such arrangements may not always be effective or sufficient to offset the fluctuations in currency exchange rates. For additional information relating to the exchange rates between different relevant currencies, see “Item 5. Operating and Financial Review and Prospects—Our Reporting Currency.”

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

Most of our worldwide sales are currently denominated in U.S. dollars, British Pounds, Danish Kroner and Euros while our reporting currency is the dollar. A decrease in the value of the dollar relative to these foreign currencies would make our products more expensive and increase our operating costs and, therefore, could adversely affect our results and harm our competitive position in the markets in which we compete.

We are subject to multiple taxing jurisdictions. If we fail to estimate accurately the amount of income tax due in any of these jurisdictions, our net income might be affected.

We operate within multiple taxing jurisdictions and are subject to taxation by these jurisdictions at various tax rates. In addition, we may be subject to audits in these jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. We cannot assure you that the final tax outcome of these issues will not be different from management estimates, which are reflected in our income tax provisions. Such differences could have a material effect on our income tax provision and net income in the period in which such outcome occurs.

Risks Relating to Operations in Israel

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

Over the past several decades, a number of armed conflicts have occurred between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity has led to security and economic problems for Israel. Since 2000, there have been ongoing hostilities between Israel and the Palestinians, which have adversely affected the peace process and at times have negatively influenced Israel's economy as well as its relationship with several other countries. Hamas, an Islamist movement responsible for many attacks, including missile strikes against Israelis, won the majority of the seats in the Parliament of the Palestinian Authority in 2006 and took control of the entire Gaza Strip by force in 2007. In January 2009, Israel engaged in a military action against Hamas in Gaza to prevent continued rocket attacks against Israel. These developments have further strained relations between Israel and the Palestinians. The current political situation between Israel and its neighbors may not improve. These political, economic and military conditions in Israel could have a material adverse effect on our business, financial condition, results of operations and future growth. In addition, nonexempt male adult citizens of Israel, including some of our officers and employees, are obligated to perform military reserve duty until the age of 40 or 45 depending on their function in the army, and are subject to being called for active duty under emergency circumstances. We cannot predict the full impact of such conditions on us in the future, particularly if emergency circumstances occur. If many of our employees are called for active duty, our operations in Israel and our business may be adversely affected.

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

We could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli firms and others doing business with Israel or with Israeli companies. Also, over the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. There can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on our business.

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

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

- effect service of process within the United States on us or any of our executive officers or directors who are non-residents of the United States;
- enforce court judgments obtained in the United States, including those predicated upon the civil liability provisions of the United States federal securities laws, against us or against any of our executive officers or directors that are non-residents of the United States, in the United States or Israel; and
- bring an original action in an Israeli court against us or against any of our executive officers or directors to enforce liabilities based upon the United States federal securities laws.

Risks Relating to Our Traded Securities

The market price of our ordinary shares may be extremely volatile and our investors may not be able to resell the shares at or above the price they paid, or at all.

During the past few years, the worldwide stock markets have experienced significant price and volume fluctuations. The market prices of securities of technology companies have been extremely volatile, and have experienced fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market fluctuations could adversely affect market price of our ordinary shares. The high and low closing prices of our ordinary shares traded on the NASDAQ Global Market and the Tel Aviv Stock Exchange, or TASE, during each of the last three years, are summarized in the table below:

	NASDAQ Global Market		TASE	
	In \$		In NIS	
	High	Low	High	Low
2009	3.85	1.62	14.24	7.07
2008	20.66	1.40	74.83	5.25
2007	21.49	5.94	85.51	25.69

As of March 22, 2010, the exchange rate between the U.S. dollar and the New Israeli Shekel was 3.741 NIS to one dollar.

During the period between January 2008 and March 2010, the market price of our ordinary shares on the NASDAQ Global Market ranged from a high of \$20.66 to a low of \$1.40. As of March 22, 2010, the market price of our ordinary shares was \$2.47. We cannot assure you that the market price of our ordinary shares will rise to similar levels as it was in the past. The market price of our ordinary shares may continue to fluctuate substantially due to a variety of factors, including:

- any actual or anticipated fluctuations in our or our competitors' quarterly revenues and operating results;
- shortfalls in our operating results from levels forecast by securities analysts;
- potential impairments of our intangible assets;
- adverse consequences of litigation;
- public announcements concerning us or our competitors;
- the introduction or market acceptance of new products or service offerings by us or by our competitors;
- changes in product pricing policies by us or our competitors;
- changes in security analysts' financial estimates;
- changes in accounting principles;
- sales of our shares by existing shareholders; and
- the loss of any of our key personnel.

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

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

Our ordinary shares trade on the NASDAQ Global Market and the TASE. Trading in our ordinary shares on these markets takes place in different currencies (dollars on the NASDAQ Global Market and NIS on the TASE), and at different times (resulting from different time zones, different trading days, and different public holidays in the United States and Israel). The trading prices of our ordinary shares on these two markets may differ due to these and other factors. 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.

Future sales of our shares to be registered for resale in the public market could dilute the ownership interest of our existing shareholders and could cause the market price for our ordinary shares to fall.

As of March 22, 2010, we had 23,376,779 ordinary shares outstanding and 2,668,537 ordinary shares reserved for issuance under our employee equity compensation plans, including 2,009,628 shares reserved for issuance upon the exercise of outstanding employee options, warrants and unvested restricted stock units. We also have the following commitments to issue our ordinary shares:

- 200,000 ordinary shares issuable upon exercise of warrants issued to institutional investors in connection with the \$3 million private placement, completed in March 2006;
- 800,000 ordinary shares issuable upon exercise of warrants issued by us to institutional investors in connection with the \$35 million private placement completed in November 2007; and
- 3,002,063 ordinary shares issuable upon exercise of warrants issued by us to institutional investors in connection with the private placement consummated in October 2009.

We registered for resale the shares underlying the warrants issued to the institutional investors in March 2006, November 2007 and October 2009, pursuant to registration rights agreements entered into with such investors. For more information, see “Item 4.B - Business Overview – Investments and Acquisitions” and “Item 5.B - Liquidity and Capital Resources – Contractual Commitments and Guarantees.”

The exercise of options by our employees and the exercise of warrants by investors would dilute the ownership interests of our existing shareholders. Any sales in the public market of our ordinary shares issuable upon exercise of options or warrants could adversely affect the market price of our ordinary shares. If a large number of our ordinary shares is sold in a short period, the price of our ordinary shares would likely decrease.

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

Although we believe that we were not a passive foreign investment company, or PFIC, in 2009, we cannot assure you that the United States Internal Revenue Service will agree with our position. We would be a PFIC if (i) 75% or more of our gross income in a taxable year (including our pro rata share of the gross income of any company treated as a corporation for U.S. federal income tax purposes in which we are considered to own directly or indirectly 25% or more of the shares by value) is passive income, or (ii) the value of our assets averaged quarterly over the taxable year (including our pro rata share of the assets of any company treated as a corporation for U.S. federal income tax purposes in which we are considered to own directly or indirectly 25% or more of the shares by value) that produce, or are held for the production of, passive income is at least 50%. Passive income includes interest, dividends, royalties, rents and annuities. If we are or become a PFIC, our U.S. investors could suffer adverse tax consequences, including being taxed at ordinary income tax rates and being subject to an interest charge on gain from the sale or other disposition of our ordinary shares and on certain “excess distributions” with respect to our ordinary shares. For additional information regarding our PFIC status, see the discussion under “Item 10.E. Taxation — United States Federal Income Tax Considerations — Tax Consequences If We Are a Passive Foreign Investment Company.”.

As a foreign private issuer whose shares are listed on The NASDAQ Global Market, we may follow certain home country corporate governance practices instead of certain listing requirements, which may not afford shareholders with the same protections that shareholders of domestic companies have.

As a foreign private issuer whose ordinary shares are listed on The NASDAQ Global Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of The NASDAQ Global Market. A foreign private issuer that elects to follow a home country practice instead of such requirements must submit to The NASDAQ Global Market 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 SEC each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. We follow home country practice with regard to distribution of annual reports to shareholders, meetings of independent directors in which only independent directors participate, approval of share compensation plans and changes in such plans and approval of share issuance or potential issuance which results in a change of control of the company.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were incorporated in Israel in 1987 under the name A. Crystal Solutions Ltd. In 1996, we changed our name to Crystal Systems Solutions Ltd. In 2003, following the acquisition of Liraz Systems Ltd., we changed our name to BluePhoenix Solutions Ltd. Our registered office is located at 8 Maskit Street, Herzliya, 46733, Israel and our telephone number is: 972-9-9526110. Our agent in the United States is Blue Phoenix Solutions USA Inc., 8000 Regency Parkway, Cary, NC 27511 and its telephone number is: (919) 380-5100.

See Item 5 – “Operating and Financial Review and Prospects” and Item 18 – “Financial Statements” for a description of capital expenditures and divestitures by us that are in progress or took place in the past three fiscal years, and see “Business Overview” below for our history.

B. Business Overview

Our Business

We develop and market unique value driven enterprise legacy IT modernization solutions, provide professional services to selected customers and sell knowledge management solutions.

Our IT legacy modernization solutions enable companies to automate the process of modernizing and upgrading their mainframe and distributed IT infrastructure in order to more effectively compete in today’s business environment. The combination of our comprehensive tools and services with our unique methodology provides an efficient and cost-effective process for extending the return on investment of existing enterprise IT assets. Our complete modernization solutions consist of a combination of automated technologies and services that minimize the risk through the whole life cycle of the modernization process. Our solutions are based on technologies and services that support the following functionalities: Understanding and mapping an application; Migration of platforms, databases and languages, data and testing; and Remediation. The solutions allow companies to fully leverage their current systems and applications, speed up and reduce the cost of the renewal process, and effectively update their systems in order to be more agile when having to adapt to new business demands. In addition, by using our technologies our customers gain the added value of extending their systems to be ready for future demands, such as Service Oriented Architecture and Cloud computing. Our modernization solutions are offered to customers in all business market sectors, particularly financial services, automotive and governmental entities. In addition, we provide consulting services such as application development services and maintenance for core banking systems.

Our solution portfolio includes software products, software tools, and services that address the most pressing IT challenges which organizations and companies face today, including:

- lack of agility and responsiveness to changing business needs;
- difficulty in recruiting and retaining mainframe professionals;
- growing cost of infrastructure software licenses, maintenance and operations;
- difficulties in complying with new regulations; and
- use of old technologies which prevent access to modern tools and inhibit the ability to meet business expectations.

Our solutions enable companies to:

- better understand and manage their IT systems and resources;
- effectively plan and carry out strategic projects that provide real business value;
- transformation to modern technology enables enterprises to recruit professional resources;
- significantly decrease maintenance, human resource, and technology costs;
- easily integrate packaged applications and build customized applications;
- substantially transform applications and databases in order to address regulatory and business changes; and
- directly gain access to cutting edge technology and new business channels.

Our comprehensive enterprise technologies span mainframe, midrange, and client/server computing platforms. We have enhanced our expertise through the successful completion of projects for many large organizations over the past two decades, establishing our credibility and achieving international recognition and presence. Based on our technology and that of our affiliates, we develop and market software products, tools, and related methodologies. We deliver our tools and methodologies together with training and support in order to provide enterprises with comprehensive solutions, primarily for the modernization of existing IT systems.

Market Background

Companies initiate IT modernization projects for a wide range of reasons, such as:

- maintaining a competitive edge in the market;
- addressing changing business needs;
- complying with new regulations;
- reducing maintenance, human resources, and technology costs; or
- gaining access to cutting edge technology and new business channels.

Alternatives to modernization include, among others, renewing legacy systems, buying packaged software, or rebuilding entire applications. Enterprise IT modernization has proven to be the most efficient and lowest risk path for companies looking to protect their existing investments. We provide a range of solutions designed to efficiently address the challenge of retaining the business knowledge built into the application code while updating the system to reflect new requirements.

The enterprise legacy IT modernization market is divided into the following categories:

Enterprise IT Understanding—These solutions enable companies to make informed strategic decisions regarding the future of their IT systems by automatically capturing multiple levels of operational and development information into a consolidated metadata warehouse. Our tools facilitate global assessments and impact analyses of application assets, thus helping reduce costs, streamline working processes, and increase efficiency.

Enterprise IT Migration—These solutions enable companies to consolidate and eliminate a wide range of legacy hardware and software through automated migration of applications, databases, platforms, programming languages, and data. These tools help to reduce costs and resources, and minimize reliance on proprietary technology, sunset products, and dwindling skill sets.

Enterprise IT Remediation—These solutions enable companies to extend the life of their existing IT systems by quickly adapting to new regulatory changes and business requirements. These automated tools can be easily customized to fit any IT environment and corporate need, including data field adjustment, IT standardization, and system consolidation.

Enterprise IT Understanding

In the current lean budgetary environment, companies that want to extend the return on investment of their existing systems need to modernize their legacy systems. Since modernization projects are intricate and complex, the essential first step is a thorough review of existing IT assets.

Our *understanding* solutions provide automated, detailed mapping of system-wide IT activity and the interconnections between all software components. This detailed road map serves as the basis for optimizing the re-use of existing IT systems, tailoring the modernization plan for the company's unique IT environment and corporate requirements, and reducing future ongoing maintenance costs.

Modernization initiatives that need to be based on an in-depth examination of actual system elements include:

- building and rewriting enterprise-scale application components;
- implementing new technologies such as Web-enablement;
- integrating purchased and newly written applications;
- consolidating servers and applications;
- migrating to more modern platforms, databases and languages;
- transforming current applications to adapt to changing business standards; and
- protecting against the loss of critical personnel and corporate knowledge base.

Our integrated set of *enterprise IT understanding* solutions is designed to assist companies in achieving these goals by accurately mapping raw IT operational and development data, down to the program code level, into a consolidated enterprise-wide warehouse. The gathered information enables companies to keep track of system inventories, resources, and inter-relationships and to intelligently mine systems and application metadata.

This enterprise-wide view can then be used for a variety of strategic purposes, including:

- performing impact, cost, and trend analyses, as well as ongoing tracking of IT resources, inventories, components, their usage and their inter-relationships;
- running business-logic analyses for business process identification, evaluation, extraction, transition and enhancement;
- achieving significant cost reductions through the elimination of unused products, unnecessary software upgrades, inefficient storage allocations, and wasteful CPU usage; and
- providing more efficient application development by reusing systems and leveraging existing business rules.

Our *enterprise IT understanding* suite includes the following solutions:

BluePhoenix™ IT Discovery—This solution provides fast and convenient access to application inventory, dependency, and operational information. This tool performs the complete audit necessary to enable companies to define and analyze all application assets in order to make informed decisions about ongoing modernization activities. *IT Discovery* provides the ability to analyze on a refreshable basis numerous technology environments, and from them extract and report on the inter-relationships among the components that make up these environments. In this manner, it provides an organization the ability to discover information about its current systems, thereby insuring that ongoing decisions are made based on an accurate audit of the current environment.

BluePhoenix™ LogicMiner—This recovery solution mines COBOL and extracts business rules from the legacy code, thus providing IT departments with the ability to begin a modernization process based on techniques that preserve the functionality of legacy code. This tool retains past investments in software assets by producing reusable code objects or descriptive data that can later be used for improving the quality of the legacy code, rewriting the legacy application, or building a full modernization plan. LogicMiner increases a system's manageability, while eliminating rules that no longer apply to current business procedures.

Enterprise IT Migration

Our comprehensive, integrated set of *enterprise IT migration* solutions enable companies to standardize and consolidate their IT systems by automatically converting and redeploying applications, databases, platforms, programming languages and data that are implemented on outdated computing platforms.

Buying a packaged application or rebuilding one can often be an expensive and risky proposition. Therefore, companies often look towards migrating their existing applications. This option is much more cost-effective and time-efficient as it leverages existing investments in custom applications. Our migration solutions enable companies to operate their IT systems independently, without relying on the original technology's vendors for support, thus the migration process provides significant cost savings on development, maintenance, and human resources.

Our migration solutions provide numerous advantages, including:

- significantly decreasing project costs, risk of errors and time;
- preserving corporate business knowledge;
- substantially reducing dependency on scarce legacy technology skill sets;
- solving problematic maintenance issues;
- enabling end-to-end project control and management;
- directly supplying a full audit trail and documentation of all changes;
- minimizing system freeze time with a unique “refresh” feature; and
- comprehensively working with most mainframe and non-mainframe platforms.

Our *enterprise IT migration* suite includes the following solutions:

BluePhoenix™ DBMSMigrator—An automated migration tool that converts applications from non-relational databases, such as IDMS (Integrated Database Management System), ADABAS, IMS, and VSAM, to relational databases, such as DB2, Oracle, and SQL Server. The tool performs automated conversions that provide companies with fully functional compliance for source and target applications and minimal application, functional, and logical program flow changes. *DBMSMigrator* leaves no residuals, emulation software, or translation procedures and allows system support to continue uninterrupted during the migration project. As a result of the conversion process, the migrated application operates more efficiently, is easier to maintain, and contains complete documentation of the customer’s knowledge base and guidelines.

BluePhoenix™ PlatformMigrator—A range of automated migration tools that convert a range of platforms, including IBM mainframe with operating systems such as VSE, MVS, in addition to Fujitsu ICL and Unisys, to Unix, Linux, Windows, and .Net. *PlatformMigrator* tools can be customized to fit the unique IT configuration and business rules of each customer site. The tool converts platforms to a pure, native installation so that programs are not required to run under emulation or through translation techniques.

PlatformMigrator solutions assist companies with reducing IT costs maintaining service levels, setting and upgrading standards, implementing the new IT environment, training IT users, implementing new facilities such as a security system or a batch scheduler, and testing for functional equivalence.

BluePhoenix™ Rehosting—Organizations implement mainframe rehosting in order to reduce the ongoing costs of existing legacy applications. Rehosting leverages the strength and investment of older COBOL, RPG and other languages applications while taking advantage of new, cost-efficient hardware and open operating system environments such as Linux, Unix, Windows, J2EE, and .NET.

Using our various automated migration tools, and through cooperation with our partners, we offer COBOL and RPG migrations, System i and mainframe rehosting solutions. We formed the following alliances for providing these solutions:

- an alliance with Clarity for assisting companies to rehost mainframe applications on more cost-efficient, open platforms;
- a collaboration with Fujitsu for assisting companies to migrate COBOL/CICS applications into Fujitsu NetCOBOL and the Fujitsu NeoKicks and NeoBatch environments for handling CICS and batch/JCL;
- a Gold level partnership with Microsoft for collaboration in migrating customers' applications to the .NET platform;
- a partnership with Oracle for assisting companies to migrate their legacy databases to the Oracle database;
- advanced membership in IBM's Partnerworld program to work together with IBM to modernize customers' databases and applications on the mainframe platform; and
- ongoing cooperation with SUN/Oracle that focuses on rehosting customers off of the mainframe and onto SUN's UNIX platform.

BluePhoenix™ LanguageMigrator—A set of automated migration tools for converting COBOL and 4GLs (fourth generation languages) such as ADSO, Natural, CA Gen (formerly COOL: Gen) to COBOL, Java/J2EE and C#/Net. This reliable, time-efficient, and comprehensive solution enables site-wide installation, simultaneous testing, and implementation of batch programs. In addition, *LanguageMigrator* identifies the compatibility of the code, converts it to the new standards required by customers, and analyzes converted programs to identify potential problems.

BluePhoenix™ DataMigrator—A Windows-based tool for migrating data between various data system environments. Coupled with a step-by-step proven methodology, the tool provides a fully structured but still versatile automated data migration process. *DataMigrator* enables full control of source and target data definitions resulting in consistent, accurate, highest quality target data with no data loss, and efficient utilization of available resources. In addition, it provides support for partial or incremental migration and for multiple runtime environments.

Enterprise IT Remediation

Our integrated set of *enterprise IT remediation* solutions enable companies to extend the life of their existing IT systems when facing ongoing regulatory changes and new business requirements. Our *remediation* solutions address a variety of corporate needs and include:

BluePhoenix™ FieldEnabler—New business decisions or regulatory requirements often require companies to make changes that impact a wide range of system components. These include field adjustments that involve changes in the type, length, and structure of a database or program field, such as expanding a dealer code. *FieldEnabler* is a rule-based tool that enables a step-by-step, comprehensive process for making these kinds of modifications across an enterprise in a reliable and time-efficient manner.

BluePhoenix™ StandardsEnabler—A highly automated solution for reliably facilitating system consolidation into a single set of naming standards. Since all resources being converted must be changed in parallel, the large task of manually standardizing the naming of system components is not practical. Our tool provides an automated solution addressing this problem.

AppBuilder

In addition to our modernization tools, we develop, maintain and distribute a development environment called *BluePhoenix™ AppBuilder*. *BluePhoenix™ AppBuilder* has been used for managing, maintaining, and reusing the complicated applications needed by large businesses. It provides the infrastructure for enterprises worldwide, across several industries, with applications running millions of transactions daily on legacy systems. Enterprises using *AppBuilder* can build, deploy, and maintain large-scale custom-built business applications for years without being dependent on any particular technology. The deployment environments include IBM mainframe, Unix, Linux and Windows. *BluePhoenix™ AppBuilder* is intended to increase productivity and agility in the creation and deployment of enterprise class computing.

System i (previously known as AS/400 or iSeries) Family of Products

We develop and market a separate but complementary family of products that provides similar solutions for System i (previously known as AS/400) applications. The products described hereunder cover the areas of *understanding*, *migration* and *redevelopment*.

ASNA Monarch™ — This product is used for *understanding* and *migration* of System i applications. It transforms applications originally written in RPG/400 into native and fully compliant Microsoft.NET®. It can also migrate the originating database to SQL Server, thus providing for a full re-platforming solution. *ASNA Monarch* reuses the original source code, which persists in a familiar syntax, allowing the existing development teams to maintain it.

ASNA Visual RPG® (*AVR*) is a modern implementation of RPG that enables RPG developers to easily build Web and Windows applications. AVR provides direct, secure and fast access to both files and program objects on IBM's System i server. Using a familiar, but modernized syntax, RPG programmers can quickly apply their long-standing RPG experience to create modern applications that connect seamlessly to the System i platform.

AVR for .NET provides similar functionalities under Microsoft's .NET framework. It enables modernizing existing RPG applications, develop Web services, and extend System i applications to .NET and the inherent support in service oriented architecture while continuing to program with a familiar, RPG-like syntax.

ASNA DataGate® — *ASNA DataGate* provides fast and secure System i database access. Applications written to access the System i through *DataGate* can later be connected to SQL Server without modification. A single application may connect to both platforms concurrently, or an application may switch, automatically, from one platform to the other in the case of a failover situation.

ASNA Visual RPG® and *ASNA DataGate*® are used for *migration* and *redevelopment* solutions.

Knowledge Management Solutions

The technology and products of BluePhoenix Knowledge Management, DSK4SP and DSK2SMB, that was purchased in December 2009 expand BluePhoenix's abilities to provide its customers a whole package of management and upgrading organizational knowledge, computerization foundation and expanding BluePhoenix's activity in the area of management and distribution of organizational knowledge in the international arena.

Our solution applies to contact centers and service oriented enterprises around the world. Our product line has proven experience in almost every market industry such as, Telecom, Media, Internet, Shipment, Logistic, Tourism, Banking, finance, insurance, Hi tech, Government, Health services and more.

In a service based organization an informational worker constantly need to find in numerous operational systems and repositories a unique piece of information inside the huge mass of the organizational information. Seeking for information activity is very expensive and costly especially in call centers where the CSR's (customer service representative) spending short amount of time with the organization and continue to other jobs. This is exactly where BluePhoenix KMS has precious value and return on investment.

In the core of our methodology we are always thinking of Rule 2 – 3 – 4, means that within 2 or 3 seconds and not more then 3 or 4 mouse clicks, In at least 80% of the cases, the service provider will locate the exact piece of information that is needed to provide the best answer to the customer in his first call with no escalation process.

Professional Services

Our world-wide professional service activity is comprised of a high-end application and infrastructure development group. BluePhoenix's professional service activity specializes in enterprise application development, maintenance and system integration.

Our application maintenance services team assumes the daily IT activities involved in maintaining, troubleshooting, analyzing and assessing the application for enhanced efficiency and performance. We also supply software product development services for companies (independent software vendors (ISV) or software publishers) to reduce significantly their cost of software product development while keeping control of the product architecture. These services enable easy ramping up and ramping down of product teams based on business priorities.

Our professional service team has the required knowledge in a wide range of technologies (legacy and modern) and can provide a competitive solution to enterprises in our region.

Investments and Acquisitions

In order to enhance our solutions and services portfolio, we have been pursuing a strategy of adding new technologies to our suite of automated modernization tools. We implement this strategy via internal development of new software tools and through acquisitions and investments. Accordingly, we devote significant resources to the development of new software modernization tools, and invest in businesses that develop software tools that are complementary to our existing portfolio. The broad portfolio that we established, among others, through these acquisitions, contributes to our ability to penetrate new markets and to offer a complete set of solutions addressing the broad array of changing demands of our customers. We integrate the acquired businesses into our business and assimilate many of their functions, including, marketing, sales, finance and administration into our existing infrastructure. For more information about our capital expenditures, see "Item 5.B. Liquidity and Capital Resources- How We Have Financed Our Business-Capital expenditures."

Following is a description of our principal investments and acquisitions during the last three fiscal years, as well as those currently in progress, which form a part of our business as described above:

Knowledge Management Business. In December 2009, we purchased the knowledge management business of DSKnowledge Ltd. The knowledge management product modernizes and transforms legacy data, information and content elements in enterprises into one knowledge management repository. Pursuant to the terms of the purchase agreement, we acquired the business for approximately \$3.0 million. We committed to pay additional contingent consideration under the purchase agreement of up to \$2,795,000 in the event that the purchased business' net profit (as defined in the purchase agreement) reaches certain predefined targets set for each of the years 2010, 2011 and 2012.

TIS Consultants Ltd. In January 2008, we entered into the TIS purchase agreement for the purchase of the entire outstanding share capital of TIS Consultants Ltd., or TIS, a company incorporated in Cyprus, that wholly owns a subsidiary incorporated in India, TISA Software Consultants Private Limited. TIS provides consulting services, solutions and value added products to the banking industry, specializing in the market for Temenos GLOBUS/T24™.

Under the TIS purchase agreement, we paid to the selling shareholders an amount of \$500,000 and an additional amount of \$700,000 as a nonrefundable advance payment on account of contingent consideration described below. As part of the transaction, we undertook to pay the selling shareholders contingent consideration if certain conditions are met.

In April 2009, the former shareholders of TIS filed a claim against us, following a dispute regarding the calculation of the consideration payable to them in connection with the TIS transaction. As part of the negotiated terms, in 2009 we paid to the former shareholders of TIS an advance payment of \$3,070,000 and in September 2009, we entered into a settlement agreement with TIS pursuant to which we paid them an aggregate of \$1,057,500 in January 2010 and undertook to pay an additional \$1,163,250 in January 2011. In addition, we issued to the former shareholders of TIS 813,461 ordinary shares of BluePhoenix. As part of the settlement, the parties agreed on a mutual release of their respective claims, and the former shareholders of TIS waived their right to any future contingent consideration.

JLC Russia. In May 2008, in order to expand our off-shore center in Russia, we purchased the activity of an offshore professional outsourcing center in Nitzni (Russia), for total consideration of \$1.18 million. Under the terms of the transaction, we agreed to pay to the selling shareholders of JLC Group Inc., or JLC, additional consideration if certain criteria are met, based on the revenue growth of JLC's activity in 2008 and 2009. Accordingly, we paid to the selling shareholders additional consideration of \$406,000 for 2008. No additional consideration was accrued for 2009.

ASNA. In August 2007, we entered into an agreement to purchase the entire outstanding share capital of Amalgamated Software North America Inc. (ASNA), a private company based in San Antonio, Texas, for total consideration of \$7 million. The criteria for additional contingent consideration under the terms of the transaction were not met and therefore no additional consideration was accrued.

ASNA's product, Monarch, is a fully integrated solution for transforming RPG applications to the Microsoft.NET® platform. ASNA is a Microsoft Gold Certified Partner, a Microsoft Visual Studio Industry Partner, an IBM Tools Network Partner, and an Advanced Tier Member of IBM's PartnerWorld.

BridgeQuest. Effective April 2007, we entered into an agreement to purchase the entire outstanding share capital of BridgeQuest Inc., a North Carolina corporation that manages and operates, through a wholly owned subsidiary, a professional outsourcing center in St. Petersburg. Through this alternative large off-shore center, we offer services at a low cost. The consideration amounted to \$2 million. Under the terms of the transaction we committed to pay the selling shareholders additional consideration computed based on BridgeQuest's revenues and earnings before interest and taxes during 2007-2009. For 2007, the contingent consideration amounted to \$1.8 million and was recorded as goodwill in 2007. Under an amendment to the agreement entered into in January 2008, we granted to the selling shareholders warrants to purchase 200,000 BluePhoenix ordinary shares upon reaching a certain financial milestone. The warrants were valued at \$2.5 million based on the Black-Scholes pricing model applied as of the commitment date, and such amount was recorded as additional goodwill in 2008. These warrants were exercised in 2008. On December 31, 2008, we signed an additional amendment to the purchase agreement, pursuant to which we paid to the selling shareholders in 2009 and 2010 additional aggregate consideration of \$1.6 million. This amount was recorded as goodwill in 2008.

CodeStream Software Ltd. In December 2006, we acquired from a company incorporated in the United Kingdom, CodeStream Software Ltd., certain business activities in the field of modernization of legacy databases, particularly IDMS and other mainframe platforms. Pursuant to the purchase agreement, we hired 18 persons previously employed by CodeStream and assumed all the obligations in respect of the purchased activities. In consideration thereof, we paid to CodeStream \$10.2 million. Pursuant to the purchase agreement, as amended in December 2007, an amount of \$2.5 million was paid in 2008. In addition, as contingent consideration for the purchased activity, we issued to the selling shareholders 400,000 ordinary shares of BluePhoenix in April 2008 valued at \$3.8 million based on the share price on the commitment date, and paid an additional amount of \$2.5 million in April 2009.

BluePhoenix I-Ter S.p.A. (previously known as I-Ter/Informatica & Territorio S.p.A.). In the second quarter of 2005, we entered into an agreement to purchase the entire outstanding share capital of I-Ter/Informatica & Territorio S.p.A., referred to as I-Ter. Pursuant to the purchase agreement, we paid to the selling shareholders of I-Ter \$1.4 million. In addition, under the terms of the agreement, we paid to the selling shareholders additional consideration based on I-Ter's average earnings before interest and taxes, for the years 2005 through 2007, in an aggregate amount of \$6.2 million, paid in 2008 and 2009.

Cicero Inc. (formerly Level 8 Systems Inc.). Pursuant to an agreement signed in October 2007 with Cicero, we repaid \$1.7 million on behalf of Cicero to cover a portion of Cicero's credit facility at Bank Ha'Poalim. In connection therewith, the bank released a \$2.0 million bank guarantee previously provided by us to the bank to secure Cicero's bank loans. Accordingly, on the repayment date, an amount of \$300,000 was charged to earnings. As consideration therefore, Cicero issued to us 2,546,149 ordinary shares of Cicero and a \$1.0 million senior promissory note, bearing an annual interest rate of LIBOR + 1% (or in the event of any unpaid interest, LIBOR + 4%) payable in two installments, the first installment of \$350,000 was paid in 2008, and the second installment of \$671,000 is to be paid on December 31, 2011. As of December 31, 2009, we hold 1,352,054 ordinary shares of Cicero which are classified as available-for-sale marketable securities.

Discontinued Operations

In January 2008, our board of directors announced our intent to sell our entire holdings in Mainsoft, in which we held a 58% controlling interest. This decision followed a strategic shift in Mainsoft's product development and marketing strategy outside of BluePhoenix's core business focus. In October 2008 we sold our stake in Mainsoft for consideration of \$1.7 million. Mainsoft met the definition of a component. Accordingly the results of operation of Mainsoft are reported as discontinued operation in the statement of operations and prior periods' results have been reclassified accordingly. In addition, comparative data of the asset and liabilities attributed to the discontinued operation have been reclassified in the balance sheet.

Customers

We provide our modernization solutions directly or through our strategic partners, such as IBM, Electronic Data System Ltd. (EDS), NCS Pte Ltd., Mann India, and Sun Micro Systems. Additionally, from time to time, other IT services companies license our technologies for use in modernization projects in various markets. Our partners include system integrators, as well as other software vendors such as Oracle and Microsoft, who assist us in increasing our penetration and exposure in the market. We provide solutions to our partners' customers in collaboration with the system integrator's team. In most cases, the partners provide related services to the customers. Our arrangements with our partners vary. We may enter into distribution agreements under which we grant license rights to our partners or to the partners' customers or provide related services, or a combination of both. Alternatively, we may enter into subcontractor relationships with our strategic partners.

Some of our agreements are fixed price contracts. These projects bear some risks and uncertainties as we price these contracts based on estimates of future costs, duration of the project, and the impact of potential changes in the scope of the work. We also enter into other types of contracts, including annual maintenance contracts, license agreements, and arrangements on a time and materials basis.

In 2009, no individual customer accounted for 10% or more of our revenues. In 2008, Capita Group Plc, accounted for 10% of our revenues. In 2007, SDC Udvikling A/S and EDS accounted for 12% and 11% of our revenues, respectively.

The following table summarizes the revenues from our tools and services by geographic regions based on the location of the end customer for the periods indicated:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
North America	\$ 27,897	\$ 22,660	\$ 17,840
Europe (other than Denmark)	26,091	40,044	31,725
Denmark	9,975	11,096	15,750
Israel	10,320	10,679	7,820
Other	3,495	7,266	8,087
	<u>\$ 77,778</u>	<u>\$ 91,745</u>	<u>\$ 81,222</u>

Research and Development

In order to maintain our position as a market leader in the IT modernization market, we are focusing our development efforts on further enhancements to current solutions, as well as addressing newly emerging aspects of the modernization market. We are planning additional research and development activities to extend our modernization solutions by leveraging our technological skills to create added value for our customers and to generate additional business opportunities.

We continue to reinvest in our company through our investment in technology and process improvement. In addition, we invest in businesses that develop software tools that are complementary to our existing portfolio. We also invest in a skilled and specialized workforce. In 2009, our investment in research and development amounted to \$11.4 million, as compared to \$18.4 million in 2008. This decrease is attributable mainly to the reallocation of human resources from research and development to delivery of our turn-key projects.

Enterprise IT Understanding

BluePhoenix™ IT Discovery—By further refining our existing understanding technology, IT Discovery provides the basis for legacy understanding needed by the rest of our modernization solutions.

Enterprise IT Automated Migration

Language Migration—In the area of automated migration, we continue to build on our COBOL and 4GL migration solutions. Our assets in the migration area cover COBOL, COOL:Gen, ADSO/IDMS, Natural, CSP, Forte and other transformations. We continue to extend the support target platform of these transformations to include J2EE and .NET platforms.

BluePhoenix™ LogicMiner—A comprehensive solution for recovery that mines COBOL and extracts business rules from the legacy code, thus providing IT departments with the ability to begin a modernization process based on techniques that preserve the functionality of a legacy code. This tool retains past investments in software assets by producing reusable code objects or descriptive data that can later be used for improving the quality of the legacy code, rewriting the legacy application, or building a full modernization plan. *LogicMiner* increases a system's manageability, while eliminating rules that no longer apply to current business procedures.

ASNA Monarch™ — This product is used for *understanding* and *migration* of AS/400 applications. It transforms applications originally written in RPG/400 into native and fully compliant Microsoft.NET®. It can also migrate the originating database to SQL Server, thus providing for a full re-platforming solution. We intend to continue to provide full support for converting AS/400 applications to C# which is the premier development language under the Microsoft .NET environment. This will complete our offering and allow the AS/400 community a choice whether to use our *ASNA Visual RPG® (AVR)* or C#.

ASNA Visual RPG® (AVR) is a modern implementation of RPG that enables RPG developers to easily build Web and Windows applications. AVR provides direct, secure and fast access to both files and program objects on IBM's System i (formerly known as iSeries, AS/400) server. Using a familiar, but modernized syntax, RPG programmers can quickly apply their long-standing RPG experience to create modern applications that connect seamlessly to the System i (iSeries, AS/400) platform.

AVR for .NET provides similar functionalities under Microsoft's .NET Framework. It enables modernizing existing RPG applications, develop Web services, and extend System i applications to .NET and the inherent support in Service Oriented Architecture while continuing to program with a familiar, RPG-like syntax. AVR for .NET is the only development solution available for Microsoft's .NET that specifically supports high performance access to the System i database. We intend to continue to extend the functionality of AVR in order to make it a more attractive development environment that will be a preferred choice for AS/400 installations. In the next cycle of investment, we will integrate AVR with MS Visual Studio 2010.

ASNA DataGate® — *ASNA DataGate* provides fast and secure iSeries-400 database access. Applications written to access the iSeries through *DataGate* can later be connected to SQL Server without modification. A single application may connect to both platforms concurrently, or an application may switch, automatically, from one platform to the other in the case of a failover situation. We intend to continue to invest in research and development activities aimed to understand the feasibility of providing support for more modern RDBMSs such as ORACLE.

Chief Scientist Grants

PowerText—We received through a subsidiary, an aggregate of approximately \$200,000 in grants from the Office of the Chief Scientist, or the OCS, for the development of PowerText. PowerText is a software solution for automated electronic document mining, management and presentment. Royalties of 3% are payable to the OCS on all sales of PowerText up to 100% of the dollar-linked grant received.

BluePhoenix™ SOA - Ready Enablement—We received through our subsidiary, an aggregate of approximately \$580,000 in grants from the OCS, for the development of BluePhoenix™ SOA - Ready Enablement. Royalties of 3% are payable to the OCS on sales of BluePhoenix™ SOA - Ready Enablement up to 100% of the dollar-linked grant received in respect of the funded product.

The balance of the contingent liability relating to the royalties payable by our subsidiaries to the OCS, at December 31, 2009, amounted to approximately \$900,000.

Other Grants

In July 2007, our subsidiary, I-Ter, received final approval from the Ministry of Production in Italy for its Easy4Plan product. Easy4Plan is a workflow management tool designed for ISO9000 companies. The total funds amounted to \$650,000 (€15,000), of which \$585,000 was received in December 2007 and the remaining amount is expected to be received during 2010. \$213,525 of the funds received constitute a grant, and the remaining \$412,000 (€294,000), is a 10-year loan to be repaid by I-Ter in annual installments until September 2018. The loan bears a minimal annual interest of 0.87%. As of March 22, 2010, the remaining loan balance was \$320,000 (€247,000).

Intellectual Property

We rely on a combination of trade secret, copyright, and trademark laws and nondisclosure agreements, to protect our proprietary know-how. Our proprietary technology incorporates processes, methods, algorithms, and software that we believe are not easily copied. Despite these precautions, it may be possible for unauthorized third parties to copy aspects of our products or to obtain and use information that we regard as proprietary. However, we believe that with regard to most of our solutions, because of the rapid pace of technological change in the industry, patent and copyright protection are less significant to our competitive position than factors such as the knowledge, ability, and experience of our personnel, new product development, and ongoing product maintenance and support.

Challenges and Opportunities

Although the market for legacy IT modernization solutions is robust and to our belief is growing, the challenges associated with driving constant revenue growth while continually improving profit margins are real. In a market that continues to innovate and evolve, new technologies and practices, by definition, render existing technology deployments out-of-date - or legacy. By the same measure, however, in order for us to capitalize on the constant source of legacy solutions, we must evolve our solutions portfolio to deal with the changing definition of what constitutes “leading edge” technologies and the growing set that is deemed to be “legacy.” Over time, as one legacy set of technologies is gradually replaced, we must be capable of addressing the modernization needs of the next set of aging technologies.

The fact that the modernization needs of the market are evolving on a constant basis, necessitates that we be capable of tracking and predicting changes in technologies. Anticipating the needs of the IT modernization market and delivering new tools and services that satisfy the emerging needs is a critical success factor.

However, even if we develop modernization solutions that address the evolving needs of the legacy IT modernization market, we cannot assure you that there will be a predictable demand for our offerings. Vagaries ranging from the macro-economic climate, to the competitive landscape, to the perceived need that the enterprise market has for a specific modernization solution, will all have an impact such as a longer sales cycle and increased pricing pressure.

In addition to our ability to foresee the needs of the market and develop appropriate modernization solutions, our growth is predicated, in part, on the acquisition of companies with services, tools, and technologies that extend or complement our existing business. We may face increased competition for choice acquisition targets or difficulties in identifying and locating new tools and technologies, which may inhibit our ability to complete suitable acquisitions on favorable terms. The successful integration of acquired businesses, technologies, and products into our existing portfolio of solutions will continue to be a significant challenge.

To keep up with the anticipated growing demand for our tools and services, we must retain our highly skilled personnel in the fields of project management, legacy systems, and leading modern technologies. Maintaining and growing the requisite skill base can be problematic; personnel with an understanding of legacy technologies is a finite resource and the market for recruiting and retaining such skills can be highly competitive.

Competition

We face competition for our tools and services from various entities operating in the market. At the highest level, the legacy IT modernization market competes with two other approaches that can be employed to evolve the operating capabilities of a business: re-building business systems from scratch or buying a commercially available application package that can be configured to serve the specific needs of a particular business. The benefits of each approach have been widely documented by major research firms such as Gartner and Forrester. It is typically understood that legacy IT modernization provides several key advantages over the other two, including:

- Lowest risk – existing tried and tested information technology is leveraged directly and translated into a version of itself based on a newer technology platform;
- Least cost and time; and
- Least impact on the business and professional skill set.

However, some enterprises still choose to abandon legacy technologies and invest in the redevelopment of new business systems.

The modernization market in which we operate is highly competitive. The principal competitive factors affecting the market for our modernization solutions include:

- the ability to offer automated solutions for legacy IT modernization;
- the range and number of languages, operating systems and databases supported by said tools;
- tool functionality, performance, and reliability;
- the extent and range of ancillary professional services that can be offered in conjunction with the actual modernization services;
- availability of experienced personnel and with appropriate modernization subject matter expertise;
- solution pricing;
- local geographic presence in customer's territory;
- credibility in the market place, customer references and perceived financial stability;
- the ability to respond in a timely manner to changing customer needs; and
- the quality of operational support and maintenance for any delivered solution.

Competition in the legacy IT modernization field is, to a large extent, based upon the functionality of the available tools and personnel expertise. Vendors in this market address the modernization of legacy systems in different ways, and therefore do not always compete directly with the others. Many small vendors, those that possess just a few niche modernization technologies or a focused set of skills, are only capable of addressing a small portion of the overall modernization market. Selected few others are able to offer comprehensive suites of integrated tools and solutions and are able to address the broad set of needs encountered by businesses.

Our principal competitors consist of system integrators, offshore outsourcers, and tool vendors, including leading software developers, who enable the replacement or modernization of legacy systems.

Major system integrators in the market include IBM, HP, SUN, Accenture, Cap Gemini and EDS, some of whom we also partner with. IBM has established legacy modernization as a strategic aspect of its long-term application development strategy. Major system integrators have a specific and dominant advantage in the underlying application development infrastructure associated with many legacy environments (predominantly IBM mainframes) and a large service delivery capability. In some cases, we cooperate with some of these system integrators in providing specific solutions or portions of comprehensive projects. Major offshore outsourcers in the market include Tata, WIPRO, Infosys and Patni. Both systems integrators and offshore outsourcers have vertical market groups offering consulting and professional services. Although system integrators and offshore outsourcers often have the advantage of brand recognition and depth of resources, their ability to compete with purely automatic tool-based modernization techniques is still limited. Modernization approaches that use relatively inexpensive offshore manual labor to conduct migration projects are still more expensive than those conducted using automated tools and are more prone to project risks and delays.

We also face competition from niche tools and solutions companies operating in the enterprise IT modernization continuum.

Examples of businesses that address specific sub-segments of the market include Cast, Meta Ware, Ateras, Anubex, Migrationware, Alchemy Solutions, HTWC, Speedware and Softmaint.

In addition, enterprises themselves represent one of the largest categories of competition. For a variety of reasons, many businesses choose to execute legacy IT modernization projects using their own internal IT resources. The rationale for a company to attempt to conduct modernization activities using in-house resources varies. Reasons include wanting to justify the existence of available resources, the belief that using internal resources will be quicker or cheaper, and decision makers underestimating the complexity of modernization projects or failing to appreciate the benefits that can result by using experienced personnel and built-for-purpose tools.

C. Organizational Structure

We run our worldwide operations through several wholly owned and controlled subsidiaries, named below:

<u>Name of Subsidiary</u>	<u>Country of Incorporation</u>
BluePhoenix Solutions USA Inc.	United States
Amalgamated Software NA Inc. (ASNA)	United States
BridgeQuest Inc.	United States
BluePhoenix Solutions Nordic, AS	Denmark
BluePhoenix Solutions U.K. Limited	United Kingdom
BluePhoenix Solutions Italia Srl.	Italy
Blue Phoenix I-Ter S.p.A.	Italy
BluePhoenix Solutions GmbH	Germany
BluePhoenix Solutions B.V.	The Netherlands
BluePhoenix Solutions Ltd.	Cyprus
BluePhoenix Solutions Srl.	Romania
BluePhoenix Solutions Co., Ltd.	Korea
Liacom Systems Ltd.	Israel
Zulu Software Inc.	United States
TIS Consultants Ltd.	Cyprus
BluePhoenix Technologies Ltd.	Israel
TISA Software Consultants Private Limited	India

D. Property, Plants and Equipment

We, together with our subsidiaries and affiliates, currently occupy approximately 6,356 square meters of office space. The aggregate annual rent we paid for these facilities in 2009 was \$2.1 million. The following table presents certain information about our facilities and the terms of lease of these facilities.

<u>Country and State</u>	<u>City</u>	<u>Sq. Meters</u>	<u>Expiration</u>	<u>Annual anticipated rental fees in 2010^(*) in thousands \$</u>
Israel	Herzliya	1,540	December 2010	352
Israel	Holon	253	December 2010	43
USA, North Carolina	Cary	604	April 2012	134
USA, Texas	San Antonio	650	July 2011	142
USA	Virginia	235	November 2012	45
Denmark	Ballerup	177	November 2010	26
Romania	Bucharest	930	May 2013	225
United Kingdom	Milton Keynes	180	December 2012	88
Cyprus	Nicosia	100	April 2011	22
Italy	Milan	110	April 2012	12
Italy	Riccione	200	December 2013	28
Italy	Milan	115	November 2014	19
Russia	St. Petersburg	836	December 2010	290
Russia	Irkutsk	136	December 2010	32
Russia	Nizhny Novgorod	160	December 2010	44
India	Mysore	130	December 2010	8
Total		6,356		1,510

(*) Includes related fees such as management fees, maintenance, parking etc.

If, in the future, we determine that we need additional space to accommodate our growth, we believe that we will be able to obtain this additional space without difficulty and at commercially reasonable prices. We do not own any real property.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Following our board of directors' decision to sell our holdings in our subsidiary, Mainsoft in January 2008, we included Mainsoft's results in our financial statements as a discontinued operation. Accordingly, all figures in this annual report exclude Mainsoft's results, which are presented as a discontinued operation. See Note 15 to our financial statements.

Overview

We engage in the IT modernization solutions business, including professional services and knowledge management solutions. We continue to pursue selective acquisitions that we believe will enrich our technological offering and will expose us to new geographies and markets. As a result of certain acquisitions and other factors described below under "Operating Results," our revenues increased from \$81.2 million in 2007 and to \$91.7 million in 2008. However, in 2009, our revenues decreased to \$77.8 million, mainly as a result of the recent global economic and financial market crisis.

The recent global economic and financial market crisis has caused, among other things, a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, and reduced corporate profits and capital spending, all of which have had and continue to have a negative effect on our business, results of operations and financial condition. In response to these market conditions, we are focusing on providing customers with legacy modernization solutions that have a cost effective impact on the customers' information technology spending, which is particularly important during a difficult economic environment. We have also implemented initiatives to reduce costs and improve working capital to mitigate the effects of the different related economic conditions on our business.

Our quarterly and annual results of operations have fluctuated significantly in the past and we expect them to continue to fluctuate significantly in the future, as a result of numerous factors, including: global economic trends, such as the recent global economic crisis; fluctuations in foreign currencies exchange rates in which we operate compared to the U.S. dollar, our reporting currency; fluctuation in sale of software products; the impact of acquisitions and dispositions of companies; and the difficulties we have encountered in introducing our tools to the market. Therefore, we believe that period-to-period comparisons of our financial results are not necessarily meaningful and you should not rely on them as an indication of future performance.

We enhance our solutions and services via internal development of new software tools and devote significant resources to the development and marketing of new software modernization tools. We continue to reinvest in our company through investments in technology and process improvement. In addition, we invest in businesses that develop software tools that are complementary to our existing portfolio. We also invest in a skilled and specialized workforce. In 2009, our investment in research and development amounted to \$11.4 million, as compared to \$18.4 million in 2008. This decrease is mainly attributable to the reallocation of human resources from research and development costs to cost of sales. In addition, some of our professionals who focused on research and development in 2008 were temporarily shifted, in 2009, to our turn-key projects.

In 2009, we continued to strengthen our sales team. Management has devoted significant attention to market awareness and to establishing a strong reputation as a leader in the modernization market. We have also increased our marketing efforts through targeted exhibitions, an expanded public relations program, web and email marketing, online web casts and other lead generation campaigns.

In evaluating our results, we focus on the following key financial and operating data: revenues, gross margin, recurring revenues, cash flow and adjusted EBITDA. Recurring revenues are analyzed in terms of revenues from products, revenues from projects based on our tools, revenues based on geography and revenues from maintenance and long term service contracts. Projects and services are priced in an effort to generate a gross margin of not less than 50% on a non-GAAP basis as described below. In addition, cash flow from operating activities is targeted to be positive (for more information, see "Item 5.B. Liquidity and Capital resources.")

The non-GAAP measure of "adjusted EBITDA" serves as an additional indicator of our operating performance and not as a replacement for other measures such as cash flows from operating activities and operating income in accordance with GAAP. We believe that adjusted EBITDA is useful to investors as a measure of forward-looking cash flows as it excludes depreciation and amortization, goodwill impairment, stock based compensation and non-recurring charges. Stock-based compensation is an incentive for certain individuals who are part of the executive management. They are affected by historical stock prices which are irrelevant to forward-looking analyses and are not necessarily linked to the operational performance. We also believe that adjusted EBITDA is commonly used by analysts and investors in our industry and enables shareholders and potential investors to apply multiples on adjusted EBITDA in making investment decisions with respect to our company. Our management uses the Non-GAAP measure of adjusted EBITDA as the main indicator to evaluate operational performance and future cash flow of our business, and to assist management in allocating financial resources and workforce as well as to determine strategic targets and executive management remuneration.

Adjusted EBITDA does not take into account certain items and therefore it has inherent limitations. We obtain our adjusted EBITDA measurement by adding to net earnings (net loss), financial expenses, amortizations, income taxes, financial expenses, results attributed to non-controlling interests and losses on exchange incurred during the year. We exclude from our adjusted EBITDA calculation the effects of non-monetary transactions recorded, such as stock-based compensation, one-time charges and employees' termination expenses related to our cost saving plan. These expenses do not reflect our on-going future operation. To compensate for these limitations, we analyze adjusted EBITDA in conjunction with other GAAP measures and other operating performance measures. Adjusted EBITDA should not be considered in isolation or as a substitute for a GAAP measure. Investors should carefully consider the specific items included in adjusted EBITDA. While adjusted EBITDA has been disclosed to permit a more complete comparative analysis of our operating performance relative to other companies, investors should be cautioned that adjusted EBITDA as reported by us may not be comparable in all instances to adjusted EBITDA as reported by other companies.

The following table provides a reconciliation of net income (loss) to adjusted EBITDA for the periods indicated:

	2009	2008	2007
Net income (loss)	(15,570)	(28,601)	(8,196)
Amortization of intangible assets	7,908	9,110	9,512
Goodwill impairment	5,670	13,328	-
Capitalization of software development costs	-	-	(3,944)
Stock-based and non-cash compensation	2,031	2,825	2,794
Cost saving expenses and one-time charges	6,167	2,338	2,664
Net loss from discontinued operation	-	8,512	7,489
Net income attributed to non-controlling interests	295	228	164
Income tax expenses (benefit)	(117)	(330)	68
Financial expenses, net	779	1,839	3,451
Adjusted EBITDA	<u>7,163</u>	<u>9,249</u>	<u>14,002</u>

Pursuant to impairment tests performed in 2009 and 2008, impairment losses of \$5.7 million and \$13.3 million, respectively, related to goodwill of our overall IT modernization reporting unit, were identified and charged to income. These impairment losses are attributed mainly to the effect of the recent global economic and financial crisis on our business as described above.

Recent Acquisitions

As part of our expansion strategy, in December 2009, we purchased the knowledge management business of DSKnowledge Ltd. This product modernizes and transforms legacy data, information and content elements in enterprises into one knowledge management repository. Pursuant to the terms of the purchase agreement, we paid approximately \$3 million. We committed to pay additional consideration under the purchase agreement which is calculated based upon the future performance of the business.

Consolidation of the Results of Operations of Our Subsidiaries and Acquired Activity

Following is information regarding the consolidation of the results of operations of certain of our subsidiaries and acquired activity during 2007, 2008 and 2009. We began to consolidate the results of operations of each of these subsidiaries and acquired activity when we acquired control in them.

<u>Name of Subsidiary/purchased activit</u>	<u>Beginning Consolidatio</u>
BridgeQuest Inc.	Second quarter of 2007
Amalgamated Software North America Inc.(ASNA)	Third quarter of 2007
TIS Consultants Ltd.	First quarter of 2008
JLC Group business	Second quarter of 2008
Knowledge Management business	Fourth quarter of 2009

Following our board of directors' decision to sell our holdings in our subsidiary, Mainsoft in January 2008, we included Mainsoft's results in our financial statements as a discontinued operation. Accordingly, all figures in this annual report exclude Mainsoft's results, which are presented as a discontinued operation. See Note 15 to our financial statements.

Critical Accounting Policies

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

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

Revenues derived from direct software license agreements are recognized in accordance with FASB ASC Topic 985 "Software" ("ASC 985"), upon delivery of the software, when collection is probable, the license fee is otherwise fixed or determinable, and persuasive evidence of an arrangement exists.

We typically sell our software products and services in stand-alone contracts for software product licenses, services, or maintenance and support. A relatively small portion of our arrangements includes multiple elements. These arrangements are usually arrangements in which we sell a software product license and PCS.

We allocate the total fee arrangement to the software and the PCS undelivered element based on vendor-specific objective evidence, referred to as VSOE, under which "The fair value of the PCS should be determined by reference to the price the customer will be required to pay when it is sold separately." The fair value of the PCS is calculated by the consistent renewal rate of the PCS stated in the relevant contract. The portion of the fee arrangement allocated to the PCS is recognized as revenues ratably over the term of the PCS arrangement.

In some agreements with our customers, the customers have the right to receive unspecified upgrades on an if-and-when available basis (we do not provide specific upgrades). These upgrades are considered Post-Contract Support ("PCS"). Revenue allocated to the PCS is recognized ratably over the term of the PCS.

Long term contracts accounted for pursuant to FASB ASC Topic 605-35-25 (prior authoritative literature: SOP 81-1, "Accounting for Performance of Construction-Type Contracts") are contracts in which we sell our software framework, on which material modifications, developments and customizations are performed, to provide the customer with a new and modern IT application with enhanced capabilities that were unavailable in its former legacy system. The aforementioned services are essential to the functionality of the software and to its compliance with customers' needs and specifications. Under this method, estimated revenue is generally accrued based on costs incurred to date, as a percentage of total updated estimated costs. Changes in our estimates may affect the recognition of our long-term contract revenues. We recognize contract losses, if any, in the period in which they first become evident. Some of our contracts include client acceptance clauses. In these contracts, we follow the guidance of ASC 985-605-55 (formerly TPA 5100.67) and SAB 104. In determining whether revenue can be recognized, when an acceptance clause exists, we consider our history with similar arrangements, the customer's involvement in the negotiation process, and the existence of other service providers and the payment terms.

We present revenues from products and revenues from services in separate line items. The product revenues line item includes revenues generated from (i) stand-alone software products; and (ii) software products that were included in multiple-element arrangements and were separated pursuant to ASC 985 as aforementioned.

In the services revenue line item, we include (i) revenues generated from stand-alone consulting services; (ii) revenues generated from stand alone PCS; (iii) revenues accounted for pursuant to ASC 605-35-25; and (iv) revenues generated from PCS included in multiple-element arrangement and were separated pursuant to ASC 985 as aforementioned. We have included all long term contracts arrangements in the service revenues line item since we can not establish VSOE of fair value to neither the service element nor the software element. Our software framework and these kinds of modifications and customizations are not sold separately. Therefore, we can not appropriately justify reflecting the product portion separately in our statement of operations.

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

In accordance with FASB ASC Topic 350 "Intangible – goodwill and other," indefinite life intangible assets and goodwill are not amortized but rather subject to periodic impairment testing.

Goodwill and intangible assets are tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is generally determined using discounted cash flows, market multiples, and market capitalization. Significant estimates used in the fair value methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples of the reportable unit. If these estimates or their related assumptions change in the future, we may be required to record additional impairment charges for our goodwill and intangible assets. These write downs may have an adverse affect on our operating results. Future events could cause us to conclude that impairment indicators exist and that additional intangible assets associated with our acquired businesses are impaired. In addition, we evaluate a reporting unit for impairment if events or circumstances change between annual tests, indicating a possible impairment. Examples of such events or circumstances include: (i) a significant adverse change in legal factors or in the business climate; (ii) an adverse action or assessment by a regulator; (iii) a more likely than not expectation that portion of the reporting unit will be sold; (iv) continued or sustained losses at a reporting unit; (v) a significant decline in our market capitalization as compared to our book value; or (vi) the testing for recoverability of a significant asset group within the reporting unit.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. In estimating the fair value of the reporting unit for the purpose of our periodic analysis, we make estimates and judgments about the future cash flows of the reporting unit. Although our cash flow forecasts are based on assumptions that are consistent with our plans and estimates we are using to manage the underlying businesses, there is significant exercise of judgment involved in determining the cash flows attributable to a reporting unit over its estimated remaining useful life. In addition, we make certain judgments about allocating shared assets to the estimated balance sheets of our reporting unit. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

We are one operating segment and therefore one reporting unit related to overall IT modernization. We utilize a two-step method to perform a goodwill impairment review in the fourth quarter of each fiscal year or when facts and circumstances indicate goodwill may be impaired. In the first step, we determine the fair value of the reporting unit using expected future discounted cash flows and estimated terminal values. If the net book value of the reporting unit exceeds the fair value, we would then perform the second step of the impairment test which requires allocation of the reporting unit's fair value of all of its assets and liabilities in a manner similar to a purchase price allocation, with any residual fair value being allocated to goodwill. The implied fair value of the goodwill is then compared to the carrying value to determine impairment, if any. In 2009 and 2008, we performed impairment tests, and identified impairment losses of \$5.7 million and \$13.3 million, respectively, related to goodwill of our overall IT modernization reporting unit, which were charged to operations. We attribute this impairment to the recent global economic and financial market crisis, which had a negative effect on our business primarily as a result of the negative equity market conditions which caused a material decline in industry market multiples.

We determine the fair value of a reporting unit using the Income Approach, which utilizes a discounted cash flow model, as we believe this approach best approximates the unit's fair value. We corroborated the fair values using the Market Approach. Judgments and assumptions related to revenue, gross profit, operating expenses, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. Additionally, we evaluated the reasonableness of the estimated fair value of the reporting unit by reconciling to its market capitalization. This reconciliation allowed us to consider market expectations in corroborating the reasonableness of the fair value of the reporting unit. Our ability to reconcile the gap between our market capitalization and our aggregate fair value of our assets as reported depends on various factors, some of which are quantitative, such as an estimated control premium that an investor would be willing to pay for a controlling interest in us, and some of which are qualitative and involve management judgment, including stable relatively high backlog and growing pipe line of anticipated business. In that regard, we base our assumption on an effective control premium rate of 30% in 2009 and 42% in 2008, which was based on various mergers and acquisitions in Israel and abroad involving similar companies, that took place during the six-month period preceding December 31, 2009. If our market capitalization stays below the value of our equity, or actual results of operations differ materially from our modeling estimates and related assumptions, or if any of our qualitative reconciliation factors changes in the future, we may be required to record additional impairment charges for our goodwill. We will continue to monitor market trends in our business, the related expected cash flows and our calculation of market capitalization for purposes of identifying possible indicators of impairment. Should our book value per share continue to exceed our market share price or we have other indicators of impairment, as previously discussed, we will be required to perform an interim step one impairment analysis, which may lead to a step two analysis resulting in goodwill impairment. Additionally, we would then be required to review our remaining long-lived assets for impairment.

Fair Value Measurements. In April 2009, the Financial Accounting Standards Board (“FASB”) issued additional guidance on factors to consider when estimating fair value consequent to a significant decrease in market activity for a financial asset. As applicable to us, this guidance became effective for interim and annual periods starting April 1, 2009, and did not have a material impact on our consolidated financial statements.

The accounting standard establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers counterparty credit risk in its assessment of fair value.

Stock Based Compensation. We account for stock based compensation to employees in accordance with FASB ASC Topic 718 “Compensation - Stock Compensation”, which was adopted effective January 2006. In the past three years, most of the awards were of restricted stock units (“RSUs”). RSUs are valued based on the market value of the underlying stock at the date of grant. We measure and recognize compensation expense with respect to share options based on estimated fair values on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option’s expected life and the price volatility of the underlying stock.

Income taxes. As a multinational corporation, we are subject to taxation in many jurisdictions, and the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various taxing jurisdictions. If we ultimately determine that the payment of these liabilities will be unnecessary, we reverse the liability and recognize a tax benefit during the period in which we determine the liability no longer applies. Conversely, we record additional tax charges in a period in which we determine that a recorded tax liability is less than we expect the ultimate assessment to be. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations and court rulings. Therefore, the actual liability for Israeli or foreign taxes may be materially different from our estimates, which could result in the need to record additional tax liabilities or potentially reverse previously recorded tax liabilities. Accounting for uncertainty in income taxes requires that tax benefits recognized in the financial statements must be at least more likely than not of being sustained based on technical merits. The amount of benefits recorded for these positions is measured as the largest benefit more likely than not to be sustained. Significant judgment is required in making these determinations. As of December 31, 2009, there are no unrecognized tax benefits. Deferred taxes are determined utilizing the "asset and liability" method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and the tax basis 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, when it's more likely than not that deferred tax assets will not be realized in the foreseeable future. In calculating our deferred taxes we are taking into account various estimations, which are examined and if necessary adjusted on a quarterly basis, regarding our future utilization of future carry forward losses.

Accounts receivable and Allowances for Doubtful Accounts. Our trade receivables include amounts due from customers. We perform ongoing credit evaluations of our customers' financial condition and we require collateral as deemed necessary. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including the aging of our receivables, historical bad debt experience and the general economic environment. Management applies considerable judgment in assessing the realization of receivables, including assessing the probability of collection and the current credit worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Derivative Instruments. Under the provisions of FASB ASC Topic 815 "Derivatives and hedging," all derivatives are recognized on the balance sheet at their fair value. Changes in fair value are recognized periodically in earnings or accumulated other comprehensive income within shareholders' equity, depending on the intended use of the derivative and whether the derivative has been designated by management as a hedging instrument. Changes in fair value of derivative instruments not designated as hedging instruments are recognized in earnings in the current period.

We use foreign currency options, forward exchange contracts and forward interest contracts to assist in managing financial risks. We do not use derivative financial instruments for speculative purposes. These instruments are recognized at fair value, with all changes in fair value recorded in current period earnings, as these transactions have not been designated as hedging instruments under ASC 815.

Discontinued Operation. In January 2008, the board of directors announced its intent to sell the entire holdings in Mainsoft Corp., in which we held a 58% controlling interest. This decision followed a strategic shift in Mainsoft's product development and marketing strategy outside of BluePhoenix's core business focus. In October 2008, we sold Mainsoft for consideration of \$1.7 million. Mainsoft met the definition of a component. Accordingly, the results of operation of Mainsoft are discontinued operation in the statement of operations and prior periods results have been reclassified accordingly. In addition, comparative data of the asset and liabilities attributed to the discontinued operation have been reclassified in the balance sheet.

Recently Issued Accounting Pronouncements

Adoption of New Accounting Standards

Accounting Standards Codification

In June 2009, the FASB issued Statement of Accounting Standards ("SFAS") No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (the "Codification"). This standard replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and establishes only two levels of U.S. GAAP, authoritative and non-authoritative. The FASB ASC has become the source of authoritative, nongovernmental GAAP, except for rules and interpretive releases of the SEC, which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative. This standard is effective for financial statements for interim or annual reporting periods ending after September 15, 2009. The adoption of the Codification changed our references to GAAP accounting standards but did not impact our results of operations, financial position or liquidity.

Participating Securities Granted in Share-Based Transactions

Effective January 1, 2009, we adopted a new accounting standard included in ASC 260, *Earnings Per Share* (formerly FASB Staff Position ("FSP") Emerging Issues Task Force ("EITF") 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*). The new guidance clarifies that non-vested share-based payment awards that entitle their holders to receive non-forfeitable dividends or dividend equivalents before vesting should be considered participating securities and included in basic earnings per share. Our adoption of the new accounting standard did not have a material effect on previously issued or current earnings per share.

Business Combinations and Noncontrolling Interests

Effective January 1, 2009, we adopted a new accounting standard included in ASC 805, *Business Combinations* (formerly SFAS No. 141(R), *Business Combinations*). The new standard applies to all transactions or other events in which an entity obtains control of one or more businesses. Additionally, the new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement date for all assets acquired and liabilities assumed; and requires the acquirer to disclose additional information needed to evaluate and understand the nature and financial effect of the business combination. Our adoption of this new accounting standard did not have a material impact on our consolidated financial statements.

Effective January 1, 2009, we adopted a new accounting standard included in ASC 810, *Consolidations* (formerly SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*). The new accounting standard establishes accounting and reporting standards for the noncontrolling interest (or minority interests) in a subsidiary and for the deconsolidation of a subsidiary by requiring all noncontrolling interests in subsidiaries be reported in the same way, as equity in the consolidated financial statements. As such, this guidance has eliminated the diversity in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. Our adoption of this new accounting standard resulted in recording all of our non-controlling interests in equity in the current year and in comparative numbers.

Fair Value Measurement and Disclosure

Effective January 1, 2009, we adopted a new accounting standard included in ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820") (formerly FASB FSP No 157-2, *Effective Date of FASB Statement No. 157*), which delayed the effective date for disclosing all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value on a recurring basis (at least annually). This standard did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued new guidance for determining when a transaction is not orderly and for estimating fair value when there has been a significant decrease in the volume and level of activity for an asset or liability. The new guidance, which is now part of ASC 820 (formerly FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*), requires disclosure of the inputs and valuation techniques used, as well as any changes in valuation techniques and inputs used during the period, to measure fair value in interim and annual periods. In addition, the presentation of the fair value hierarchy is required to be presented by major security type as described in ASC 320, *Investments — Debt and Equity Securities*. The provisions of the new standard were effective for interim periods ending after June 15, 2009. The adoption of this new standard on April 1, 2009 did not have a material impact on our consolidated financial statements.

In April 2009, we adopted a new accounting standard included in ASC 820, (formerly FSP 107-1 and Accounting Principles Board ("APB") 28-1, *Interim Disclosures about Fair Value of Financial Instruments*). This new standard requires disclosure of the fair value of financial instruments for interim reporting periods of publicly traded companies in addition to the annual disclosure required at year-end. The provisions of the new standard were effective for interim periods ending after June 15, 2009. Our adoption of this new accounting standard did not have a material effect on our consolidated financial statements.

In August 2009, the FASB issued new guidance relating to the accounting for the fair value measurement of liabilities. The new guidance, which is now part of ASC 820, provides clarification that in certain circumstances in which a quoted price in an active market for the identical liability is not available, a company is required to measure fair value using one or more of the following valuation techniques: the quoted price of the identical liability when traded as an asset, the quoted prices for similar liabilities or similar liabilities when traded as assets, or another valuation technique that is consistent with the principles of fair value measurements. The new guidance clarifies that a company is not required to include an adjustment for restrictions that prevent the transfer of the liability and if an adjustment is applied to the quoted price used in a valuation technique, the result is a Level 2 or 3 fair value measurement. The new guidance is effective for interim periods beginning after August 27, 2009. Our adoption of the new guidance did not have a material effect on our consolidated financial statements.

Derivative Instruments and Hedging Activities

Effective January 1, 2009, we adopted a new accounting standard included in ASC 815, *Derivatives and Hedging* (SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133*). The new accounting standard requires enhanced disclosures about an entity's derivative and hedging activities and is effective for interim and annual periods beginning after November 15, 2008. Since the new accounting standard only required additional disclosure, the adoption did not impact our consolidated financial statements.

Other-Than-Temporary Impairments

In April 2009, the FASB issued new guidance for the accounting for other-than-temporary impairments. Under the new guidance, which is part of ASC 320, *Investments — Debt and Equity Securities* (formerly FSP 115-2 and 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*), an other-than-temporary impairment is recognized when an entity has the intent to sell a debt security or when it is more likely than not that an entity will be required to sell the debt security before its anticipated recovery in value.

The new guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities and is effective for interim and annual periods ending after June 15, 2009. Our adoption of the new guidance did not have a material effect on our consolidated financial statements.

Subsequent Events

In May 2009, the FASB issued new guidance for subsequent events. The new guidance, which is part of ASC 855, *Subsequent Events* (formerly SFAS No. 165, *Subsequent Events*) is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, this guidance sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This new guidance is effective for interim and annual periods ended after June 15, 2009 and will be applied prospectively. Our adoption of the new guidance did not have a material effect on our consolidated financial statements.

Accounting Standards Not Yet Effective

Accounting for the Transfers of Financial Assets

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as SFAS No. 166, *Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140*, was adopted into the Codification in December 2009 through the issuance of Accounting Standards Updated (“ASU”) 2009-16. The new standard eliminates the concept of a “qualifying special-purpose entity,” changes the requirements for derecognizing financial assets, and requires additional disclosures in order to enhance information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and an entity’s continuing involvement in and exposure to the risks related to transferred financial assets.

The new guidance is effective for fiscal years beginning after November 15, 2009. We will adopt the new guidance in 2010 and we began evaluating the impact it will have on our consolidated financial statements.

Accounting for Variable Interest Entities

In June 2009, the FASB issued revised guidance on the accounting for variable interest entities. The revised guidance, which was issued as SFAS No. 167, *Amending FASB Interpretation No. 46(R)*, was adopted into Codification in December 2009 through the issuance of ASU 2009-17. The revised guidance amends FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, in determining whether an enterprise has a controlling financial interest in a variable interest entity. This determination identifies the primary beneficiary of a variable interest entity as the enterprise that has both the power to direct the activities of a variable interest entity that most significantly impacts the entity’s economic performance, and the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the variable interest entity. The revised guidance requires ongoing reassessments of whether an enterprise is the primary beneficiary and eliminates the quantitative approach previously required for determining the primary beneficiary. We do not expect that the provisions of the new guidance will have a material effect on our consolidated financial statements.

Revenue Recognition

In October 2009, the FASB issued ASU 2009-13, *Multiple-Deliverable Revenue Arrangements*. The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable based on the relative selling price. The selling price for each deliverable is based on vendor-specific objective evidence (“VSOE”) if available, third-party evidence if VSOE is not available, or estimated selling price if neither VSOE or third-party evidence is available. ASU 2009-13 is effective for revenue arrangements entered into in fiscal years beginning on or after June 15, 2010. We do not expect that the provisions of the new guidance will have a material effect on our consolidated financial statements.

Our Reporting Currency

The currency of the primary economic environment in which the operations of BluePhoenix and most of its subsidiaries are conducted is the U.S. dollar. In addition, a substantial portion of our revenues and costs are incurred in dollars. Thus, the dollar is our functional and reporting currency.

We follow FASB ASC Topic 830 "Foreign currency translation" and accordingly non monetary transactions denominated in currencies other than the dollar are measured and recorded in dollar at the exchange rates prevailing at transaction date. Monetary assets and liabilities denominated in currencies other than the dollar are translated at the exchange rate on the balance sheet date. Exchange gain or losses on foreign currency translation are recorded in income.

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

For the year ended December 31,	Inflation rate in Israel	Devaluation of NIS against the US\$	Devaluation of euro against the US\$
	%	%	%
2007	3.4	(8.7)	(11.7)
2008	3.8	(1.1)	5.6
2009	3.9	(0.7)	(3.3)

A. Operating Results

The following table presents the percentage relationships of certain items from our consolidated statement of operations, as a percentage of total revenues for the periods indicated:

Statement of Operations Data as a Percentage of Revenues:

	Year ended December 31,		
	2009	2008	2007
	%	%	%
Revenues	100.0	100.0	100.0
Cost of revenues	57.7	50.2	45.0
Gross profit	42.3	49.8	55.0
Research and development costs	14.7	20.0	15.6
Selling, general, and administrative expenses	39.1	35.3	34.9
Goodwill impairment	7.3	14.5	
Restructuring costs	-	-	0.8
Operating income (loss)	(18.8)	(20.0)	3.7
Financial expenses, net	(1.0)	(2.4)	(5.3)
Other income, net	-	0.4	1.0
Loss before taxes on income	(19.8)	(22.0)	(0.6)
Income tax (expense) benefit	0.2	0.4	(0.1)
	(19.6)	(21.6)	(0.7)
Equity in earnings of affiliated companies, net	-	(0.1)	-
Net loss from continued operation	(19.6)	(21.7)	(0.7)
Loss from discontinued operation	-	(9.2)	(9.2)
Net loss	(19.6)	(30.9)	(9.9)
Net results attributable to non-controlling interests	(0.4)	(0.2)	(0.2)
Net loss attributable to BluePhoenix' shareholders	(20.0)	(31.1)	(10.1)

Years Ended December 31, 2009 and 2008

Revenues. Revenues decreased by 15% from \$91.7 million in 2008 to \$77.8 million in 2009. The decrease is mainly attributable to the recent global economic and financial crisis which caused a decrease in demand from existing customers for our consulting services and pricing pressure in attracting new customers for our legacy modernization projects. The majority of our projects are specifically tailored and negotiated separately, and therefore, the lack of uniform rates and price lists makes us unable to quantify the decrease in pricing.

Revenues generated from our services decreased by 16%, from \$84.9 million in 2008 to \$71.0 million in 2009. This decrease is attributable to a decrease in demand by existing customers for consulting services. Revenues generated from our products (software license) were \$6.8 million in each of 2009 and 2008.

Our revenues are generated from recurring revenues such as long term services and maintenance contracts, and from legacy systems modernization, namely, turn-key projects, products and related maintenance. Revenues generated from recurring revenues decreased from \$54.1 million in 2008 to \$43.2 million in 2009. This was the result of a decrease in revenues from services. As a percentage of revenues, recurring revenues decreased from 59% in 2008 to 56% in 2009. Revenues generated from legacy modernization, namely, turn-key projects, products and related maintenance, decreased from \$37.6 million in 2008 to \$34.6 million in 2009. As a percentage of revenues, revenues from legacy modernization increased from 41% of revenues in 2008 to 44% of revenues in 2009. Approximately 44% of our revenues in 2009 were derived from financial institutions compared to 60% of revenues in 2008.

The table below presents the breakdown of our revenues based on the location of our customers for the periods indicated:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	%	%	%
North America	36	25	22
Europe (other than Denmark)	34	44	39
Denmark	13	12	19
Israel	13	12	10
Other	4	7	10
Total	100	100	100

Gross Profit. As a percentage of revenues, gross profit was 42% in 2009 compared to 50% in 2008. The decrease is attributable to: additional expense of \$2.8 million incurred during the fourth quarter of 2009 with regard to a large project; pricing pressures in attracting new customers for our legacy modernization projects; and the reallocation of human resources from research and development costs to cost of sales. Some of our professionals, who focused on research and development during 2008, were shifted in 2009 to our turn-key projects.

Cost of revenues. Cost of revenues consists of salaries, amortization of intangible assets, fees paid to independent subcontractors and other direct costs. Cost of revenues decreased by 2% from \$46.0 million in 2008 to \$45 million in 2009. This decrease is a direct result of the decrease in revenues. Cost of revenues as a percentage of revenues increased from 50% in 2008 to 58% in 2009. This increase was attributable to \$2.8 million of unexpected costs during the end of 2009 due to a delay in delivery of a large project, pricing pressures in attracting new customers for our legacy modernization projects and the reallocation of human resources from research and development costs to cost of sales.

Research and development costs. Research and development costs consist of salaries and consulting fees that we pay to professionals engaged in the development of new software tools and related methodologies. Our development costs are allocated among our modernization suite of tools and are charged to operations as incurred. Research and development costs decreased by 38% from \$18.4 million in 2008 to \$11.4 million in 2009, mainly as a result of reallocation of professional human resources from research and development to the delivery of turn key projects. As a percentage of revenues, research and development costs decreased from 20% in 2008 to 15% in 2009.

Selling, general, and administrative expenses. Selling, general, and administrative expenses consist primarily of wages and related expenses, travel expenses, sales commissions, selling expenses, marketing and advertising expenses, rent, insurance, utilities, professional fees, and depreciation. Selling, general, and administrative expenses decreased by 6% from \$32.4 million in 2008 to \$30.4 million in 2009. This decrease is attributable to the dismissal of employees in connection with our cost savings plan implemented at the end of 2008, offset by increased acquisition related expenses and by provision for termination costs in connection with our cost savings plan implemented in 2009. In 2009, our acquisition related expenses were allocated to general and administrative expenses as a result of a new pronouncement which became effective in 2009. As a percentage of revenues, selling, general and administrative expenses increased from 35% in 2008 to 39% in 2009 as a result of a decrease in revenues in 2009.

Goodwill impairment. Our intangible assets are tested for impairment on an annual basis or whenever events or circumstances indicate impairment may have occurred. In 2009 and 2008, we performed impairment tests. An impairment loss of \$5.7 million was identified in 2009 attributed to goodwill of our overall IT modernization reporting unit, which was charged to operations, compared to an impairment loss of \$13.3 million identified in 2008. We attribute this impairment to the recent global economic and financial market crisis, which had a negative effect on our business primarily as a result of the negative equity market conditions which caused a material decline in industry market multiples starting the second half of 2008.

Financial expenses, net. Financial expenses decreased from \$2.2 million in 2008 to \$779,000 in 2009. The decrease in financial expenses is attributable to \$1.5 million of financial income attributed to the warrants issued by us in recent years. This financial income attributed to the warrants is treated under ASC 815-40-15, under which as of January 1, 2009, the warrants (ratchet down of exercise price based upon lower exercise price in future offerings), which are not indexed to our own stock and therefore are a derivative financial liability, are bifurcated and separately accounted for and being recorded. The derivative is presented at fair value and all changes in fair value are recorded as non cash financial income/expenses as applicable. This decrease in financial expenses was offset by fluctuations in foreign currency exchange rates of certain foreign currencies, which had a negative effect on our financial charges.

Other income, net. Other income, net, in 2008, consisted of a \$350,000 loan repayment by Cicero Inc. There was no other income, net, in 2009.

Income tax expense. In 2008, we had income tax benefits of \$330,000 compared to an income tax benefit of \$117,000 in 2009. The tax expenses for 2009 are compounded from \$422,000 current tax expenses offset by \$493,000 deferred taxes which represent our estimated tax benefits for future years. We have net operating losses carried forward for tax purposes in the amount of \$55 million that resulted in relatively low tax rate charges compared to our income before tax results.

Net income attributable to non-controlling interests. Non-controlling interest in earnings in 2009 was \$295,000 compared to \$179,000 in 2008, and represented the non-controlling share in the net profit of our subsidiaries, Liacom Systems Ltd. and Zulu Software Inc. The increase in non-controlling interest results from an increase in the net profit of these subsidiaries. There was no change in the non-controlling interest.

Discontinued operation. We had a loss from discontinued operation of \$8.5 million in 2008 related to Mainsoft.

Years Ended December 31, 2008 and 2007

Revenues. Revenues increased 13% from \$81.2 million in 2007 to \$91.7 million in 2008.

Revenues generated from our services increased by 38%, from \$61.7 million in 2007 to \$84.9 million in 2008. Our services revenues growth is attributable to our acquisitions of TIS and JLC which contributed approximately \$6.3 million in 2008 revenues in the aggregate, while the remaining increase is attributed to revenue generated from certain sizable information technology modernization projects.

Revenues generated from recurring revenues such as long term services contracts and maintenance as a proportion of revenue increased from 54% in 2007 to 59% in 2008. Revenues generated from legacy modernization, namely turn-key projects and products, as a proportion of revenue decreased from 46% in 2007 to 41% in 2008. Revenues generated from our products (software license) were \$19.6 million in 2007 when we signed several large-scale software agreements compared to \$6.9 million in 2008. However, in 2008 we encountered a growing demand for turn-key projects, rather than products sales. Approximately 60% of our revenues in 2008 were derived from financial institutions. Following the economic crisis that accelerated in the second half of 2008, the crisis began to affect our business. There was a decrease in consulting services to existing customers and a number of new customers negotiated lower prices for our legacy modernization projects. The majority of our projects are specifically tailored and negotiated separately, and therefore, the lack of uniform rates and price lists makes us unable to quantify the decrease in pricing. Although a longer sales cycle in 2008 caused the closing of deals to be delayed into future periods, a strong backlog of deals from 2007 enabled us to maintain revenue growth in 2008.

The table below presents the breakdown of our revenues based on the location of our customers for the periods indicated:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	%	%	%
United States	25	22	15
Europe (other than Denmark)	44	39	44
Denmark	12	19	17
Israel	12	10	17
Other	7	10	7
Total	<u>100</u>	<u>100</u>	<u>100</u>

Gross Profit. Gross profit was 50% in 2008 compared to 55% in 2007. The decrease is attributed mainly to the low revenues from product sales in 2008 compared to 2007, as revenues from products generates a higher margin than revenues from services and turn-key projects.

Cost of revenues. Cost of revenues increased by 26% from \$36.5 million in 2007 to \$46.0 million in 2008. This increase was attributed mainly to costs generated from TIS and JLC which were acquired in 2008, and as a direct result of our revenues growth. Cost of revenues as a percentage of revenues increased from 45% in 2007 to 50% in 2008, as a result of the change in the revenue mix in 2008 compared to 2007. Revenue mix in 2007 included 24% of revenues generated from products (software license) and 76% from services, while in 2008, 8% of our revenues were generated from products (software license) and 92% from services. Cost of services is much higher than cost of products.

Research and development costs. Research and development costs increased 45% from \$12.7 million in 2007 to \$18.4 million in 2008. As a percentage of revenues, research and development costs, net increased from 16% in 2007 to 20% in 2008. The low level of costs in 2007 was attributed to a \$3.9 million capitalization of research and development costs. The remaining increase was attributed to the consolidation of acquired companies.

Selling, general, and administrative expenses. Selling, general, and administrative expenses increased by 14% from \$28.4 million in 2007 to \$32.4 million in 2008. As a percentage of revenues, selling, general and administrative expenses remained 35% in 2007 and 2008. The increase in selling, general, and administrative expenses was attributed to a provision of \$2.3 million made in connection with an implementation of our global saving plan in the fourth quarter of 2008. This global saving plan cost consisted of: (a) severance pay and expenses related to the dismissal of employees; and (b) costs associated with closing offices in countries where we previously had two offices, such as in Italy and the United Kingdom. The remaining increase is attributed to the consolidation of acquired companies.

Goodwill impairment. For 2008, we performed an impairment test based on a third party valuation study, and an impairment loss of \$13.3 million attributed to goodwill of over overall IT modernization reporting unit has been identified and was charged to operations. We attribute this impairment to the recent global economic and financial market crisis, which had a negative effect on our business primarily as a result of the negative equity market conditions which caused a material decline in industry market multiples in the second half of 2008.

Financial expenses, net. Financial expenses decreased from \$4.3 million in 2007 to \$2.2 million in 2008. The decrease in financial expenses was attributable to: (a) a repayment of \$32 million loans in November 2007; and (b) non-cash expenses related to the convertible debentures and embedded derivatives that were charged to 2007 financial expenses.

Other income, net. Other income, net, in 2008, consisted of a \$350,000 loan repayment by Cicero. Other income, net, in 2007, consisted of a \$758,000 loan repayment by Cicero, of which \$300,000 was paid in cash and \$458,000 was in securities. For more information, see "Item 4.B. Business Overview—Investments and Acquisitions—Cicero." Other income, net is also attributed to a dividend received from Steps Ventures, an Israeli venture capital investment group, in which we hold 375,000 shares representing 3.75% of Steps Ventures' outstanding share capital. The dividend received in 2008 was \$48,000 compared to \$134,000 in 2007.

Income tax expense. In 2008, we had income tax benefits of \$330,000 compared to an income tax benefit of \$68,000 in 2007. The tax expense is compounded from tax expense related to 2008 and prior years in the amount of \$564,000 offset by a \$894,000 deferred tax which represents our estimated tax benefits for future years. We have net operating losses carried forward for tax purposes in the amount of \$56 million that resulted in relative low tax rate charges comparing to our income before tax results.

Net results attributable to non-controlling interests. Minority interest in earnings in 2007 was \$199,000 compared to \$179,000 in 2008, and representing the minority share in the net profit of Liacom Systems Ltd. and Zulu Software Inc. There were no changes in the minority interest.

Discontinued operation. In January 2008, we announced our decision to sell our holdings in our subsidiary Mainsoft, in which we held a 58% controlling interest. Our management's decision followed a strategic shift in Mainsoft's product development and marketing strategy outside of BluePhoenix's core business focus. As a result, we generated a loss from discontinued operation of \$7.5 million in 2007 compared to \$8.5 million in 2008. Based on an impairment test for 2008, an impairment loss of \$7 million related to goodwill in Mainsoft has been identified and was charged to income in 2008 as a loss from discontinued operation.

B. Liquidity and Capital Resources

How We Have Financed Our Business

Public Offerings

In 1997, we consummated two public offerings, and received net proceeds of \$33.9 million after deducting underwriting discounts and commissions and offering expenses.

In February 2006, we completed an underwritten public offering in Israel of series A convertible notes in an aggregate principal amount of NIS 54.0 million that were equal at the time of the transaction to approximately \$11.5 million (the dollar amount was calculated based on the exchange rate at the date of the transaction). All of the notes have been converted into shares.

Private Placements

In 2004, we completed a \$5 million private placement of convertible debentures to institutional investors. Pursuant to our agreement with the institutional investors, in March 2006, the institutional investors exercised their right to purchase from us, for an aggregate purchase price of \$3 million, additional convertible debentures due in 2009. In 2008, the institutional investors converted the entire principal amount of the debentures into 1,620,790 of our ordinary shares.

In November 2007, we completed a \$35 million private placement of ordinary shares and warrants issued to institutional investors. The warrants are exercisable for 800,000 ordinary shares until November 2012 at an adjusted exercise price of \$18.80 (the exercise price was adjusted pursuant to anti dilution provisions triggered by the private placement that took place in October 2009). The net proceeds from the offering were mainly used for repayment of debt.

In October 2009, we completed a \$4.2 million private placement of ordinary shares and warrants issued to institutional investors. Under the Securities Purchase Agreement entered into with the institutional investors, we sold to the investors 1,364,575 ordinary shares at a purchase price of \$3.05 per share. The investors were also granted a series of warrants to purchase our ordinary shares as follows: (i) 818,744 Series A Warrants exercisable until October 2014, at an exercise price of \$3.95; (ii) 1,364,575 Series B Warrants exercisable until April 29, 2010 at an exercise price of \$3.05; and (iii) 818,744 Series C Warrants exercisable immediately upon the exercise of the Series B Warrants, during a five-year period at an exercise price of \$3.95. As agreed with the investors, we registered the shares purchased by the investors and those underlying the warrants for resale under an effective registration statement.

Other Financing Arrangements

In order to improve our liquidity, we entered into sale of receivables' agreements with regard to some of our customers, pursuant to which, control, credit risk and legal isolation of those trade receivables were fully transferred. This facility enables us to receive short term financing from time to time, as the related costs of the financing are similar to the costs of credit lines from banks, and no covenants are required. In 2009, \$30 million of receivables were sold. Of this amount, \$27.1 million was collected by the financial institutions as of March 22, 2010.

We have entered into credit facilities with Bank Discount Le'Israel Ltd., Bank Ha'Poalim Ltd., the First International Bank Ltd. and Bank Leumi Le'Israel Ltd. The aggregate amount outstanding under these credit facilities as of December 31, 2009 and as of March 22, 2010, was \$15 million. We use these credit facilities to finance certain acquisitions from time to time, to make contingent consideration payments, to re-purchase our shares according to our policy, and for interim financing, in accordance with our cash requirements. In connection with these credit facilities, we are committed to the banks for certain covenants related to our operations, such as:

- maintaining a minimum level of shareholders' equity of no less than 40% of our total assets and no less than \$50 million;
- maintaining a minimum level of tangible shareholders' equity not to exceed a deficit of \$30 million;
- maintaining a cash balance of \$10 million;
- maintaining a level of EBITDA net of one time expenses in four sequential quarters of no less than \$5 million; and
- maintaining a ratio of our bank liabilities to current assets, excluding other current assets, of no more than 40%.

To date, we have met all such covenants.

Cash and Cash Equivalents

As of December 31, 2009, we had cash and cash equivalents of \$22.3 million and working capital of \$27.6 million. As of December 31, 2008, we had cash and cash equivalents of \$30.3 million and working capital of \$32.4 million.

Net cash provided by operating activities was \$966,000 in 2009 compared to \$902,000 in 2008. Net cash provided by operating activities was \$902,000 in 2008 compared to \$16.1 million in 2007. Cash provided by operating activities decreased primarily as a result of the decrease in revenues from software sales in 2008 compared to 2007 and increase in turn-key projects in which payments are received according to milestones.

Net cash used for investment activities was \$11.9 million in 2009 compared to \$11.3 million in 2008. Cash used for investment activities includes investments in fixed assets of \$589,000 in 2009 compared to \$1.2 million in 2008, investments in newly purchased subsidiaries of \$2.5 million in 2009 compared to \$2.3 million in 2008 and contingent consideration for previously purchased subsidiaries of \$8.9 million in 2009, compared to \$7.9 million in 2008. Net cash provided from financing activities, in 2009, was \$2.9 million, representing \$4.1 million received from the private placement consummated in October 2009, offset by \$1.2 million repayment of net loans to banks. Net cash provided from financing activities in 2008, was \$16.5 million, representing \$16.1 million of loans from banks and \$2.0 million of cash from the exercise of employee options and warrants, offset by \$1.6 million for the purchase of treasury shares.

Although we incurred a loss from continued operation of \$15.3 million in 2009, \$21.8 million were non-cash or one-time charges, such as provision for termination expenses, one time charge regarding a project, depreciation and amortization, goodwill impairment and stock-based compensation. In 2008, we incurred a loss from continued operation of \$28.4 million, of which \$36 million were non-cash or one-time charges

Capital Expenditures

Our capital expenditures include the consideration paid for acquired activities and technologies. For more information about our investments and acquisitions, see “Item 4.B. Business Overview—Investments and Acquisitions.”

In 2009, we paid an aggregate of \$8.9 million as contingent consideration with regard to the acquisition of BridgeQuest, TIS, Codestream, I-Ter and JLC, and \$3.0 million for the newly acquired knowledge management business. In 2008, we paid an aggregate amount of \$7.9 million as contingent consideration with regard to the acquisition of BridgeQuest, Codestream, I-Ter, TIS and JLC. The final payment with regard to the TIS contingent consideration settlement is \$1,163,250 which is due in January 2011

Investment in property and equipment required to support our software development activities was comprised mainly of computers and peripheral equipment and was \$589,000 in 2009, \$1.2 million in 2008 and \$1.0 million in 2007. The decrease in 2009 was primarily the result of our purchase of certain licenses and equipment in 2008.

In 2009, we repurchased 44,994 of our shares for an aggregate amount of \$83,000. In 2008, we repurchased 677,302 of our shares for an aggregate amount of \$1.6 million. The repurchases were made in accordance with the resolution of our board of directors adopted in March 2008 authorizing the repurchase of our shares, subject to market conditions, under our existing buy-back programs. As of December 31, 2009, we had repurchased an aggregate of 2,371,140 of our ordinary shares under our buy-back programs, for an aggregate of approximately \$15.2 million. Under our buy-back programs, we may purchase our shares from time to time, subject to market conditions and other relevant factors affecting us. Under the Israeli Companies Law, 1999, referred to as the Companies Law, the repurchased shares held by us do not confer upon their holder any rights. The first buy-back program adopted in May 1998 enables us to purchase our shares, utilizing up to \$5 million. Under the second buy-back program adopted in September 1998, and amended in May 1999, we may purchase, up to an additional 2,000,000 ordinary shares. The closing price of our ordinary shares as quoted on the NASDAQ Global Market on March 22, 2010 was \$2.47.

For more information about the shares purchased under our buy-back programs, see "Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers."

We believe that cash generated from operations together with existing sources of liquidity and existing credit facilities, will be sufficient to meet our anticipated cash needs for at least the next 18 months.

Contractual Commitments and Guarantees

2006 Warrants

In connection with a private placement to institutional investors consummated in 2004, in March 2006, the institutional investors exercised their right to purchase from us additional debentures (already fully converted into our shares) and received warrants, exercisable until September 2011, for 200,000 ordinary shares at an exercise price of \$6.31 per share (the exercise price was adjusted pursuant to anti dilution provisions triggered by the private placement that took place in October 2009).

As of March 22, 2010, none of these warrants have been exercised. As agreed upon by the investors, we registered the shares underlying the warrants for resale under an effective registration statement.

2007 Warrants

In November 2007, as part of a \$35 million private placement, we issued to institutional investors warrants to purchase an aggregate of up to 800,000 BluePhoenix ordinary shares at an exercise price of \$21.88 per share, subject to certain adjustments. The exercise price was adjusted to \$18.80 per share pursuant to anti dilution provisions triggered by the private placement that took place in October 2009. These warrants may be exercised during a 5-year period, which commenced in November 2007. As agreed upon by the investors, we registered the shares underlying the warrants for resale under an effective registration statement.

2009 Warrants

In October 2009, as part of a \$4.2 million private placement, we issued to institutional investors a series of warrants to purchase our ordinary shares as follows: (i) 818,744 Series A Warrants exercisable until October 2014, at an exercise price of \$3.95; (ii) 1,364,575 Series B Warrants exercisable until April 29, 2010 at an exercise price of \$3.05; and (iii) 818,744 Series C Warrants exercisable immediately upon the exercise of the Series B Warrants, during a five-year period at an exercise price of \$3.95. The exercise price of the warrants is subject to adjustment in certain events.

As agreed with the investors, we registered the shares underlying the warrants for resale under an effective registration statement.

Registration Rights Agreement

In October 2002, we granted certain registration rights to Formula Systems (1985) Ltd., or Formula, our former controlling shareholder, Mr. Arie Kilman and another shareholder of Liraz, in the Share Exchange Agreement with those shareholders. Under this registration rights agreement, if we propose to register our ordinary shares under the Securities Act, each of these holders may request that we register his shares as well, subject to certain limitations. We shall bear all expenses in connection with the registration, provided that all underwriting commissions shall be paid by the holders selling shares with respect to their shares sold. In 2007, Formula waived its rights under this agreement in connection with the sale of its shares of BluePhoenix.

Chief Scientist

Two of our subsidiaries have entered into agreements with the Office of the Chief Scientist, or OCS. These subsidiaries are obliged to pay royalties to the OCS at a rate of 3% on sales of the funded products, up to 100% of the dollar-linked grant received in respect of these products from the OCS. As of December 31, 2009, the contingent liability amounted to \$900,000 million.

Ministry of Production in Italy

In July 2007, our subsidiary, I-Ter, received final approval from the Ministry of Production in Italy for its Easy4Plan product. Easy4Plan is a workflow management tool designed for ISO9000 companies. The total funds amounted to \$650,000 (€15,000), of which \$585,000 was received in December 2007 and the remaining amount is expected to be received during 2010. \$213,525 of the funds received constitute a grant, and the remaining \$412,000 (€94,000), is a 10-year loan to be repaid by I-Ter in annual installments until September 2018. The loan bears a minimal annual interest rate of 0.87%. As of March 22, 2010, the remaining loan balance was \$320,000 (€47,000).

Customers' Bank Guarantees

Under agreements between us and certain of our customers, we undertook to provide these customers with bank guarantees for the assurance of performance of our obligations under our agreements with such customers. As of December 31, 2009, there were outstanding bank guarantees on our behalf for our customers in the aggregate amount of \$192,000.

Operating Leases

We are committed under operating leases for rental of office facilities, vehicles, and other equipment for the years 2010 until 2015. Annual rental fees under current leases are approximately \$3.2 million. In connection with the office leases, we issued bank guarantees of \$83,000 in the aggregate.

Indemnification of Office Holders

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

Effective Corporate Tax Rates

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

On January 1, 2006, an additional tax reform was passed relating primarily to profits from investments. The main goal of the reform was to unify the tax rates applicable to profits from investments, such as interest, capital gains, and dividends. In addition, under the reform, the tax rates applicable to companies were reduced to 26% in 2009 and 25% in 2010. The corporate tax rate is scheduled to be further reduced to 24% in 2011, 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015 and 18% in 2016.

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

C. Research and Development, Patents and Licenses

For a description of our research and development activities, see "Item 4.B. Business Overview – Research and Development."

D. Trend Information

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

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

E. Off-Balance Sheet Arrangements

None.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our contractual obligations and commitments as of December 31, 2009:

<u>Contractual Obligations</u>	<u>Payment due by period</u>				
	<u>Total</u>	<u>Less than 1 year</u>	<u>1-2 years</u>	<u>3-5 years</u>	<u>More than 5 years</u>
			In thousands \$		
Contingent Consideration	3,396	3,396	-	-	-
Operating Lease Obligations	4,618	2,619	1,940	59	-
Loans from Banks	15,377	2,490	6,997	5,770	120
Total	23,391	8,505	8,937	5,829	120

The above table does not include royalties that we may be required to pay to the OCS and that may reach, in the aggregate, as of December 31, 2009, \$900,000. For more information about grants received from the OCS, see "Item 4.B. Business Overview – Research and Development." We are unable to reasonably estimate the amounts that we will eventually be required to pay to the OCS, if at all, and the timing of such payments, since these payments depend on our ability to sell products based on the OCS-funded technologies and the timing of such sales, if any.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT, AND EMPLOYEES

A. Directors and Senior Management

The following table describes information about our executive officers and directors as of March 22, 2010.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Arie Kilman ⁽³⁾	57	Chairman of the Board
Yaron Tchwellla	49	Chief Executive Officer
Michael Chill ⁽¹⁾⁽²⁾⁽³⁾	43	Director
Amira Berkovitz-Amir ⁽¹⁾⁽²⁾⁽³⁾	43	Director
Sam Somech ⁽¹⁾⁽²⁾	57	Director
Gur Shomron ⁽¹⁾	57	Director
Varda Sagiv	49	Chief Financial Officer
Yael Peretz	36	General Counsel
Len Erlikh	52	Chief Technology Officer
Steven Dmiszewicki	48	Vice President & General Manager, Professional Services

(1) Member of the audit committee and independent director under The NASDAQ Global Market listing requirements.

(2) An outside director.

(3) Member of the option committee.

Arie Kilman served as our chief executive officer and a director since May 2003 and until August 2008, when he was appointed an executive chairman of our board of directors. Mr. Kilman also served as president and chief executive officer of certain of our subsidiaries. From 1998 to July 2000, Mr. Kilman served as chief executive officer of Cicero, Inc. Mr. Kilman holds a BA degree in economics and computer science from New York Institute of Technology.

Yaron Tchwell was appointed as our chief executive officer in January 2009. Mr. Tchwell first joined our company in August 2008 when he was appointed as our president and assumed responsibility for the overall activities of the company. Mr. Tchwell served during 2007 and 2008 as president of Comverse Inc. Prior to this position and as part of his 11 years at Comverse, Mr. Tchwell served as president of the Messaging Division and a member of the executive management team at Comverse. He has also held various executive managerial positions within the product, delivery and customer-facing organizations. Prior to joining Comverse, Mr. Tchwell held engineering and managerial positions over a 13-year period at Advanced Technology Ltd., known today as Ness Technology. Mr. Tchwell holds a BSc in electrical engineering from Tel Aviv University.

Michael Chill has served as one of our outside directors and a member of our audit committee since July 2003. Since July 2009, Mr. Chill has served as a managing director at Roth Capital Partners LLP, an investment bank. From January 2008, Mr. Chill has served as a managing director at Rodman & Renshaw LLC, an investment bank. From July 2005 through December 2007, Mr. Chill served as co-head of the Direct Investments at Paramount Biocapital Asset Management Inc., a venture capital hedge fund and broker dealer. Prior to that, Mr. Chill served as an analyst and independent advisor to various high technology companies and venture capital firms both in Israel and the United States. During 2000 and the first half of 2001, Mr. Chill served as the president and head of investment banking department at Jerusalem Global Ltd., a venture capital and investment banking firm. Mr. Chill holds a B.S. in accounting from the Sy Syms School of Business at Yeshiva University and an MBA from the Columbia Business School.

Amira Berkovitz -Amir has served as one of our outside directors and as a member of our audit committee since December 2004. Ms. Berkovitz-Amir has also served as an outside director of Formula Vision Technologies (F.V.T) Ltd. since May 2009. Since March 2007, Ms. Berkovitz-Amir has served as a director of finance of the Baruch Padeh Medical Center, Poriya, Israel. Until October 2005, Ms. Berkovitz-Amir served as vice president, finance of Of-Tov Products (2001) Ltd., a manufacturer in the food industry and a member of Osem Industries Group. Previously, Ms. Berkovitz-Amir served as vice president, finance and controller of Pri-Hagalil Industries, a manufacturer in the food industry. Ms. Berkovitz-Amir holds a BA degree in economics and accounting and an MA in business administration, both from the Hebrew University. Ms. Berkovitz-Amir is a certified public accountant in Israel.

Sam Somech has served as one of our outside directors since January 2009 and also serves as a member of our audit committee. Since 2007, Mr. Somech has served as a chairman of the boards of directors of Corelsense, Inc., Dapper, Inc., Action Base, Inc., and GigaSpaces, Inc. Mr. Somech has also served as a director of Super Derivatives, Inc. since 2004. In 2004, Mr. Somech co-founded Itemfield, Inc. (which was later sold to Informatica, Inc.) and served as its chief executive officer from its inception until 2006. Previously, Mr. Somech served as president and chief technology officer of Cicero, Inc., a public company traded on the NASDAQ, which he co-founded in 1995. Prior to that, Mr. Somech founded and served as chief executive officer of Data Voice Systems, Inc. Mr. Somech holds a B.S. in electrical engineering from the Technion, Israel Institute of Technology, an M.Sc. in computer science from Columbia University and an MBA from Baruch College.

Gur Shomron has served as one of our directors and as a member of our audit committee from July 2005 through December 2007, and was reappointed as our director and as a member of our audit committee in May 2008, replacing a former director who resigned. Mr. Shomron has served as the chairman of the board of directors of Fidelis Diagnostics Inc. since 2004. Prior to that, Mr. Shomron served as a chairman of the board and chief executive officer of Mainsoft Corporation, a venture partner at StageOne VC fund, the president of Foraz R&D Fund and co-founder and R&D manager of Quality Computers 77 Ltd. Mr. Shomron is also a director of business development of Tangent Logic, Inc. and serves as a director of several privately-held high technology companies.

Varda Sagiv has served as our chief financial officer since June 2007. From 1998 until 2007, Ms. Sagiv served as the chief financial officer of Formula Ventures Ltd., a venture capital fund manager. Ms. Sagiv holds a BA in accounting from Tel Aviv University, and is a certified public accountant in Israel.

Yael Peretz has served as our general counsel since 2000. Prior to joining BluePhoenix, Ms. Peretz worked as a lawyer with Shine, Hunter & Martin, a law firm. Ms. Peretz holds an LLB from the Hebrew University in Jerusalem and an MA in business administration from Tel Aviv University. Ms. Peretz is a member of the Israel Bar.

Len Erlikh joined our company in 2007 as our chief technology officer, following the acquisition of BridgeQuest, where he was co-founder and chief technology officer. Prior to that, from 1997 until 2002, Mr. Erlikh served as chief technology officer of Relativity Technologies, a supplier of application modernization and application portfolio management software. Before co-founding Relativity Technologies, between 1990 and 1996, Mr. Erlikh helped to establish Seer Technologies, where he served as senior vice president of development and general manager of technology division. Mr. Erlikh holds a BAA in computer applications and business from Baruch College, CUNY, an MS in advanced technology from SUNY in Binghamton, and a PhD from St. Petersburg State University, Russia.

Steven Dmiszewicki was appointed our vice president and general manager, professional services in 2007, following the acquisition of BridgeQuest, where he was co-founder and chief executive officer. Prior to 2003, Mr. Dmiszewicki held positions as managing director of a management consulting firm and president and chief executive officer at Cicero, Inc. Mr. Dmiszewicki came to Cicero, Inc. as part of the acquisition of Seer Technologies, where he held the post of co-president. Mr. Dmiszewicki originally joined Seer in 1990 and had a series of senior management positions in the company, including chief financial officer. Before 1990, Mr. Dmiszewicki held management positions with several UK-based investment banking firms. He is on the advisory board of several technology companies and is a graduate of Bucknell University.

B. Compensation

In 2009, we paid to all of our directors and executive officers, as a group (15 persons), aggregate remuneration of approximately \$2.4 million. This amount includes bonuses and amounts set aside or accrued to provide pension, social security or similar benefits but do not include amounts expended by us for automobiles made available to our officers and expenses reimbursed to officers (including business travel, professional and business association dues and expenses).

Under Israeli law, we are not required to disclose, and have not otherwise disclosed, the compensation of our senior management and directors on an individual basis, except for Mr. Kilman, the active chairman of our board of directors whose compensation was approved by our shareholders.

We maintain written employment agreements with our officers. The employment agreements are not for a specific term and we may terminate them upon prior notice of up to nine months. If we terminate the employment agreements, we will have to pay the usual severance pay required under Israeli law for all employees and, in certain cases, additional severance pay equal to salary and benefits during a period of up to 12 months. Our directors, unless they also serve as officers, are not entitled to any benefits upon termination. The agreements with our officers provide for annual base salary and other benefits such as vacation, sick leave, provision of an automobile, insurance contributions, and non-compete and confidentiality agreements.

Mr. Kilman's Employment Agreement

In December 2008, our shareholders approved, following the approval of our audit committee and our board of directors, the compensation of Mr. Arie Kilman, the executive chairman of our board of directors, as follows: (a) a base salary of \$350,000 per annum, paid monthly, to be calculated based on the US\$ representative exchange rate published by the Bank of Israel, but in any event not less than NIS 3.35 per US\$1. The base salary was reduced to \$315,000 per annum, as part of across the board reduction in salary that took place in February 2009; and (b) 90,000 restricted share units, referred to as RSUs, to be granted quarterly, at the end of each calendar quarter in 2009, and such other amount of RSUs in each quarter of the following years of service as to be determined by our board of directors. The RSUs will be granted under the terms and conditions set forth in our 2007 Award Plan. The RSUs shall vest in three equal installments on the date of grant and on the first day of each of two additional years of service. In addition, Mr. Kilman is entitled to a bonus as described below, if the targets defined by our board of directors for each fiscal year of employment (beginning in 2009) are achieved and the terms defined by the board are fulfilled:

- (i) On target bonus of up to \$150,000 per annum, payable in quarterly installments, if the quarterly targets (based on our quarterly results as defined by the board) are achieved;
- (ii) Quarterly grants, each of which of 7,500 RSUs, during 2009, and such other amount of RSUs in each of the following years of service as to be determined by our board of directors, if the quarterly targets (based on our quarterly results as defined by the board) are achieved. The RSUs will be granted under the terms and conditions set forth in our 2007 Award Plan. The RSUs shall vest in three equal installments on the date of grant and on the first day of each of two additional years of service; and
- (iii) Bonus for exceeding targets of up to US\$150,000 per annum, if certain targets exceeding the targets mentioned in sub-section (i) above, as to be defined by the board for each fiscal year of employment beginning in 2009, are achieved. For 2009 no bonus was granted.

During the employment term, Mr. Kilman shall be entitled to a benefits package which includes, inter alia, contributions by our company to a Managers' Insurance Policy in an amount equal to 8.33% of the base salary, Further Education Fund contributions by our company of 7.5% of the base salary, up to 26 vacation days per year, sick leave according to the law and recuperation pay as required by law. Mr. Kilman shall also be entitled to reimbursement for out-of-pocket expenses reasonably incurred by him in connection with his service, and to use a company car which all of its expenses shall be borne by us. The agreement is for a three-year period beginning on January 1, 2009. The agreement shall be renewed automatically for successive three-year periods (unless terminated by either of the parties in accordance with the terms of the agreement). Each of the parties shall be entitled to terminate the agreement upon 6-months' prior notice, or a shorter period in certain circumstances defined in the agreement. The agreement with Mr. Kilman provides for compensation upon termination in such amounts and on such terms described in the agreement, such compensation to be paid in addition to earned amounts and vested benefits. The agreement with Mr. Kilman also includes non-competition and non-solicitation provisions. Mr. Kilman focuses on strategic customers and alliances, M&A activity and the Company's long term strategic direction.

Compensation of Our Non-Employee Directors

Our non-employee directors, which currently include Gur Shomron, receive cash compensation, as approved by our audit committee (which is comprised only of independent directors) and the board of directors in accordance with the Companies Regulations (Reliefs in Transactions with Related Parties) 2000 in the same amounts and on such terms payable to our outside directors. See "Compensation of our Outside Directors" below. In addition, our shareholders approved in December 2008, following the approval of our audit committee and the board of directors, the grant of RSUs to each of our non-employee directors, as follows:

- (i) 40,000 RSUs on the day of the first year of service, but not earlier than January 1, 2009; and
- (ii) 30,000 RSUs on the first day of each following year of service as a director.

"Non-employee directors" referred to above include directors serving on our board of directors from time to time, including outside directors, and excluding directors that receive or may receive compensation or management fees from us.

The RSUs shall vest in three equal annual installments, on the date of grant of the RSUs and on the first day of each of two additional years of service. The grant of the RSUs shall be under the terms set forth in our 2007 Award Plan and in accordance with our standard grant letter. In the event of termination of the service of a non-employee director (excluding outside directors), all outstanding RSUs previously granted shall be automatically vested, unless termination was made in accordance with sections 227A, 228(a)(2) – (5) or 231-234 of the Companies Law.

Compensation of Our Outside Directors

In December 2008, our shareholders approved, following the approval of our audit committee (which is comprised only of independent directors) and our board of directors, the compensation payable to our outside directors as follows:

- (i) an annual cash payment in an amount which is the higher of (x) the minimum amount payable to outside directors in accordance with the Israeli Companies Regulations (Rules for the Payment of Remuneration and Expenses of Outside Directors) 2002, referred to as the Outside Directors Regulations, as to be updated from time to time; and (y) NIS 45,000 (the equivalent of approximately \$12,000 as of the date hereof), payable in four equal quarterly installments; and
- (ii) a participation fee in an amount which is the higher of (x) the minimum amount payable to outside directors in accordance with the Outside Directors Regulations, as to be updated from time to time; and (y) NIS1,900 (the equivalent of approximately \$500 as of the date hereof), for every meeting of the board of directors or its committees in which the director participates. In accordance with the Outside Directors Regulations, the payment for telephone meetings (or a meeting held by other similar means) shall be equal to 60% of the abovementioned amount, and payment for written resolutions shall be equal to 50% of the abovementioned amount.

The abovementioned amounts are linked to the Israeli consumer price index as provided in the Outside Directors Regulations.

The cash compensation shall be paid to the outside directors on the first day of each quarter for the preceding quarter.

In addition to the cash compensation, our shareholders approved, following the approval of our audit committee and the board of directors, the grant of RSUs to each of our outside directors in the same amounts and on such terms granted to our non-employee directors.

C. Board Practices

Pursuant to our articles of association, directors are elected at a general meeting of our shareholders by a vote of the holders of a majority of the voting power represented at the meeting. Additional directors may be elected between general meetings by a majority of our directors. Our board is comprised of 5 persons, of which 4 have been determined to be independent within the meaning of the applicable NASDAQ requirements. Three of these independent directors also serve as outside directors mandated under Israeli law and subject to additional criteria to help ensure their independence. See "Outside Directors," below. Each director, except for the outside directors, holds office until the next annual general meeting of shareholders. Officers are appointed by our board of directors.

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

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

Our board of directors has appointed an option committee, comprised of Messrs. Michael Chill, Amira Berkovitz-Amir and Arie Kilman. The option committee is responsible for granting options and restricted share units to employees and consultants. Options and restricted share units may also be granted by the majority of the independent directors.

The compensation of our executive officers (who do not serve as directors), including options and other share-based compensation, is determined by the independent members of our board of directors. The compensation of directors, as well the procurement of insurance coverage or indemnification for directors, are approved by the audit committee, the board of directors and shareholders, in accordance with the requirements of the Companies Law.

Outside Directors Under the Companies Law

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

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder.

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

- (1) the majority of shares voted at the meeting, including at least one-third of the shares of non-controlling shareholders or their representatives voted at the meeting, vote in favor of election; or
- (2) the total number of shares of non-controlling shareholders voted against the election of the outside director does not exceed one percent of the aggregate voting rights in the company.

Pursuant to the Companies Law, all outside directors must have financial and accounting expertise or professional qualifications, and at least one outside director must have financial and accounting expertise. The terms "financial and accounting expertise" and "professional qualifications" have been defined in regulations promulgated under the Companies Law.

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

The initial term of an outside director is three years and may be extended for an additional three years. At present, Michael Chill, Amira Berkovitz-Amir and Sam Somech serve as our outside directors, Mr. Chill to hold office until July 2012, Ms. Berkovitz-Amir until December 2010 and Mr. Somech until December 2011. In accordance with the Israeli Companies Regulations (Alleviation for Public Companies Whose Shares are Listed on a Stock Exchange Outside of Israel) 2000, dual listed companies, such as BluePhoenix, may re-appoint an outside director for additional three-year terms, above the maximum six-year term permitted under the Companies Law, if the audit committee and the board of directors confirm that due to the expertise and special contribution of the outside director to the work of the board and its committees, his re-appointment is in the best interests of the company.

Each committee exercising the powers of the board of directors is required to include at least one outside director. However, the audit committee is required to include all the outside directors.

An outside director is entitled to compensation as provided in regulations promulgated under the Companies Law and is otherwise prohibited from receiving any compensation, directly or indirectly, in connection with services provided as an outside director. For more information about the compensation of our outside directors, see "Item 6.B. Compensation-Compensation of Our Outside Directors."

Independent Directors Under the Companies Law

Under an amendment to the Companies Law adopted in 2008, a publicly traded company may prescribe in its articles of association that its board of directors shall include independent directors in such number or such percentage as to be provided in the articles. An "independent director" is defined as a director who meets all of the following:

- the audit committee confirms that he or she meets the qualifications for being appointed as an outside director, except for the requirement for financial and accounting expertise or professional qualifications; and
- he or she has not served as a director of the company for a period exceeding nine consecutive years. For this purpose, a break of up to two years in the service shall not be deemed to interrupt the continuation of the service.

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

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

Qualifications of Other Directors Under the Companies Law

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

Audit Committee

The Companies Law requires public companies to appoint an audit committee, comprised of at least three directors, which must include all of the company's outside directors. The chairman of the board of directors, any director which is employed or provides services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee.

In addition, under applicable NASDAQ rules, we are currently required to have at least three independent directors and to maintain an audit committee, whose members are independent of management. Our outside directors qualify as independent directors under the applicable NASDAQ rules and those of the Securities and Exchange Commission. We have established an audit committee, consisting of Mr. Gur Shomron and our three outside directors, Mr. Michael Chill, Ms. Amira Berkovitz-Amir and Mr. Somech. The board has determined that both Michael Chill and Amira Berkovitz-Amir are "audit committee financial experts" as defined by applicable SEC regulations.

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

Internal Auditor

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

Approval of Certain Transactions under the Companies Law

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

Under the Companies Law, arrangements regarding the compensation of directors require the approval of the audit committee, the board of directors and shareholder approval, except in certain circumstances prescribed in regulations promulgated under the Companies Law.

The Companies Law requires that an office holder of a company promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an "extraordinary transaction" as defined under the Companies Law, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing.

In addition, the office holder must also disclose any interest held by any corporation in which the office holder owns 5% or more of the share capital, is a director or general manager or in which he or she has the right to appoint at least one director or the general manager. An “extraordinary transaction” is defined as a transaction other than in the ordinary course of business, otherwise than on market terms or that is likely to have a material impact on the company’s profitability, assets or liabilities.

Following the disclosure by the office holder of his or her interest in the transaction, the transaction is required to be approved by such entities prescribed under the Companies Law, provided that the transaction is not adverse to the company’s interest. If the transaction is an extraordinary transaction, the company must receive any approval stipulated by its articles of association, the approval of the audit committee, the approval of the board of directors and shareholder approval. A director who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not be present at this meeting or vote on this matter unless the majority of the board members or members of the audit committee, as applicable, have a personal interest in such matter and in such case, the matter is required to also be approved by the shareholders of the company.

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

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

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

Under the Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders and to refrain from abusing his power in the company including, among other things, voting in a general meeting of shareholders on the following matters:

- any amendment to the articles of association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party transactions that require shareholder approval.

In addition, any controlling shareholder, any shareholder who knowingly possesses power to determine the outcome of a shareholder vote and any shareholder who, pursuant to the provisions of a company's articles of association, has the power to appoint or prevent the appointment of an office holder in the company, is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty.

For information concerning personal interests of certain of our office holders and our principal shareholders in certain transactions with us, see "Item 7.B. Related Party Transactions."

Exculpation, Insurance and Indemnification of Directors and Officers

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

Office Holders Insurance

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

- a breach of his duty of care to us or to another person;
- a breach of his duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that such act would not prejudice our interests; or
- a financial obligation imposed on him or her in favor of another person.

Indemnification of Office Holders

Our articles of association provide that, subject to the provisions of the Companies Law, we may indemnify our office holders in respect of an obligation or expense specified below imposed on an office holder in respect of an act performed in his or her capacity as an office holder, as follows:

- (i) a financial obligation imposed on him or her in favor of another person by a court judgment, including a compromise judgment or an arbitrator's award approved by court;
- (ii) reasonable litigation expenses, including attorney's fees, incurred by the office holder as a result of an investigation or proceeding instituted against the office holder by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder; and either (a) concluded without the imposition of any financial liability in lieu of a criminal proceeding; or (b) a financial liability was imposed on him in lieu of a criminal proceeding for an offense that does not require proof of criminal intent; and
- (iii) reasonable litigation expenses, including attorney's fees, expended by the office holder or charged to the office holder by a court, in a proceeding instituted against the office holder by the company or on its behalf or by another person, or in a criminal charge from which the office holder was acquitted, or in a criminal proceeding in which the office holder was convicted of an offense that does not require proof of criminal intent.

We may undertake to indemnify an office holder as aforesaid, (a) prospectively, provided that in respect of (i) above, the undertaking is limited to categories of events that in the opinion of our board of directors are foreseeable in light of the company's operations at the time that the undertaking to indemnify is given, and for an amount or criteria that our board has determined as reasonable under the circumstances, and further provided that that such events and amount or criteria are indicated in the indemnification undertaking; and (b) retroactively.

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

Limitations on Exemption, Insurance and Indemnification

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

- a breach by the office holder of his duty of loyalty, except that the company may indemnify or provide insurance coverage to the office holder if the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- a breach by the office holder of his duty of care if the breach was done intentionally or recklessly, except for a breach that was made in negligence;
- any act or omission done with the intent to derive an illegal personal benefit; or
- any fine levied against the office holder.

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

We have procured directors' and officers' liability insurance and obtained all necessary approvals.

D. Employees

The table below presents certain information regarding the number of our employees, the sector in which they are employed and their geographical area of employment, in the periods indicated.

	2009	2008	2007
Technical Experts	427	477	454
Research and Development	191	207	161
Sales, General and Administrative	114	120	147
Total	732	804	762
In Israel	213	191	189
In Europe	440	502	464
In the United States	79	111	109

The numbers of employees indicated in the table above include expert consultants who we train for the implementation of our modernization tools and methodologies.

The increase in the number of employees in 2008 compared to 2007 was attributed to the acquisitions of TIS and JLC in 2008, increases in the number and size of projects for existing clients, and the addition of new clients. The decrease in the number of employees in 2009 compared to 2008 was a result of dismissal of employees and closing offices in countries where we previously had two offices, including Italy and the United Kingdom, as part of our cost savings plan implemented at the end of 2008 and during 2009.

With respect to our employees in Israel, we are subject to various Israeli labor laws and labor practices, and to administrative orders extending certain provisions of collective bargaining agreements between the Histadrut (Israel's General Federation of Labor) and the Coordinating Bureau of Economic Organizations (the Israeli federation of employers' organizations) to all employees in Israel.

For example, mandatory cost of living adjustments, which compensate Israeli employees for a portion of the increase in the Israeli consumer price index, are determined, from time to time, on a nationwide basis. Israeli law also requires the payment of severance benefits upon the termination, retirement (in some instances) or death of an employee. We meet this requirement, inter alia, by contributing on an ongoing basis towards “managers’ insurance” and pension funds. In addition, Israeli employers and employees are required to pay specified percentages of wages to the National Insurance Institute, which is similar to the United States Social Security Administration. Other provisions of Israeli law and regulations govern matters such as the length of the workday, minimum wages, other terms of employment and restrictions on discrimination. We are also subject to the labor laws and regulations of other jurisdictions in the world where we have employees.

E. Share Ownership

The following presents information regarding the ownership of our ordinary shares by the persons listed in the table under “Directors and Senior Management,” as of March 22, 2010. The percentage of outstanding ordinary shares is based on 23,376,779 ordinary shares outstanding as of March 22, 2010 (excluding 2,217,573 held by BluePhoenix).

Unless otherwise specifically indicated, the address of each of the persons set forth below is at c/o BluePhoenix, 8 Maskit Street, Herzliya 46733.

<u>Name</u>	<u>Number of shares beneficially owned⁽¹⁾</u>	<u>Percentage of outstanding ordinary shares</u>	<u>Number of Restricted Share Units (RSUs)</u>	<u>Number of options to purchase ordinary shares</u>
Arie Kilman	488,836 ⁽²⁾	5.1%	61,250	725,000
Yaron Tchwellla ⁽³⁾	*	*	268,334	-
Gur Shomron ⁽⁷⁾	*	*	20,000	-
Michael Chill ⁽⁴⁾	*	*	33,334	-
Amira Berkovitz-Amir ⁽⁵⁾	*	*	33,334	-
Sam Somech ⁽⁶⁾	*	*	33,334	-
Varda Sagiv ⁽⁸⁾	*	*	6,667	50,000
Yael Peretz ⁽⁹⁾	*	*	5,000	27,500
All directors and officers as a group (8 persons)	735,000	6.1%	461,253	802,500

* Less than 1%.

- Each of the directors and executive officers whose holdings are not separately specified in the above table beneficially owns less than one percent of our outstanding ordinary shares. Options to purchase ordinary shares that are currently exercisable or exercisable within 60 days after the date of this report are deemed outstanding and beneficially owned by the person holding the options for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.
- Mr. Kilman was granted options to purchase 725,000 ordinary shares, exercisable under the following terms: (i) options to purchase 375,000 ordinary shares at \$2.25 per share, which expire in April 2013; (ii) options to purchase 200,000 ordinary shares exercisable at \$4.00 per share, which expire in October 2013; and (iii) options to purchase 150,000 ordinary shares at \$6.00 per share, which expire in September 2015. In addition, Mr. Kilman was granted RSUs, of which: (i) 8,750 RSUs are convertible into ordinary shares in April 2010; (ii) 7,500 RSUs are convertible into ordinary shares in July 2010; (iii) 7,500 RSUs are convertible into ordinary shares in October 2010; (iv) 7,500 RSUs are convertible into ordinary shares in January 2011; (v) 7,500 RSUs are convertible into ordinary shares in April 2011; (vi) 7,500 RSUs are convertible into ordinary shares in July 2011; (vii) 7,500 RSUs are convertible into ordinary shares in October 2011; and (viii) 7,500 RSUs are convertible into ordinary shares in January 2012.
- Mr. Tchwellla was granted RSUs, of which: (i) 7,500 RSUs are convertible into ordinary shares in April 2010; (ii) 7,500 RSUs are convertible into ordinary shares in July 2010; (iii) 100,000 RSUs are convertible into ordinary shares in August 2010; (iv) 9,167 RSUs are convertible into ordinary shares in October 2010; (v) 10,000 RSUs are convertible into ordinary shares in January 2011; (vi) 7,500 RSUs are convertible into ordinary shares in April 2011; (vii) 7,500 RSUs are convertible into ordinary shares in July 2011; (viii) 100,000 RSUs are convertible into ordinary shares in August 2011; (ix) 9,167 RSUs are convertible into ordinary shares in October 2011; and (x) 10,000 RSUs are convertible into ordinary shares in January 2012.
- Mr. Chill was granted RSUs, of which: (i) 23,334 RSUs are convertible into ordinary shares in January 2011; and (ii) 10,000 RSUs are convertible into ordinary shares in January 2012.
- Ms. Berkovitz-Amir was granted RSUs, of which: (i) 23,334 RSUs are convertible into ordinary shares in January 2011; and (ii) 10,000 RSUs are convertible into ordinary shares in January 2012.
- Mr. Somech was granted RSUs, of which: 23,334 RSUs are convertible into ordinary shares in January 2011; and (ii) 10,000 RSUs are convertible into ordinary shares in January 2012.
- Mr. Shomron was granted RSUs, of which: (i) 10,000 RSUs are convertible into ordinary shares in January 2011; and (ii) 10,000 RSUs are convertible into ordinary shares in January 2012.
- Ms. Sagiv was granted currently exercisable options to purchase 50,000 ordinary shares at \$2.01 per share of which: (i) 16,333 are options to purchase ordinary shares in May 2010; (iii) 16,334 are options to purchase ordinary shares in May 2011; (iv) 16,334 are options to purchase ordinary shares in May 2012. In addition, Ms. Sagiv was granted RSUs, of which: (i) 3,333 RSUs are convertible into ordinary shares in April 2010; and (ii) 3,334 RSUs are convertible into ordinary shares in April 2011.
- Ms. Peretz was granted currently exercisable options to purchase 27,500 ordinary shares, exercisable under the following terms: (i) options to purchase 2,500 ordinary shares at \$5.00 per share, which expire in December 2015; (ii) options exercisable at \$2.54 per share to purchase 8,333 ordinary shares in August 2010; (iii) options exercisable at \$2.54 per share to purchase 8,333 ordinary shares in August 2011; (iv) options exercisable at \$2.54 per share to purchase 8,334 ordinary shares in August 2012. In addition, Ms. Peretz was granted RSUs, of which: (i) 21,500 RSUs are convertible into ordinary shares; and (ii) 5,000 RSUs are convertible into ordinary shares in August 2010;

Arrangements Involving the Issuance of BluePhoenix's Shares or Grant of Options to Purchase Shares

In 1996, we adopted two option plans. One of these option plans was terminated after all options granted under it had been exercised and the other 1996 plan was renamed the BluePhoenix 2003 Employee Share Option Plan. Pursuant to our 2003 Employee Share Option Plan, as amended, we reserved 4,200,000 ordinary shares for issuance to the directors, officers, consultants and employees of the Company and its subsidiaries. As of March 22, 2010, options to purchase 532,326 ordinary shares are available for future award under the plan. The exercise price of the options granted under the 2003 option plan ranges from \$2.01 to \$10.50.

Our board of directors administers our 2003 option plan. Under the 2003 option plan, as amended, options to purchase our ordinary shares may be granted to our and our subsidiaries' directors, officers, consultants and employees. Our board of directors is empowered, among other things, to designate the grantees, dates of grant, the exercise price of the options and the terms of exercise of the options. Unless determined otherwise by the board, the options generally vest over a three-year period. Unvested options are forfeited shortly following termination of employment, unless otherwise agreed. Under the 2003 option plan, the grantee is responsible for all personal tax consequences of the grant and the exercise of the options. Each option granted under the 2003 option plan is exercisable during a term of ten years from the date of grant of the option. The 2003 option plan will expire on August 6, 2013, except as to options outstanding on that date.

In July 2007, we adopted an award plan, referred to as the 2007 Award Plan, under which our board of directors may grant conditional rights to receive BluePhoenix ordinary shares (RSUs) to our and our subsidiaries' directors, officers, consultants and employees. Our board of directors approved the issuance of the shares under the 2007 Award Plan and award agreements. As of March 22, 2010, we granted 1,073,417 RSUs under the plan. Our board of directors administers the plan and is empowered, among other things, to designate the grantees, dates of grant, the purchase price and the terms of RSUs, including the vesting schedule. Unvested RSUs are forfeited following termination of employment, unless otherwise agreed. Under the 2007 Award Plan, the grantee is responsible for all personal tax consequences of the grant and the sale of the shares. The plan will expire on 2017.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**A. Major Shareholders**

The following table presents information regarding the ownership of our ordinary shares at March 22, 2010 by each person known to us to be the beneficial owner of 5% or more of our ordinary shares. Options to purchase ordinary shares that are currently exercisable or exercisable within 60 days after the date of this report are deemed outstanding and beneficially owned by the person holding the options for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Except where we indicated otherwise, we believe, based on information furnished by these owners, that the beneficial owners of our shares listed below have sole investment and voting power with respect to the shares.

<u>Name and Address</u>	<u>Number of Ordinary Shares Owned</u>	<u>Percent of Total Shares⁽¹⁾</u>
Prescott Group Capital Management, L.L.C. ⁽²⁾	7,033,390⁽²⁾	28.3%
Arie Kilman⁽³⁾	1,212,586	5.1%
All directors and officers as a group (8 persons)⁽⁴⁾	1,476,250	6.1%

(1) Percentages in the above table are based on 23,376,779 ordinary shares outstanding as of March 22, 2010 and do not include 2,217,573 held by BluePhoenix. Pursuant to Israeli law, these shares do not confer upon their holder any rights.

(2) Based on a Schedule 13G filed by Prescott Group Capital Management, L.L.C. on February 12, 2010, Prescott Group Capital Management LLC, referred to as Prescott Capital, is the beneficial owner of 7,033,390 ordinary shares and Mr. Phil Frohlich is the beneficial owner of 7,033,390 ordinary shares. Such shares consist of 5,532,359 ordinary shares, Series A warrants exercisable to purchase 409,372 ordinary shares, Series B warrants exercisable to purchase 682,287 ordinary shares and Series C warrants to purchase 409,372 ordinary shares. Accordingly, Prescott Capital and Mr. Phil Frohlich are the beneficial owners of 28.3% of the outstanding Ordinary Shares.

(3) Number of shares owned includes an aggregate of 733,750 ordinary shares underlying options exercisable within 60 days of the date hereof and restricted share units vested within 60 days of the date hereof.

(4) Includes options to purchase ordinary shares exercisable within 60 days of the date hereof and restricted share units vested within 60 days of the date hereof.

All of our ordinary shares have equal voting rights. Under our two buy-back programs (as described in “Item 5.B. Liquidity and Capital Resources” above), two of our subsidiaries purchased ordinary shares, and as of March 22, 2010, BluePhoenix holds 2,217,573 of our ordinary shares. Under applicable Israeli law, so long as the shares are held by BluePhoenix, they do not confer upon their holder any rights.

As of March 10, 2010, there were 29 record holders of our ordinary shares. Of these record holders, 20 holders had mailing addresses in the United States owning an aggregate 98% of our outstanding ordinary shares.

B. Related Party Transactions

Indemnification of Office Holders

Since July 2003, we grant to our office holders’ indemnification letters covering acts performed in their capacity as office holders or employees of our company. In December 2005, our shareholders approved an amendment to those indemnification letters, following an amendment to the Companies Law. Pursuant to the amended indemnification letters, we undertake to indemnify each office holder to the maximum extent permitted by law in respect of the following for any act or omission taken or made by the office holder in his or her capacity as an office holder of our company:

- any financial obligation imposed on the office holder in favor of another person by a court judgment, including a settlement or an arbitrator’s award approved by court,
- all reasonable litigation expenses, including attorney’s fees, expended by the office holder as a result of an investigation or proceeding instituted against the office holder by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder and either (a) concluded without the imposition of any financial liability in lieu of criminal proceedings; or (b) concluded with the imposition of a financial liability in lieu of criminal proceeding but relates to a criminal offense that does not require proof of *mens rea* (criminal intent); and
- all reasonable litigation expenses, including attorney’s fees, expended by the office holder or charged to him or her by a court in a proceeding instituted against the office holder by us or on our behalf or by another person, or in any criminal proceedings in which the office holder is acquitted, or in any criminal proceedings of a crime that does not require proof of *mens rea* (criminal intent) in which the office holder is convicted.

The indemnification also applies to any action taken by the office holder in respect of an act performed in his or her capacity as an office holder or an employee of one of our subsidiaries or as a director or observer at board of directors’ meetings of one of our affiliates. Our undertaking for indemnification is limited to up to 25% of our shareholders’ equity at the time of the claim for indemnification.

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

- a breach by the office holder of his or her duty of loyalty, unless, to the extent permitted by law, the office holder acted in good faith and had reasonable cause to assume that such act would not prejudice the interests of our company;
- a willful breach by the office holder of his or her duty of care, unless such breach was solely due to negligence;
- an action taken or not taken with the intent of unlawfully realizing personal gain;
- a fine or penalty imposed on the office holder for an offense; and
- a counterclaim made by us in connection with a claim against us filed by the office holder.

Our undertaking for indemnification is limited to such events specified in the indemnification letter and determined by our board of directors to be foreseeable in light of the company's operations.

Under the indemnification letters, we exempt our office holders to the fullest extent permitted by law, from liability for damages caused as a result of a breach by the office holder of his or her duty of care to the company.

Office Holders Insurance

We procured an insurance policy covering our directors' and officers' liability, as well as a run-off policy for seven years for former directors and officers. Our subsidiaries participate in the premium payments of the insurance, on a proportional basis. The total premium we paid during 2009 was \$137,000.

C. Interests of Expert and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

Financial Statements

The financial statements required by this item are found at the end of this annual report, beginning on page F-1.

Legal Proceedings

We are not involved in any proceedings in which any of our directors, members of our senior management or any of our affiliates is either a party adverse to us or to our subsidiaries or has a material interest adverse to us or to our subsidiaries. We are also not involved in any material legal proceedings, except as described below.

In June 2003, a former Liraz shareholder filed an application with the Tel-Aviv-Jaffa District Court to approve a claim filed by him against us, as a class action. The claim relates to the acquisition of Liraz shares, which we completed in March 2003. The shareholder alleges that the share price we paid to Liraz's shareholders in the tender offer and in a subsequent mandatory purchase was lower than the fair price of Liraz shares. The maximum amount of the claim is approximately NIS 37.1 million (\$9.9 million) in the aggregate. Under Israeli law, the court's approval is required for the plaintiff to represent all of the shareholders of Liraz who sold their shares to us pursuant to the tender offer and the mandatory acquisition. The plaintiff has applied for such approval in the lawsuit. Since the critical issue in our case concerns the basis upon which the fair price of shares purchased within the context of a tender offer is to be determined, and due to the fact that this particular issue has come before the Supreme Court of Israel in an appeal concerning another separate case, the plaintiff in our claim has agreed to postpone the proceedings until the Supreme Court has given its decision in the appeal. In December 2009, the Supreme Court held that, as a general rule, the fair price of shares purchased within the context of a full tender offer shall be determined in accordance with the discounted cash flow method. The plaintiff in our case is expected to notify the court whether he wishes to renew the proceedings. As of the date of this annual report, the plaintiff has not yet applied to the court. Based on our analysis of the statement of claim, including an evaluation of the fair value of the Liraz shares, and the price paid for Liraz in a previous transaction immediately prior to the tender offer, we believe that the allegations against us in this proceeding are without merit and we intend to vigorously defend the claim and contest the allegations made therein.

In April 2009, former shareholders of TIS filed a claim against us with the District Court in Tel-Aviv-Jaffa, following a dispute regarding the calculation of the consideration payable to them in connection with the TIS transaction. As part of the negotiated terms, in 2009 we paid to the former shareholders of TIS an advanced payment of \$3,070,000 and in September 2009, we entered into a settlement agreement with TIS pursuant to which we paid them an aggregate of \$1,057,500 in January 2010 and undertook to pay an additional \$1,163,250 in January 2011. In addition, we issued to the former shareholders of TIS 813,461 ordinary shares of BluePhoenix. As part of the settlement, the parties agreed on a mutual release of their respective claims, and the former shareholders of TIS waived their right to any future contingent consideration.

In January 2010, the temporary liquidator of Danshir group, a group of companies affiliated to DSKnowledge Ltd., applied to the district court in Tel-Aviv-Jaffa for grant of instructions to initiate an investigation of the business of Danshir group and to cancel the assets purchase transaction, under which we purchased the business activity of DSKnowledge Ltd. In the application, the temporary liquidator claimed that DSKnowledge Ltd. was actually part of the Danshir group and its business was unlawfully sold to us. The court requested the response of the Principal Receiver (a government officer). The Principal Receiver supported the application to conduct an investigation of the business of Danshir group, but stated that the application to cancel the purchase of the business activity of DSKnowledge has no merit, and should be filed again if the investigation's conclusion support that finding. We believe the application to cancel the transaction has no merit, and we intend to vigorously oppose the claim.

Dividend policy

We have never declared or paid dividends to our shareholders and we do not intend to pay dividends in the future. We anticipate that we will retain all of our future earnings for use in the expansion and operation of our business. We are not subject to any contractual restrictions on paying dividends. Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition, future prospects and other factors as the board of directors may deem relevant. Israeli law limits the distribution of cash dividends to the greater of retained earnings or earnings generated over the two most recent years, in either case provided that we reasonably believe that the dividend will not render us unable to meet our current or foreseeable obligations when due.

B. Significant Changes

Except as otherwise disclosed in this annual report, there has been no material change in our financial position since December 31, 2009.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

The following table shows the high and low closing price for our ordinary shares on the NASDAQ Global Market for the periods indicated.

Calendar Period	Closing Price Per Share	
	In US\$	
	High	Low
Annual		
2005	4.75	3.81
2006	6.45	3.85
2007	21.49	5.94
2008	20.66	1.40
2009	3.85	1.62
Fiscal Quarters		
2008		
First Quarter	20.66	7.25
Second Quarter	12.07	4.61
Third Quarter	5.80	3.45
Fourth Quarter	3.73	1.40
2009		
First Quarter	2.65	1.62
Second Quarter	2.49	1.79
Third Quarter	3.85	2.11
Fourth Quarter	3.74	2.46
Most Recent Six Months		
September 2009	3.85	2.89
October 2009	3.74	2.62
November 2009	2.91	2.51
December 2009	2.65	2.46
2010		
January 2010	2.94	2.67
February 2010	2.93	2.30
March 2010 (through March 22nd)	2.62	2.39

The following table shows the high and low closing price for our ordinary shares on the TASE for the periods indicated.

<u>Calendar Period</u>	<u>Closing Price Per Share</u>	
	<u>in NIS</u>	
<u>Annual</u>	<u>High</u>	<u>Low</u>
2005	20.99	16.01
2006	26.88	17.41
2007	85.51	25.69
2008	74.83	5.25
2009	14.24	7.07
<u>Fiscal Quarters</u>		
2008		
First Quarter	74.83	24.68
Second Quarter	40.56	15.95
Third Quarter	20.55	12.22
Fourth Quarter	13.01	5.25
2009		
First Quarter	10.84	7.07
Second Quarter	9.69	7.71
Third Quarter	14.24	8.62
Fourth Quarter	14.06	9.08
<u>Most Recent Six Months</u>		
September 2009	14.24	10.56
October 2009	14.06	10.42
November 2009	11.36	9.61
December 2009	9.97	9.08
2010		
January 2010	10.95	10.00
February 2010	10.99	9.02
March 2010 (through March 22nd)	9.72	9.15

B. Plan of Distribution

Not applicable.

C. Markets

Our ordinary shares have been traded in the United States on the NASDAQ Global Market since our initial public offering on January 30, 1997 and were not publicly traded prior to this date. The symbol on the NASDAQ Global Market for our ordinary shares is BPHX. On January 21, 2001, we listed our ordinary shares for trading on the TASE. Our series A convertible notes were traded on the TASE from February 12, 2006 and until February 19, 2008.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We are registered with the Israeli Companies Register under the number 52-004306-8. Our objects are specified in our memorandum of association. These objects include:

- operating within the field of informational and computer systems;
- providing management, consulting and sale services for computers, computer equipment, software for computers and for information systems;
- the business of systems analysis, systems programming and computer programming; and
- establishing facilities for instruction and training for computers and digital systems.

Description of Our Share Capital

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

Transfer of Shares

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

Modification of Class Rights

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

Dividend Rights and Liquidation Rights

Our board of directors is authorized to declare dividends, subject to the provisions of the Companies Law. Dividends, if declared, shall be paid to the holders of ordinary shares according to their rights and interests in our profits. Dividends on our ordinary shares may be paid only out of profits and other surplus, as defined in the Companies Law, as of the end date of the most recent financial statements or as accrued over a period of two years, whichever is higher. Alternatively, if we do not have sufficient profits or other surplus, then permission to effect a distribution can be granted by order of an Israeli court. In any event, our board of directors is authorized to declare dividends, provided there is no reasonable concern that the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. Under the Companies Law, the declaration of a dividend does not require the approval of the shareholders of the company, unless the company's articles of association require otherwise. Our articles of association provide that our board of directors may declare and pay dividends without any further action of our shareholders. Dividends may be paid in cash or in kind. We may pay the dividend as an allotment of shares or a distribution of assets. If we do decide to issue dividends by an allotment of shares at a price lower than the nominal value of those shares, we must convert a portion of our profits or any other source of equity to share capital in an amount equal to the difference between the nominal value of the shares and the price paid in the dividend. If dividends remain unclaimed for seven years from the date we declared the dividend, they lapse and revert back to us. In case of liquidation, after satisfying liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to their holdings. This right may be affected by the grant of a preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

Redemption provisions

In accordance with our articles of association, we may issue redeemable shares and accordingly redeem those shares. Our board may attach to redeemable shares the attributes of shares, including voting rights and the right to participate in profits.

Voting, Shareholder Meetings and Resolutions

Holders of our ordinary shares have one vote for each ordinary share held on all matters submitted to the vote of shareholders. These voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

We must hold an annual general meeting once a year with a maximum period of fifteen months between the meetings. All other meetings of shareholders other than annual general meetings are considered special general meetings. Our board of directors may, whenever it decides it is appropriate, and shall, within 21 days after receiving a written demand from one director or from one or more shareholders representing at least 10% of the outstanding share capital and 1% of the voting power, call a special general meeting. The quorum required for a general meeting of shareholders consists of two or more holders present in person or by proxy who hold or represent at least 35% of the voting power. A meeting adjourned for a lack of a quorum generally is adjourned to the same day in the following week at the same time and place or to another later time if such time is specified in the original notice convening the general meeting or if we give notice to the shareholders of another time at least 72 hours before the date fixed for the adjourned meeting. At the reconvened meeting, if a quorum is not present within half an hour from the time appointed for holding the meeting, the required quorum will consist of two shareholders present in person or by proxy.

Under the Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority, except in certain circumstances provided for under the Companies Law, which require a majority of at least 75% of the shares present at the meeting. In accordance with the Companies Law, all shareholders meetings require prior notice of at least 21 days. In some instances specified in regulations promulgated under the Companies Law, a 35-day prior notice is required to be given of a shareholders meeting.

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

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

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

Election of Directors

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

Anti-Takeover Provisions; Mergers and Acquisitions under Israeli Law

Mergers

The Companies Law includes provisions that allow a merger transaction and requires that each company that is party to a merger approve the transaction by its board of directors and a vote of the majority of its shares voting on the proposed merger at a shareholders' meeting called on at least 21 days' prior notice. In determining whether a majority has approved the merger, shares held by the other party to the merger or any person holding at least 25% of the other party to the merger are excluded from the vote. The Companies Law does not require court approval of a merger other than in specified situations. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be completed unless at least (i) 30 days have passed from the date of the merger approval by the shareholders of each of the merging companies; and (ii) 50 days have passed from the time that a proposal for approval of the merger has been filed with the Israeli registrar of companies.

Tender Offers

The Companies Law also provides that an acquisition of shares of a public company on the open market must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% shareholder of the company. The rule does not apply if there is already another 25% shareholder of the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would become a 45% shareholder, unless there is a shareholder holding at least 45% interest in the company. These rules do not apply if the acquisition is made by way of a merger as opposed to a tender offer. Regulations adopted under the Companies Law provide that these tender offer requirements do not apply to companies whose shares are listed for trading outside of Israel if, according to the law in the country in which the shares are traded, including the rules and regulations of the stock exchange on which the shares are traded, there is either a limitation on acquisition of any level of control of the company, or the acquisition of any level of control requires the purchaser to do so by means of a tender offer to the public. The Companies Law also provides that if following any acquisition of shares, the acquirer holds 90% or more of the company's shares or of a class of shares, the acquisition must be made by means of a tender offer for all the target company's shares or all the shares of the class, as applicable. An acquirer who wishes to eliminate all minority shareholders must do so by way of a tender offer and acquire 95% of all shares not held by or for the benefit of the acquirer before the acquisition. If, however, the tender offer to acquire 95% is not successful, the acquirer may not acquire shares tendered if by doing so the acquirer would own more than 90% of the shares of the target company.

C. Material Contracts

We consider the agreements related to the \$4.2 million private placement consummated in October 2009 as a material contract. For a summary of the terms of this transaction, see "Item 4.B. Business Overview – Investments and Acquisitions" and "Item 5.B. Liquidity and Capital Resources."

In addition, in September 2008 we entered into loan agreements with three commercial banks in Israel, Bank Discount Le'Israel Ltd., Bank Ha'Poalim Ltd. and the First International Bank Ltd. As of March 22, 2010, the aggregate amount outstanding under the credit facilities with these banks was \$15 million. The loans are in U.S. dollars and bear an average interest rate of Libor (3 months) plus 2.7%. The loans were set for different maturity periods from one year to five years. For more information about our credit facilities with the banks, see "Item 5.B. Liquidity and Capital Resources-How We Have Financed Our Business-Other Financing Arrangements."

D. Exchange Controls

Under current Israeli regulations, we may pay dividends or other distributions in respect of our ordinary shares either in non-Israeli or Israeli currencies. If we make these payments in Israeli currency, they will be freely transferred in non-Israeli currencies at the rate of exchange prevailing at the time of conversion. Because exchange rates between the NIS and the dollar fluctuate continuously, a U.S. shareholder will be subject to the risk of currency fluctuations between the date when we declare NIS-denominated dividends and the date when we pay them in NIS. See "Item 3.D. Risk Factors."

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

E. Taxation

Israeli Taxation

On January 1, 2006, an additional tax reform was passed relating primarily to profits from investments. The main goal of the reform was to unify the tax rates applicable to profits from investments, such as interest, capital gains, and dividends. In addition, under the reform, the tax rates applicable to companies were reduced to 26% in 2009 and 25% in 2010. The corporate tax rate is scheduled to be further reduced to 24% in 2011, 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015 and 18% in 2016.

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

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

Tax Consequences Regarding Disposition of Our Ordinary Shares

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

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

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

Taxes Applicable to Dividends

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

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

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

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

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

United States Federal Income Tax Considerations

Subject to the limitations described herein, this discussion summarizes certain U.S. federal income tax consequences of the purchase, ownership and disposition of our ordinary shares to a U.S. holder. A U.S. holder is a holder of our ordinary shares that is:

- an individual citizen or resident of the U.S. for U.S. federal income tax purposes;
- a corporation (or another entity taxable as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States or any political subdivision thereof, or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income tax regardless of its source; or
- a trust (i) if, in general, a U.S. court is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or (ii) that has in effect a valid election under applicable U.S. Treasury Regulations to be treated as a U.S. person.

If a partnership (or any other entity treated as a partnership for U.S. federal income tax purposes) holds our ordinary shares, the tax treatment of the partnership and a partner in such partnership will depend on the status of the partner and the activities of the partnership. Such a partner or partnership should consult its tax advisor as to its consequences.

Unless otherwise specifically indicated, this discussion does not consider the U.S. federal income tax consequences to a person that is not a U.S. holder of our ordinary shares (a "Non-U.S. holder") and considers only U.S. holders that will own the ordinary shares as capital assets (generally, for investment).

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended ("Code"), current and proposed Treasury Regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with a retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder's individual circumstances. In particular, this discussion does not address the U.S. federal income tax consequences to U.S. holders who are broker-dealers or who own, directly, indirectly or constructively, 10% or more (by voting power) of our outstanding voting shares, U.S. holders holding the ordinary shares as part of a hedging, straddle or conversion transaction, U.S. holders whose functional currency is not the U.S. dollar, insurance companies, financial service companies, real estate investment trusts, regulated investment trusts, grantor trusts, S Corporations, certain former citizens and long-term residents of the United States, tax-exempt organizations, financial institutions, persons who acquired their ordinary shares upon the exercise of employee stock options or otherwise as compensation, and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, the possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws to a U.S. holder is not discussed below.

You are advised to consult your tax advisor with respect to the specific U.S. federal, state, local, and foreign income and other tax consequences to you of purchasing, owning, or disposing of our ordinary shares.

Taxation of Distributions on the Ordinary Shares

We have never paid dividends, and currently do not intend to pay dividends in the future. If we make distributions in the future, the amount of the distribution with respect to the ordinary shares will equal the amount of cash and the fair market value of any property distributed and will also include the amount of any non-U.S. taxes withheld, including Israeli taxes withheld as described above under "Taxation – Israeli Taxation." Subject to the discussion below under "Tax Consequences if We Are a Passive Foreign Investment Company," a distribution paid by us with respect to our ordinary shares to a U.S. holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. The amount of any distribution that exceeds the amount treated as a dividend will be treated first as a nontaxable return of capital, reducing the U.S. holder's tax basis in its ordinary shares to the extent thereof, and then as capital gain from the deemed disposition of our ordinary shares. Corporate holders will not be allowed a deduction for dividends received in respect of the ordinary shares. Dividends that are received by U.S. holders that are individuals, estates or trusts will be taxed at a reduced rate of tax (currently a maximum rate of 15% for taxable years beginning on or before December 31, 2010), provided that such dividends meet the requirements of "qualified dividend income." Dividends that fail to meet such requirements, and dividends received by corporate U.S. holders, are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend (1) if the U.S. holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code Section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities) or (2) to the extent that the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a "passive foreign investment company" (as such term is defined in the Code) for any taxable year, dividends paid on our ordinary shares in such year or in the following taxable year would not be qualified dividends. In addition, a non-corporate U.S. holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates. U.S. holders are urged to consult their own tax advisors regarding the U.S. federal income tax rate that would be applicable to their receipt of any dividends paid with respect to any ordinary shares.

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

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

Taxation on Disposition of the Ordinary Shares

Subject to the discussion below under "Tax Consequences if We are a Passive Foreign Investment Company," upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder's tax basis in the ordinary shares. The gain or loss recognized on the disposition will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the disposition. Long-term capital gains of certain non-corporate taxpayers are subject to a maximum tax rate of 15% for taxable years beginning on or before December 31, 2010. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

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

Tax Consequences If We Are a Passive Foreign Investment Company

We will be a passive foreign investment company, or PFIC, for a taxable year if either (1) 75% or more of our gross income in the taxable year is passive income or (2) 50% or more of the value, determined on the basis of a quarterly average, of our assets in the taxable year produce, or are held for the production of, passive income. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation's assets and as directly earning our proportionate share of the other corporation's gross income. We believe that in 2009 we were not a PFIC and currently we expect that we will not be a PFIC in 2010. However, PFIC status is determined as of the end of each taxable year and is dependent on a number of factors, including our income, assets and the value of our ordinary shares. Therefore, there can be no assurance that we will not become a PFIC for the current fiscal year ending December 31, 2010 or in any future taxable year. We will notify U.S. holders in the event we conclude that we will be treated as a PFIC for any taxable year.

If we are a PFIC, a U.S. holder must determine under which of three alternative taxing regimes it wishes to be taxed:

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

Once made, the QEF election applies to all subsequent taxable years of the U.S. holder in which it holds our ordinary shares and for which we are a PFIC, and can be revoked only with the consent of the United States Internal Revenue Service ("IRS"). The QEF election is made by attaching a completed IRS Form 8621, including the PFIC annual information statement, to a timely filed U.S. federal income tax return. Even if a QEF election is not made, a U.S. holder who is a shareholder in a PFIC must file a completed IRS Form 8621 every year. If we believe we are or will become a PFIC, we will determine whether we will comply with the reporting requirements that would enable U.S. holders to make a QEF election. If a QEF election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.

- A second regime, the “mark-to-market” regime, may be elected so long as our ordinary shares are “marketable stock” (e.g., “regularly traded” on the NASDAQ Global Market). Pursuant to this regime, an electing U.S. holder’s ordinary shares are marked-to-market each taxable year that we are a PFIC and the U.S. holder recognizes as ordinary income or loss an amount equal to the difference as of the close of the taxable year between the fair market value of our ordinary shares and the U.S. holder’s adjusted tax basis therein. Losses are allowed only to the extent of net mark-to-market gain previously included by the U.S. holder under the election for prior taxable years. An electing U.S. holder’s adjusted basis in our ordinary shares is increased by income recognized under the mark-to-market election and decreased by the deductions allowed under the election. Under the mark-to-market election, in a taxable year in which we are a PFIC, gain on the sale of our ordinary shares is treated as ordinary income, and loss on the sale of our ordinary shares, to the extent the amount of loss does not exceed the net mark-to-market gain previously included, is treated as ordinary loss. Under current law, a mark-to-market election cannot be made with respect to warrants or options to acquire our ordinary shares. The mark-to-market election applies to the taxable year for which the election is made and all subsequent tax years, unless the ordinary shares cease to be marketable stock or the IRS consents to the revocation of the election. If the mark-to-market election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.
- A U.S. holder making neither the QEF election nor the mark-to-market election is subject to the “excess distribution” regime. Under this regime, “excess distributions” are subject to special tax rules. An excess distribution is either (1) a distribution with respect to ordinary shares that is greater than 125% of the average distributions received by the U.S. holder from us over the shorter of either the preceding three years or such U.S. holder’s holding period for our ordinary shares or (2) 100% of the gain from the disposition of our ordinary shares (including gain deemed recognized if the ordinary shares are used as security for a loan).

Excess distributions must be allocated ratably to each day that a U.S. holder has held our ordinary shares. A U.S. holder must include amounts allocated to the current taxable year and to any period prior to the first day of the first taxable year for which we are a PFIC in its gross income as ordinary income for the current taxable year. All amounts allocated to other taxable years of the U.S. holder would be taxed at the highest tax rate for each such other year applicable to ordinary income and would be subject to an interest charge on the deferred tax liability for each such other year calculated as if such liability had been due with respect to each such other year. The portions of distributions that are not characterized as “excess distributions” are subject to tax in the current taxable year under the normal tax rules of the Code. A U.S. holder who inherits shares in a foreign corporation that was a PFIC in the hands of the decedent is denied the otherwise available step-up in the tax basis of such shares to fair market value at the date of death. Such U.S. holder’s basis in such shares is equal to the lower of the decedent’s basis or the fair market value of such shares on the decedent’s date of death.

The PFIC rules described above are complex. U.S. holders are urged to consult their tax advisors regarding the application of the PFIC rules, including eligibility for and the manner and advisability of making, the QEF election or the mark-to-market election.

Non-U.S. Holders of Ordinary Shares

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

Information Reporting and Backup Withholding

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

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

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

BluePhoenix is subject to the reporting requirements of the Exchange Act of 1934, as amended, that are applicable to a foreign private issuer. In accordance with the Exchange Act, we file with the SEC reports, including annual reports on Form 20-F by June 30 each year. In addition, we file interim financial information on Form 6-K on a quarterly basis. We also furnish to the SEC under cover of Form 6-K certain other material information required to be made public in Israel, filed with and made public by any stock exchange or distributed by us to our shareholders. You may inspect without charge and copy at prescribed rates such material at the public reference facilities maintained by the SEC, 100 F Street, N.E., Washington, D.C. 20549. You may also obtain copies of such material from the SEC at prescribed rates by writing to the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

The SEC maintains an Internet site at <http://www.sec.gov> that contains reports and other material that are filed through the SEC's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system. BluePhoenix began filing through the EDGAR system beginning on November 14, 2002.

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

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

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In light of our multi-currency activity and our exposure to fluctuation in foreign currencies exchange rates, we presently engage in hedging or other transactions intended to manage risks relating to foreign currency exchange rate or interest rate fluctuations. We use foreign currency options and forward exchange contracts to assist in managing financial risks. We do not use derivative financial instruments for speculative purposes. These instruments are recognized at fair value, with all changes in fair value recorded in current period earnings, as these transactions have not been designated by management as hedging instruments under FASB ASC Topic 813 "Derivatives and Hedging".

We invest our cash and cash equivalents in short-term deposits. As of December 31, 2009, we invested substantially all of the cash we held in US\$ deposits. As of December 31, 2009, we had approximately \$15.5 million outstanding loans to banks of which \$15 million are denominated in U.S. dollars.

Fluctuations in foreign currency exchange rates, such as euro or NIS versus the dollar may have a negative impact on our operating results and financial condition. Exposure relating to these exchange rates is recorded under the financial expenses line item of our consolidated statements of operations. Accordingly, financial expenses may fluctuate significantly from quarter to quarter.

The table below details the balance sheet main currency exposure for which we use different foreign currency instruments in order to minimize its exposure (i.e., the gap between accounts receivables and accounts payables in a given currency). The details are provided by currency, as of December 31, 2009 (at fair value):

	<u>Euro</u>	<u>British Pound</u>	<u>New Israeli Shekel</u>	<u>Danish Kroner</u>	<u>USD</u>	<u>Other</u>	<u>Total</u>
Accounts Receivables	20%	13%	17%	3%	47%	*	100%
Accounts Payables	12%	9%	16%	5%	58%	*	100%

Less than 1%.

The table below details (U.S. Dollar in thousands) the derivative instrument in order to limit the exposure to exchange rate fluctuations. The data are as of December 31, 2009 and are presented in U.S. Dollar equivalents. All instruments are matured in 2010:

	<u>Buy</u>	<u>Cross currency (Sell)</u>	<u>Notional amount</u>	<u>Weighted average settlement ratio</u>
Forward:				
	DKK	NIS	456	0.75
	USD	GBP	2,254	1.60
	USD	DKK	1,029	5.17
	NIS	USD	1,256	3.78
Options:				
Buy Put	NIS	USD	1,609	3.78
Sell Call	GBP	NIS	1,743	44.28

In light of our multi-currency activity and our exposure to fluctuation in foreign currencies exchange rates, we presently engage in hedging or other transactions intended to manage risks relating to foreign currency exchange rate or interest rate fluctuations. The Company uses foreign currency options, forward exchange contracts and forward interest contracts to assist in managing financial risks. The Company does not use derivative financial instruments for speculative purposes. These instruments are recognized at fair value, with all changes in fair value recorded in current period earnings, as these transactions have not been designated by management as hedging instruments.

We have market risk exposure to changes in interest rates on our long-term loans from banks. The majority of our loans are stated in U.S. Dollars and have variable interest rates in order to reduce the risks associated with interest rate fluctuation. The book value of these liabilities approximates their fair value as of December 31, 2009. For each 1% upward shift in the LIBOR rate our yearly interest payments will increase by approximately by \$150,000 in 2010 and \$110,000 in 2011.

Our liabilities, the interest rate they bear and their repayment schedule by currency as of December 31, 2009, are set forth in the table below in U.S. Dollars equivalent terms:

	<u>Total amount</u>	<u>Interest rate</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013 and thereafter</u>
<u>US \$ in thousands</u>						
Long-term debt:						
Variable rate (US \$):						
Loan from bank	2,000	Libor + 2.5%	1,000	1,000	-	-
Loan from bank	3,000	Libor + 3.25%	-	3,000	-	-
Loan from bank	8,000	Libor + 2.8%	1,230	2,462	2,462	1,846
Loan from bank	2,008	Libor + 3.8%	235	471	471	831
Fixed Rate (Euro):						
Loan from bank	49	6.30%	25	24		
Other	320	0.87%	-	38	38	244
	<u>15,377</u>		<u>2,490</u>	<u>6,995</u>	<u>2,971</u>	<u>2,921</u>

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

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

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

(a) *Disclosure Controls and Procedures.* Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of December 31, 2009. Based on this evaluation, our chief executive officer and chief financial officer have concluded that, as of such date, our disclosure controls and procedures were: (i) designed to ensure that material information relating to us, including our consolidated subsidiaries, is accumulated and communicated to our management, including our chief executive officer and chief financial officer, by others within those entities, as appropriate to allow timely decisions regarding required disclosure, particularly during the period in which this report was being prepared; (ii) providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and (iii) effective at the reasonable assurance level.

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

Our chief executive officer and chief financial officer assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, they used the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our chief executive officer and chief financial officer have concluded that, as of December 31, 2009, our internal control over financial reporting is effective based on those criteria.

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

(c) *Attestation Report of the Registered Public Accounting Firm.* This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial report. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report in this annual report.

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

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Michael Chill and Ms. Amira Berkovitz-Amir, both members of our audit committee, are "audit committee financial experts" and are independent as defined by applicable SEC regulations.

ITEM 16B. CODE OF ETHICS

BluePhoenix has adopted a code of business conduct and ethics applicable to its executive officers, directors and all other employees. A copy of the code is available without charge to all BluePhoenix's employees, investors and others upon request to the following address: BluePhoenix Solutions Ltd., 8 Maskit Street, Herzliya 46733, Israel, Attn: General Counsel. Any waiver of this code for executive officers or directors will be disclosed through the filing of a Form 6-K.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Policy of Pre-approval of Audit and Non-Audit Services of Independent Auditors

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

Principal Accountant Fees and Services

BluePhoenix was billed for the following fees for professional services rendered by Ziv Haft independent registered certified public accountants (Isr.) and other BDO member firm, for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	(\$ in thousands)	
Audit Fees	\$ 185	\$ 279
Audit-Related Fees	20	-
Tax Fees	85	100
Total	<u>\$ 290</u>	<u>\$ 379</u>

The audit fees for the years ended December 31, 2009 and 2008 were for professional services rendered for the audits of our annual consolidated financial statements (including audit of our internal control over financial reporting in 2008), review of quarterly reports, statutory audits of BluePhoenix and its subsidiaries, issuance of comfort letters, consents and assistance with review of documents filed with the SEC.

Audit-related fees are fees for services related to due-diligence.

Tax fees are for services related to tax compliance, including the preparation of tax returns and claims for refund, and tax planning and tax advice, including assistance with tax audits and appeals, and assistance with respect to requests for rulings from tax authorities.

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

Not applicable.

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

The following table sets forth certain information related to purchases made by BluePhoenix of its ordinary shares during the periods indicated:

<u>Period</u>	(a) Total Number of Ordinary Shares Purchased	(b) Average Price Paid Per Ordinary Share	(c) Total Dollar amount Purchased as Part of Publicly Announced Program (1)	(d) Maximum Dollar amount available for repurchase Under the Programs (1)
March 1 to March 31, 2009	44,994	\$ 1.85	\$ 83,111	\$ 3,492,000
Total	44,994		\$ 83,111	

(1) All these treasury transactions were made under our buy-back program in accordance with the resolution of our board of directors adopted in March 2008 authorizing the repurchase of our shares, subject to market conditions, under our existing buy-back programs. During 2007 and 2006, we did not repurchase any shares under our buy-back program. In January 2006, we sold an aggregate of 136,000 of the shares to Israeli institutional investors in Israel, for aggregate consideration of approximately \$534,000. In February 2006, we sold 86,971 shares held by one of our subsidiaries to Outlook Systems Ltd. In 2008, we purchased an aggregate of 44,994 of the shares for consideration of \$83,111.

(2) In 2009, treasury shares were used for the issuance of 153,667 shares pursuant to the exercise of options and vested RSUs.

ITEM 16F. CHANGE IN REGISTRANT CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

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

Pursuant to NASDAQ Listing Rule IM-5615(a)(3), we received a permanent exemption from Listing Rule IM-5250(d)(1), which requires a company to distribute to its shareholders copies of its annual report containing its audited financial statements. We follow the common practice among TASE companies, and do not send our annual financial statements to shareholders. A copy of our annual report on Form 20-F is posted on our website promptly after it is filed with the SEC and the TASE.

In addition, pursuant to NASDAQ Listing Rule IM-5615(a)(3), we notified NASDAQ that we follow Israeli law and practice in lieu of certain NASDAQ rules, and accordingly do not follow those NASDAQ rules:

- specified in NASDAQ Listing Rule IM-5605-2 requiring that independent directors have regularly scheduled meetings at which only independent directors are present;
- specified in NASDAQ Listing Rules 5635(c) and IM-5635-1, which require a shareholder approval for establishment of stock options or purchase plans and for material amendments therein; and
- specified in NASDAQ Listing Rule 5635(b) requiring shareholder approval prior to the issuance of securities when the issuance or potential issuance results in a change of control of the company.

PART III

ITEM 17. FINANCIAL STATEMENTS

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

ITEM 18. FINANCIAL STATEMENTS

The financial statements required by this item are found at the end of this annual report, beginning on page F-1.

ITEM 19. EXHIBITS

Exhibit No.

- | | |
|------------|--|
| 1.1 | English translation of the Memorandum of Association as amended on July 23, 2003 and on December 30, 2009* |
| 1.2 | Articles of Association as amended on December 30, 2009* |
| 4.1 | Form of Ordinary Shares Purchase Warrant dated as of November 21, 2007 ⁽¹⁾ |
| 4.2 | Securities Purchase Agreement dated as of October 14, 2009, among the Registrant and the purchasers identified therein ⁽²⁾ |
| 4.3 | Form of Ordinary Shares Purchase Warrant dated as of October 14, 2009 ⁽²⁾ |
| 4.4 | Registration Rights Agreement dated as of October 14, 2009, among the Registrant and the purchasers signatory thereto ⁽²⁾ |
| 4.5 | Share Exchange Agreement dated October 13, 2002 among the Registrant, Formula Systems (1985), Arie Kilman and other shareholder of Liraz Systems Ltd. ⁽³⁾ |
| 4.6 | Form of Indemnification Letter dated December 27, 2005 between the Registrant and certain office holders ⁽⁴⁾ |
| 4.7 | BluePhoenix 2003 Employee Share Option Plan (previously known as the Crystal 1996 Employee Share Option Plan), as amended on January 28, 1997, December 5, 1999, December 18, 2000, December 26, 2000, August 6, 2003, December 30, 2004 and February 21, 2010 * |
| 4.8 | The 2007 Award Plan adopted by the Registrant on July 8, 2007 ⁽⁵⁾ |

8.1	List of Subsidiaries*
12.1	Certification of the Chief Executive Officer pursuant to §302 of the Sarbanes-Oxley Act*
12.2	Certification of the Chief Financial Officer pursuant to §302 of the Sarbanes-Oxley Act*
13.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act*
13.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act*
15	Consent of Ziv Haft registered certified public accountants (Isr.) BDO member firm*

* Filed herewith.

(1) Incorporated by reference to the Registrant's Registration Report on Form F-3 filed with the Securities and Exchange Commission on January 7, 2008.

(2) Incorporated by reference to the Registrant's Report on Form 6-K filed with the Securities and Exchange Commission on October 13, 2009.

(3) Incorporated by reference to the Registrant's Annual Report on Form 20-F filed with the Securities and Exchange Commission on June 19, 2003.

(4) Incorporated by reference to the Registrant's Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2006.

(5) Incorporated by reference to the Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on October 31, 2007.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

BLUEPHOENIX SOLUTIONS LTD.
(Registrant)

By: /s/ Varda Sagiv
Varda Sagiv
Chief Financial Officer

Date: March 25, 2010

EXHIBIT INDEX

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BLUEPHOENIX SOLUTIONS LTD.

2009 Annual Report

BLUEPHOENIX SOLUTIONS LTD.
2008 CONSOLIDATED FINANCIAL STATEMENTS

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



Ziv Haft

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Tel Aviv 66180, Israel
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of

BLUEPHOENIX SOLUTIONS LTD.

We have audited the accompanying consolidated balance sheets of BluePhoenix Solutions Ltd. (the "Company") and its subsidiaries as of December 31, 2009 and 2008 and the related consolidated statements of operations, changes in equity and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for noncontrolling interests and warrants as of January 1, 2009.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2009 and 2008, and the related consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

Tel Aviv, Israel
March 25, 2010

Ziv Haft

Certified Public Accountants (Isr.)
BDO Member Firm

BLUEPHOENIX SOLUTIONS LTD.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2009	2008
	(in thousands)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 22,328	\$ 30,308
Marketable securities	129	423
Trade accounts receivable (Note 13A1)	25,578	28,232
Other current assets (Note 13A2)	2,873	3,217
Total current assets	50,908	62,180
LONG TERM ASSETS:		
Investment in affiliated company	147	157
Property and equipment, net (Note 4)	1,890	2,493
Goodwill (Note 5)	51,990	52,006
Intangible assets and other, net (Note 6)	17,619	23,151
Total long term assets	71,646	77,807
Total assets	\$ 122,554	\$ 139,987
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit and others	\$ 2,490	\$ 1,021
Accounts payable and accruals:		
Trade	6,093	5,133
Deferred revenue	4,424	5,541
Other (Note 13A3)	10,263	18,125
Total current liabilities	23,270	29,820
LONG-TERM LIABILITIES:		
Accrued severance pay, net (Note 7)	1,309	1,797
Loans from banks and others (Note 9)	12,887	15,048
Derivatives liabilities - warrants	2,414	-
Total long-term liabilities	16,610	16,845
Total liabilities	39,880	46,665
COMMITMENTS AND CONTINGENCIES (Note 10)		
Equity (Note 11):		
Share capital - ordinary shares of NIS 0.01 par value (authorized: December 31, 2009 40,000,000 shares ; December 31, 2008 - 30,000,000 shares; issued: December 31, 2009 - 25,594,252 shares; December 31, 2008 - 23,161,904 shares)	52	46
Additional paid-in capital	128,591	129,827
Accumulated other comprehensive loss	(1,641)	(1,616)
Accumulated deficit	(30,184)	(20,605)
Treasury shares - December 31, 2009 -2,371,140 shares (December 31, 2008 - 2,326,146 shares)	(15,240)	(15,157)
BluePhoenix Shareholders' Equity	81,578	92,495
Noncontrolling interest	1,096	827
Total equity	82,674	93,322
Total liabilities and equity	\$ 122,554	\$ 139,987

The accompanying notes are an integral part of the consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	2009	2008	2007
	(in thousands, except per share data)		
Revenues (Note 13B1):			
Services	\$ 70,942	\$ 84,854	\$ 61,664
Products	6,836	6,891	19,558
Total revenues	77,778	91,745	81,222
Cost of revenues:			
Services	44,486	45,610	35,330
Products	399	422	1,199
Total cost of revenues	44,885	46,032	36,529
Gross profit	32,893	45,713	44,693
Research and development costs	11,420	18,378	12,653
Selling, general, and administrative expenses	30,406	32,359	28,370
Goodwill impairment	5,670	13,328	-
Restructuring (Note 13B3)	-	-	694
Operating income (loss)	(14,603)	(18,352)	2,976
Financial expenses, net (Note 13B4)	779	2,237	4,343
Other income, net (Note 13B5)	-	398	892
Loss before taxes on income	(15,382)	(20,191)	(475)
Taxes on income (benefit) (Note 12)	(117)	(330)	68
	(15,265)	(19,861)	(543)
Share in earnings (loss) of affiliated company	(10)	(49)	35
Loss from discontinued operation	(15,275)	(19,910)	(508)
Loss from discontinued operation (Note 15)	-	(8,512)	(7,489)
Net loss	(15,275)	(28,422)	(7,997)
Net income attributable to noncontrolling interests	(295)	(179)	(199)
Loss attributed to BluePhoenix Shareholders	\$ (15,570)	\$ (28,601)	\$ (8,196)
Loss per share - basic and diluted:			
Loss from continued operations attributable to BluePhoenix shareholders	\$ (0.72)	\$ (1.12)	\$ (0.23)
Discontinued operation attributable to BluePhoenix shareholders	-	(0.23)	(0.25)
Net loss attributable to BluePhoenix shareholders	\$ (0.72)	\$ (1.35)	\$ (0.48)
Weighted average shares outstanding, basic and diluted	21,500	21,196	17,145
Amounts attributable to BluePhoenix common shareholders:			
Loss from continued operation	\$ (15,570)	\$ (23,664)	\$ (3,852)
Loss from discontinued operation	-	(4,937)	(4,344)
Net loss	\$ (15,570)	\$ (28,601)	\$ (8,196)

The accompanying notes are an integral part of the consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Share capital		Additional paid-in capital	Accumulated other comprehensive loss	Cost of Company shares held by subsidiaries	Retained earnings (Accumulated deficit)	Non controlling interest	Total
	Number of shares	Par value						
Balance at January 1, 2007	14,298,358	31	58,556	(1,537)	(13,548)	16,447	563	60,512
Changes during 2007:								
Net loss	-	-	-	-	-	(8,196)	199	(7,997)
Unrealized gain on available-for-sale marketable securities	-	-	-	178	-	-	-	178
Total comprehensive income								(7,819)
Stock-based compensation	-	-	1,025	-	-	-	-	1,025
Compensation by former shareholder	-	-	1,769	-	-	-	-	1,769
Conversion of convertible debentures	1,363,656	2	6,822	-	-	-	-	6,824
Conversion of convertible notes series A	2,062,297	5	11,911	-	-	-	-	11,916
Exercise of warrants	210,000	*	840	-	-	-	-	840
Issuance of shares with respect of minority interests acquisition	100,719	*	515	-	-	-	-	515
Issuance of shares, net	1,999,998	5	32,918	-	-	-	-	32,923
Implementation of FSP EITF 00-19-2	-	-	706	-	-	(255)	-	451
Tax benefit related to exercise of stock options	-	-	594	-	-	-	-	594
Exercise of employee stock options and RSUs	591,599	1	2,919	-	-	-	-	2,920
Balance at December 31, 2007	20,626,627	44	118,575	(1,359)	(13,548)	7,996	762	112,470
Changes during 2008:								
Net loss	-	-	-	-	-	(28,601)	65	(28,536)
Unrealized loss on available for-sale marketable securities	-	-	-	(257)	-	-	-	(257)
Total comprehensive loss								(28,793)
Stock-based compensation	-	-	2,825	-	-	-	-	2,825
Exercise of warrants	200,000	*	1,347	-	-	-	-	1,347
Exercise of employees stock options and RSUs	274,191	*	660	-	-	-	-	660
Purchase of treasury stocks	(677,302)	-	-	-	(1,609)	-	-	(1,609)
Conversion of convertible notes series A	12,242	*	67	-	-	-	-	67
Issuance of shares and warrants in connection with previously acquired subsidiaries	400,000	2	6,353	-	-	-	-	6,355
Balance at December 31, 2008	20,835,758	46	\$ 129,827	(1,616)	(15,157)	(20,605)	827	93,322
Recognition of derivatives liabilities related to adoption of FASB ASC 815-40-15	-	-	(6,152)	-	-	5,991	-	(161)
Net loss	-	-	-	-	-	(15,570)	295	(15,275)
Unrealized loss on marketable securities	-	-	-	(103)	-	-	-	(103)
Reclassification adjustment to income on marketable securities	-	-	-	78	-	-	-	78
Total comprehensive loss								(15,300)
Stock-based compensation	-	-	2,031	-	-	-	-	2,031
Dividend to noncontrolling interest	-	-	-	-	-	-	(26)	(26)
Purchase of treasury stocks	(44,994)	*	-	-	(83)	-	-	(83)
Exercise of employees stock options and RSUs	254,312	*	6	-	-	-	-	6
Issuance of shares in connection with previously acquired subsidiaries	813,461	2	2,503	-	-	-	-	2,505
Issuance of shares, net	1,364,575	4	376	-	-	-	-	380
Balance at December 31, 2009	23,223,112	\$ 52	\$ 128,591	\$ (1,641)	\$ (15,240)	\$ (30,184)	\$ 1,096	\$ 82,674

* Less than \$1 thousand.

The accompanying notes are an integral part of the consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (15,275)	\$ (28,422)	\$ (7,997)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Loss from discontinued operation	-	8,512	7,489
Share in earnings of affiliated companies, net dividend received	10	49	(2)
Depreciation and amortization	8,894	10,107	10,407
Goodwill impairment	5,670	13,328	-
Increase (decrease) in accrued severance pay, net	(572)	248	(132)
Loss (gain) on sale of property and equipment	-	10	4
Change in value of long term-loans and liabilities	-	-	2,311
Stock - based compensation	2,031	2,825	2,794
Change in fair value of warrants	(1,514)	-	-
Decreases in provision for losses in formerly consolidated subsidiary	-	-	(300)
Deferred income taxes, net	(493)	(894)	(1,025)
Tax benefit related to exercise of stock options	-	-	594
Changes in operating assets and liabilities:			
Reclassification adjustment to income on marketable securities	78	-	560
Decrease (increase) in trade receivables	3,017	(4,702)	4,213
Decrease (increase) in other current assets	568	(407)	936
Increase (decrease) in trade payables	981	992	(601)
Decrease in other accounts payable	(2,429)	(744)	(3,155)
Net cash provided by operating activities	<u>966</u>	<u>902</u>	<u>16,096</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(589)	(1,200)	(1,029)
Proceeds from sale of property and equipment	-	6	10
Proceeds from sale of marketable securities	192	-	-
Capitalization of research and development costs	-	-	(3,944)
Additional consideration for previously acquired subsidiaries and activities	(8,908)	(7,869)	(1,310)
Advance in investment of new activity	(93)	-	-
Investment in newly-consolidated subsidiaries and purchase of newly-activity (Appendix A)	(2,454)	(2,269)	(9,077)
Net cash used in investing activities	<u>(11,852)</u>	<u>(11,332)</u>	<u>(15,350)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Short-term bank credit, net	-	-	(936)
Repayment of long-term loans	(3,057)	-	(20,609)
Receipt of long-term loans	2,000	16,069	-
Dividend paid to noncontrolling interest	(26)	-	-
Repayment of provision for losses in formerly consolidated subsidiary	-	-	(1,671)
Purchase of treasury shares	(83)	(1,609)	-
Issuance of shares and warrants, net	4,066	-	33,213
Exercise of employee share options and warrants	6	2,007	3,761
Net cash provided by financing activities	<u>2,906</u>	<u>16,467</u>	<u>13,758</u>
Cash Flows Provided By (used in) Discontinued Operation:			
Net cash used in operating activity	-	-	(367)
Net cash provided by investing activity	-	1,700	25
Total net increase (decrease) in cash and cash equivalents	<u>(7,980)</u>	<u>7,737</u>	<u>14,162</u>
Changes in cash and cash equivalents from discontinued operation	-	-	342
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FROM CONTINUED OPERATION	(7,980)	7,737	14,504
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>30,308</u>	<u>22,571</u>	<u>8,067</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 22,328</u>	<u>\$ 30,308</u>	<u>\$ 22,571</u>

The accompanying notes are an integral part of the consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
Cash paid during the year for:			
Income taxes	\$ 347	\$ 859	\$ 841
Interest	\$ 802	\$ 194	\$ 2,142

APPENDIX A - INVESTMENT IN NEWLY-CONSOLIDATED SUBSIDIARIES AND PURCHASE OF ACTIVITY:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
Working capital, other than cash	\$ 431	\$ 777	\$ 2,785
Investment and loans to affiliated Company	-	-	(205)
Property and equipment	-	(67)	(303)
Other intangible assets	(172)	(91)	(1,317)
Goodwill	(907)	(710)	(5,975)
Technology	(1,633)	(1,088)	(2,423)
Customer relations intangible asset	(257)	(1,090)	(1,824)
Non-current liabilities	84	-	185
Net cash used in acquisition	\$ (2,454)	\$ (2,269)	\$ (9,077)

APPENDIX B - NON-CASH ACTIVITIES:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
Investment in subsidiaries	\$ 4,746	\$ 14,848	\$ 246
Conversion of convertible debentures	\$ -	\$ 67	\$ 18,740
Issuance costs	\$ -	\$ -	\$ 290

The accompanying notes are an integral part of the consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies:

A. General:

The significant accounting policies, applied on a consistent basis, are as follows:

1. The Company:

BluePhoenix Solutions Ltd. ("BluePhoenix") (together with its subsidiaries, the "Company" or "we") is an Israeli corporation, which operates in one operating segment of IT modernization solutions.

The Company develops and markets software tools and provides consulting services for efficient modernization of legacy systems and cross-platform migration. The Company manages its business in various international markets through several entities, including its wholly-owned subsidiaries located in: USA, Russia, UK, Denmark, Germany, Italy, Netherlands, Cyprus, Romania, and Israel.

2. Accounting Principles:

The consolidated financial statements are prepared in accordance with accounting principles generally accepted ("GAAP") in the United States of America.

3. Functional Currency:

The currency of the primary economic environment in which the operations of the Company and its subsidiaries are conducted is the U.S. dollar ("dollar"). In addition, a substantial portion of the Company's revenues and costs are incurred in dollars. Thus, the functional and reporting currency of the Company is considered to be the dollar.

The Company follows FASB ASC Topic 830 "Foreign Currency Matters" ("ASC 830") and accordingly non monetary transactions denominated in currencies other than the dollar are measured and recorded in dollar at the exchange rates prevailing at transaction date. Monetary assets and liabilities denominated in currencies other than the dollar are translated at the exchange rate on the balance sheet date. Exchange gain or losses on foreign currency translation are recorded in income.

4. Use of Estimates and Assumptions in the Preparation of the Financial Statements:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

B. Principles of Consolidation:

The consolidated financial statements include the accounts of BluePhoenix and its subsidiaries in which it has a controlling interest. Acquisition of subsidiaries is accounted for under the acquisition method. All intercompany balances and transactions have been eliminated upon consolidation. Noncontrolling interests are included in equity.

C. Cash and Cash Equivalents:

Cash equivalents are considered by the Company to be highly-liquid investments, including inter-alia, short-term deposits with banks, of which did not exceed three months at the time of deposit and which are not restricted.

D. Provision for Doubtful Accounts:

The provision for doubtful accounts was based on specific receivables, which their collection, in the opinion of Company's management, is in doubt. Trade receivables are charged off in the period in which they are deemed to be uncollectible.

E. Investee companies:

Investments in affiliates over which the Company exercises significant influence but are not subsidiaries (affiliated companies) are accounted for under the equity method.

F. Investments in Marketable Securities:

Management determines the appropriate classification of its investments at the time of purchase all marketable securities are reported at fair value based on quoted market and classified as available for-sale. Available for sale securities are carried at fair value, with the unrealized gains and losses, reported in "accumulated other comprehensive income (loss)" in equity. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

G. Property and Equipment, Net:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over their estimated useful lives. Annual rates of depreciation are as follows:

	%
Computers and peripheral equipment	20-33 (mainly 33)
Office furniture and equipment	6-15 (mainly 7)
Leasehold improvements	Over the shorter of lease term or the life of the assets
Motor vehicles	15

H. Impairment of Long-Lived Assets:

The Company's long-lived assets are reviewed for impairment in accordance with FASB ASC Topic 360 "Property Plant and Equipment" whenever events or changes in circumstances indicate that the carrying amount 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 amount of the assets exceeds their fair value. During the years ended December 31, 2009, 2008 and 2007, no impairment losses have been identified.

I. Goodwill and other purchased intangible assets:

Goodwill and certain other purchased intangible assets have been recorded as a result of acquisitions. Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired.

Goodwill is not amortized, but rather is subject to an annual impairment test. The Company performs an annually impairment test, or more frequently if impairment indicators are present. Intangible assets that are not considered to have an indefinite useful life are amortized using the straight-line basis over their estimated useful lives of between 5 to 12 years. The carrying amount of these assets is reviewed whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the assets is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset (see also Note 1H).

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

I. Goodwill and other purchased intangible assets (Cont.):

The Company performed impairment tests in 2009 and 2008. The goodwill impairment tests are conducted in two steps. In the first step, the Company determines the fair value of the reporting unit using expected future discounted cash flows and estimated terminal values. If the net book value of the reporting unit exceeds the fair value, the Company would then perform the second step of the impairment test which requires allocation of the reporting unit's fair value of all of its assets and liabilities in a manner similar to a acquisition cost allocation, with any residual fair value being allocated to goodwill. The implied fair value of the goodwill is then compared to the carrying value to determine impairment, if any.

The Company determines the fair value of a reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates its fair value at this time. The Company has corroborated the fair values using the Market Approach. Judgments and assumptions related to revenue, gross profit, operating expenses, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. Additionally, the Company evaluated the reasonableness of the estimated fair value of its reporting units by reconciling to its market capitalization. This reconciliation allowed the Company to consider market expectations in corroborating the reasonableness of the fair value of the reporting unit. The ability to reconcile the gap between the market capitalization and the aggregate fair value depends on various factors, some of which are quantitative, such as an estimated control premium that an investor would be willing to pay for a controlling interest in the Company, and some of which are qualitative and involve management judgment, including stable relatively high backlog and growing pipe line.

In such reconciliation, as part of the 2009 impairment test the Company considered a 30% effective control premium rate which reflects the weighted average control premium rate implied from 6 published transactions involving controlling interests in comparable companies in Israel and abroad, that took place during the six months ended December 31, 2009. These 6 transactions were selected because they involved companies in the software and the IT service industries.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

I. Goodwill and other purchased intangible assets (Cont.):

The Company is one operating segment and therefore one reporting unit related to its overall IT modernization. In 2008 and 2009, step one of the assessment resulted that the carrying value of the IT modernization reporting unit exceeds its fair value. As described in the preceding paragraphs, the second step was performed by allocating the reporting unit's fair value to all of its assets and liabilities, with any residual fair value being allocated to goodwill. The Company determined that the carrying value of goodwill should be impaired. As a result, the Company recorded a non-cash goodwill impairment charge of \$13.3 million in 2008 and \$5.7 million in 2009.

J. Research and Development Costs:

Research and development costs of software and products enhancement that are intended for sale and acquired technology which were incurred after the establishment of technological feasibility of the relevant product, are capitalized. Technological feasibility is determined when detailed program design is completed and verified in accordance with the provisions of FASB ASC Topic 985 "Software". Research and development costs before technological feasibility is established are charged to the statement of operations as incurred.

Amortization of capitalized research development costs begins when the product is available for general release to customers. Annual amortization is computed by the straight-line method, over the remaining useful life of the product, or based on the ratio of current gross revenues to current and anticipated future gross revenues, whichever is higher. Currently, capitalized research and development costs are amortized over a period of 5 years.

During the years ended December 31, 2009 and 2008, the Company did not capitalized research and development costs since all costs incurred between the completion of detailed program design and the point in which the products were ready for general release have been insignificant and amortized capitalized research and development costs aggregating \$6.6 million (in 2008: \$8.2 million and in 2007: \$8.9 million) included in cost of revenues.

In the Company's management estimate, total capitalized costs do not exceed the net realizable value of the software product. In the event that unamortized research and development costs exceed the net realizable value of the product, they would be written down to net realizable value.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

J. Research and Development Costs (Cont.):

In the second quarter of 2008, the Company impaired \$7.1 million with respect to capitalized software development costs which was presented as discontinued operation related to Mainsoft (see Note 15). The impairment was charged in order to reflect the fair value of Mainsoft based upon the consideration assigned to Mainsoft in a LOI dated July 7, 2008. Management did not identify any additional impairment during the years ended 2008, 2007 and 2006.

K. Stock-based Compensation:

The Company accounts for stock based compensation to employees in accordance with SFAS ASC Topic 718 "Compensation – Stock Compensation" which was adopted effective January 2006. In the past three years majority of the awards were of restricted stock units ("RSUs"). RSU's are valued based on the market value of the underlying stock at the date of grant. The Company measures and recognizes compensation expense with respect to share options based on estimated fair values on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that the Company makes several estimates, including the option's expected life and the price volatility of the underlying stock.

For the year ended December 31, 2009, 2008 and 2007 the Company recorded stock-based and RSUs compensation costs in the amount of \$2,031, \$2,825 and \$1,025 thousand, respectively. On December 31, 2009, the total unrecognized stock-based and RSUs compensation costs amounted to \$1,107 thousand, and are expected to be recognized over of the next 3 years.

L. Revenue Recognition:

Revenues derived from direct software license agreements are recognized in accordance with FASB ASC Topic 985 "Software" ("ASC 985"), upon delivery of the software, when collection is probable, the license fee is otherwise fixed or determinable and persuasive evidence of an arrangement exists.

The arrangements that include multiple elements are usually arrangements where the Company sells software products and Post Contract Support (PCS).

For multiple elements arrangements, ASC 985 requires that the fair value of each component in a multiple element arrangement will be determined based on the vendor's specific objective evidence (VSOE) for that element, and revenue is allocated to each component based on its fair value. ASC 985 requires that revenue be recognized under the "residual method" when VSOE does not exist for all the delivered elements, VSOE of fair value exists for all undelivered elements, and all other accounting standards criteria are met. The specific objective evidence for the PCS is established by the price charged on PCS renewed.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

L. Revenue Recognition (Cont.):

The Company recognizes revenues from consulting fees based on the number of hours performed.

In some of the agreements with the Company's customers, the customers have the right to receive unspecified upgrades on an if-and-when available basis (the Company does not provide specific upgrades). These upgrades are considered Post-Contract Support (PCS). Revenues allocated to the PCS are recognized ratably over the term of the PCS.

When a project involves significant production, modification or customization of software, revenue is recognized according to the percentage of completion method in accordance with the provisions of FASB ASC Topic 605-35-25 (prior authoritative literature: SOP 81-1 "Accounting for Performance of Construction-Type Contracts"). Under this method, estimated revenue is generally accrued based on costs incurred to date, as a percentage of total updated estimated costs. The Company recognizes contract losses, if any, in the period in which they first become evident.

Some of the Company's contracts include client acceptance clauses. In these contracts, the Company follows the guidance of ASC 985-605-55 (formerly TPA 5100.67) and SAB 104. In determining whether revenue can be recognized, when an acceptance clause exists, the Company considers its history with similar arrangements, the customer's involvement in the progress, and the existence of other service providers and the payments terms. There are no rights of return, price protection or similar contingencies in the Company's contracts.

On December 31, 2009 approximately \$19.3 million (on December 31, 2008: \$13.3 million) of the accounts receivable balance was unbilled due to the customers payment terms.

The Company presents revenues from products and revenues from services in separate line items.

The product revenues line item includes revenues generated from (i) standalone software products and (ii) software products that were included in multiple-element arrangements and were separated pursuant to ASC 985 as aforementioned.

In the services revenue line item, the Company included (i) revenues generated from standalone consulting services, (ii) revenues generated from stand alone post contract support ("PCS"), (iii) revenues accounted for pursuant to ASC 605-35-25 and (iv) revenues generated from PCS included in multiple-element arrangement and were separated pursuant to ASC 985 as aforementioned.

Tax collected from customers and remitted to governments authorities (including VAT) are presented in income statement on a net basis.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

M. Advertising Costs:

The Company expenses advertising costs as incurred. Advertising costs for the years ended December 31, 2009, 2008 and 2007 were \$291, \$318 and \$90 thousand, respectively.

N. Income Taxes:

Effective January 1, 2007, upon the adoption of a new pronouncement which clarifies the accounting for uncertainty in income taxes and prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, the Company should record accruals for uncertain tax positions. Those accruals should record to the extent that the Company concludes that a tax position is not sustainable under a "more-likely-than-not" standard. In addition, the Company should classify interest and penalties recognized in the financial statements relating to uncertain tax positions under the provision for income taxes.

The adoption of the new pronouncement did not result in a change of the Company's retained earnings. As of December 31, 2009, there are no unrecognized tax benefits.

Deferred taxes are determined utilizing the "asset and liability" method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and the 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. The Company provides a valuation allowance, when it's more likely than not that deferred tax assets will not be realized in the foreseeable future. Deferred tax liabilities and assets are classified as current or non-current based on the expected reversal dates of the specific temporary differences.

O. Earnings (loss) Per Share:

Earnings (loss) per share ("EPS") were computed in accordance with FASB ASC Topic 260, "Earnings Per Share" (ASC 260). ASC 260 requires the presentation of both basic and diluted EPS.

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year (see also Note 13C). Since the Company incurred net loss during the periods presented, no diluted EPS was presented as all the dilutive potential ordinary shares were anti-dilutive.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

P. Financial Instruments:

1. Concentration of credit risks:

Financial instruments that have the potential to expose the Company to credit risks are mainly cash and cash equivalents, marketable securities, bank deposit accounts, and trade receivables.

The Company holds cash and cash equivalents, marketable securities, and deposit accounts at large banks in Israel, the United States, and Europe, thereby substantially reducing the risk of loss.

With respect to trade receivables, the risk is limited due to the geographically spreading, nature and size of the entities that constitute the Company's customer base. The Company assesses the financial position of its customers prior to the engagement with them, and has not encountered material credit difficulties therewith.

2. Fair value measurement:

The Company measures fair value and discloses fair value measurements for financial assets and liabilities. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. On January 1, 2009, the Company adopted a newly issued accounting standard for fair value measurement of all non-financial assets and liabilities as well. The adoption did not have a significant effect on the Company's financial statements (refer to note 3).

Q. Comprehensive Income:

Comprehensive income, net of related taxes where applicable, includes, in addition to net income unrealized holding gains and losses on available-for-sale securities.

R. Derivative Instruments:

The Company uses foreign currency options, forward exchange contracts to assist in managing financial risks in order to minimize the currency exposure on identifiable assets and liabilities in currencies other than the functional currency. The Company does not use derivative financial instruments for speculative purposes. These instruments are recognized at fair value, with all changes in fair value recorded in current period earnings, as these transactions have not been designated by management as hedging instruments. The net loss recognized in earnings during 2009, representing the derivative instruments was \$894 thousand (in 2008: gain of \$55 thousand). As of December 31, 2009 the Company has open forward and option exchange contracts (notional amounts) of \$8.3 million (December 31, 2008: \$6.6 million).

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

S. Treasury Shares:

The Company repurchases its Ordinary shares from time to time on the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity.

T. Transfers of Financial Assets:

FASB ASC Topic 860 "Transfers and Servicing" ("ASC 860"), establishes a standard for determining when a transfer of financial assets should be accounted for as a sale. The underlying conditions are met for the transfer of financial assets to qualify for accounting as a sale. The transfers of financial assets are typically performed by the sell of receivables to on financial institution.

In 2009 and 2008, the Company sold trade receivables to financial institution in a total amount of \$30 and \$24.2 million respectively, at an average annual rate of Libor plus 2.4%-2.5% (in 2008- Libor plus 1.75%-2%). Control and risk of those trade receivables were fully transferred and accounted for as a sale in accordance with ASC 860. The agreements, pursuant to which the Company sells its trade receivables, are structured such that the Company (i) transfers the proprietary rights in the receivable from the Company to the financial institution; (ii) legally isolates the receivable from the Company's other assets, and presumptively puts the receivable beyond the legal reach of the Company and its creditors, even in bankruptcy or other receivership; (iii) confers on the financial institution the right to pledge or exchange the receivable; and (vi) eliminates the Company's effective control over the receivable, in the sense that the Company is not entitled and shall not be obligated to repurchase the receivable other than in case of failure by the Company to fulfill its commercial obligation.

U. Reclassifications:

Certain comparative figures have been reclassified to conform to the current year presentation.

V. Derivative Liabilities - Warrants:

In connection with the adoption of EITF 07-05, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock," ("EITF 07-05") on January 1, 2009 (ASC 815-40-15), the Company determined that the warrants issued at several occasions in 2007 ,2006 and 2004 (ratchet down of exercise price based upon lower exercise price in future offerings) are not indexed to the Company's own stock and therefore should be recorded as a derivative financial liability for pursuant FASB ASC Topic 815 "Derivative and Hedging" (ASC 815-40-25). The fair value of these warrants as of January 1, 2009 was \$161 thousand and was recorded as a derivative liability in a way of cumulative adjustment to beginning of the year equity.(see also Note 11A5).

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

W. Recently Issued Accounting Pronouncements:

Adoption of New Accounting Standards

Accounting Standards Codification

In June 2009, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (the "Codification"). This standard replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and establishes only two levels of U.S. generally accepted accounting principles ("GAAP"), authoritative and nonauthoritative. The FASB ASC has become the source of authoritative, nongovernmental GAAP, except for rules and interpretive releases of the SEC, which are sources of authoritative GAAP for SEC registrants. All other nongrandfathered, non-SEC accounting literature not included in the Codification will become nonauthoritative. This standard is effective for financial statements for interim or annual reporting periods ending after September 15, 2009. The adoption of the Codification changed the Company's references to GAAP accounting standards but did not impact the Company's results of operations, financial position or liquidity.

Participating Securities Granted in Share-Based Transactions

Effective January 1, 2009, the Company adopted a new accounting standard included in ASC 260, *Earnings Per Share* (formerly FASB Staff Position ("FSP") Emerging Issues Task Force ("EITF") 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*). The new guidance clarifies that non-vested share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities and included in basic earnings per share. The Company's adoption of the new accounting standard did not have a material effect on previously issued or current earnings per share.

Business Combinations and Noncontrolling Interests

Effective January 1, 2009, the Company adopted a new accounting standard included in ASC 805, *Business Combinations* (formerly SFAS No. 141(R), *Business Combinations*). The new standard applies to all transactions or other events in which an entity obtains control of one or more businesses. Additionally, the new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement date for all assets acquired and liabilities assumed; and requires the acquirer to disclose additional information needed to evaluate and understand the nature and financial effect of the business combination. The Company's adoption of this new accounting standard did not have a material impact on the Company's consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

W. Recently Issued Accounting Pronouncements:

Adoption of New Accounting Standards (cont.):

Business Combinations and Noncontrolling Interests (cont.):

Effective January 1, 2009, the Company adopted a new accounting standard included in ASC 810, *Consolidations* (formerly SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*). The new accounting standard establishes accounting and reporting standards for the noncontrolling interest (or minority interests) in a subsidiary and for the deconsolidation of a subsidiary by requiring all noncontrolling interests in subsidiaries be reported in the same way, as equity in the consolidated financial statements. As such, this guidance has eliminated the diversity in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. The Company's adoption of the new accounting standard resulted in recording noncontrolling interests in equity at the current year and in comparative numbers.

Fair Value Measurement and Disclosure

Effective January 1, 2009, the Company adopted a new accounting standard included in ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820") (formerly FASB FSP No 157-2, *Effective Date of FASB Statement No. 157*), which delayed the effective date for disclosing all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value on a recurring basis (at least annually). This standard did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued new guidance for determining when a transaction is not orderly and for estimating fair value when there has been a significant decrease in the volume and level of activity for an asset or liability. The new guidance, which is now part of ASC 820 (formerly FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*), requires disclosure of the inputs and valuation techniques used, as well as any changes in valuation techniques and inputs used during the period, to measure fair value in interim and annual periods. In addition, the presentation of the fair value hierarchy is required to be presented by major security type as described in ASC 320, *Investments — Debt and Equity Securities*. The provisions of the new standard were effective for interim periods ending after June 15, 2009. The adoption of the new standard on April 1, 2009 did not have a material impact on the Company's consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

W. Recently Issued Accounting Pronouncements:

Adoption of New Accounting Standards (cont.):

Fair Value Measurement and Disclosure (cont.):

In April 2009, the Company adopted a new accounting standard included in ASC 820, (formerly FSP 107-1 and Accounting Principles Board ("APB") 28-1, *Interim Disclosures about Fair Value of Financial Instruments*). The new standard requires disclosures of the fair value of financial instruments for interim reporting periods of publicly traded companies in addition to the annual disclosure required at year-end. The provisions of the new standard were effective for the interim periods ending after June 15, 2009. The Company's adoption of this new accounting standard did not have a material effect on the Company's consolidated financial statements.

In August 2009, the FASB issued new guidance relating to the accounting for the fair value measurement of liabilities. The new guidance, which is now part of ASC 820, provides clarification that in certain circumstances in which a quoted price in an active market for the identical liability is not available, a company is required to measure fair value using one or more of the following valuation techniques: the quoted price of the identical liability when traded as an asset, the quoted prices for similar liabilities or similar liabilities when traded as assets, or another valuation technique that is consistent with the principles of fair value measurements. The new guidance clarifies that a company is not required to include an adjustment for restrictions that prevent the transfer of the liability and if an adjustment is applied to the quoted price used in a valuation technique, the result is a Level 2 or 3 fair value measurement. The new guidance is effective for interim and annual periods beginning after August 27, 2009. The Company's adoption of the new guidance did not have a material effect on the Company's consolidated financial statements.

Derivative Instruments and Hedging Activities

Effective January 1, 2009, the Company adopted a new accounting standard included in ASC 815, *Derivatives and Hedging* (SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133*). The new accounting standard requires enhanced disclosures about an entity's derivative and hedging activities and is effective for fiscal years and interim periods beginning after November 15, 2008. Since the new accounting standard only required additional disclosure, the adoption did not impact the Company's consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

W. Recently Issued Accounting Pronouncements:

Adoption of New Accounting Standards (cont.):

Other-Than-Temporary Impairments

In April 2009, the FASB issued new guidance for the accounting for other-than-temporary impairments. Under the new guidance, which is part of ASC 320, *Investments — Debt and Equity Securities* (formerly FSP 115-2 and 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*), an other-than-temporary impairment is recognized when an entity has the intent to sell a debt security or when it is more likely than not that an entity will be required to sell the debt security before its anticipated recovery in value.

The new guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities and is effective for interim and annual reporting periods ending after June 15, 2009. The Company's adoption of the new guidance did not have a material effect on the Company's consolidated financial statements.

Subsequent Events

In May 2009, the FASB issued new guidance for subsequent events. The new guidance, which is part of ASC 855, *Subsequent Events* (formerly SFAS No. 165, *Subsequent Events*) is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, this guidance sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The new guidance is effective for fiscal years and interim periods ended after June 15, 2009 and will be applied prospectively. The Company's adoption of the new guidance did not have a material effect on the Company's consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

W. Recently Issued Accounting Pronouncements:

Accounting Standards Not Yet Effective

Accounting for the Transfers of Financial Assets

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as SFAS No. 166, *Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140*, was adopted into Codification in December 2009 through the issuance of Accounting Standards Updated ("ASU") 2009-16. The new standard eliminates the concept of a "qualifying special-purpose entity," changes the requirements for derecognizing financial assets, and requires additional disclosures in order to enhance information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and an entity's continuing involvement in and exposure to the risks related to transferred financial assets.

The new guidance is effective for fiscal years beginning after November 15, 2009. The Company will adopt the new guidance in 2010 and is evaluating the impact it will have to the Company's consolidated financial statements.

Accounting for Variable Interest Entities

In June 2009, the FASB issued revised guidance on the accounting for variable interest entities. The revised guidance, which was issued as SFAS No. 167, *Amending FASB Interpretation No. 46(R)*, was adopted into Codification in December 2009 through the issuance of ASU 2009-17. The revised guidance amends FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, in determining whether an enterprise has a controlling financial interest in a variable interest entity. This determination identifies the primary beneficiary of a variable interest entity as the enterprise that has both the power to direct the activities of a variable interest entity that most significantly impacts the entity's economic performance, and the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the variable interest entity. The revised guidance requires ongoing reassessments of whether an enterprise is the primary beneficiary and eliminates the quantitative approach previously required for determining the primary beneficiary. The Company does not expect that the provisions of the new guidance will have a material effect on its consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (Cont.):

W. Recently Issued Accounting Pronouncements:

Accounting Standards Not Yet Effective (cont.):

Revenue Recognition

In October 2009, the FASB issued ASU 2009-13, *Multiple-Deliverable Revenue Arrangements*. The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable based on the relative selling price. The selling price for each deliverable is based on vendor-specific objective evidence ("VSOE") if available, third-party evidence if VSOE is not available, or estimated selling price if neither VSOE or third-party evidence is available. ASU 2009-13 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company does not expect that the provisions of the new guidance will have a material effect on its consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update 2009-14, Revenue Recognition (Topic 605)-Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements (ASU 2009-14). ASU 2009-14 excludes tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of ASC 605-985, Software-Revenue Recognition. ASU 2009-14 shall be applied on a prospective basis to revenue arrangements entered into or materially modified in our first quarter of 2012. Early adoption is permitted. The Company does not expect that the provisions of the new guidance will have a material effect on its consolidated financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions:

In order to enhance the Company's solutions and services portfolio, the Company has been pursuing a strategy of adding new technologies to its suite of automated modernization tools. The Company implements this strategy via internal development of new software tools and through acquisitions and investments. Accordingly, the Company invests in businesses that develop software tools that are complementary to its existing portfolio.

A. DSK:

DSKnowledge Ltd. (DSK). In December 2009, the Company purchased the product business of DSKnowledge Ltd., referred to as DSK, a provider of knowledge management software for enterprises. DSK's product modernizes and transforms legacy data, information and content elements in enterprises into one knowledge management repository. Pursuant to the terms of the purchase agreement, the Company acquired DSK's product business for approximately \$3 million. According to the purchase agreement, the Company committed to pay additional consideration calculated based upon future milestones based revenues in 2010, 2011 and 2012. Acquisition costs amounted to approximately \$ 120 thousand and were charged to income as general and administrative expenses..

The acquisition was accounted for by the acquisition method. The results of operations were included in the consolidated financial statements of the company commencing December 8, 2009. The consideration for the acquisition was attributed to net assets on the basis of fair value of assets acquired and liabilities assumed, based upon an appraisal study. The allocation of the acquisition costs to the net assets acquired and liabilities assumed in this acquisition is preliminary, as the business combination was consummated on December 8, 2009, and has not been finalized. The final allocation could differ from this preliminary allocation. An amount of \$1,633 thousand was allocated to core technology and to be amortized over a 5 years period , an amount of \$257 thousand was allocated to estimated fair value of the customers related intangible assets, which is being amortized over 5 years and \$172 thousand of Backlog which is being amortized over 1 year. The excess cost of the acquisition over the fair value of net tangible and intangible assets amounted to \$907 thousand and was allocated to goodwill .Goodwill is deductible for tax purposes over 10 years period. Based upon this preliminary allocation no fair value was attributed to the future contingent payments as the company estimates at this stage that DSK will not reach the agreed milestones.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (Cont.):

A. DSK (Cont.):

The following table summarizes the fair values of assets acquired and liabilities assumed as of the date of purchase:

	<u>(in thousands)</u>
Current assets	\$ 385
Goodwill	907
Technology	1,633
Customer related intangible asset	257
Backlog	<u>172</u>
Total tangible and intangible assets acquired	3,354
Current liabilities	250
Non Current liabilities	<u>84</u>
Total liabilities assumed	<u>334</u>
Net assets acquired	<u>\$ 3,020</u>
	<u>(in thousands)</u>
Cost of investment:	
Cost paid	\$ 2,511
Current liability	<u>509</u>
	<u>\$ 3,020</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (Cont.):

B. TIS:

In January 2008, the Company entered into an agreement for the purchase of the entire outstanding share capital of TIS Consultants Ltd., or TIS, a company incorporated in Cyprus, that wholly owns a subsidiary incorporated in India, TISA Software Consultants Private Limited. TIS provides consulting services, solutions and value added products to the banking industry, specializing in the market for Temenos GLOBUS/T24™. TIS' acquisition expands the Company's products offerings and services.

Under the agreement, the Company paid to the selling shareholders an amount of \$500,000 and an additional amount of \$700,000 as a nonrefundable advance payment on account of contingent consideration described below. As part of the transaction, the Company undertook to pay the selling shareholders contingent consideration. Following a dispute with regard to the contingent consideration, and as part of the negotiated terms, the Company paid in 2009 \$3,070 thousand to the former shareholders of TIS that was already recorded as a liability in 2008, and entered into a settlement agreement for dismissal of legal proceedings between the Company and the former shareholders of TIS regarding the final amount of contingent consideration owed related to the Company's purchase of TIS. As part of the settlement, the parties agreed on mutual release of their respective claims and the former shareholders of TIS waived the rights to any future contingent consideration. Under the settlement agreement dated September 13, 2009, the Company will pay the former shareholders of TIS contingent consideration of \$1,057 thousand in January 2010 and \$1,163 thousand in January 2011. In addition, the Company issued to the former shareholders of TIS 813,461 of its ordinary shares, NIS 0.01 par value per share, valued \$2,505 thousand based on the closing settlement date. As a result, in 2008 and 2009 the Company assigned \$3,070 thousand and \$4,790 thousands respectively, to goodwill.

The acquisition was accounted for by the purchase method. The results of operations of TIS are included in the consolidated financial statement commencing January 1, 2008. The consideration of the acquisition which amounted to \$1.2 million was attributed to net assets acquired and liabilities assumed based on their fair value. Upon a purchase price allocation, an amount of \$1,088 thousand was allocated to core technology and to be amortized over a 5 years period and an amount of \$795 thousand was allocated to estimated fair value of the customers related intangible assets, which is being amortized over its estimated useful life - currently 5 years. The amount assigned to assets acquired and liabilities assumed exceeded the cost of the acquired entity by the amount of \$988 thousand, and therefore recognized as liability in accordance with FASB ASC 805 Topic "Business Combinations" since the final consideration contains a contingent consideration payment.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (cont.):

B. TIS (cont.):

The following table summarizes the fair values of assets acquired and liabilities assumed as of the date of purchase:

	<u>(in thousands)</u>
Current assets	\$ 577
Property and equipment	67
Technology	1,088
Customer related intangible asset	795
Total tangible and intangible assets acquired	2,527
Current liabilities	330
Total liabilities assumed	330
Net assets acquired	<u>\$ 2,197</u>
Cost of investment	
Cash paid	\$ 1,209
Contingent consideration	988
	<u>\$ 2,197</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (Cont.):

C. JLC Russia

In May 2008, the Company purchased the activity of a professional outsourcing center in Nitzni (Russia), in order to expand the Company's off-shore center in Russia, for a total consideration of \$1.18 million. Under the terms of the transaction, the Company agreed to pay to the selling shareholders an additional consideration if certain criteria are met, based on the revenues growth of the JLC's activity in each of the years 2008 and 2009. Accordingly, the Company paid in 2009 to the selling shareholders additional consideration of \$406 thousand that was recorded as a liability in 2008 based on the relevant criteria. No additional consideration was granted for 2009.

The acquisition was accounted for by the purchase method. The results of operations of JLC are included in the consolidated financial statement commencing May 1, 2008. The consideration of the acquisition was attributed to net assets acquired and liabilities assumed based on their fair value. Upon a purchase price allocation an amount of \$295 thousand was allocated to estimated fair value of the customer related intangible assets, which is being amortized over its estimated useful life - currently 5 years, and an amount of \$91 thousand was allocated to backlog and is being amortized over a 1 year period. The excess cost of the acquisition over the fair value of net tangible and intangible assets amounted to \$710 thousand and was allocated to goodwill in 2008.

The following table summarizes the fair values of assets acquired and liabilities assumed as of the date of purchase:

	<u>(in thousands)</u>
Current assets	\$ 424
Goodwill	710
Backlog	91
Customer related intangible asset	295
Total tangible and intangible assets acquired	<u>1,520</u>
Current liabilities	<u>335</u>
Total liabilities assumed	335
Net assets acquired	<u>\$ 1,185</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (Cont.):

D. Amalgamated Software North America (ASNA):

In August 2007, the Company entered into an agreement to purchase the entire outstanding share capital of Amalgamated Software North America Inc. (ASNA), a private company based in San Antonio, Texas, for a total consideration of \$7 million. Under the terms of the transaction, the Company agreed to pay to the selling shareholders an additional consideration if certain criteria are met, based on ASNA's operating profit in 2008 and 2009. Those criteria have not been met and no additional consideration was paid.

E. Bridge Quest Inc:

Effective April 2007, the Company entered into an agreement to purchase the entire outstanding share capital of Bridge Quest Inc., a North Carolina corporation that manages and operates, through a wholly owned subsidiary, a professional outsourcing center in St. Petersburg, Russia. BridgeQuest is experienced in providing development services from the Russian Federation. The consideration amounted to \$2 million. Under the terms of the transaction, the Company committed to pay the selling shareholders additional consideration computed based on BridgeQuest revenues and earnings before interest and taxes referred to as EBIT, during 2007-2009. Based on the above mentioned contingent consideration, the additional amount of goodwill recorded for fiscal 2007 amounted to \$1.8 million.

Based on an amendment to the agreement effective January 2008, the Company granted to the selling shareholders warrants to purchase 200,000 BluePhoenix' ordinary shares valued at \$2.5 million based on the Black-Scholes pricing model on the commitment date upon reaching the relevant milestone that was recorded as additional goodwill in 2008. These warrants were exercised in 2008. On December 31, 2008, the Company signed an additional amendment to the agreement, pursuant to which the Company committed to pay the selling shareholders an amount of \$1.6 million as final consideration in connection with the transaction payable as follows: \$750 thousand on January 31, 2009 which has already been paid; \$310 thousand on October 1, 2009; and \$560 thousand on February 15, 2010. The amount of \$1.6 million was recorded as additional goodwill as of December 31, 2008.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (Cont.):

F. CodeStream Software Ltd.:

In December 2006, the Company acquired from a company incorporated in the United Kingdom, CodeStream Software Ltd., certain business activities in the field of modernization of legacy databases, particularly IDMS and other mainframe platforms. Pursuant to the purchase agreement, the Company hired 18 persons previously employed by CodeStream and assumed all the obligations in respect of the purchased activities. In consideration thereof, the Company paid to CodeStream \$10.2 million. Pursuant to the purchase agreement, as amended in December 2007, an amount of \$2.5 million to be paid in 2008 was recorded as additional goodwill as of December 31, 2007. In addition, as a contingent consideration for the purchased activity, the Company issued the selling shareholders 400,000 BluePhoenix' ordinary shares in April 2008 valued at \$3.8 million based on the share price on the commitment date, upon reaching certain milestone, and undertook to pay an additional amount of \$3.5 million to be paid in 2009. The amounts were recorded as additional goodwill as of December 31, 2008.

G. BluePhoenix I-Ter S.p.A. (formerly: I-Ter/Informatica & Territorio S.p.A.):

In the second quarter of 2005, the Company entered into an agreement to purchase the entire outstanding share capital of I-Ter/Informatica & Territorio S.p.A., referred to as I-Ter. Pursuant to the purchase agreement, the Company paid to the selling shareholders of I-Ter \$1.4 million. In addition, under the terms of the agreement, the Company agreed to pay the selling shareholders an additional contingent consideration based on I-Ter's average earnings before interest and taxes, for the years 2005 through 2007. Based on the above mentioned contingent consideration, the additional amount of goodwill recorded as of December 31, 2007 and 2008 amounted to \$4.6 million and \$1.6 million, respectively. The Company's outstanding liability in this regard as of December 31, 2008 was \$1.8 million that were paid in two installments in the first half of 2009.

H. Unaudited Pro Forma Information:

The following unaudited pro forma summary presents information as if the acquisition of BridgeQuest, TIS, and Asna had occurred as of January 1, 2007, the acquisition of JLC's activity had occurred as of January 1, 2008 and 2007, and the acquisition of DSK's activity had occurred as of January 1, 2009 and 2008. The pro forma information, which is provided for informational purposes only, is based on historical information and does not necessarily reflect the results that would have occurred, nor is it necessarily indicative of future results of operations of the consolidated entity.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Certain Transactions (Cont.):

H. Unaudited Pro Forma Information (Cont.):

	Year ended December 31,		
	2009	2008	2007
	(In thousands, except per share data)		
	(Unaudited)		
Revenues	\$ 78,797	\$ 94,385	\$ 90,213
Net loss attributable to BluePhoenix Shareholders	\$ (15,425)	\$ (28,245)	\$ (10,610)
Loss per share - basic and diluted	\$ (0.72)	\$ (1.33)	\$ (0.62)

Note 3 - Fair Value Measurement:

The Company measures fair value and discloses fair value measurements for financial assets and liabilities. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. On January 1, 2009, the Company adopted a newly issued accounting standard for fair value measurement of all non-financial assets and liabilities as well. The adoption did not have a significant effect on the Company's financial statements.

In April 2009, the FASB issued additional guidance on factors to consider when estimating fair value consequent to a significant decrease in market activity for a financial asset. As applicable for the Company, this guidance became effective for interim and annual periods starting April 1, 2009, and did not have a material impact on the Company's consolidated financial statements.

The accounting standard establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers counterparty credit risk in its assessment of fair value.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Fair Value Measurement (Cont.):

	Fair value measurements using input type			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 22,328	\$ -	\$ -	\$ 22,328
Marketable securities	129	-	-	129
Foreign currency derivatives, net	-	35	-	35
Derivatives liabilities - warrants	-	2,414	-	2,414
Goodwill *	-	-	51,990	51,990
	<u>\$ 22,457</u>	<u>\$ 2,449</u>	<u>\$ 51,990</u>	<u>\$ 76,896</u>

*As to relevant inputs- see note 1.E

Note 4 - Property and Equipment, Net:

Composition of property and equipment, grouped by major classifications:

	December 31,	
	2009	2008
	(in thousands)	
Cost:		
Computers and peripheral equipment	\$ 9,537	\$ 9,668
Office furniture and equipment	963	992
Leasehold improvements	518	519
Motor vehicles	444	488
	<u>11,462</u>	<u>11,667</u>
Accumulated Depreciation:		
Computers and peripheral equipment	8,281	7,979
Office furniture and equipment	734	728
Leasehold improvements	370	321
Motor vehicles	187	146
	<u>9,572</u>	<u>9,174</u>
Depreciated cost	<u>\$ 1,890</u>	<u>\$ 2,493</u>

Depreciation expenses totaled \$968, \$1,003, and \$870 thousand for the years ended December 31, 2009, 2008, and 2007, respectively.

During 2008 the Company recorded a reduction of \$ 481 thousand to the cost and accumulated depreciation of fully equipment no longer in use.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Goodwill:

	December 31,	
	2009	2008
	(in thousands)	
Carrying amount at beginning of year	\$ 52,006	\$ 49,683
Acquired goodwill *	5,654	15,651
Goodwill impairment **	(5,670)	(13,328)
Carrying amount at the end of the year	<u>\$ 51,990</u>	<u>\$ 52,006</u>
* Including contingent consideration resolving:		
DSKnowledge business	\$ 907	\$ -
TIS Consultants Ltd.	(273)	(988)
TIS Consultants Ltd.	5,020	3,070
JLC Russia	-	710
JLC Russia	-	406
Amalgamated Software North America Inc.	-	(746)
BridgeQuest Inc.	-	2,557
BridgeQuest Inc.	-	1,620
CodeStream Software Ltd.	-	3,782
CodeStream Software Ltd.	-	3,459
BluePhoenix I-Ter S.p.A.	-	1,645
Others	-	136
	<u>\$ 5,654</u>	<u>\$ 15,651</u>

** There were no goodwill impairments before 2008.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Intangible Assets and Others, Net:

Composition:

	Useful life years	December 31,	
		2009	2008
(in thousands)			
Original amount:			
Technology	5	\$ 47,581	\$ 45,948
Customer related intangible assets	5-8	4,916	4,659
Distribution agreement related intangible assets	11	359	359
Brand name related intangible assets	12	958	958
Deferred tax asset		1,696	1,368
Others		375	203
		<u>55,885</u>	<u>53,495</u>
Accumulated amortization:			
Technology		35,440	28,301
Customer related intangible assets		2,339	1,685
Distribution agreement related intangible assets		84	51
Brand name related intangible assets		200	120
Other		203	187
		<u>38,266</u>	<u>30,344</u>
		<u>\$ 17,619</u>	<u>\$ 23,151</u>

The estimated future amortization of the intangible assets (excluded of deferred tax assets) as of December 31, 2009 is as follows:

	(in thousands)
2010	\$ 6,876
2011	4,255
2012	2,326
2013	1,203
2014	699
2015 and thereafter	564
	<u>\$ 15,923</u>

* Amortization of intangible assets (excluding deferred tax) amounted to \$7,926, \$9,094 and \$9,554 thousand for the years ended December 31, 2009, 2008 and 2007 respectively.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Accrued Severance Pay, Net:

A. Accrued Liability:

The Company is liable for severance pay to its employees pursuant to the applicable local laws prevailing in the respective countries of employment and employment agreements. For Israeli employees, the liability is partially covered by individual managers' insurance policies under the name of the employee, for which the Company makes monthly payments. The Company may make withdrawals from the managers' insurance policies only for the purpose of paying severance pay.

The amounts accrued and the amounts funded with managers' insurance policies are as follows:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
	<u>(in thousands)</u>	
Accrued severance pay	\$ 4,761	\$ 5,610
Less - amount funded	3,452	3,813
	<u>\$ 1,309</u>	<u>\$ 1,797</u>

B. Expenses:

The expenses related to severance pay for the years ended December 31, 2009, 2008 and 2007 were \$799, \$1,273 and \$762 thousand, respectively.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 - Provision for Losses in Formerly-consolidated Subsidiary:

Liraz, a wholly owned subsidiary of the Company, was liable until October 2007 for a credit facility guarantee in a former subsidiary it had consolidated until the second quarter of 2001. The provision for such liability as of December 31, 2006 was accounted for under FASB ASC Topic 450 "Contingencies" FASB ASC Topic 460 "Guarantees" (previously SFAS 5 and FIN 45) and amounted to \$2 million, representing the maximum potential amount Liraz has guaranteed to secure a bank loan of the said subsidiary.

Pursuant to an agreement signed in October 2007 with Cicero, the Company repaid \$1.7 million on behalf of Cicero to cover part of Cicero's credit facility with the bank. In connection therewith, a \$2.0 million bank guarantee that the Company previously provided to Bank Ha'Poalim to secure Cicero's bank loans, was released. Accordingly, on that repayment date, an amount of \$300 thousand was charged to earnings.

As consideration thereto Cicero issued to the Company (a) a \$1.0 million senior promissory note, bearing an annual interest rate of LIBOR + 1% (or in the event of any unpaid interest, LIBOR + 4%) payable in two installments, the first installment of \$350 thousand due on January 30, 2009 and was already paid during 2008, and the second installment of \$671 thousand due on December 31, 2011. The Company is entitled to receive Cicero's shares instead of any unpaid debt (b) 2,546,149 ordinary shares of Cicero. Cicero committed to register these share for trade until certain date, otherwise the Company is entitled to additional shares (see also note 13B5).

As of December 31, 2009, the Company holds 1,352,054 ordinary shares of Cicero and which are classified as the entire available-for-sale marketable securities in the balance sheet. Unrealized loss in 2009 amounted to \$103 thousand (loss of \$257 thousand in 2008 and gain of \$178 thousand in 2007).

Note 9 - Loans from Banks and Others:

A. Composition:

Average Interest rate as of December 31, 2009	Linkage Basis	December 31,	
		*2009	2008
%		Total long-term liabilities net of current portion (in thousands)	
6.30	€	\$ 49	\$ 69
0.87	€	320	-
Libor + an average rate of 3%	\$	15,008	16,000
Less - current portion		(2,490)	(1,021)
		\$ 12,887	\$ 15,048

*As for the Company's covenants - see note 10.A.5.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Loans from Banks and Others (Cont.):

B. Long-term Loans from Banks and Other are due as follows:

	December 31,	
	2009	2008
(in thousands)		
First year (current portion)	\$ 2,490	\$ 1,021
Second year	6,972	4,252
Third year	2,972	6,483
Fourth year and thereafter	2,943	4,313
Total	\$ 15,377	\$ 16,069

Note 10 - Commitments and Contingencies:

A. Commitments:

- Lease.** The Company rents its offices, vehicles and, other equipment under various operating lease agreements. Rent expenses for the years ended December 31, 2009, 2008 and 2007 were \$ 3.2 million, \$3.1 million and \$3.0 million. Aggregate minimum rental commitments under non-cancelable leases as of December 31, 2009 were as follows:

	Office Facilities	Vehicles, Equipment, and Other
Fiscal 2010	\$ 1,510	\$ 1,109
Fiscal 2011	511	754
Fiscal 2012	373	302
Fiscal 2013	51	8
	\$ 2,445	\$ 2,173

- Customers' bank guarantees.** Under agreements between the Company and certain of its customers, the Company undertook to provide such customers a bank guarantee for the assurance of performance of its obligations under its agreements with such customers. As of December 31, 2009, there are outstanding bank guarantees on behalf of customers in the aggregate amount of \$192 thousand.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Commitments and Contingencies (Cont.):

A. Commitments (cont.):

3. **Chief Scientist.** Three of the Company's subsidiaries have entered into agreements with the OCS; these subsidiaries are obliged to pay royalties to the OCS at a rate of 3% on sales of the funded products, up to 100% of the dollar-linked grant received in respect of these products from the OCS. As of December 31, 2009, the contingent liability that was not recognized amounted to \$900 thousand.
4. **Ministry of Production in Italy.** In July 2007, the Company's subsidiary, I-Ter, received final approval from the Ministry of Production in Italy for its Easy4Plan product. Easy4Plan is a workflow management tool designed for ISO9000 companies. The total funds amounted €15,000. 36.5% of the funds received constitute a grant, and the remaining 63.5% is a 10-year loan to be repaid by annually by I-Ter until September 2018. The loan bears a minimal annual interest of 0.87% and linked to the Euro. As of December 31, 2009 the balance amount was €247 thousand.
5. **Credit lines from banks.** In connection with the credit line from Bank Discount Le'Israel Ltd, Bank Ha'Poalim Ltd., The First International Bank Ltd., the Company committed to certain covenants related to its operation such as:
 - a) maintaining a minimum level of shareholders' equity of no less than 40% of our total assets and no less than \$50 million;
 - b) maintaining a minimum level of tangible shareholders' equity not to exceed a deficit of \$30 million;
 - c) maintaining a cash balance of \$10 million;
 - d) maintaining a level of EBITDA net of one time expenses in a four sequential quarters of no less than \$5 million; and
 - e) Maintaining a ratio of our bank liabilities to current assets, excluding other current assets, of no more than 40%.

The Company has met all such financial covenants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Commitments and Contingencies (Cont.):

B. Contingencies:

1. In June 2003, a former Liraz shareholder filed an application with the Tel-Aviv-Jaffa District Court to approve a claim filed by him against us, as a class action. The claim relates to the acquisition of Liraz shares, which the Company completed in March 2003. The shareholder alleges that the share price the Company paid to Liraz's shareholders in the tender offer and in a subsequent mandatory purchase was lower than the fair price of Liraz shares. The maximum amount of the claim is approximately NIS 37.1 million (\$9.9 million) in the aggregate. Under Israeli law, the court's approval is required for the plaintiff to represent all of the shareholders of Liraz who sold their shares to us pursuant to the tender offer and the mandatory acquisition. The plaintiff has applied for such approval in the lawsuit. Since the critical issue in our case concerns the basis upon which the fair price of shares purchased within the context of a tender offer is to be determined, and due to the fact that this particular issue has come before the Supreme Court of Israel in an appeal concerning another separate case, the plaintiff in our claim has agreed to postpone the proceedings until the Supreme Court has given its decision in the appeal. In December 2009, the Supreme Court held that, as a general rule, the fair price of shares purchased within the context of a full tender offer shall be determined in accordance with the discounted cash flow method. The plaintiff in our case is expected to notify the court whether he wishes to renew the proceedings. As of the date of this annual report, the plaintiff has not yet applied to the court.

Based on our analysis of the statement of claim, including an evaluation of the fair value of the Liraz shares, and the price paid for Liraz in a previous transaction immediately prior to the tender offer, the Company believes that the allegations against us in this proceeding are without merit and intends to vigorously defend the claim and contest the allegations made therein.
2. In January 2010, the temporary liquidator of Danshir group, a group of companies affiliated to DSKnowledge Ltd., applied to the district court in Tel-Aviv-Jaffa for grant of instructions to initiate an investigation of the business of Danshir group and to cancel the assets purchase transaction, under which the Company purchased the business activity of DSKnowledge Ltd. In the application, the temporary liquidator claimed that DSKnowledge Ltd. was actually part of the Danshir group and its business was unlawfully sold to the Company. The court requested the response of the Principal Receiver (a government officer). The Principal Receiver supported the application to conduct an investigation of the business of Danshir group, but stated that the application to cancel the purchase of the business activity of DSKnowledge has no merit, and should be filed again if the investigation's conclusion support that finding. The Company believes that the application to cancel the transaction has no merit, and intends to vigorously oppose the claim.
3. The Company evaluates estimated losses for indemnifications due to product infringement under FASB Topic ASC 450 "Contingencies". At this time, it is not possible to determine the maximum potential amount under these indemnification clauses due to lack of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. Historically, the Company has not incurred material costs as a result of obligations under these agreements and has not accrued any liabilities related to such indemnification obligations in the Company's financial statements.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity:

A. Share Capital:

1. On January 31, 1997, the Company's ordinary shares were first offered in an initial public offering. Since this transaction, the Company's shares have been traded in the United States on the NASDAQ Global Market. Their current symbol is "BPHX."

In January 2001, the Company's ordinary shares were listed for trading on the Tel-Aviv stock Exchange under the "Dual Listing" arrangement. Ordinary share confers upon their holders the rights to receive notice to participate and vote in general meeting of the Company, and the right to receive dividends if declared. During 2009 the Company's board of directors approved the increase of the authorized share capital to 40,000,000 shares from 30,000,000 shares 0.01 NIS par value.
2. The Company holds a total of 2,371,140 of its shares in a total consideration of \$15.2 million. All of the Company's ordinary shares have equal voting rights. However, under applicable Israeli law, the shares held by the Company have no voting rights and, therefore, are excluded from the number of its outstanding shares. Commencing 2010, the Company will use these treasury share for the issuance of shares pursuant to the exercise of options and vested RSUs.

In March 2008 the board of directors approved two buy-back programs. Under the buy-back programs, the Company may purchase its shares from time to time, subject to market conditions and other relevant factors affecting the Company. In 2009 and 2008 the Company repurchased 44,994 and 677,302, respectively, of its shares for an aggregate amount of \$1.7 million under the buy-back programs.
3. In October 2009, the Company completed a \$4.2 million private placement of ordinary shares and warrants to institutional investors. Pursuant to the securities purchase agreement, the Company issued to the investors 1,364,575 ordinary shares. In addition, the Company issued to the investors series A warrants exercisable immediately into 818,744 ordinary shares during a five year term from the issuance date at an exercise price of \$3.95 per share, series B warrants exercisable immediately into 1,364,575 ordinary shares until April 29, 2010 at an exercise price of \$3.05 and series C warrants exercisable immediately upon the exercise of the Series B warrants into 818,744 ordinary shares during a five year period at an exercise price of \$3.95. All warrants (Series A,B, and C) are subject to anti-dilution protection under which any future issuance of securities at a price lower than the current exercise price of the warrants will cause an adjustment of the applicable warrant exercise price to the price of the dilutive issuance. As a result of such anti-dilution protection the warrants are not indexed to the Company's own stock and, and therefore recorded at issuance date as a derivative financial liability. The value assigned to the warrants at issuance date was approximately \$3.8 million out of the total proceeds of \$4.2 million - see also Note 11.A.5.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

A. Share Capital (cont.):

4. In November 2007, the Company completed a \$35 million private placement of ordinary shares and warrants issued to institutional investors. Under the Securities Purchase Agreement entered into with the institutional investors, the Company sold to the investors 1,999,998 ordinary shares at a purchase price of \$17.50 per share. The investors were also granted warrants to purchase 800,000 ordinary exercisable during a 5-year term at an exercise price of \$21.88. The exercise price was adjusted to \$18.8 per share pursuant to anti dilution provision triggered by the private placement that took place in October 2009. As agreed with the investors, the Company registered the shares purchased by the investors and those underlying the warrants for resale under an effective registration statement.

At issuance date, shares and warrants overcome all criteria set forth in SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" and EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company's Own Stock" (currently, FASB ASC Topic 815 "Derivative and Hedging"). In addition, the commitment to register the shares and to keep the filing in effect was analyzed pursuant to the FSP EITF 00-19-2 "Accounting for Registration Payment Arrangements" and was accordingly determined under the provision of SFAS 5 (currently, FASB ASC Topic 450 "Contingencies") therefore, as of December 31, 2008 the Company has not recorded a liability thereof. The proceeds amount net of issuance costs totaled \$33 million and was recorded in equity. On January 1, 2009 the Company implemented EITF 07-05 (ASC 815-40-15) and as a result the warrants were accounted for as a derivative - see note 11.A.5.

5. Derivative liability- warrants:

In connection with the adoption of EITF 07-05, "*Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*," ("EITF 07-05") on January 1, 2009 (ASC 815-40-15), the Company determined warrants issued at several occasions throughout the years (ratchet down of exercise price based upon lower exercise price in future offerings) are not indexed to the Company's own stock and are recorded as a derivative liability pursuant to FASB ASC Topic 815 "Derivative and Hedging" (ASC 815-40-25).

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

A. Share Capital (cont.):

5. Derivative liability- warrants (Cont.):

The Company measured the fair value of the outstanding warrants at issuance and at the balance sheet date using a Black-Scholes valuation model (Binomial method was used for Series B and C since their expiration dates are co-dependent). As a result of the application of ASC 815-40-15, the fair value of the warrants as of December 31, 2009 amounted to \$2,414 thousand as follows:

- 3,002,065 warrants issued in November 2009 divided into three series as follows: 818,744 of series A at fair value of \$1,101 thousand, 1,364,575 of series B at fair value of \$ 249 thousand, and 818,744 of series C at fair value of \$ 768 thousand.
- 800,000 warrants issued in November 2007- (see also Note 11A4)-Fair value of \$222 thousand.
- 200,000 warrants issued in 2006.- Fair value of \$74 thousand.

The initial application of ASC 815-40-15 (EITF 07-05) on the warrants issued in November 2007, 2006 and 2004 resulted in a charge of \$ 161 thousand which was recorded as a derivative liability in a way of cumulative adjustment to beginning of the year equity based on their fair value as of January 1, 2009..

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

B. Share Options:

1. Employee Share Option Plans:

Stock-based compensation plans comprise employee stock option plans and restricted stock units ("RSUs") to employees, officers and directors. The purpose of the plans is to enable the Company to attract and retain qualified personnel and to motivate such persons by providing them with an equity participation in the Company.

On December 31, 2009, the Company had two share-based compensation plans: (a) the 1996 share option plan. (b) The 2007 Restricted Share Units plan. Both plans are described below. The compensation costs that were charged to income for those plans amounted to \$2 million, \$2.8 million and \$ 1.8 million for 2009 and 2008 and 2007 respectively.

In 1996, the Company adopted two option plans (the 1996 Share Option Plan). One of these option plans was terminated after all options granted under it were exercised. Pursuant to the other 1996 option plan, as amended, the Company reserved 3,700,000 ordinary shares for issuance to directors, officers, consultants and employees of the Company and its subsidiaries. The exercise price of the options granted under the 1996 option plan ranges from \$2.25 to \$10.50. As of December 31, 2009 532,326 stock options remain available for future awards.

Under the 1996 option plan, unless determined otherwise by the Board, options vest over a three to four years period from the date of grant and expire 10 years after grant date. Unvested options are forfeited 30-90 days following termination of employment. Any options that are forfeited before expiration become available for further grants.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

B. Share Options (Cont.):

1. Employee Share Option Plans (Cont.):

The following table summarizes information about share options outstanding and exercisable as of December 31, 2009:

Options Outstanding		Options Exercisable	
Number Outstanding on December 31, 2009	Weighted Average Remaining Contractual Life Years	Number Exercisable on December 31, 2009	Exercise Price \$
100,000	9.40	-	2.01
375,000	3.25	375,000	2.25
25,000	9.40	-	2.49
25,000	9.60	-	2.54
25,000	9.40	-	2.74
75,000	8.87	-	2.80
60,910	3.50	60,910	3.00
39,300	2.50	39,300	3.00
200,000	3.76	200,000	4.00
15,750	1.50	15,750	4.50
113,285	6.00	113,285	5.00
14,491	0.38	11,008	5.50
57,596	4.42	57,596	6.00
150,000	5.67	150,000	6.00
2,000	0.58	2,000	9.63
59,300	0.32	59,300	10.50
<u>1,337,632</u>		<u>1,084,149</u>	

Data related to the share option plan as of December 31, 2009, 2008 and 2007 and changes during the years ended on those dates are as follows:

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

B. Share Options (Cont.):

1. Employee Share Option Plans (Cont.):

	2009		2008		2007	
	Number of Options	Weighted Average Exercise Price \$	Number of Options	Weighted Average Exercise Price \$	Number of Options	Weighted Average Exercise Price \$
Options outstanding at beginning of year	1,283,523	4.17	1,352,264	4.22	2,222,967	4.60
Changes during the year:						
Granted	175,000	2.26	100,000	2.80	-	-
Exercised	(2,000)	3.00	(135,024)	4.24	(575,766)	5.07
Forfeited	(118,891)	3.90	(33,717)	5.67	(294,937)	5.89
Options outstanding at end of year	<u>1,337,632</u>		<u>1,283,523</u>	4.07	<u>1,352,264</u>	4.22
Options exercisable at year-end	<u>1,084,149</u>		<u>1,173,785</u>	4.17	<u>1,266,796</u>	4.2
Weighted-average fair value of options granted during the year*	<u>1.67</u>		<u>1.45</u>		<u>-</u>	

* The fair value of each option granted is estimated on the date of grant, using the Black-Scholes option-pricing model with the following weighted average assumptions: dividend yield of 0% for all years; expected volatility: 2009 - 45%; 2008 - 50%; risk-free interest rate: 2009 - 2.74%; 2008 - 1.9%, and expected life: 2009 - 6.5 years; 2008 - 6.5 years.

As of December 31, 2009 and 2008, there was no intrinsic value for outstanding and granted options since the exercise price was higher or the same as the market price. The interstice value of options exercised was \$1 thousand and \$572 thousand for the years ended December 31, 2009 and 2008 respectively.

The Company is required to assume a dividend yield as an input in the Black-Scholes model. The dividend yield assumption is based on the Company's historical experience and expectation of future dividends payouts and may be subject to change in the future.

The Company uses historical volatility in accordance with FASB ASC Topic 718, "Compensation - stock compensation". The computation of volatility uses historical volatility derived from the Company's exchange-traded shares.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

B. Share Options (cont.):

1. Employee Share Option Plans (Cont.):

The risk-free interest assumption is the implied yield currently available on U.S. Treasury zero-coupon bonds, issued with a remaining term equal to the expected life term of the Company's options.

Pre-vesting rates forfeitures between 5% and 9% were estimated based on pre-vesting for feature experience.

The Company uses the simplified method to compute the expected option term for options granted.

2. Restricted Share Units (RSU):

In 2007, the Company adopted a Restricted Share Units plan (RSU). Under the RSU plan, as amended, the Company granted in 2009 and 2008 319,500 and 447,500 RSUs, respectively. Under the RSU plan, unless determine otherwise by the board of directors, RSUs vest over a three years period from the date of the grant. 103,499 and 88,916 RSUs in 2009 and 2008 ,respectively , approved for immediate vesting on grant date.

Data related to the restricted share units as of December 31, 2009 and changed during the year are as follows:

	<u>Year ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
RSUs outstanding at the beginning of the year	465,333	163,667
Changes during the year:		
Granted *	319,500	447,750
Vested	(252,312)	(140,417)
Forfeited	(51,667)	(5,667)
RSUs outstanding at the end of the year	<u>480,854</u>	<u>465,333</u>
Weighted Average fair value at grant date	<u>\$ 2.39</u>	<u>\$ 6.71</u>

* The fair value of RSUs is established based on the market value of the Company's stock on the date of the award. The Company has expensed compensation costs, net of estimated forfeitures, applying the accelerated vesting method.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Equity (Cont.):

C. Dividends:

The Company has not paid any cash dividends on its ordinary shares in the past and does not expect to pay cash dividends on its ordinary shares in the foreseeable future.

Note 12 - Income taxes:

A. Tax Benefits under the Law for the Encouragement of Industry (Taxation), 1969:

The Company qualifies as an Industrial Company within the meaning of the Law for the Encouragement of Industry (Taxes), 1969 (the "Industrial Encouragement Law"). The Industrial Encouragement Law defines an "Industrial Company" as a company that is resident in Israel and that derives at least 90% of its income in any tax year, other than income from defense loans, capital gains, interest and dividends, from an enterprise whose major activity in a given tax year is industrial production. Under the Industrial Encouragement Law the Company is entitled to amortization of the cost of purchased know-how and patents over an eight-year period for tax purposes as well as the right to deduct for tax purposes, over a period of 3 years, expenses relating to public issuance of shares.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

B. Tax Benefits under the Law for the Encouragement of Capital Investments 1959 (the law):

BluePhoenix is entitled to tax benefits under the Law, and has such is considered to be "Privileged Enterprise" status pursuant to the Law, which provides certain tax benefits to its investment programs.

A company that obtained an Approved Enterprise approval may elect to forego the entitlement to grants and apply for an alternative package of tax benefits (the "Alternative Package"). Under the Alternative Package, undistributed income from the Approved Enterprise operations is fully tax exempt (the "tax holiday") for a defined period.

On April 1, 2005, an amendment to the Law came into effect (the "Amendment") and has significantly changed the provisions of the Law (the "Old Law"). On the Alternative Package the Amendment enacted major changes in the manner in which tax benefits are awarded under the Law so that companies are no longer required to obtain 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".

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Income taxes (Cont.):

B. Tax Benefits under the Law for the Encouragement of Capital Investments 1959 (the law") (Cont.):

This year is the later of: (1) the year in which taxable income is first generated by the company, or (2) the Year of Election. If a company requested the Alternative Package of benefits for an Approved Enterprise under the Law, it was precluded from filing a Privileged Enterprise status for three years after the year in which the Approved Enterprise was activated ("Cooling Period"). In November 2008 the law was amended to shorten the Cooling Period to two years. Following the amendment, the Year of Election for the Company's first Privileged Enterprise is 2008.

The benefits available to a Privileged Enterprise relate only to taxable income attributable to the specific investment program and are conditioned upon terms stipulated in the Investment Law and the related regulations and the criteria set forth in the applicable certificate of approval (for an Approved Enterprise). If the Company does not fulfill these conditions, in whole or in part, the benefits can be cancelled and the Company may be required to refund the amount of the benefits, linked to the Israeli consumer price index plus interest.

The Company's income attributed to the Approved Enterprise and Privileged Enterprise under the alternative package is tax exempt for a period of two years and is subject to a reduced corporate tax rate of eight years, as BluePhoenix considered to be "foreign investment company".

In the event of distribution of dividends from the above mentioned tax-exempt income, the amount distributed will be subject to the same reduced corporate tax rate that would have been applied to the Privileged Enterprise's income.

C. Tax Rate Applicable to Income in Israel:

Until 2008, results for Israeli tax purposes were measured on a real basis as adjusted for the increase in the Israeli Consumer Price Index ("Israeli CPI"). The regular corporate tax rate in Israel in 2009 was 26%. The corporate tax rate is to be reduced in 2010 and onward to 25%. Deferred income tax balances have been adjusted accordingly; the effect of such adjustment was not material. On July 23, 2009, the Israel Economic Efficiency Law (Legislation Amendments for Applying the Economic Plan for 2009 and 2010), 2009 (hereinafter – the 2009 Amendment), became effective, stipulating, among other things, an additional gradual decrease in tax rates in 2011 and thereafter, as follows: 2011—24%, 2012—23%, 2013—22%, 2014—21%, 2015—20% and 2016 and thereafter—18%.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Income taxes (Cont.):

C. Tax Rate Applicable to Income in Israel (Cont.):

The Company elected to compute its taxable income in accordance with Income Tax Regulations (Rules for Accounting for Foreign Investors Companies and Certain Partnerships and Setting their Taxable Income), 1986. Accordingly, the Company's taxable income or loss is calculated in U.S. dollars. Applying these regulations would reduce the effect of foreign exchange rate (of NIS against other currencies) on the Company's taxable income as well as the effects of Israeli inflation.

D. Deferred tax assets and liabilities:

Deferred tax reflect the net tax effects of temporary differences between the carrying amounts of assets or liabilities for financial reporting purposes and the amounts used for income tax purposes. As of December 31, 2009 and 2008 the Company's deferred taxes were in respect of the following:

	December 31,	
	2009	2008
	(in thousands)	
Net operating losses carry forwards	\$ 17,816	\$ 14,641
Provisions for employee rights and other temporary differences	362	507
Deferred tax assets before valuation allowance	18,158	15,148
Valuation allowance	(15,617)	(13,102)
Deferred tax assets	2,541	2,046
Deferred tax liability	(265)	(263)
Deferred tax assets, net	<u>\$ 2,276</u>	<u>\$ 1,783</u>

E. Non-Israeli Subsidiaries:

Non-Israeli subsidiaries are taxed based upon tax laws in the country of domicile of the respective subsidiary.

F. Loss before Taxes on Income is composed as Follows:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
Domestic (Israel)	\$ (18,010)	\$ (31,372)	\$ (3,443)
Foreign	2,628	11,181	2,968
	<u>\$ (15,382)</u>	<u>\$ (20,191)</u>	<u>\$ (475)</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Taxes on Income (Cont.):

G. Taxes on Income Included in the Statements of Income:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
For the reported year - current:			
Domestic (Israel)	\$ 136	\$ 21	\$ 276
Foreign	286	536	609
	422	557	885
Taxes related to prior years	(46)	7	208
Deferred taxes, net	(493)	(894)	(1,025)
	\$ (117)	\$ (330)	\$ 68

H. Uncertain Tax Position:

As stated in Note 1.N, effective January 1, 2007, the Company adopted a new pronouncement which clarifies the accounting for uncertainty in income taxes and prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

There was no cumulative effect adjustment for unrecognized tax benefits, which would have been accounted for as an adjustment to the January 1, 2007 balance of retained earnings. The Company has recorded no liability for income taxes associated with unrecognized tax benefits at the date of adoption and have not recorded any liability associated with unrecognized tax benefits during 2007, 2008 and 2009. Accordingly, the Company has not recorded any interest or penalty in regard to any unrecognized benefit.

The Company's policy regarding interest and/or penalties related to income tax matters is to recognize such items as a component of income tax expense (benefit). The Company does not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Taxes on Income (Cont.):

I. A reconciliation of the theoretical tax expense, assuming all income is taxed at the regular rates and the actual tax expense is as follows:

	December 31,		
	2009	2008	2007
	(in thousands)		
Income (loss) before taxes on income, per consolidated statements of income	\$ (15,382)	\$ (20,191)	\$ (475)
Theoretical tax income (expense) (29% in 2007 and 27% in 2008 and 26% in 2009)	3,999	5,451	(138)
Decrease in taxes resulting from the following differences:			
Carry-forward losses for which the Company provided valuation allowance	(2,515)	(2,711)	992
Goodwill impairment	(1,474)	(3,598)	-
Effect of different tax rates in foreign subsidiaries	(112)	458	(1,029)
Taxes related to previous years	(46)	7	208
Non-deductible expenses	31	63	35
Taxes on income in the consolidated statements of income for the reported year	<u>\$ (117)</u>	<u>\$ (330)</u>	<u>\$ 68</u>
Effective tax rate	-	-	-

J. Tax Losses:

The Company and its subsidiaries have NOL carry forwards for income tax purposes as of December 31, 2009 of approximately \$55 million with no expiration date.

K. Tax Assessments:

The Company received final tax assessments in Israel through tax year 2004.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Supplementary Financial Statement Information:

A. Balance Sheets:

1. Trade Accounts Receivables:

	December 31,	
	2009	2008
	(in thousands)	
Trade accounts receivable	\$ 25,900	\$ 28,545
Less provision for doubtful accounts	(322)	(313)
	<u>\$ 25,578</u>	<u>\$ 28,232</u>

For the years ended December 31, 2009, 2008 and 2007 the Company charged expenses for doubtful accounts amounted to \$9, \$118 and \$ 561 thousand , respectively.

For the years ended December 31, 2009, 2008 and 2007 the Company deducted from the provision (bad debts) \$ 0, \$795 and \$561 thousand, respectively.

2. Other Current Assets:

	December 31,	
	2009	2008
	(in thousands)	
Prepaid expenses	\$ 896	\$ 1,125
Short-term lease deposits	274	434
Government departments and agencies	592	778
Interest and other income receivable	266	202
Deferred taxes	845	678
	<u>\$ 2,873</u>	<u>\$ 3,217</u>

3. Accounts Payable and Accruals - Other:

	December 31,	
	2009	2008
	(in thousands)	
Government departments and agencies	\$ 759	\$ 761
Employees and wage-related liabilities	5,700	6,921
Liability with respect to previous contingent consideration	3,396	9,389
Accrued expenses and other current liabilities	408	1,054
	<u>\$ 10,263</u>	<u>\$ 18,125</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Supplementary Financial Statement Information (Cont):

A. Balance Sheets (cont.):

4. The Company's Long-lived Assets are as Follows:

	December 31,	
	2009	2008
	(in thousands)	
Israel	\$ 6,552	\$ 8,106
U.S.A.	6,042	9,741
Europe and other	1,437	2,293
	\$ 14,031	\$ 20,140

Long-lived assets information is based on the physical location of the assets at the end of each of the fiscal years. It is comprised from the Company's property and equipment and Technology intangible asset. The Company does not identify or allocate goodwill by geographic areas.

B. Statements of Operations:

1. Geographic Areas Information:

Sales: Classified by Geographic Areas:

The Company adopted FASB ASC Topic 280, "segment reporting". The Company operates in one operating segment (see Note 1 for a brief description of the Company's business). The total revenues are attributed to geographic areas based on the location of end customers.

The following present total revenues for the years ended December 31, 2009, 2008 and 2007:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
Europe (other than Denmark)	\$ 26,091	\$ 40,044	\$ 31,725
North America	27,897	22,660	17,840
Denmark	9,975	11,096	15,750
Israel	10,320	10,679	7,820
Other	3,495	7,266	8,087
	\$ 77,778	\$ 91,745	\$ 81,222

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Supplementary Financial Statement Information (Cont.):

B. Statements of Operations (cont.):

2. Principal Customers:

Major customer over 10% of the Company's revenues:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Customer A	-	10%	-
Customer B	-	-	12%
Customer C	-	-	11%

3. Restructuring Expenses:

During the second and third quarter of fiscal year 2007, the Company implemented a restructuring plan which included reductions in workforce in all functions of the organization worldwide and closures of redundant facilities in order to reduce the Company's cost structure. The Company followed FASB ASC Topic 420, "Exit or Disposal Cost Obligations". A restructuring charge of \$694 thousand was recorded during the year ended December 31, 2007, which was related to severance and benefits to terminated employees. All expenses, including adjustments, associated with the Company's restructuring plans are included in "Restructuring" in the Consolidated Statements of Operations.

4. Financial Expenses, Net:

	<u>Year ended December 31,</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
	<u>(in thousands)</u>		
Interest income	\$ 113	\$ 254	\$ 437
Foreign currency translation adjustments (see Note 1A3)	143	(1,705)	(767)
Interest expense	(1,576)	(731)	(1,800)
Debentures and convertible debt financial expenses	-	-	(2,002)
Derivative financial instruments and realized gain on marketable securities	(973)	(55)	(211)
Change in fair value of warrants	1,514	-	-
	<u>\$ (779)</u>	<u>\$ (2,237)</u>	<u>\$ (4,343)</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Supplementary Financial Statement Information (Cont.):

B. Statements of Operations (cont.):

5. Other Income, Net:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
Dividend income (*)	\$ -	\$ 48	\$ 134
Decrease of provision for losses in formerly consolidated subsidiary (Note 8)	-	-	300
Settlement with Cicero (Note 8)	-	350	458
	<u>\$ -</u>	<u>\$ 398</u>	<u>\$ 892</u>

(*) Dividend income from Steps Ventures, an Israeli venture capital investment group, in which the Company held 3.75% of their outstanding share capital. The Fund was liquidated in Q4 2008.

C. Earnings per Share:

Basic and diluted earnings per share ("EPS") were computed based on the average number of shares outstanding during each year. No effect was given to potential instruments such as: share options, RSU's and warrants since their inclusion would be anti-dilutive.

The following table sets forth the computation of basic and diluted net earnings per share attributable to Bluephoenix:

	Year ended December 31,		
	2009	2008	2007
	(in thousands)		
1. Numerator:			
Amount for basic and diluted loss per share	<u>\$ (15,570)</u>	<u>\$ (28,601)</u>	<u>\$ (8,196)</u>
2. Denominator:			
Denominator for basic net loss per share - weighted average of shares	<u>21,500,323</u>	<u>21,196,102</u>	<u>17,144,902</u>
Effect of dilutive securities	<u>-</u>	<u>-</u>	<u>-</u>
Denominator for diluted net earnings per share - weighted average shares and assuming dilution	<u>21,500,323</u>	<u>21,196,102</u>	<u>17,144,902</u>
Basic and diluted loss per share attributed to Bluephoenix Shareholders	<u>\$ (0.72)</u>	<u>\$ (1.35)</u>	<u>\$ (0.48)</u>

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14 - Transactions with Related Parties:

		Year ended December 31,		
		2009	2008	2007
		(in thousands)		
A.	Selling, general and administrative expenses: management fees to Formula	-	-	\$ 45
B.	Reimbursement related to services rendered to affiliated and other companies related to Formula	-	-	\$ 117
C.	In connection with the sale by Formula of its controlling interest in BluePhoenix in June 2007, Formula paid a cash bonus of \$1.8 million directly to Mr. Arie Kilman, the Company's chief executive officer. The amount was included in the financial statements as a one-time non-cash expense under selling, general and administrative expenses with a corresponding credit to contributed (paid-up) capital, in accordance with SAB Topic 5T.			
D.	In January 2008, the Company entered into an agreement for the purchase of the entire outstanding share capital of TIS. Yossi Shemesh, the Company's vice president, operations at that time was a holder of 25% of the outstanding share capital of TIS at the time of the transaction. See also Note 2B.			

Note 15 - discontinued operation:

In January 2008, the board of directors announced its intent to sell the entire holdings in Mainsoft Corp., in which the Company held a 58% controlling interest. This decision followed a strategic shift in Mainsoft's product development and marketing strategy outside of BluePhoenix's core business focus. On October 1, 2008 the Company sold Mainsoft for a consideration of \$1.7 million.

Mainsoft met the definition of a component. Accordingly the results of operation of Mainsoft as discontinued operation in the statement of operations and prior periods results have been reclassified accordingly. In addition, comparative data of the asset and liabilities attributed to the discontinued operation have been reclassified in the balance sheet.

BLUEPHOENIX SOLUTIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15 - discontinued operation (Cont.):

The following is the composition from discontinued operation:

	Year ended December 31,	
	2008	2007
	(in thousands)	
Revenues	\$ 4,778	\$ 7,176
Cost of revenues	549	2,132
Technology Impairment	7,142	-
Gross profit (loss)	(2,913)	5,044
Research and development expenses	2,488	1,456
Selling, General and administrative expenses	2,725	4,450
Goodwill Impairment	3,863	6,989
Operating loss	(11,989)	(7,851)
Gain on realization of shareholdings	509	-
Loss before taxes on income	(11,480)	(7,851)
Taxes on income	266	-
Net income attributable to noncontrolling interests	(3,234)	(362)
Net loss	\$ (8,512)	\$ (7,489)

Memorandum of Association

1. Company name: BluePhoenix Solutions Ltd.
 2. The goals for which this company was founded (state the main goals)
 - A. To practice programming, marketing, production, sales, import, export of products of all types and sorts, including computers for individuals and non-individuals, organizations, companies and legal bodies of all kind.
 - B. To practice consultancy, training, mediation of any kind for individuals and non-individuals, companies, organizations and legal entities of all sorts, to give, to receive, to mediate, to plan, to organize and to implement consultancy activities of all kinds, including planning and programming of computers.
 - C. To provide negotiation and advisory services of all sorts, to arrange, to manage, to provide, to plan, to develop and to organize activities of the aforementioned kinds, directly or through others, including computer planning and programming.
 - D. To plan, to develop, to establish, to create, to acquire and to sell, to import products and services of all kind and to give consultancy and managerial services for pertaining any of the aforementioned activities.
 3. The members' guarantee is limited.
 4. The company's share capital is as set forth in the Company's Articles of Association, as amended from time to time.
 5. Resolution of the General Meeting with respect to changes in the Company's Memorandum with respect to the Company's name and its purposes only shall be carried by a majority of those present and voting at a General Meeting (a simple majority).
-
-

We, the undersigned, wish to form a company in accordance to this memorandum of association, and agree to take the number of shares in the company's capital as written next to each of the names below.

Names of the Undersigned	Number of shares issued	Signatures
1. Aaron Crystal ID# 852668 Computer Programmer From: 40 Hashalom Street Mevaseret Zion	99	
2. Anat Crystal ID# 00588180 Teacher From: 40 Hashalom Street Mevaseret Zion	1	

Total of shares issued:100

This day, the 30th of December 1986

Witness to the above signatures: _____
Moshe Knovler, Advocate

THE COMPANIES LAW, 1999
A PUBLIC COMPANY LIMITED BY SHARES
ARTICLES OF ASSOCIATION
OF
CRYSTAL SYSTEMS SOLUTIONS LTD.

PART A: DEFINITIONS AND INTERPRETATION

1. Definitions

In these Articles, the following terms shall have the meaning appearing opposite them, unless another interpretation is expressly stated herein:

"Alternate Director"	As defined in Part E below;
"Articles" or "these Articles"	These Articles of Association, as amended from time to time by the General Meeting;
"Board" or "Board of Directors"	The Board of Directors of the Company elected or properly appointed in accordance with the provisions of these Articles; any committee of the Board of Directors to the extent that any of the authorities of the Board of Directors are delegated to it; any person authorized by the Board of Directors, to the extent so authorized, for the purposes of any matter or class of matters;
"business day"	A day on which customer services are provided by a majority of the commercial banks in Israel;
"Companies Law"	The Companies Law, 5759 – 1999, as amended from time to time, or any other law which shall replace it, and any regulations promulgated thereunder;
"Companies Ordinance"	The Companies Ordinance [New Version] 5743 – 1983, as amended from time to time, or any other law which shall replace it and any regulations promulgated thereunder;
"Company"	Crystal Systems Solutions Ltd.;
"Corporate Representative"	As defined in Part E below;

"Extraordinary Transaction"	A transaction which is not in the ordinary course of business of the Company; a transaction which is not on market terms or a transaction liable to have a material affect on the profitability of the Company, its assets or its liabilities; an arrangement between the Company and an Officer regarding the terms of his office and engagement, including the grant of a release from liability, insurance, and an undertaking to indemnify or an indemnity according to the indemnity permit;
"General Manager"	The person holding this title and any person having the authority of a General Manager, whatever his title;
"Memorandum"	The Memorandum of Association of the Company as amended from time to time;
"Office" or "the Offices of the Company"	The registered office of the Company at the relevant time;
"Officer"	An Office Holder, as such term is defined in the Companies Law;
"Register"	The shareholders register together with any additional shareholders register that the Company may maintain outside Israel;
"security"	Share, debenture, capital note, security, certificate or right entitling membership or participation in the Company or a claim from it (if issued in series), a certificate or right entitling the holder to acquire a security of the Company, in each case whether the security is in name form or bearer form including a debenture or option convertible into shares;
"simple majority"	A majority of those present and voting at a General Meeting or meeting of the Board of Directors. The vote of any person present at a meeting as aforesaid who does not vote or abstains from voting with respect to any matter on the agenda shall not be included in the number of votes cast;
"transaction"	A contract or an agreement or a unilateral decision to bestow a right or some other benefit;
"Year" or "Month"	According to the Gregorian calendar;

2. Interpretation

- 2.1 Subject to the provisions of Article 1 above, and unless the context expressly requires some other interpretation, the terms defined in the Companies Law or in the Companies Ordinance, as the case may be, shall bear the same meaning in these Articles; words in the singular shall include the plural and, vice versa; masculine terms shall include the feminine gender, and words indicating individuals shall include corporations.

- 2.2 Any Article in these Articles which provides for an arrangement which differs in whole or in part from any provision in the Companies Law, the Companies Ordinance or any other provisions of any law, which can be stipulated against, amended or added to, in whole or with regard to specific matters or within specific limitations, in accordance with any law, shall be considered a stipulation against the provision of the Companies Law or Companies Ordinance, as the case may be, even if the actual stipulation is not specified in the said Article, and even if it is expressly stated in the Article (in whatever form) that the effectiveness of the Article is subject to the provisions of any law.
- 2.3 In the event of a contradiction between any Article and the provisions of any law that may not be stipulated against, amended or added to, the provisions of the said law shall prevail, provided that nothing thereby shall nullify or impair the effectiveness of these Articles or any other Article therein.
- 2.4 In interpreting any Article or examining its effectiveness, the interpretation shall be given to that Article which is most likely to achieve its purpose as appearing therefrom or as appearing from the other Articles included within these Articles.

PART B: THE COMPANY, ITS OBJECTS AND THE SHARE CAPITAL

3. The Company and its Objects

- 3.1 The Company is a public Company.
- 3.2 The objects of the Company shall be as specified in the Memorandum.
- 3.3 The Company may contribute reasonable amounts for any suitable purpose or categories of purpose even if such contributions do not fall within business considerations of the Company. The Board of Directors may determine the amounts of the contributions, the purpose or category of purposes for which the contribution is to be made, and the identity of the recipients of any contribution.
- 3.4 The Company may at any time undertake any kind of business activity which is permitted to the Company under the terms of these Articles, expressly or by implication, and may refrain from these activities, whether or not the Company has commenced that kind of business activity, all in the absolute discretion of the Board of Directors.

4. Limited Liability

The liability of the shareholders of the Company for the indebtedness of the Company shall be limited as follows:

- 4.1 If the shares of the Company have a nominal value, the liability of each shareholder for the indebtedness of the Company is limited to payment of the nominal value of the shares of that shareholder.

4.2 If at any time the Company shall issue shares with no nominal value, the liability of the shareholders shall be limited to payment of the amount which the shareholders should have paid to the Company in the respect of each share according to the conditions of issue.

5. Share Capital

The authorized share capital of the Company is NIS 400,000 (Four hundred thousand New Israeli Shekels) divided into 40,000,000 ordinary shares of NIS 0.01 nominal value each.

6. Changes in the Share Capital

6.1 The General Meeting of the Company may, from time to time, increase the share capital of the Company or change the class of authorized shares (whether issued or not), by creating new shares, whether or not all of the shares that have been resolved to be issued have in fact been issued at such time, and whether or not all of the shares which have been issued at such time have been paid in full. Such increase or change in share capital shall be in such amount and divided into shares and shall be made subject to such terms and conditions and with such rights and preferences as specified in the resolution creating the shares, and if no such directions are included within the resolution, as the Board of Directors shall determine, and in particular, the shares may be issued with preferred or subordinated rights (or without rights) to dividends, voting, repayment of capital or with respect to any other matters.

6.2 Unless the resolution authorizing the increase in share capital provides otherwise, the new shares shall be issued subject to all of the provisions of these Articles which apply to the existing share capital of the Company.

6.3 The General Meeting may, from time to time, cancel any of its unissued authorized share capital, unless there is any outstanding obligation on the part of the Company, including a conditional obligation, to issue the shares.

6.4 Subject to the provisions of any law and the provisions of these Articles, the Company shall be entitled, from time to time, to cancel any issued share capital.

7. Rights attached to the Shares and Issuance of Shares

7.1 Unless these Articles provide otherwise, all of the shares shall carry equal rights for all purposes, and each share shall vest in the holder thereof:

- (a) The right to receive an invitation to and to participate in each General Meeting of the Company, annual or special, and the right to one vote in respect of each share that he holds in every vote at each General Meeting of the Company in which he participates (whether in person or by proxy, including through a written ballot), provided that the share is owned by the shareholder on the record date specified in the resolution to convene the General Meeting;
- (b) The right to receive dividends (if and to the extent distributed), the right to receive bonus shares (if and to the extent distributed), in each case in accordance with the nominal value of the shares (without taking into account any premium paid in connection with such shares) that the holder holds in relation to the total nominal value of the shares outstanding, all on the date upon which it is resolved to distribute the dividend or bonus shares or other distribution (as the case may be) or at such later date as shall be provided in the resolution in question and in accordance with the number of shares the holder holds on the said date;

- (c) The right to participate in the distribution of any surplus assets of the Company upon liquidation in accordance with the nominal value of each share in relation to the total nominal value of the shares outstanding.

The provisions of these Articles with respect to General Meetings shall apply to all meetings of any class of shareholders, mutatis mutandis.

- 7.2 The unissued shares forming part of the authorized share capital of the Company shall at all times be under the control of the Board of Directors. Without prejudice to any special rights granted to the current shareholders of the Company prior to such date, if any, the Company (acting through the Board of Directors) may issue shares, whether included within the original capital of the Company or as a result of an increase in capital, with rights that are superior or inferior to the outstanding shares, or may issue shares which are preferred or subordinated with regard to distributions, voting rights, the right to repayment of capital or in connection with any other matter, all as the Company shall determine from time to time.
- 7.3 The Company may issue redeemable securities upon such terms as the Board of Directors shall determine. The Board of Directors may attach to redeemable securities the attributes of shares, including voting rights and the right to participate in profits.
- 7.4 The Board of Directors may pay brokerage, underwriting or agents fees in connection with any issue of securities of the Company, in such a manner as the Board of Directors shall determine, and subject to the provisions of any law.
- 7.5 In the event of an issuance of shares or other securities by the Company, the Company will have no obligation to offer such shares or other securities to the Company's shareholders first.
- 7.6 If at any time the share capital is divided into different classes of shares, the General Meeting may, unless the terms of issue of that class of shares provide otherwise, amend, convert, expand, add to or otherwise alter the rights, preferences, limitations and directions relating to those shares (or which do not relate at such time to one of the classes), provided that the holders of the class of shares that have been issued and whose rights will be affected thereby agree thereto at a meeting of the holders of the shares of the said class.

The special rights of the holders of any shares or class of shares that have been issued, including shares issued with preferred rights or other special rights, shall not be deemed to have been altered or impaired as a result of the creation or issue of additional shares of equal rank or as a result of the cancellation of authorized share capital of the same class which have not yet been issued, unless it is otherwise specified in the conditions of issue of those shares.

The consolidation or division of the share capital of the Company shall not be deemed to amend the rights attached to the shares which are the subject of such consolidation or division.

8. Shareholders

- 8.1 Unless otherwise specified in any law or in these Articles, the Company shall be entitled to treat the registered holder of any share, including a shareholder registered as holding a share on trust, as the absolute owner, and accordingly shall not, except as ordered by a court of competent jurisdiction, or as required under any law, be bound to recognize any equitable or other claim to, or interest in, such share of any other person.
- 8.2 The Company will be entitled, in accordance with its absolute discretion, to transfer and to pay any amount (in any manner of payment that it selects), any asset of any sort, including bonus shares, to shareholders of the Company whose shares are not registered in their name in the Register, by executing such transfer to a Registration Company or to members of the stock exchange on which the shares of the Company are traded or to a trustee that the Company shall appoint for such matter. As long as the Company has acted based upon information that appears to have been provided to the Company by the shareholders thereof (including information provided by a Registration Company or a member of the stock exchange), the Company shall not be responsible for any unpaid amount or any asset that was not transferred to such shareholder, and the Company shall be deemed as if it has paid the said amounts and transferred the said assets, as the case may be, in full, on the date such amounts or assets were transferred to such Registration Company, member of the stock exchange or trustee.
- 8.3 The Board of Directors of the Company may, from time to time, settle procedures in connection with determining the identity of shareholders and in connection with the manner in which any right, benefit, asset or amount should be transferred to or distributed among them, including, without limitation, with respect to the distribution of dividends or bonus shares, and with respect to the grant of any right, asset or other benefit to the shareholders of the Company in their capacity as such. Any amounts, bonus shares, rights or property of any kind that are transferred to a shareholder (including to his agent, attorney or to any other person that the shareholder directs) whose identity has been authenticated in accordance with the procedures as aforesaid shall be deemed settlement in full and release of the indebtedness of the Company towards any person claiming a right to such payment, transfer, distribution or grant of right, as the case may be.

PART C: THE SHARES

9. Share Certificates

- 9.1 Share certificates shall be signed by two directors of the Company, or by any other person authorized by the Board of Directors, alongside the name of the Company.

- 9.2 Each shareholder whose name appears in the Register shall be entitled to receive one share certificate in respect of the shares registered in his name, or, if the Board of Directors so authorizes (and after payment of the amount which the Board of Directors shall determine from time to time) a number of share certificates, each one in respect of one or more of these shares. Each share certificate shall indicate the name of the shareholder, the number of shares in respect of which it has been issued, and any additional information as shall be determined by the Board of Directors.
- 9.3 A certificate in respect of a share registered in the names of two or more persons shall be delivered to such person as all of the registered shareholders of that share shall direct, and in the absence of agreement, to the person whose name appears first on the Register from among the names of the joint owners.
- 9.4 If a share certificate is defaced, lost or destroyed, it may be replaced, upon payment of such fee, and upon the furnishing of such evidence of ownership and such indemnity, as the Board of Directors may think fit.
- 9.5 The Company shall not issue shares other than shares that are paid in full. Shares shall be deemed to have been paid in full if the full amount of the nominal value and any premium thereon has been paid, in accordance with the terms of issue of the shares.
- 9.6 The Company may issue bearer shares or exchange a bearer certificate for a bearer share certificate.

10. Transfer of Shares

- 10.1 A transfer of shares shall be effected by way of delivery of a share transfer deed in the form set forth below, which shall include all of the details and bear the signature of the transferor and the transferee and of the witnesses to their signatures.
- 10.2 The transferor shall be deemed to have remained a shareholder until the name of the transferee is registered in the Register in respect of the share that is transferred.
- 10.3 The Company is entitled to require payment for the registration of a transfer of shares in the Register (including registration of a transfer of shares registered in the name of a Registration Company to the names of the owner of those shares) in such amount as the Board of Directors shall determine from time to time.
- 10.4 The Board of Directors or any other person authorized thereto by the Board of Directors for such purpose, is entitled:
- (a) to refuse to recognize a share transfer unless the certificate of the transferred shares is being presented, and the transferor provides any additional details necessary to prove his or her entitlement to transfer the shares. The share transfer deeds that are registered shall remain with the Company. Any share transfer deed that the Board of Directors refuses to register shall be returned to the person delivered it to the Company, at his request;
 - (b) to refuse to recognize any share transfer until receipt of payment in respect of registration of the transfer.

10.5 The share transfer deed shall be substantially in the form set forth below, or in such regular or customary form as shall be approved by the Board of Directors:

"The undersigned, I.D. Number/Company Number _____ (hereinafter "the Transferor") in consideration for the payment of NIS _____ that has been paid to me by _____, whose address is at _____, (hereinafter "the Transferee") hereby transfer to the Transferee _____ shares of NIS _____ each, numbered from __ until _____ inclusive, in Crystal Systems Solutions Ltd., so that the Transferee shall hold the same in accordance with the terms upon which the undersigned held the shares immediately prior to signature of this deed;

and the Transferee, agrees to receive the abovementioned shares upon the abovementioned terms.

IN WITNESS WHEREOF the parties have executed this deed, the _____ day of _____.

Transferor

Transferee

Witness to the signature of Transferor

Witness to the signature of Transferee"

10.6 Notwithstanding other provisions of these Articles, the Company shall amend the Register by order of the court, or if the Board of Directors is satisfied that the legal requirements for the assignment or transmission of the right to shares are fulfilled.

10.7 The provisions of this Article shall apply also a transfer of a right to a share held by a number of holders jointly, mutatis mutandis.

10.8 The Company may destroy share transfer deeds seven years after registration of the transfer, and share certificates that have been cancelled three years after cancellation, and there shall be a presumption that all share transfer deeds and certificates that have been destroyed were in full force and that the transfers and cancellations and the registrations that were effected based thereon were lawfully carried out.

11. Decedents' Shares

Any person becoming entitled to a share in consequence of the death of any person, upon producing evidence of the grant of probate or letters of administration or declaration of succession (or such other evidence as the Board of Directors may reasonably deem sufficient that he sustains the character in respect of which he proposes to act under this Article or of his title), shall be registered as a member in respect of such share, or may, transfer such share.

12. Receivers and Liquidators

The Company may recognize the receiver or liquidator of any corporate member in winding-up or dissolution, or the receiver or trustee in bankruptcy of any member, as being entitled to the shares registered in the name of such member. The receiver or liquidator of a corporate member in winding-up or dissolution, or the receiver or trustee in bankruptcy of any member, upon producing such evidence as the Board of Directors deems sufficient that he sustains the character in respect of which he proposes to act under this Article or of his title, shall with the consent of the Board of Directors (which the Board of Directors may grant or refuse in its absolute discretion), be registered as a member in respect of such shares, or may, subject to the regulations as to transfer herein contained, transfer such shares.

PART D – GENERAL MEETINGS

13. Annual General Meeting

The Company shall hold an Annual General Meeting once every year and no later than fifteen months following the last Annual General Meeting held. The Agenda for the Annual Meeting shall be determined by the Chairman of the Board of Directors in accordance with the instructions of the Board of Directors and shall include, inter alia, discussing the Financial Statements, any matter to be discussed at such meeting according to these Articles or any law, and any other matter that the Board of Directors may determine. To the extent required, the agenda may include appointment of directors, appointment of an auditor, receipt of report from the Board of Directors regarding the fees of the auditor in connection with the audit and any other matter that may require the convening of a Special Meeting.

14. Special Meeting

All General Meetings other than Annual General Meetings shall be called "Special Meetings". The Board of Directors may, whenever it deems fit, and it shall, within 21 days after receiving a demand in writing by shareholders or directors, as provided in the Companies Law, convene a Special Meeting, at such time and place, as may be determined by the Board of Directors. Any such demand must state the purpose for which the meeting is to be convened, be signed by the petitioners, and deposited at the Office.

15. Record Date

Notwithstanding any provision of these Articles to the contrary, and to allow the Company to determine the shareholders entitled to notice of, or to vote at, any General Meeting, or to express consent to or dissent from any corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of, or to take or be the subject to, any other action, the Board of Directors may fix, a record date, which shall not be more than forty (40) days (or any longer period permitted under the Companies Law), nor less than four (4) days before the date of such meeting or other action. A determination of holders of record entitled to notice of or to vote at a meeting shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

16. Convening the Meeting

- 16.1 The time and place of each General Meeting shall be determined by the Board of Directors or by the Chairman thereof. If no location for the convening of the meeting is specified by the Board of Directors or by the Chairman of the Board of Directors, the meeting shall convene at the Offices of the Company.
- 16.2 The Board of Directors may, in its absolute discretion, resolve to enable persons entitled to attend a General Meeting to do so by simultaneous attendance and participation at the principal meeting place and a satellite meeting place or places anywhere in the world and the shareholders present in person, by proxy or by written ballot at satellite meeting places shall be counted in the quorum for and entitled to vote at the General Meeting in question, and that meeting shall be duly constituted and its proceedings valid, provided that the Chairman of the General Meeting is satisfied that adequate facilities are available throughout the General Meeting to ensure that all shareholders attending at the meeting place are able to:
- (a) participate in the business for which the meeting has been convened;
 - (b) hear all persons who speak (whether by the use of microphones, loudspeakers audio-visual communications equipment or otherwise) at the principal meeting place and any satellite meeting place, and
 - (c) be heard by all other persons so present in the same way.

The Chairman of the General Meeting shall be present at, and the meeting shall be deemed to take place at, the principal meeting place.

- 16.3 Unless otherwise expressly directed by a court of competent jurisdiction, the provisions of these Articles shall apply, with such changes as required in the circumstances, to the convening, conduct and proceedings of a General Meeting convened by order of a court of competent jurisdiction and of a General Meeting lawfully convened other than by the Board of Directors, and to any vote at such meeting.
- 16.4 The Company shall not be required to give notice under Section 69(b) of the Companies Law.

17. Proceedings at General Meetings

- 17.1 No discussion shall be commenced at a General Meeting unless a quorum is present at the commencement of the meeting.
- Other than where a different rule is provided in these Articles or by any law or by a court of competent jurisdiction, a quorum shall be two or more shareholders present in person or by proxy or by written proxy, who hold an aggregate of at least 35% (thirty five percent) of the voting rights in the Company.
- 17.2 If within an hour from the time set for the General Meeting no quorum is present, the meeting shall automatically be adjourned to the same day and same time one week thereafter (unless such day shall fall on a public holiday either in Israel or the United States, in which case the General Meeting will be adjourned to the first day, not being Friday, Saturday or Sunday, which follows such public holiday), at the same place fixed for the original meeting (with no need for any notice to the shareholders) or until such other later time if such time is specified in the original notice convening the General Meeting, or if the Company gives notice to the shareholders no less than 72 hours before the date fixed for the adjourned meeting.

- 17.3 If at an adjourned meeting there is no quorum present half an hour after the time set for the meeting, any two shareholders present in person or by proxy, shall constitute a quorum.
- 17.4 Notwithstanding any other provision in these Articles, if the convening of a Special Meeting is demanded other than by resolution of the Board of Directors of the Company, the adjourned meeting shall take place only if there are present at least two shareholders holding voting rights in an amount no less than the amount required in order to convene the original meeting. If there is no quorum as aforesaid at the adjourned meeting, the meeting shall not be adjourned to another date and all of the proposed resolutions on the agenda shall be deemed to have been rejected by the meeting.
- 17.5 The Chairman of the Board of Directors of the Company shall act as Chairman of every General Meeting of the Company. If there is no Chairman of the Board of Directors and the Board of Directors has not determined that another individual shall act as Chairman of the meeting as aforesaid, or if the proposed Chairman is not present fifteen minutes after the time set for the meeting, or if that person does not wish to act as Chairman of the meeting, the shareholders present at the meeting shall in person or by their proxies elect a shareholder or a proxy present at the meeting to act as Chairman of the meeting.
- 17.6 The Chairman of the meeting may, with the consent of a meeting at which a quorum is present, postpone the meeting from time to time and from place to place, and he must postpone the meeting as aforesaid if the meeting directs him to do so. At a resumption of the meeting that has been adjourned as aforesaid, only those matters which were on the agenda of the original meeting and the discussion of which was not completed or commenced, shall be discussed. Notwithstanding anything in these Articles to the contrary, if a meeting is adjourned for twenty-one (21) days or more, a notice shall be given of the adjourned meeting as in the case of an original meeting. Except as aforesaid, no shareholder shall be entitled to receive any notice of an adjournment or of the business to be transacted at the adjourned meeting.
- 17.7 At any General Meeting, a resolution, in respect of any business put to a vote at the meeting shall be decided by a poll. Such poll shall be held in the manner and at the time and place as the Chairman of the General Meeting directs (including the use of ballots or tickets), whether immediately or after an interval or postponement, or in any other way, and, subject to the other provisions of these Articles and the Companies Law, the results of the poll shall be deemed to be a resolution of the General Meeting. The holding of a poll shall not prevent the continued business of the General Meeting.
- 17.8 Unless specified otherwise under any law, each resolution of the General Meeting (including a resolution with respect to the amendment, alteration or addition to these Articles or replacement thereof) shall be carried by a simple majority.
- 17.9 The announcement by the Chairman that a resolution has been carried unanimously or by a certain majority or has been rejected shall be prima facie evidence of that fact. An announcement as aforesaid and a notification to this effect that has been recorded in the minute books of the Company shall be prima facie evidence of the matter stated therein and there shall be no need to prove the number of votes or the proportion of the votes cast in favor or against the proposed resolution.

18. Voting

- 18.1 Each share shall entitle the holder thereof to one vote for a share which held by him and to which a voting right is attached without regard to the nominal value of that share, unless the terms of issue of the share provide otherwise.
- 18.2 A corporation which is a shareholder may authorize an officer in the corporation to be its representative at any meeting of the Company. A person authorized as aforesaid shall be entitled to use, on behalf of the corporation that he represents, the same powers which the corporation itself could have used if it was an individual shareholder.
- 18.3 A shareholder who is a minor and a shareholder who has been declared legally incompetent by a court of competent jurisdiction may vote only through his guardian, and the said guardian may vote by proxy.
- 18.4 In the case of joint owners of a share, the vote of the principal joint owner shall be accepted by the Company, whether given in person or by proxy, and the vote of the remaining joint owners shall not be accepted. For the purpose of this Article, the principal joint owner shall be deemed to be the shareholder whose name first appears in the Register with respect to the relevant shares.

19. Voting by Proxy

- 19.1 A shareholder may appoint a proxy to vote in his place and the proxy need not be a shareholder in the Company. The appointment of a proxy shall be in writing signed by the person making the appointment or by an attorney authorized for this purpose, and if the person making the appointment is a corporation, by a person or persons authorized to bind the corporation.
- 19.2 The document appointing the proxy to vote (the "Appointment") and power of attorney (if any) pursuant to which the Appointment has been signed, or a copy thereof certified to the satisfaction of the Board of Directors, shall be deposited in the Office (or at such other place in Israel or abroad as the Board of Directors may direct from time to time) or at the location set for the meeting not less than 2 (two) hours (or not less than 24 (twenty four) hours with respect to a meeting to be held outside of Israel), before the time of the meeting, or shall be delivered by hand to the Chairman at the commencement of the meeting, provided that the Chairman of the meeting may waive this requirement for any meeting. Any question that may be raised concerning the eligibility of an Appointment will be decided by the Chairman of the meeting and his decision will be final.

19.3 A shareholder holding more than one share may appoint more than one proxy, subject to the following provisions:

- (a) The Appointment shall indicate the class and number of shares in respect of which it is given;
- (b) If the number of the shares of any class specified in the Appointments that have been given by one shareholder exceeds the number of shares of that class held by him, all of the Appointments given by that shareholder shall be void;
- (c) If only one proxy is appointed by the shareholder and the Appointment does not indicate the number and class of shares in respect of which it is given, the Appointment shall be deemed to have been given with respect to all of the shares owned by the shareholder at the time for determining the entitlement to participate and vote at the meeting (if the Appointment is given for a specific meeting) or in respect of all of the shares held by the shareholder at the date of depositing the Appointment with the Company or on the date of delivery to the Chairman of the meeting, as the case may be. In the event that an Appointment is given with respect to a number of shares less than the number of shares held by the shareholder, the shareholder shall be deemed to have abstained from voting with respect to the remainder of the shares that he owns and the Appointment shall be valid with respect to the number of shares specified therein.

19.4 Each appointment of a proxy, whether for a specific meeting or otherwise, shall, to the extent that the circumstances permit, be substantially in the following form:

"I, _____ (I.D. Number/Company Number _____) of _____, in my capacity as shareholder of Crystal Systems Solutions Ltd., hereby appoint _____, (I.D. Number/Company Number _____) of _____, or in his/her absence, _____, (I.D. Number/Company Number _____) of _____, to vote on my behalf and in my name with respect to _____ Class __ shares held by me at the (annual/special) meeting of the Company that shall be held on the ___ day of _____, and at any adjournment of such meeting.

In witness whereof I have signed hereon this ___ day of _____.

Name and Signature"

19.5 A vote cast pursuant to an Appointment appointing a proxy shall be valid notwithstanding the death of the person making the Appointment or the cancellation of the power of attorney or the transfer of the share in respect of which the vote is cast as aforesaid, unless notice in writing of the death, cancellation or transfer as aforesaid has been received in the Offices of the Company or by the Chairman of the meeting, by the time of the vote.

19.6 Subject to the provisions of the Companies Law and any other regulations that may be enacted from time to time pursuant thereto, the Board of Directors is entitled, from time to time, at its absolute discretion, to determine which resolutions may also be approved at the general meeting or any other type of meeting (whether applying generally or applying one-time only) by proxy and to change the said matters determined by the General Meeting and also to determine from time to time any administrative provisions with respect to any matter connected with the proxies or position papers.

Should the Board of Directors formulate procedures and matters as specified above, such procedures and matters will be brought to the attention of the shareholders such that they will be available for review by the shareholders at any reasonable time at the Office or at any other place or in any other manner to be determined by the Board of Directors.

19.7 Subject to the provisions of any law, resolutions approved by a General Meeting, at which the shareholders are entitled to vote by proxy, will not be invalidated if the Company, in error:

- (a) did not send to the shareholders a proxy, notice of convening the General Meeting or a notice regarding the possibility of voting at that General Meeting by way of proxy or if it did not send any position paper or any other document to the shareholders;
- (b) sent documents and notices late or to an incorrect address;
- (c) did not count the shareholders votes or counted the votes as said but in an incorrect or imprecise manner, provided that such counting of votes did not result in a change of the resolutions passed at the General Meeting or in the derogation of the validity of the General Meeting or of the validity of the passed resolution had the votes for such resolution been counted precisely.
- (d) did not act in accordance with the provisions of the law or procedures prescribed by the Board of Directors with regard to voting by way of proxies and the sending of position papers.

20. Powers of the General Meeting

The Company's decisions on the following matters shall be adopted by the General Meeting in accordance with the required majority provided by with any law and any provision of these Articles:

- 20.1 Changes in the Articles.
- 20.2 Changes in the Memorandum with respect to the Company's name and its purposes only.
- 20.3 Appointment of the Company's auditor and the termination of his service.
- 20.4 Appointment of directors, including outside directors, and the termination of their service, all as provided in these Articles.

- 20.5 The increase and reduction of the registered share capital and a change of the rights attached to the existing shares, all in accordance with the provisions of any law.
- 20.6 A merger, in accordance with the provisions of any law.
- 20.7 Approval of acts and transactions that require the approval of the General Meeting under the provisions of any law or of these Articles.
- 20.8 Exercise of the powers of the Board of Directors in the events prescribed under the law.

PART E: THE BOARD OF DIRECTORS

21. Appointment and Dismissal of Directors

- 21.1 Until such time as the General Meeting decides otherwise, the number of members of the Board of Directors shall be set by the Board from time to time, provided, however, that such number shall be not less than three (3) and not more than six (6).
- 21.2 The directors will be elected by the General Meeting (whether at the Annual General Meeting or at a Special Meeting) on the agenda of which will be the appointment of directors.
- 21.3 For as long as the Company is required in accordance with any law, to appoint outside directors, the Company's General Meeting (whether the Annual General Meeting or Special Meeting) shall appoint any number of outside directors, on any conditions in a manner prescribed by law.
- 21.4 In addition to the directors who are appointed by the General Meeting as aforesaid, the Board of Directors of the Company may at its discretion appoint additional directors, provided that the number of members of the Board of Directors after such appointment shall not exceed the maximum number of directors fixed in these Articles.
- 21.5 Subject to the provisions of any law regarding the cessation of the service of outside directors, the General Meeting is entitled to dismiss a director, including a director that was not appointed by the General Meeting, before the completion of his service for any reason, provided that the director is given a reasonable opportunity to bring his position before the General Meeting.
- 21.6 Any dismissal, replacement, appointment or re-appointment of a director that was appointed by the Board of Directors shall be approved by the majority of directors present and voting at a meeting of the Board of Directors, in which the agenda includes the appointment.
- 21.7 An organ that is entitled to appoint a director will be entitled to determine the commencement of his service that will either be at the time of the appointment of that director or at a later time.
- 21.8 The service of a director that was appointed by the General Meeting will cease (if he has not been dismissed earlier by the General Meeting, as described above) at the end of the first Annual General Meeting held after the said date of appointment (without a need to give the director an opportunity to present his position).

- 21.9 Subject to the provisions of any law, a director who has ceased to serve as a director is eligible to be re-appointed.
- 21.10 Subject to the provisions of any law, the office of a director (including the office of an Alternate Director and a Corporate Representative) shall be vacated automatically in each of the following events:
- (a) upon his death;
 - (b) if he is declared to be legally incompetent;
 - (c) if he is declared bankrupt, and if the director is a corporation, if a liquidator, receiver, special manager or trustee (in each case temporary or permanent) is appointed for the corporation or its assets within the context of a creditors scheme of arrangement or an order of stay of proceedings;
 - (d) if he resigns from office by written notice to the Company, to the Chairman of the Board of Directors or to the Board of Directors, in which case the office of the director shall be vacated on the date of service of notice or at such later date as specified in the notice as the effective date of resignation;
 - (e) if his term of office was terminated in accordance with the provisions of these Articles;
 - (f) if the director is convicted in a final judgment of an offence of a nature which disqualifies a person from serving as a company director;
 - (g) if a court of a competent jurisdiction decides to terminate his office in a decision or judgment for which no stay of enforcement granted.
- 21.11 Notwithstanding anything stated in these Articles, the appointment of a director, an Alternate Director or a Corporate Representative, as the case may be, (together "the Appointee") shall not come into effect before the Appointee has delivered to the Company a notice in writing in which the Appointee declares that he is lawfully competent to be appointed as a director of the Company and that he agrees to be appointed as a director of the Company. The notice shall include the personal details of the appointee required by law. The form of the aforesaid notice shall be set down by the Board of Directors from time to time and may be in the form of an affidavit prepared and authenticated in accordance with the law.
- 21.12 If any director is not appointed, or if the appointment of any director does not come into effect, or if the office of a director becomes vacant, the remaining directors may act in any manner provided that their number does not fall below the minimum number specified in these Articles. If the number of directors falls below the minimum number as aforesaid, the directors shall not be able to act other than in emergencies, or for the purpose of convening a General Meeting, or for the purpose of the appointment of additional directors by the Board of Directors.
- 21.13 A corporation is fit to act as a director and as an Alternate Director of the Company.

22. Alternate Director

- 22.1 A director may at any time appoint an alternate ("the Alternate Director"), who is competent to serve as director of the Company. A person who at that time is serving as a director, an Alternate Director of another director or a Corporate Representative may not serve as an Alternate Director. The Alternate Director shall have all of the duties, rights and authorities (other than the authority to appoint an alternate for himself) which the director who appointed him has, provided, however, that an Alternate Director shall have no standing in any meeting in which the director who appointed him is present.
- 22.2 The appointment of an Alternate Director and the cancellation thereof shall be by a written notice to be delivered by the appointing director to the Company. The appointment and cancellation of an appointment shall come into effect on the date of delivery of the notice to the Company or at the date specified in the notice, whichever is later.
- 22.3 A director who appoints an Alternate Director may at any time cancel the appointment. In addition, the office of an Alternate Director shall be vacated whenever the Alternate Director notifies the Company in writing of his resignation, with effect from the date of his notice or whenever the director who has appointed the Alternate Director ceases to be a director of the Company for whatever reason.
- 22.4 An Alternate Director shall alone be responsible for his own acts and defaults, and he shall not be deemed the agent of the director who appointed him.

23. Corporate Representative

- 23.1 A corporation which acts as a director or an Alternate Director shall appoint an individual qualified to be appointed as a director of the Company to act on its behalf in the Board of Directors (the "Corporate Representative").
- 23.2 The appointment of a Corporate Representative and the cancellation thereof shall be by a written notice to be delivered by the appointing corporation to the Company. The appointment shall come into effect on the date of service of notice to the Company or on the date specified in the notice, whichever is later.
- 23.3 The appointing corporation is entitled to the rights and authorities of a director only at the time at which the corporation has validly appointed a Corporate Representative.

24. Chairman of the Board of Directors

- 24.1 The Board of Directors may appoint one of the directors (other than an Alternate Director or a Corporate Representative) to act as a Chairman of the Board of Directors, remove such Chairman from office and appoint another person in his place. The Chairman of the Board of Directors shall not have an additional or casting vote at meetings of the Board of Directors.

- 24.2 The service of the Chairman of the Board of Directors continues even after the convening of the General Meeting at which directors are appointed or dismissed and will cease upon the occurrence of any of the following events:
- (a) the completion of the period of service that was determined in the appointment resolution;
 - (b) where the Chairman of the Board of Directors resigns such position by a written notice to the Board of Directors. In such a case, his service will cease on the date upon which the notice is delivered or on the date prescribed in the notice to be the effective date of the resignation, whichever is later.
 - (c) the Chairman of the Board of Directors ceases to serve as a director for any reason;
 - (d) the Chairman is dismissed by the Board of Directors.
- 24.3 The Chairman of the Board of Directors may, from time to time by a written notice to the Board of Directors, appoint another director to act as a Deputy Chairman of the Board of Directors, to dismiss the Deputy Chairman and to appoint another in his place, provided that the tenure of the Deputy Chairman of the Board of Directors shall not cease even if the person who appointed him ceases to act as Chairman of the Board of Directors or as a director, unless the Board of Directors decides otherwise. If the Chairman of the Board of Directors is not present 15 minutes after the beginning of a meeting of the Board of Directors, or if he does not wish to sit as Chairman of the meeting, the Deputy Chairman or in the absence of a Deputy Chairman, any other director chosen by the Board of Directors to be the Chairman of such meeting, shall conduct the meeting and may exercise all of the authorities vested in the Chairman of the Board of Directors.
- 24.4 The Chairman of the Board of Directors shall have all of the powers, rights and authorities granted to him under these Articles or by law. Without prejudice to the generality of the aforesaid, the Chairman of the Board of Directors shall have all power and authority necessary in order to carry out his functions and to exercise his rights and authorities in an efficient manner, including the authority to act in the name of the Company and on its behalf in the matters referred to above and to give directions to the General Manager of the Company and to employees and consultants of the Company for this purpose.
- 24.5 If both the Chairman of the Board of Directors and the Deputy Chairman are absent 15 minutes after the beginning of a meeting of the Board of Directors, or they do not wish to act as Chairman, or no Chairman of the Board of Directors has been appointed for the Company, the Board of Directors shall appoint one of its members (including an Alternate Director or Corporate Representative) to be the Chairman of such meeting.

25. Convening and Conduct of Meetings of the Board of Directors

- 25.1 The Board of Directors shall convene as often as the needs of the Company require and shall do so at least once every three months.
- 25.2 The Board of Directors shall be convened as follows:
- (a) In accordance with a decision of the Chairman of the Board of Directors;
 - (b) At the request of two directors, but if the Board of Directors comprises up to five members, at the request of one director;
 - (c) By the Chairman of the Board of Directors if and when a notice or a report from the General Manager is received requiring the action of the Board of Directors or a notice from the auditor regarding substantial defects in the audit of the Company.
 - (d) In any other case in which it is required by law to convene a meeting of the Board of Directors.
- 25.3 If a meeting of the Board of Directors is convened by the Chairman of the Board of Directors or by a majority of the members of the Board of Directors, the meeting shall be convened no earlier than the next business day following delivery of a notice of the meeting to all of the members of the Board of Directors, unless the Chairman of the Board of Directors or a majority of the members of the Board of Directors determine that because of the urgent nature of any matter on the agenda, the meeting must be convened within a shorter time. In such a case, the meeting shall be convened in the manner which allows the participation of the maximum number of members of the Board of Directors in the meeting.
- 25.4 The Board of Directors may hold meetings using any means of communication, provided that all of directors participating can hear one another at the same time, as well as in any other manner permitted by law. Such a meeting will be considered for the purposes of any matter, including the matters of sending notices, legal quorums and the recording of protocols, as an ordinary meeting of the Board of Directors.
- 25.5 Until otherwise unanimously decided by the Board of Directors, a quorum at a meeting of the Board of Directors shall be constituted by the presence of a majority of the directors then in office who are lawfully entitled to participate in the meeting, but shall not be less than two.
- 25.6 The Board of Directors may make a decision without actually convening, provided that all of the directors entitled to participate in the discussion and vote on the matter brought for decision agree thereto. A resolution in writing signed unanimously by all the directors then in office and lawfully entitled to vote thereon or to which all of the directors have given their unanimous written consent (by letter, e-mail, facsimile or otherwise) shall be deemed to have been adopted by a meeting of the Board of Directors duly convened and held.
- 25.7 Other than expressly provided in these Articles, the minutes of each meeting of the Board of Directors, shall be signed by the Chairman of the Board of Directors, or the Chairman of the meeting, as the case may be.

- 25.8 At a vote of the Board of Directors, each director shall have one vote.
- 25.9 Resolutions of the Board of Directors shall be carried by a simple majority of the directors voting on any matter on the agenda.
- 25.10 Any action taken by or in accordance with a resolution of the Board of Directors or by or in accordance with a decision of a Committee of the Board of Directors or by a director acting in his capacity as director is valid and effective even if it is subsequently discovered that there was a defect in the appointment of the directors or the election of the directors or if all or one of them was disqualified, in each case as if each of the directors had been lawfully elected and as if he was fully qualified to act as director, Alternate Director, Corporate Representative or member of the said Committee, as the case may be.

26. Notice of Meetings of the Board of Directors

- 26.1 Notice of a meeting of the Board of Directors shall be delivered to each director verbally, by telephone, in writing or by any other means of communication. If a director has appointed an Alternate for himself, notice shall be delivered to the Alternate. Notice to a director which is a corporation shall be delivered to the Corporate Representative.
- 26.2 A notice convening a meeting of the Board of Directors shall include reasonable particulars of all of the matters on the agenda, as well as the place and time fixed for the meeting.
- 26.3 All of the directors may agree to waive prior notice of a meeting of the Board of Directors.

27. Authorities of the Board of Directors

- 27.1 The Board of Directors shall set the policy guidelines for the Company and shall supervise the performance and activities of the General Manager, and as part thereof it:
- (a) shall determine the Company's plans of activity, the principles of financing them and the order of priority among them;
 - (b) shall examine the Company's financial situation and set a framework of credit which the Company may take;
 - (c) shall determine the organizational structure and the wage policy;
 - (d) may decide to issue a series of debentures;
 - (e) is responsible for the preparation and approval of the financial reports;
 - (f) shall appoint and dismiss the General Manager of the Company;
 - (g) shall decide on the acts and transactions that require its approval in accordance with these Articles or the Companies Law;

- (h) may allocate shares and securities convertible into shares up to the limit of the Company's registered share capital;
 - (i) may decide on a distribution;
 - (j) shall express its opinion on a special purchase offer.
- 27.2 Without prejudice to the generality of the aforesaid, the Board of Directors shall be entitled to use all of its authorities and powers and to carry out all the actions vested in it by law or by these Articles.
- 27.3 The Board of Directors may exercise any authority of the Company which has not been delegated by these Articles or by law to the General Manager or to the General Meeting, and such authority shall be deemed to have been delegated to the Board of Directors by these Articles.
- 27.4 The power of the Board of Directors shall be subject to the provisions of any law, and to any article that shall be adopted by the Company in General Meeting, provided that no such article shall invalidate any action taken prior thereto by the Board of Directors or pursuant to a decision thereof which would have been legally valid but for the adoption of the said article.
- 27.5 The General Meeting may assume the authority vested in the Board of Directors (including the authorities vested in the Board of Directors in the absence of a General Manager) for a specific matter or for a specific period of time.
- 27.6 For the purpose of exercising the general authorities vested in the Board of Directors and without limiting or restricting in any way whatsoever the said authorities or any of them, it is hereby expressly stated that the Board of Directors shall have the following authorities:
- (a) From time to time to appoint one or more persons (whether or not that person is a member of the Board of Directors) as a General Manager or another Officer of the Company, either for a fixed period of time or for an unlimited period of time, and from time to time (bearing in mind the terms of any contract between the Company and such person or persons) to dismiss him or them from office and appoint another person or persons in his or their place.
 - (b) Subject to any rule of law, to fix the remuneration of the General Manager or of any other Officer from time to time (bearing in mind the terms of any contract between the Company and such person). Such remuneration may be in the form of a fixed salary, payment based on the profits or turnover of the Company or of any other company in which the Company is interested, or by way of participation in such profits, or by way of receipt of securities of the Company, or in one or more of these ways, or in any other manner which the Board of Directors deems fit.
 - (c) To determine the remuneration of the auditor of the Company.
- 27.7 For the purpose of setting the policy guidelines for the Company and supervising its activities, any director may examine the documents and records of the Company and receive copies thereof, examine the assets of the Company and receive professional advice at the expense of the Company if the Board of Directors or the court approves the covering of this expense.

28. Reserved.

29. Committees of the Board of Directors

- 29.1 The Board may delegate all or any of its powers, authorities and responsibilities (except for those powers, authorities and responsibilities which, under the Companies Law, the Board is unable to delegate) to any committee consisting of such members of the Board as the Board may, from time to time, think fit, subject to the Companies Law, widen, curtail or revoke such delegation of powers, authorities and responsibilities.
- 29.2 To the fullest extent permitted by law, the Board, after determining a number of shares reserved for the issuance of shares, options or warrants to the Company's employees, directors, and consultants, may delegate the power to issue such options and shares to a committee of the Board.
- 29.3 Any committee of the Board shall in the exercise of the power, authorities and responsibilities so delegated conform to any regulations that may be lawfully imposed on it by the Board.
- 29.4 The meetings and proceedings of a Committee of the Board shall be governed by the provisions herein contained for regulating the meetings and proceedings of the Board, so far as the same are applicable thereto and are not lawfully suspended or superseded by any regulations imposed by the Board.
- 29.5 The Board shall appoint an audit committee consisting of at least three (3) members, the members of which and the authorities, powers and responsibilities of which shall be governed by the Companies Law and any other applicable law or rule.

PART F: THE GENERAL MANAGER AND OTHER OFFICERS

30. The General Manager

- 30.1 The Board of Directors of the Company shall appoint one or more General Manager for the Company. If more than one General Manager is appointed, the Board of Directors may determine that the authorities of a General Manager be divided between the General Managers.
- 30.2 The General Manager shall have full managerial and operational authority to carry out all of the activities which the Company may carry on by law and under these Articles and which have not been vested by law or by these Articles in any other organ of the Company. The General Manager shall be subject to the supervision of the Board of Directors.
- 30.3 The General Manager may, with the approval of the Board of Directors, delegate his authority to another person who is subordinate to him.
- 30.4 The Board of Directors may decide to transfer any authority vested in the General Manager to the Board of Directors, in a specific instance or for a specific period of time.

31. Secretary and Officers

- 31.1 The Board of Directors may appoint a Secretary for the Company and determine his duties and authorities. The Secretary, if appointed, shall be subject to the Board of Directors and shall report to it.
- 31.2 Officers of the Company, except directors and the General Manager, will be appointed and dismissed by the Board of Directors. The conditions of service, employment and retirement of the said Officers will be determined by the General Manager with the approval of the relevant committee of the Board of Directors, unless it is determined otherwise in any law or by the Board of Directors.

32. Personal Interest in Transactions of the Company

Any transaction which is not an Extraordinary Transaction and which is (i) a transaction with an Officer or (ii) a transaction of the Company with another person in which an Officer has a personal interest, may be approved by the same organ authorized to approve such a transaction, assuming that no party has a personal interest in it.

33. Insurance, Release and Indemnification of Officers

- 33.1 Subject to the provisions of the Companies law, the Company may prospectively exculpate an Officer from all or some of the Officer's responsibility for damage resulting from the Officer's breach of his or her duty of care to the Company.

- 33.2 Subject to the provisions of the Companies Law, the Company may indemnify an Officer to the maximum extent permitted by the law, in respect of an obligation or expense specified below imposed on the Officer or incurred by him in respect of an act performed in his capacity as an Officer, as follows:
- (i) a financial obligation imposed on him in favor of another person by a court judgment, including a compromise judgment or an arbitrator's award approved by court;
 - (ii) reasonable litigation expenses, including attorney's fees, incurred by the Officer as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the Officer and either (A) concluded without the imposition of any financial liability in lieu of a criminal proceeding; or (B) a financial liability was imposed on him in lieu of a criminal proceeding for an offense that does not require proof of criminal intent; and
 - (iii) reasonable litigation expenses, including attorney's fees, expended by an Officer or charged to the Officer by a court, in a proceeding instituted against the Officer by the Company or on its behalf or by another person, or in a criminal charge from which the Officer was acquitted, or in a criminal charge from which the Officer was acquitted, or in a criminal proceeding in which the Officer was convicted of an offense that does not require proof of criminal intent.

The Company may undertake to indemnify an Officer as aforesaid, (aa) prospectively, provided that in respect of Article 33.2(i), the undertaking is limited to categories of events which in the opinion of the Board of Directors are foreseeable in light of the Company's actual activities at the time the undertaking to indemnify is given, and for an amount or criteria which the Board of Directors has determined are reasonable under the circumstances, and further provided that such events and amount or criteria are stated in the undertaking to indemnify, and (bb) retroactively.

- 33.3 Subject to the provisions of the Companies law, the Company may enter into a contract for the insurance of all or a part of the liability of any Officer imposed on the Officer in respect of an act performed in his capacity as an Officer, in respect of each of the following:
- (i) a breach of his duty of care to the Company or to another person;
 - (ii) a breach of his duty of loyalty to the Company, provided that the Officer acted in good faith and had reasonable cause to assume that such act would not prejudice the interests of the Company;
 - (iii) a financial obligation imposed on him in favor of another person.

- 33.4 The provisions of Articles 26.1, 26.2 and 26.3 above are not intended, and shall not be interpreted, to restrict the Company in any manner in respect of the procurement of insurance and/or in respect of indemnification (i) in connection with any person who is not an Officer, including, without limitation, any employee, agent, consultant or contractor of the Company who is not an Officer, and/or (ii) in connection with any Officer to the extent that such insurance and/or indemnification is not specifically prohibited under law; provided that the procurement of any such insurance and/or the revision of any such indemnification shall be approved by the Audit Committee.

33.5 The provisions of this Article shall apply to a Corporate Representative and an Alternate Director.

34. Signature Rights

The signature rights in the name of the Company shall be determined by the Board of Directors, generally, for a class of matters or for a specific matter. Any signature in the name of the Company shall be accompanied by the name of the Company. The authorized signatories do not have to be directors.

PART G: MINUTES, REGISTERS AND BOOKS OF ACCOUNTS

35. Minutes

35.1 The Board of Directors shall ensure that records of the following matters are duly maintained in books that shall be prepared for this purpose:

- (a) The names of members of the Board of Directors who are present at any meeting of the Board of Directors and at any meeting of a Committee of the Board of Directors (including any decision of the Board of Directors or of its Committees which is adopted without actually convening).
- (b) The names of the registered shareholders participating in any General Meeting.
- (c) The instructions given by the Board of Directors to the Committees of the Board of Directors.
- (d) The proceedings at General Meetings, meetings of the Board of Directors, and meetings of the Committees of the Board of Directors, including resolutions adopted without actually convening these meetings.

35.2 Any minute of a meeting of the Board of Directors or of any Committee of the Board of Directors or of the General Meeting of the Company which purports to be signed by the Chairman of the meeting or by the Chairman of the next following meeting shall be prima facie evidence of the matters stated therein.

36. Books and Registers of the Company

36.1 Each book, register and registration that the Company must maintain in accordance with the provisions of the Companies Law or these Articles shall be made in regular books or by electronic means, as the General Manager shall determine, provided that the persons entitled to inspect them are able to receive copies of the documents.

36.2 The Company may destroy any request for entering any change in the Register seven years after the date of the change in the Register, and there shall be a prima facie assumption that all requests for changes in the Register were valid and that any action taken by virtue or as a result thereof was lawfully taken.

36.3 Subject to any provision of law, the Company may determine the manner and form in which documents which shareholders are entitled to inspect are presented to them, and may decide that copies of documents be provided against payment.

PART H: AUDIT

37. Auditor

- 37.1 At least once in each calendar year, the financial statements of the Company shall be audited by an auditor or auditors who will express their opinion as to the financial statements.
- 37.2 The Company shall appoint at the Annual Meeting an auditor or auditors to serve in this capacity until the following Annual Meeting, but the General Meeting may appoint an auditor to serve for a longer period, not extending beyond the end of the third Annual Meeting after the appointment.
- 37.3 Subject to the provisions of the Companies Law, any act of the auditor of the Company shall be valid with regard to any person acting in good faith with the Company, notwithstanding any defect in the appointment or qualification of the auditor.
- 37.4 The fees of the auditor shall be fixed by the Board of Directors. The Board of Directors shall report at the Annual Meeting the fees of the auditor so fixed.
- 37.5 The Board of Directors will notify the auditor of General Meetings and of meetings of the Board of Directors in which the financial statements audited by the auditor are presented, and the auditor shall be entitled to attend such meetings.

38. Internal Auditor

- 38.1 As long as the Company is a public company, the Company will have an internal auditor, to be appointed by the Board of Directors in accordance with the proposal of the Audit Committee.
- 38.2 The role and authorities of the internal auditor shall be as provided in the Companies Law.

PART I: RESERVES, DISTRIBUTIONS AND BONUS SHARES

39. Reserves

- 39.1 The Board of Directors may at any time allocate such amounts as it sees fit from the surpluses (as defined in the Companies Law) to a reserve for any purpose determined by it. Likewise, the Board of Directors may direct the management of, and the uses to which, any reserve or part thereof is put, including using of any reserve or part thereof for the business of the Company, without need to maintain such amount separate from the remaining assets of the Company.
- 39.2 The Board of Directors may from time to time, subject to the provisions of any law and the provisions of these Articles, change the purpose for which any capital reserve has been designated or the manner in which it is managed, to combine or split reserves and to transfer the amount of any capital reserve to the surplus account or to any other account in the accounting records of the Company. Notwithstanding the aforesaid, the Board of Directors may not transfer any amount from the share premium account other than to the share capital of the Company or for the purposes of a distribution that does not satisfy the profit test.

40. Distribution of Dividends and Bonus Shares

- 40.1 Subject to these Articles, the Company may declare and pay any dividend or decide on a distribution permitted under the Companies Law.
- 40.2 No dividend shall bear interest or linkage against the Company.
- 40.3 A dividend may be paid, in whole or in part, by way of distribution of assets of any kind. A distribution of assets as aforesaid shall be made by a transfer, assignment, transfer of title, grant of a contractual or proprietary right or in any other manner as the Board of Directors directs.
- 40.4 If the Board of Directors decides to distribute a dividend, in whole or in part by way of an allotment of shares in the Company to those shareholders entitled to the dividend, at a price lower than the nominal value of those shares or to distribute bonus shares, the Company shall convert to share capital a portion of its profits or of its share premiums or of any other source included in the equity in its last financial statements (all as defined in the Companies Law) in an amount equal to the difference between the nominal value of the said shares and the price paid therefor.
- 40.5 The Board of Directors may allot from time to time bonus shares and determine the source of such distribution. Such bonus shares shall form part of the share capital of the Company and shall be considered to be fully paid in such amount, being not less than the nominal value of the shares, as the Board of Directors shall direct. The said bonus shares shall be allotted without payment to the shareholders of the Company who would have been entitled to receive the amount converted to share capital for the purpose of distribution of the bonus shares if that amount had been distributed by way of cash dividend and in the same proportion.
- 40.6 The Board of Directors may decide that bonus shares shall be of the same class of shares as these shares which entitle the holders thereof to participate in the distribution of bonus shares, or that all bonus shares shall be of a single class which shall be distributed to all persons entitled thereto without taking into account the class of shares which they hold, or that bonus shares be a combination of classes of shares.
- 40.7 The Board of Directors may from time to time issue to the holders of the Company's securities that are convertible into the Company's shares, bonus shares or dividends as if the said securities had been converted into shares prior to the distribution in question, in each case subject to the terms of issue of the said securities.

The Board of Directors may make any arrangement and take any action necessary for the efficient and speedy implementation of the provisions of this Article, to determine the rights which the holders of convertible securities receive and the manner in which they receive these rights, and to carry out any necessary adjustment with respect to the rights of the holders, in this respect. The Board of Directors may exercise any authority granted to it in connection with the distribution of a dividend or bonus shares or rights to the shareholders in the Company, mutatis mutandis, all in the absolute discretion of the Board of Directors.

In order to implement any resolution regarding the distribution of a dividend or bonus shares or in connection with the acquisition of securities of the Company, the Board of Directors may sign any document and effect any arrangement which is, in the opinion of the Board of Directors, necessary in order to enable or facilitate the distribution, including the issuance of certificates for partial shares or to decide that shares in the Company which entitle the holder thereof to partial shares in an amount lower than the level fixed by the Board of Directors shall not entitle the holder to participate in that distribution, or to sell the partial shares and to pay the net proceeds of sale (after deduction of the expenses of sale and any tax that shall be payable in respect of the sale) to the persons entitled thereto;

- 40.8 The Board of Directors may appoint a trustee or trustees ("the Trustee") to hold dividends, bonus shares or any other right (together "the Benefit") which the Company has issued or distributed to its shareholders and which was not demanded by any of the shareholders. Any action taken by the Trustee, and any agreement between the Board of Directors and the Trustee shall be valid and shall bind the shareholders in connection with the Benefit to which they are entitled and for which the Trustee has been appointed.
- 40.9 The Trustee shall be appointed for the purpose of exercising, collecting, receiving or depositing the Benefit, but the Trustee shall not be entitled to transfer the Benefit or part thereof or to grant any right in the Benefit or to make any use thereof. The Trustee shall not be entitled to vote in respect of any securities of the Company which are included in the Benefit.
- 40.10 The Trustee shall transfer the Benefit, including any income arising thereon, less the Trustee's fee as settled by the Board of Directors, to the shareholders entitled to the Benefit as soon as possible after he receives the first written demand from the shareholders, subject to authentication of the identity of any shareholder and details of the Benefit to which he is entitled.
- 40.11 If the payment of the dividend is not demanded within seven (7) years from the date of the decision to distribute that dividend, the person entitled thereto shall be deemed to have waived the dividend, and ownership thereof shall return to the Company.
- 40.12 The Board of Directors may pay all dividends or money due in respect of shares by sending checks in the mail, and if the Benefit is, in whole or in part, an asset or a right, by sending by mail any document confirming or creating the said right. Any check or document sent to the address of the shareholder as appearing in the Register shall be dispatched at the risk of the shareholder.
- 40.13 The transferee of any shares shall not be entitled to any dividend or any other distribution with respect to such shares, which has been declared after the date of transfer but before registration of the transfer in the Register, and in the event of the transfer of shares which is subject to the approval of the Board of Directors, before the date of said approval.
- 40.14 The Board of Directors may deduct from any dividend, distribution or other amounts which are to be paid to a shareholder (including to a person who is one of the joint holders of a share) any amounts due from such a person to the Company in his capacity as shareholder.

40.15 If there is a number of persons registered as joint holders of a share, each one may give a valid receipt to the Company for any Benefit granted in respect of that share.

41. Buy-Back

A decision regarding the acquisition of securities which have been issued by the Company and the manner in which these securities shall be dealt with by the Company shall be taken by the Board of Directors.

PART J: NOTICES

42. Notices

42.1 Subject to these Articles, any notice to shareholders of the Company shall be given in accordance with the provisions of the law.

42.2 Any written notice or other document may be served by the Company upon any shareholder either personally or by sending it by prepaid mail (air mail if sent internationally) or by cablegram, telex, facsimile or email addressed to such shareholder at his address as described in the Register or such other address as he may have designated in writing for the receipt of notices and other documents. Such designation may include a broker or other nominee holding shares at the instruction of the shareholder. Proof that an envelope containing a notice was properly addressed, stamped and posted shall be conclusive evidence that notice is given. A declaration of an authorized person on behalf of the stock transfer agent of the Company or other distribution agent stating that a notice was mailed to a shareholder will suffice as proof of notice for purposes of this Article.

42.3 Any written notice or other document may be served by any shareholder upon the Company by tendering the same in person to the Secretary or the General Manager at the Offices of the Company or by sending it by any of the means provided for in Article 42.2 to the Company at its Office.

42.4 Any notice or other document referred to above shall be deemed to have been served 48 hours after it has been posted (seven days if sent internationally), or 24 hours after sent by cablegram, telex, facsimile or email. The date of mailing, publication or other method of sending a notice and the date of the meeting shall be counted as part of the days comprising any notice period. If a notice is, in fact, received by the addressee, it shall be deemed to have been duly served when received, notwithstanding that it was received sooner than provided herein, defectively addressed or failed, in some other respect, to comply with the provisions of this Article.

42.5 All notices to be given to the shareholders shall, with respect to any share to which persons are jointly entitled, be given to whichever of such persons is named first in the Register, and any notice so given shall be sufficient notice to the holders of such share.

42.6 Any shareholder whose address is not described in the Register, and who shall not have designated in writing an address for the receipt of notices, shall not be entitled to receive any notice from the Company.

42.7 Notwithstanding anything to the contrary herein, notice by the Company of a General Meeting which is published:

- (i) in two daily newspapers in the State of Israel shall be deemed to have been duly given on the date of such publication to any shareholder whose address as registered in the Register (or as designated in writing for the receipt of notices and other documents) is located in the State of Israel.
- (ii) in one daily newspaper in the City of New York and in one international wire service shall be deemed to have been duly given on the date of such publication to any shareholder whose address as registered in the Register (or as designated in writing for the receipt of notices and other documents) is located outside the State of Israel.

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The Companies Law 5759-1999

Public Company Limited by Shares

**ARTICLES OF ASSOCIATION
OF
Crystal Systems Solutions Ltd.**

**BLUEPHOENIX SOLUTIONS LTD
BLUEPHOENIX 2003 EMPLOYEE STOCK OPTION PLAN
As amended on February 21, 2010**

**(former name: CRYSTAL SYSTEMS SOLUTIONS LTD
1996 EMPLOYEE SHARE OPTION PLAN - PART ONE)**

BLUEPHOENIX SOLUTIONS LTD.

2003 EMPLOYEE SHARE OPTION PLAN

A. NAME AND PURPOSE

1. **Name.** This plan, as amended from time to time, shall be known as the "BluePhoenix 2003 Employee Stock Option Plan" (the "Plan").
2. **Purpose.** The purpose and intent of the Plan is to provide incentives to employees, directors, officers and consultants of BluePhoenix Solutions Ltd. (the "Company") and of its subsidiaries and affiliates who are not controlling shareholders of the Company, by providing them with opportunities to purchase Ordinary Shares, nominal value 0.01 New Israeli Shekels each (the "Shares"), of the Company, pursuant to a plan approved by the Board of Directors of the Company which with respect to employees of the Company, is designed to benefit from, and is made pursuant to, the provisions of Section 102 of the Israeli Income Tax Ordinance [New Version], 1961 (the "Tax Ordinance"), and the rules and regulations promulgated thereunder (the "Regulations"). Grant of options to Non – Israeli residents shall be in accordance with the provisions of Appendix A of this Plan.

B. GENERAL TERMS AND CONDITIONS OF THE PLAN

3. **Administration.**

3.1 The Plan will be administered by the Board of Directors of the Company (the "Board") or by a committee appointed by the Board (the "Committee"), which, if appointed, will consist of such number of Directors of the Company as may be fixed, from time to time, by the Board. If a Committee is not appointed, or if it is required under any law the term Committee, whenever used herein, shall mean the Board. The Board shall appoint the members of the Committee, may from time to time remove members from, or add members to, the Committee and shall fill vacancies in the Committee however caused.

3.2 The Committee shall select one of its members as its Chairman and shall hold its meetings at such times and places as it shall determine. Actions taken by a majority of the members of the Committee, at a meeting at which a majority of its members is present, or acts reduced to or approved in writing by all members of the Committee, shall be the valid acts of the Committee. The Committee may appoint a Secretary, who shall keep records of its meetings and shall make such rules and regulations for the conduct of its business as it shall deem advisable.

3.3 Subject to the general terms and conditions of this Plan, the Committee shall have the full authority in its discretion, from time to time and at any time, to determine:

- (i) Whether the Options shall be issued to a trustee nominated by the Committee pursuant to Section 102(b) of the Tax Ordinance, or the Options shall issued without a trustee pursuant to Section 102(c) of the Tax Ordinance;
- (ii) The person to be nominated as a trustee pursuant to the Plan;
- (iii) In the event that the Company elects to grant Options pursuant to Section 102(b) of the Tax Ordinance – whether the Options be granted pursuant to Section 102(b)(1) of the Tax Ordinance ("Income Track Options") or pursuant to Section 102(b)(2) of the Tax Ordinance ("Capital Gains Track Options"). (issuance of Income Track Options or Capital Gains Track Options shall be referred to herein as "Tax Track(s)"). In the event that the Company elects one of the Tax Tracks as described above, it may not grant Options pursuant to the other Tax Track during a period commencing on the end of the year in which the Options were granted until the end of the subsequent year;

(iv) (a) The persons ("Grantees") to whom options to purchase Shares ("Option(s)") shall be granted, (b) the number of Options to be granted to each Grantee, (c) the time or times at which the same shall be granted, (d) the schedule and conditions on which such Options may be exercised and on which such Shares shall be paid for, and/or (e) any other matter which is necessary or desirable for, or incidental to, the administration of the Plan. In determining the number of Options to be granted to each Grantee, the Committee may consider, among other things, the Grantee's salary and the duration of the Grantee's employment by the Company.

3.4 The Committee may, from time to time, adopt such rules and regulations for carrying out the Plan as it may deem necessary. No member of the Board or of the Committee shall be liable for any act or determination made in good faith with respect to the Plan or any Option granted thereunder.

3.5 The interpretation and construction by the Committee of any provision of the Plan or of any Option thereunder shall be final and conclusive unless otherwise determined by the Board.

4. **Eligible Grantees and General Terms.**

4.1 The Committee, at its discretion, may grant Options to employees, directors, officers and consultants of the Company and its subsidiaries and affiliates provided that such Grantees are not controlling shareholders of the Company (as such term is defined in Section 32(9) of the Tax Ordinance). Anything in this Plan to the contrary, notwithstanding all grants of Options to directors and officers -"Nosei Misra" - as such term is defined in the Israeli Companies Law, 1999, (the "Companies Law") - shall be authorized and implemented only in accordance with the provisions of the Companies Law. The grant of an Option to a Grantee hereunder, shall neither entitle such Grantee to participate, nor disqualify him from participating, in any other grant of options pursuant to this Plan or any other stock option plan of the Company.

4.2 Each Option is exercisable into one Share.

5. **The Trust.**

5.1 The Trustee.

- (a) In the event that the Committee has elected to grant Options to a trustee designated by the Board and approved by the Israeli Commissioner of Income Tax (the "Trustee"), as prescribed under Section 3.3(i) above, the Trustee shall hold each such issued Option and the Shares issued upon exercise thereof in trust (the "Trust") for the benefit of the Grantee in respect of whom such Option was granted (the "Beneficial Grantee").
- (b) Issuance of Options to a Trustee pursuant to any of the Tax Tracks is subject to the completion and execution of all procedures required under the Tax Ordinance and/or the Regulations.
- (c) All certificates representing Shares issued to the Trustee under the Plan shall be deposited with the Trustee, and shall be held by the Trustee until such time that such Shares are released from the Trust as herein provided.

- (d) Pursuant to the provisions of Section 102 of the Tax Ordinance and the Regulations, the taxation of the Options or Shares issued upon the exercise of Options pursuant to any of the Tax Tracks, are subject to their deposition in Trust for the required holding period (the "Required Holding Period") as follows: (i) in the event that the Company elects the Income Tax Track - twelve (12) months after the end of the year in which the Options were granted and deposited in Trust; (ii) in the event that the Company elects the Capital Gains Tax Track – twenty four (24) months after the end of the year in which the Options were granted and deposited in Trust; or (iii) any other shorter period to be determined by the Committee which was approved by the tax authorities or in accordance with tax regularization to be adopted from time to time.

No Options or Shares shall be released from the Trust until the later of (i) the end of the Required Holding Period; and (ii) the vesting of such Options pursuant to Section 7.4 hereof (such later date being hereinafter referred to as the "Release Date").

- (e) Subject to the terms hereof, at any time after the Release Date with respect to any Options or Shares the following shall apply:
 - (i) Options and/or Shares issued to the Trustee shall continue to be held by the Trustee, on behalf of the Beneficial Grantee. From and after the Release Date, upon the written request of any Beneficial Grantee, the Trustee shall release from the Trust the Options and/or the Shares issued, on behalf of such Beneficial Grantee, by executing and delivering to the Company such instrument(s) as the Company may require, giving due notice of such release to such Beneficial Grantee, provided, however, that the Trustee shall not so release any such Options and/or Shares to such Beneficial Grantee unless the latter, prior to, or concurrently with, such release, provides the Trustee with evidence, satisfactory in form and substance to the Trustee, that all taxes or other compulsory payments, if any, required to be paid upon such release have, in fact, been paid.

- (ii) Alternatively, from and after the Release Date, upon the written instructions of the Beneficial Grantee to sell any Shares issued upon exercise of Options, the Trustee shall use its best efforts to effect such sale and shall transfer such Shares to the purchaser thereof concurrently with the receipt, or after having made suitable arrangements to secure the payment of the proceeds, of the purchase price in such transaction. The Trustee shall withhold from such proceeds any and all taxes or other compulsory required to be paid in respect of such sale, shall remit the amount so withheld to the appropriate tax authorities and shall pay the balance thereof directly to the Beneficial Grantee, reporting to such Beneficial Grantee and to the Company the amount so withheld and paid to said tax authorities.

Should the Trustee sell Shares at the request of the Beneficial Grantee, the company shall pay the Trustee for his services and expenses incurred with respect to such sale of Shares, and the Trustee will be entitled to withhold such amounts and pay the balance thereof to said Beneficial Grantee.

Notwithstanding the provisions of Subsection (d) above, Subject to the approval of the Committee, the Beneficial Grantee may sell or transfer the Options or Shares issued upon the exercise of Options prior to the end of the Required Holding Period, provided however that the Trustee shall withhold applicable tax or shall insure withholding of applicable tax in accordance with the provisions of the Regulations and Section 102 of the tax Ordinance relating to transfer prior to the end of the Required Holding Period.

5.2 Dividend and Voting Rights. All Shares issued upon the exercise of Options granted under the Plan shall entitle the Beneficial Grantee thereof to receive dividends with respect thereto, and to vote the same at any meeting of the shareholders of the Company. For so long as Shares issued to the Trustee on behalf of a Beneficial Grantee are held in the Trust, the dividends paid or distributed with respect thereto shall be remitted to the Trustee for the benefit of such Beneficial Grantee, and the Trustee shall vote all such Shares in accordance with the instructions of such Grantee.

6. **Reserved Shares.** The Company has reserved 4,200,000 authorized but unissued Shares or treasury Shares for purposes of the Plan subject to adjustments as provided in Section 11 hereof. All Shares under the Plan or any previous option plan, in respect of which the right thereunder of a Grantee to purchase the same shall, for any reason, terminate, expire or otherwise cease to exist, shall again be available for grant through Options under the Plan or under any other plan.

7. **Grant of Options.**

7.1 The effective date of the grant of an Option (the "Date of Grant") shall be the date specified by the Committee in its determination relating to the award of such Option. The Committee shall promptly give the Grantee written notice (the "Notice of Grant") of the grant of an Option. The Committee in its discretion may award to Grantees Options to purchase Shares in the Company available under the Plan. The execution of the Plan and issuance of Options pursuant thereto are subject to obtaining all permits and approvals by the appropriate authorities to which the Plan, the Options and Shares issuable upon exercise of the Options are subject.

7.2 The Notice of Grant shall state, inter alia, the applicable tax Track (if any), the number of Shares covered thereby, the dates when the Option may be exercised, the exercise price, and such other terms and conditions as the Committee at its discretion may prescribe, provided that they are consistent with this Plan.

7.3 The issuance of Options to a Grantee hereunder is subject to the signing of the Grantee on an application form to receive such Options (the "Application Form") and returning such signed Application Form to the Company within the time schedule specified in the Notice of Grant. By affixing his signature on the Application Form, the Grantee shall confirm his consent to receive all the Options granted to him subject to the terms and conditions applicable to such Options pursuant to the Plan, the provisions of Section 102 of the Tax Ordinance and the Regulations and the provisions of the applicable Tax Track and shall represent and warrant that he acknowledges the provisions of Section 102 of the Tax Ordinance and the applicable Tax Track and that he agrees to the trust agreement between the Company and the Trustee, a copy of which shall be enclosed to the Application Form. The Grantee shall also sign an undertaking to release the Trustee from any liability in respect of any action or decision duly taken and bona fide executed in relation to the Plan, such Options or any shares acquired upon the exercise thereof.

7.4 Vesting Period and date of Exercise.

- (a) The term "Vesting Period" shall mean the period commencing on the Date of Grant until the first date on which the Option may be exercised, namely, after the Release Date as defined in Section 5.1(d) above. The Vesting Period shall be determined by the Committee from time to time. The committee may decide on different vesting Periods applicable to different Grantees.
- (b) The Committee may, at its sole discretion, accelerate the Vesting Period with respect to certain Options granted pursuant to the Plan, subject to the provisions of Section 5.1(d) above.
- (c) Without derogating from the provisions of Section 5.1(d) and 10 hereof and the rights and powers of the Committee under Sections 3.3 and 7.2 hereof, unless otherwise specified in the Notice of Grant (a) each Option under the Plan shall be exercisable following the end of the Vesting Period, and (b) the schedule pursuant to which such Options shall vest, and the Beneficial Grantee thereof shall be entitled to pay for, and acquire, the Shares, shall be such that one-third of such Options shall vest on each of the first, second and third anniversaries of the Date of Grant.

8. **Exercise Price.** The exercise price per Share covered by each Option shall be determined by the Committee in its sole and absolute discretion.

9. **Exercise of Options.**

9.1 Options shall be exercisable pursuant to the terms under which they were granted and subject to the terms and conditions of the Plan.

9.2 The exercise of an Option shall be made by a written notice of exercise (the "Notice of Exercise") delivered by the Beneficial Grantee (or, with respect to Options held in the Trust, by the Trustee upon receipt of written instructions from the Beneficial Grantee) to the Company at its principal executive office, specifying the number of Shares to be purchased and accompanied by the payment therefor, and containing such other terms and conditions as the Committee shall prescribe from time to time.

9.3 Anything herein to the contrary notwithstanding, but without derogating from the provisions of Section 10 hereof, if any Option has not been exercised and the Shares covered thereby not paid for within ten (10) years after the Date of Grant (or any shorter period set forth in the Notice of Grant), such Option and the right to acquire such Shares shall terminate, all interests and rights of the Grantee in and to the same shall ipso facto expire, and, in the event that in connection therewith any Options are still held in the Trust as aforesaid, the Trust with respect thereto shall ipso facto expire and the Trustee shall thereafter hold such Options in an unallocated pool until instructed by the Company that some or all of such Options are again to be held in trust for one or more Grantees.

9.4 Each payment for Shares shall be in respect of a whole number of Shares, and shall be effected in cash or by a cashier's check payable to the order of the Company, or such other method of payment acceptable to the Company.

10. **Termination of Employment.**

In the event that a Grantee ceases, for any reason, to be employed by the Company or by any of its subsidiaries or affiliates (or with respect to a Grantee who is a director, officer or consultant, if his service with the Company or with any of its subsidiaries or affiliates, terminates for any reason), all Options theretofore granted to such Grantee shall terminate. As follows:

10.1

- (a) If the Grantee's termination of employment is due to such Grantee's death or "Disability" (as hereinafter defined), such Options (to the extent exercisable at the time of the Grantee's termination of employment or provision of services, namely, Options with respect to which the Release Date has occurred) shall be exercisable by the Grantee's legal representative, estate manager or any other person to whom the Grantee's rights are transferred by will or by laws of descent or distribution, or the Grantee, as the case might be, for a period of six (6) months following such termination of employment or provision of services (but in no event after the expiration date of such Option), and shall thereafter terminate. For purposes hereof, "**Disability**" shall mean the inability, due to illness, injury or mental condition to engage in any gainful occupation for which the individual is qualified by education, training or experience, and such condition continues for at least six (6) months.

- (b) If the Grantee's termination of employment or provision of services is due to, or connected with, one of the following instances, the trust with respect to said Grantee's options shall ipso facto expire, the options already vested shall automatically expire and the Grantee shall not be entitled to exercise any of the Options notwithstanding they were already vested at that time. The said instances are as follows:
- (i) The Grantee commits a criminal offense (whether against the Company or any other person or entity);
 - (ii) The Grantee is dishonest or breaches his fiduciary duties or duty of loyalty towards the Company and/or its subsidiaries;
 - (iii) The Grantee intentionally or recklessly damages the Company's and/or its subsidiaries' property and/or good name and/or business;
 - (iv) The Grantee is grossly negligent in fulfilling his duties towards the Company and/or its subsidiaries;
 - (v) The Grantee deviates intentionally in a material way from his authority and/or instructions given to him by the Company's and/or its subsidiaries' competent organs;
 - (vi) The Grantee breaches intentionally in a material way the terms of his employment agreement, or other agreement with the Company and/or its subsidiaries.

- (c) If the Grantee's termination of employment is for any reason other than those described in sub-sections (a) and (b) above, such Options (to the extent exercisable at the time of the Grantee's termination of employment) may be exercisable for a period of thirty (30) days following such termination of employment or provision of services, and shall thereafter terminate. Options which are not exercisable at the time of the Grantee's termination of employment (namely, which are not yet so vested in such Grantee), shall expire upon the termination of employment.

10.2 Notwithstanding the foregoing provisions of Section 10.1, the Committee may provide, either at the time an Option is granted or thereafter, that such Option may be exercised after the periods provided for in Section 10.1, but in no event beyond the term of the Option.

11. **Adjustment Upon Changes in Capitalization.**

11.1 Subject to any required action by the shareholders of the Company, the number of Shares covered by each outstanding Option, and the number of Shares which have been authorized for issuance under the Plan but as to which no Options have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per share of Shares covered by each such outstanding Option, shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Shares or the payment of a stock dividend (bonus shares) with respect to the Shares or any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Committee, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to an Option.

11.2 Unless otherwise determined by the Committee, in the event of the proposed dissolution or liquidation of the Company, to the extent it has not been previously exercised, each Option will terminate immediately prior to the consummation of such proposed action. In the event of a consolidation or the merger of the Company with or into another corporation, each Option shall be assumed or an equivalent option shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation.

12. **Non-Transferability.**

Unless permitted by the Committee, no Option shall be assignable or transferable by the Grantee to whom granted otherwise than by will or the laws of descent and distribution, and an Option may be exercised during the lifetime of the Grantee only by such Grantee or by such Grantee's guardian or legal representative. The terms of such Option shall be binding upon the beneficiaries, executors, administrators, heirs and successors of such Grantee.

13. **Term and Amendment of the Plan.**

13.1 The Plan was authorized by the Company on August 6, 2003, and shall expire on August 6, 2013 (except as to Options outstanding on that date), but such expiration shall not affect the instructions contained herein or in any applicable law with respect to the Options and Shares held in the Trust at such time of expiration. The Committee may decide upon the extension of the Plan.

13.2 Subject to applicable laws, the Board may, at any time and from time to time, terminate or amend the Plan in any respect. In no event may any action of the Company alter or impair the rights of a Grantee, without his consent, under any Option previously granted to him.

14. **Tax Consequences.** All tax consequences and obligations regarding any other compulsory payments arising from the grant or exercise of any Option, from the payment for, or the subsequent disposition of, Shares covered thereby or from any other event or act (of the Company or the Grantee) hereunder, shall be borne solely by the Grantee, and the Grantee shall indemnify the Company and the Trustee and hold them harmless against and from any and all liability for any such tax or other compulsory payment, or interest or penalty thereon, including without limitation, liabilities relating to the necessity to withhold, or to have withheld, any such tax or other compulsory payment from any payment made to the Grantee.

15. **Miscellaneous.**

15.1 Continuance of Employment: Neither the Plan nor the grant of an Option thereunder shall impose any obligation on the Company or on any of its subsidiaries or affiliates to continue the employment or service of any Grantee, and nothing in the Plan or in any Option granted pursuant thereto shall confer upon any Grantee any right to continue in the employ or service as aforesaid, or restrict the right of the Company or of any of its subsidiaries or affiliates to terminate such employment or service at any time.

15.2 Governing Law: The Plan and all instruments issued thereunder or in connection therewith, shall be governed by, and interpreted in accordance with, the laws of the State of Israel. Any action related to this Plan shall be venued solely in the competent courts in Tel Aviv.

15.3 **Application of Funds:** The proceeds received by the Company from the sale of Shares pursuant to Options granted under the Plan will be used for general purposes of the Company, as may be determined by the Board or the Company from time to time.

15.4 **Multiple Agreements:** The terms of each Option may differ from other Options granted under the Plan at the same time, or at any other time. The Committee may also grant more than one Option to a given Grantee during the term of the Plan, either in addition to, or in substitution for, one or more Options previously granted to that Grantee. The grant of multiple Options may be evidenced by a single Notice of Grant or multiple Notices of Grant, as determined by the Committee.

15.5 **Non-Exclusivity of the Plan:** The adoption of the Plan by the Board shall not be construed as amending, modifying or rescinding any previously approved incentive arrangement or as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under the Plan, and such arrangements may be either applicable generally or only in specific cases.

Appendix A
to
BluePhoenix 2003 Employee Stock Option Plan
(the "Plan")

The Committee of Board of Directors of BluePhoenix Solutions Ltd. (the "Company") may grant options from time to time to any employees, officers, consultants or directors of the Company or any of its subsidiaries who are not residents of Israel. Any such option shall be evidenced by a stock option agreement ("**Stock Option Agreement**") between the Company and the option recipient.

The Stock Option Agreements shall contain provisions covering matters substantially as prescribed under Sections 7.4(c), 9.2-9.4, 10.1, 11, 12 and 15.1. Notwithstanding the foregoing, the Stock Option Agreements may contain different language and deviate from the language which is used in the Plan.

In addition to the aforementioned provisions, the Stock Option Agreement shall state that the agreement is governed by the law of the State of Israel and that all tax consequences shall be borne by the Grantee.

The provisions of Section 15.4 of the Plan, which allows that the terms of each option grant may differ from other options granted under the Plan at the same time, or at any other time, shall apply also to grant of options pursuant to this Appendix A.

The terms in this Appendix shall have the meaning ascribed to them in the Plan, unless otherwise expressly stated.

LIST OF SUBSIDIARIES

<u>Name of Subsidiary</u>	<u>Country of Incorporation</u>
BluePhoenix Solutions USA Inc.	United States
Amalgamated Software NA Inc. (ASNA)	United States
BridgeQuest Inc.	United States
BluePhoenix Solutions Nordic, AS	Denmark
BluePhoenix Solutions U.K. Limited	United Kingdom
BluePhoenix Solutions Italia Srl.	Italy
Blue Phoenix I-Ter S.p.A.	Italy
BluePhoenix Solutions GmbH	Germany
BluePhoenix Solutions B.V.	The Netherlands
BluePhoenix Solutions Ltd.	Cyprus
BluePhoenix Solutions Srl.	Romania
BluePhoenix Solutions Co., Ltd.	Korea
Liacom Systems Ltd.	Israel
Zulu Software Inc.	United States
TIS Consultants Ltd.	Cyprus
BluePhoenix Technologies Ltd.	Israel
TISA Software Consultants Private Limited	India

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Yaron Tchwellia, certify that:

1. I have reviewed this annual report on Form 20-F for the year ended December 31, 2009 of BluePhoenix Solutions Ltd. (the "Registrant");
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
 4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
-

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: March 25, 2010

/s/ Yaron Tchwell

Yaron Tchwell
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Varda Sagiv, certify that:

1. I have reviewed this annual report on Form 20-F for the year ended December 31, 2009 of BluePhoenix Solutions Ltd. (the "Registrant");
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
 4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
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5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: March 25, 2010

/s/ Varda Sagiv
Varda Sagiv
Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of BluePhoenix Solutions Ltd. (the "Company") on Form 20-F for the period ending December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Yaron Tchwellia, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 25, 2010

/s/ Yaron Tchwellia

Yaron Tchwellia
Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of BluePhoenix Solutions Ltd. (the "Company") on Form 20-F for the period ending December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Yaron Tchwelli, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 25, 2010

/s/ Varda Sagiv

Varda Sagiv
Chief Executive Officer
(Principal Executive Officer)

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-144798, No. 333-147058, No. 333-158057, No. 333-152206 and No. 333-165630), Form F-3 (No. 333-116044, No. 333-133330, No. 333-148504 and No. 333-150015) of BluePhoenix Solutions Ltd., of our report dated March 25, 2010 relating to the consolidated financial statements included in this Annual Report on Form 20-F.

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

Tel-Aviv, Israel
March 25, 2010
