CHECK POINT SOFTWARE TECHNOLOGIES LTD
Form 20-F
April 04, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004

OR

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

For the transition period from _______ to _________

Commission file number 0-28584

CHECK POINT SOFTWARE TECHNOLOGIES LTD.

(Exact name of Registrant as specified in its charter)

ISRAEL

(Jurisdiction of incorporation or organization)

3A Jabotinsky Street, Ramat-Gan 52520, Israel

(Address of principal executive offices)

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

Securities registered or to be registered pursuant to Section 12(g) of the Act: Ordinary shares, NIS 0.01 nominal value

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

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report: 248,217,798 ordinary shares, NIS 0.01 nominal value.

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

Yes x No o

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 x

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

The following selected consolidated statement of income data for the years ended December 31, 2002, 2003 and 2004, and the selected consolidated balance sheet data as of December 31, 2003 and 2004, have been derived from the audited consolidated financial statements of Check Point Software Technologies Ltd. (together with its subsidiaries, the Company or Check Point) set forth elsewhere in this Form 20-F. These financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). The selected consolidated statement of income data for the years ended December 31, 2000 and 2001 and the selected consolidated balance sheet data as of December 31, 2000, 2001 and 2002 have been derived from the Company s audited consolidated financial statements not included in this Form 20-F and have also been prepared in accordance with U.S. GAAP. The selected consolidated financial data set forth below should be read in conjunction with and is qualified by reference to the Company s consolidated financial statements and the related notes as well as Item 5 Operating and Financial Review and Prospects included elsewhere in this Form 20-F.

On June 29, 2000 the Company s Board of Directors approved a two-for-one stock split in the form of a stock dividend effective July 14, 2000. On January 18, 2001, the Company s Board of Directors approved a three-for-two stock split in the form of a stock dividend effective February 1, 2001. All share and per share amounts herein reflect adjustments resulting from these stock splits.

	Year Ended December 31,				
	2000	2001	2002	2003	2004 (1)
	(in thousands, except share data)				
Consolidated Statement of Income Data:					
Revenues	$ 425,283	$ 527,643	$ 426,989	$ 432,572	$ 515,360
Operating expenses:					
Cost of revenues	35,265	26,571	20,693	18,923	27,784
Research and development	30,309	33,221	28,709	29,314	43,186
Selling and marketing	110,003	109,086	104,606	111,007	132,796
General and administrative	20,409	22,002	17,969	17,644	23,657
Acquisition related in-process R&D	-	-	-	-	23,098
Stock-based compensation	-	-	-	-	4,620
Total operating expenses	195,986	190,880	171,977	176,888	255,141
Operating income	229,297	336,763	255,012	255,684	260,219
Financial income, net	29,147	44,760	49,314	43,506	44,777
Income before taxes on income	258,444	381,523	304,326	299,190	304,996
Taxes on income	37,231	59,603	49,246	55,311	56,603
Net Income	$ 221,213	$ 321,920	$ 255,080	$ 243,879	$ 248,393
Basic net earnings per share (2)	$ 0.95	$ 1.34	$ 1.04	$ 0.98	$ 0.99
Shares used in computing basic net earnings per share (2)	232,611	240,008	244,097	247,691	251,244
Diluted net earnings per share (2)	$ 0.84	$ 1.25	$ 1.00	$ 0.96	$ 0.95
Shares used in computing diluted net earnings per share (2)	262,515	258,075	254,772	255,083	260,608

(1) Including the following significant pre-tax charges: acquisition related in-process R&D of $23.1 million, stock-based compensation of $4.6 million and amortization of intangible assets of $4.2 million.

(2) See Note 2r of the Notes to the Consolidated Financial Statements for an explanation of the determination of the number of shares used in computing net earnings per share.

December 31,

	2000	2001	2002	2003	2004
			(in thousands)		
Consolidated Balance Sheet Data:					
Working capital	$ 313,218	$ 355,032	$ 643,318	$ 983,533	$ 791,720
Total assets	777,639	1,145,665	1,425,611	1,713,665	1,917,891
Shareholders' equity	549,283	915,728	1,187,042	1,461,545	1,630,824

RISK FACTORS

This Form 20-F contains forward-looking statements that involve risks and uncertainties. The statements contained in this Form 20-F that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), including, without limitation, statements regarding the Company s expectations, beliefs, intentions, goals, plans, investments or strategies regarding the future and any assumptions underlying any of the foregoing. Forward-looking statements include, among others, statements in (i) Item 4 Information on the Company regarding the Company s belief as to increased acceptance of Internet technologies, expansion of connectivity services, acceleration of the use of networks, increasing demands on enterprise security systems, the impact of the Company s relationship with technology partners on its sales goals, the contribution of the Company s Internet security products to the Company s future revenue and the development of future products and (ii) Item 5 Operating and Financial Review and Prospects regarding, among other things, future amounts and sources of revenue, ongoing relationships with current and future end-user customers and distributors, future costs and expenses, and adequacy of capital resources. Forward-looking statements involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause the Company s actual results to differ materially from such results discussed in these statements. Many of these risks and uncertainties are described in the risk factors set forth below in this section and elsewhere in this Form 20-F. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements.

Risks Relating to Recent Acquisition of Zone Labs

In March 2004 the Company completed the acquisition of Zone Labs, Inc. (Zone Labs). The acquisition of Zone Labs involved the integration of two companies that had previously operated independently. The difficulties of combining the companies operations included, and continue to be, but are not limited to: the necessity of coordinating geographically separate organizations and integrating personnel with diverse business backgrounds, potential difficulties in retaining employees and the associated adverse effects on relationships with existing partners. The integration may interrupt the activities of one or more of the combined company s businesses and may result in the loss of key personnel. This could have an adverse effect on the business, results of operations, financial condition or prospects of the Company.

The Implementation of SFAS No. 123(R) Would Negatively Affect the Company s Profitability

The Financial Accounting Standards Board (FASB) has recently adopted an accounting standard (SFAS No. 123(R)) that requires the fair value of all equity-based awards granted to employees be recognized in the statement of operations as compensation expense, beginning in the third quarter of 2005.

The various methods for determining the fair value of stock options are based on, among other things, the volatility of the underlying stock. The Company s stock price has historically been volatile. The adoption of SFAS No. 123(R) will negatively affect the Company s profitability and may adversely affect the Company s stock price. Such adoption may also affect the Company s management discretion to continue to use stock options as an incentive and retention tool, which could, in turn, hurt the Company s ability to recruit employees and retain existing employees. See Notes 2s and 2v of the Notes to the Consolidated Financial Statements for a description of SFAS No. 123(R) and its possible effects on the Company s earnings and earnings per share.

Competition

The market for Internet security solutions is intensely competitive and the Company expects competition to increase in the future. The Company s principal competitors include Cisco Systems, Inc., Juniper Networks, McAfee, Inc., Microsoft Corporation, SonicWALL Inc., Symantec Inc. and WatchGuard Technologies Inc.

Some of the Company s current and potential competitors have longer operating histories, greater name recognition, access to larger customer bases and significantly greater financial, technical and marketing resources than the Company s. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than the Company. In addition, consolidation in the Internet security market may affect the Company s competitive position. There can be no assurance that the Company will be able to compete successfully against current and future competitors. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which will materially adversely affect the Company s business, operating results and financial condition.

Vendors of operating system software or networking hardware may enhance their products to include functionality that is currently provided by the Company s products. The widespread inclusion of the functionality of the Company s software as standard features of operating system software or networking hardware could render the Company s products obsolete and unmarketable, particularly if the quality of such functionality were comparable to that of the Company s products. Furthermore, even if the Internet security functionality provided as standard features by operating systems software or networking hardware is more limited than that of the Company s solutions, there can be no assurance that a significant number of customers would not elect to accept more limited functionality in lieu of purchasing additional solutions. In the event of any of the foregoing, the Company s business, operating results and financial condition will be materially and adversely affected. See Item 4 Information on the Company.

Rapid Technological Change

The Internet security industry is characterized by rapid technological advances, changes in customer requirements, frequent new product introductions and enhancements and evolving industry standards in computer hardware and software technology. As a result, the Company must continually change and improve its products in response to changes in operating systems, application software, computer and communications hardware, networking software, programming tools and computer language technology. The introduction of products embodying new technologies and the emergence of new industry standards may render existing products obsolete or unmarketable. In particular, the market for Internet and intranet applications is rapidly evolving. The Company s future operating results will depend upon the Company s ability to enhance its current products and to develop and introduce new products on a timely basis that address the increasingly sophisticated needs of its end-users and that keep pace with technological developments, new competitive product offerings and emerging industry standards. While the Company has been successful in developing and marketing new products or product enhancements that respond to technological change and evolving industry standards, there can be no assurance that the Company will continue to do so, or that the Company will not experience difficulties that could delay or prevent the successful development, introduction and marketing of these products, or that any new products and product enhancements will adequately meet the requirements of the marketplace and achieve market acceptance. If the Company does not respond adequately to the need to develop and introduce new products or enhancements of existing products in a timely manner in response to changing market conditions or customer requirements, the Company s business, operating results and financial condition will be materially adversely affected. See Item 4 Information on the Company.

Potential Fluctuations in Future Operating Results

The quarterly operating results of the Company can vary significantly due to several factors, including the occurrence of Internet security breaches or threats, regional or global prevailing economic and political conditions, seasonal trends in customer purchasing, the volume and timing of orders and the ability to fulfill orders, the level of product and price competition, the Company s ability to develop new and enhanced products and control costs, the mix of products sold, the mix of distribution channels through which products are sold, the Company s ability to integrate the technology and operations of acquired businesses with those of the Company, changes in customer capital spending budgets, fluctuations in foreign currency exchange rates and general economic factors.

The Company s sales are subject to seasonal fluctuations related to the slowdown in spending activities for the quarter ending September 30 and the increased activity related to the year-end purchasing cycles of many end-users of the Company s products. The Company believes that it will continue to encounter quarter-to-quarter seasonality.

The Company operates with virtually no backlog and, therefore, the timing and volume of orders within a given period and the ability to fulfill such orders determines the amount of revenues within a given period. The Company s sales are principally derived through indirect channels, which make revenues from such sales difficult to predict. Furthermore, the Company s expense levels are based, in part, on expectations as to future revenues. If revenue levels are below expectations, operating results are likely to be adversely affected, since most of the Company s expenses are not variable. As a result, the Company believes that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. If the Company s operating results were below the expectations of public market analysts and investors, the price of the Company s ordinary shares would likely be materially adversely affected. See Item 5- Operating and Financial Review and Prospects.

Potential Decline in Operating Margins

The Company may experience a decline in operating margins due to the following reasons: increasing competition and pricing pressure; additional investments in the continuing development and expansion of the Company s sales and marketing organization, including the expansion of its field organization both in the United States and additional countries in Europe, Asia, and Latin America and additional expansion of the research and development organization. The amount and timing of the above-mentioned additional expenses are likely to result in fluctuations in operating margins. In addition, if revenue levels are below expectations, operating margins are likely to be adversely affected, since most of the Company s expenses are not variable. See Item 5 Operating and Financial Review and Prospects.

Risks Associated With Emerging Internet Security, Internet and Intranet Markets

The markets for the Company s products are rapidly evolving. There can be no assurance that the market for Internet security solutions will continue to expand. Continued growth of this market will depend, in large part, upon the continued expansion of Internet usage and the number of organizations adopting or expanding intranets, upon the ability of their respective infrastructures to support an increasing number of users and services, and upon the continued development of new and improved services for implementation across the Internet, and between the Internet and intranets. If the necessary infrastructure or complementary products and services are not developed in a timely manner and, consequently, the enterprise security, Internet and intranet markets fail to grow or grow more slowly than the Company currently anticipates, the Company s business, operating results and financial condition will be materially adversely affected. See Item 4 Information on the Company and Competition in this Item 3.

Dependence upon Limited Number of Key Distributors and Resellers; Product Concentration; Impact of New Product Introductions

In 2004, sales to the Company s five largest distributors and resellers accounted for approximately 35% of the Company s revenues. The Company expects that it will continue to be dependent upon a limited number of distributors and resellers for a significant portion of its revenues. If anticipated orders from these distributors and resellers fail to materialize, the Company s business, operating results and financial condition will be materially adversely affected.

The Company has derived most of its revenues, and expects to continue to derive the majority of its revenues in the foreseeable future, from sales of its Internet security products, packaged and marketed mostly under the VPN-1 brand, including related software subscriptions, support, training and consulting. The Company s future financial performance will depend in significant part on the successful development, introduction, marketing and customer acceptance of new products and enhancements and new features for its existing product lines. See Item 4 Information on the Company and Item 5 Operating and Financial Review and Prospects.

Dependence upon Key Personnel

The Company s future performance depends, in significant part, upon the continued service of its key technical, sales and management personnel, including Gil Shwed, Marius Nacht and Jerry Ungerman. The loss of the services of one or more of the Company s key personnel could have a material adverse effect on the Company s business, operating results and financial condition. The Company s future success also depends on its continuing ability to attract and retain highly qualified technical, sales and managerial personnel. Competition for such personnel is significant, and there can be no assurance that the Company can retain its key technical, sales and managerial employees or that it can attract, motivate or retain other highly qualified technical, sales and managerial personnel in the future. If the Company cannot retain or is unable to hire such key personnel, the Company s business, operating results and financial condition will be materially adversely affected. See Item 4 Information on the Company.

Dependence on Third Party Technology

The Company s products incorporate certain technologies that are licensed by the Company from others. There can be no assurance that the Company will be able to continue to license such technologies or enter into new license agreements with respect to new technologies that it may wish to license and incorporate in its products, either on acceptable terms or at all. If the Company is unable to continue to license these technologies or enter into new license agreements for new technologies, it will not be able to incorporate such technologies into its products, thereby adversely affecting the Company s ability to compete with competitors utilizing such technologies in their products.

Risk of Litigation

The Company is and has been a party to various lawsuits, including employment claims, and other legal proceedings in the normal course of its business. In addition, the Company has received a number of class action complaints, which were later consolidated by the court into one action, alleging violations of the federal securities laws. See Item 8 Financial Information. Legal proceedings can be expensive, lengthy and disruptive to normal business operations, regardless of their merit. Moreover, the results of complex legal proceedings are difficult to predict and an unfavorable resolution of a lawsuit or proceeding could have a material adverse effect on the Company s business, results of operations or financial condition.

Principal Operations in Israel

The Company is incorporated under the laws of the State of Israel, and its principal offices and research and development facilities are located in Israel. Although most of the Company s sales are currently made to distributors and resellers outside Israel, the Company is nonetheless directly influenced by the political, economic and military conditions affecting Israel. Major hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on the Company s business, operating results and financial condition. Furthermore, several countries restrict business with Israeli companies. In addition, many of the Company s male officers and employees are subject to being called for military reserve duty, and for active military duty under emergency circumstances. While the Company has operated effectively under these requirements since its incorporation, the Company cannot predict the full impact of such conditions on the Company in the future, particularly if emergency circumstances occur. If many of the Company s employees are called for active duty, the Company s operations in Israel and its business may be adversely affected.

International Operations

The Company intends to continue to expand its international operations, which will require significant management attention and financial resources. In order to continue to expand worldwide, the Company needs to establish additional operations, hire additional personnel and recruit additional distributors and resellers internationally. To the extent that the Company is unable to do so effectively, the Company s growth is likely to be limited and the Company s business, operating results and financial condition will be materially adversely affected. In addition, as the Company expands its international operations, a portion of revenues generated in international jurisdictions may be subject to taxation by such jurisdictions at rates higher than those to which the Company is subject in Israel. Most of the Company s worldwide sales are currently denominated in U.S. dollars. An increase in the value of the U.S. dollar relative to foreign currencies would make the Company s products more expensive and, therefore, potentially less competitive in those markets. Additional risks inherent in the Company s worldwide business activities generally include unexpected changes in regulatory requirements, tariffs and other trade barriers, costs of localizing products for foreign countries, lack of acceptance of localized products in foreign countries, longer accounts receivable payment cycles, difficulties in operations management, potentially adverse tax consequences, including restrictions on the repatriation of earnings, and the burdens of complying with a wide variety of foreign laws. There can be no assurance that such factors will not have a material adverse effect on the Company s future international sales and, consequently, the Company s business, operating results and financial condition. See Item 4 Information on the Company and Item 5 Operating and Financial Review and Prospects.

Product Liability; Risk of Product Defects

The Company s sales agreements typically contain provisions designed to limit the Company s exposure to potential product liability or related claims. In selling its products, the Company relies primarily on shrink wrap licenses that are not signed by the end-user, and, for this and other reasons, such licenses may be unenforceable under the laws of certain jurisdictions. As a result, the limitation of the liability provisions contained in the Company s agreements may not be effective. The Company s products are used to manage Internet security, which may be critical to organizations, and, as a result, the sale and support of products by the Company may entail the risk of product liability and related claims. A product liability claim brought against the Company could have a material adverse effect upon the Company s business, operating results and financial condition. Software and hardware products, as complex as those offered by the Company may contain undetected errors or failures when first introduced or when new versions are released. In particular, the personal computer hardware environment is characterized by a wide variety of non-standard configurations that make pre-release testing for programming or compatibility errors very difficult and time-consuming. Despite testing by the Company and by current and potential distributors, there can be no assurance that errors will not be found in new products or releases after commencement of commercial shipments. The occurrence of these errors could result in adverse publicity, loss of or delay in market acceptance or claims by distributors against the Company, any of which could have a material adverse effect upon the Company s business, operating results and financial condition. See Item 4 Information on the Company.

Dependence on Proprietary Technology; Risks of Infringement

The Company relies primarily on a combination of common law copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect its proprietary rights as set forth below in the section entitled Proprietary Rights in Item 4 Information on the Company. The Company has certain patents in the United States and some other countries, as well as pending patent applications. There can be no assurance that the Company s patent applications will be issued either at all or within the scope of the claims sought by the Company. Furthermore, there can be no assurance that any issued patent will not be challenged, and if such challenges are brought, that such patents will not be invalidated. In addition, there can be no assurance that others will not develop technologies that are similar or superior to the Company s technology or design around any patents issued to the Company. Despite the Company s efforts to protect its proprietary rights, unauthorized parties may copy aspects of the Company s products or obtain and use information that the Company regards as proprietary. Policing any of such unauthorized uses of the Company s products is difficult, and although the Company is unable to determine the extent to which piracy of its software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of some foreign countries do not protect the Company s proprietary rights as fully as do the laws of the United States or Israel. There can be no assurance that the Company s efforts to protect its proprietary rights will be adequate or that the Company s competitors will not independently develop similar technology.

Approved Enterprise Status

The Company receives significant tax benefits in Israel, particularly as a result of the Approved Enterprise status of the Company s facilities and programs. To be eligible for tax benefits, the Company must meet certain conditions, relating principally to adherence to the investment program filed with the Investment Center of the Israeli Ministry of Industry, Trade and Labor and to periodic reporting obligations. Although the Company believes that it will be able to meet such conditions in the future, if the Company fails to meet such conditions it would be subject to corporate tax in Israel at the regular statutory rate, and could be required to refund the tax benefits already received, together with linkage adjustment to the Israeli consumer price index and interest. In recent years, the Israeli government has reduced the benefits available under these programs and Israeli governmental authorities have indicated that the government may in the future reduce or eliminate the benefits of those programs. There can be no assurance that new benefits will be available, or that existing benefits will be continued in the future at their current level or at any level. A termination or reduction of certain programs and tax benefits (particularly benefits available to the Company as a result of the Approved Enterprise status of the Company s facilities and programs), a requirement to refund the tax benefits already received or changes in legislation, could have a material adverse effect on the Company s business, operating results and financial condition. See Item 4 Information on the Company and Israeli Taxation, Foreign Exchange Regulation and Investment Programs in Item 10 Additional Information.

Anti-Takeover Effects of Israeli Laws

Under the Israeli Companies Law, a merger is generally required to be approved by the shareholders and Board of Directors of each of the merging companies. Shares held by a party to the merger and certain of its affiliates are not counted toward the required approval. If the share capital of the company that will not be the surviving company is divided into different classes of shares, the approval of each class is also required. Under the Company s Articles of Association, the required shareholder vote is a supermajority of at least 75% of the shares voting in person or by proxy on the matter. A merger may not be approved if the surviving company will not be able to satisfy its obligations. At the request of a creditor, a court may block a merger on this ground. In addition, a merger can be completed only after 30 days have passed from the shareholders approval of each of the merging companies and all approvals have been submitted to the Israeli Registrar of Companies and 50 days have passed from the time that a proposal for approval of the merger was filed with the Registrar.

The Israeli 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 25% shareholder of the company, unless there is already another 25% shareholder of the company. Similarly, the Israeli 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 of the company, unless someone else already holds 45% of the voting power of the company. These rules do not apply if the acquisition is made by way of a merger.

Regulations promulgated under the Israeli 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, either:

- There is 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 Israeli Companies Law provides specific rules and procedures for the acquisition of shares held by minority shareholders, if the majority shareholder holds more than 90% of the outstanding shares. Israeli tax law treats specified acquisitions, including a stock-for-stock swap between an Israeli company and a foreign company, less favorably than does U.S. tax law.

These laws may have the effect of delaying or deterring a change in control of the Company, thereby limiting the opportunity for shareholders to receive a premium for their shares and possibly affecting the price that some investors are willing to pay for the Company s securities.

Provisions Affecting a Potential Change of Control; Potential Rights of Unissued Preferred Shares

The Company s Articles of Association provide that the Company s Board of Directors has the authority to issue up to 5,000,000 preferred shares and to determine the price, rights (including voting rights), preferences, privileges and restrictions of such preferred shares, without any vote or actions by the Company s shareholders. If this provision withstands judicial scrutiny under the Israeli Companies Law, the rights and preferences of such preferred shares could include a preference over the ordinary shares on the distribution of the Company s assets upon a liquidation or sale of the Company, preferential dividends, redemption rights, and the right to elect one or more directors and other voting rights. The rights of the holders of the ordinary shares will be subject to, and may be adversely affected by, the rights of the holders of any preferred shares that may be issued in the future. The Company has no current plans to issue preferred shares. The issuance of preferred shares, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of the outstanding voting shares of the Company. Furthermore, certain provisions of the Company s Articles of Association could delay or make more difficult a merger, tender offer or proxy contest involving the Company. These provisions stipulate that the Company cannot engage in a business combination with an interested shareholder (defined generally as the beneficial owner of 15% of the outstanding shares and its affiliates) for a period of three years following the date that such shareholder became an interested shareholder, unless certain conditions are met. These provisions may have the effect of delaying or deterring a change in control of the Company, thereby limiting the opportunity for shareholders to receive a premium for their shares and possibly affecting the price that some investors are willing to pay for the Company s securities.

Concentration of Share Ownership

As of February 28, 2005, the directors and executive officers of the Company beneficially owned approximately 24% of the outstanding ordinary shares of the Company. The percentage of ownership is calculated based on the number of ordinary shares owned, directly or indirectly, and the number of options immediately exercisable or that are exercisable within 60 days from February 28, 2005. As a result, these shareholders are able to exercise significant influence over all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. Such concentration of ownership may have the effect of delaying or preventing a change in control of the Company. See Item 7 Major Shareholders and Related Party Transactions.

Indemnification of Directors and Officers

The Company has agreements with its directors and senior officers which provide, subject to Israeli law, for the Company to indemnify each such director and senior officer for any of the following obligations or expenses incurred in connection with the acts or omissions of such person in his or her capacity as a director or officer of the Company:

- monetary liability imposed upon him or her in favor of a third party by a judgment, including a settlement or an arbitral award confirmed by the court, and
- reasonable litigation expenses, including attorney fees, incurred by such a director or officer or imposed on him or her by a court, in a proceeding brought against him or her by or on behalf of the Company or by a third party, or in a criminal action in which he or she was acquitted, or in a criminal action which does not require criminal intent in which he or she was convicted.

Exchange Controls and Other Limitations Affecting Security Holders

In 1998, the Israeli currency control regulations were liberalized significantly, and there are currently no control restrictions on remittances of dividends on securities of Israeli companies (provided that Israeli income tax has been paid or withheld thereon) or on the proceeds from the sale of Israeli securities. Legislation remains in effect, however, pursuant to which currency controls can be imposed by administrative action at any time.

Neither the Memorandum and Articles of Association of the Company nor the laws of Israel restricts in any way the ownership or voting of ordinary shares by non-residents of Israel, except with respect to citizens of those countries, which are in a state of war with Israel.

ITEM 4. INFORMATION ON THE COMPANY

General

Check Point develops markets and supports Internet security solutions for enterprise and high-end networks, service providers, small and medium businesses and consumers. The Company delivers solutions that enable secure, reliable and manageable communications over Internet Protocol (IP) networks including the Internet, intranets and extranets. The technology of Check Point aims to provide intelligent security solutions that protect business communications and resources for corporate networks and applications, remote employees, branch offices and partner extranets, in three distinct areas: perimeter, Web and internal networks. The Company also provides endpoint security solutions that protect personal computers from hackers, spyware and data theft. The capabilities of Check Point products can be extended with the Company s Open Platform for Security (OPSEC) framework, enabling integration with leading hardware appliances and third-party security software applications.

Check Point was incorporated in 1993. Its registered office and principal place of business is 3A Jabotinsky Street, Ramat-Gan 52520, Israel. The telephone number is 972-3-753-4555. The Company s website is www.checkpoint.com. The contents of the Company s website are not incorporated by reference into this Form 20-F. This Form 20-F can be obtained upon request from the Company s investor relations department, 800 Bridge Parkway, Redwood City, California 94065 (telephone no. 650-628-2000).

Industry Background

Information, and the ability to access and distribute it, is a key strategic asset in today s competitive business environment. This need to effectively use and communicate information as well as work more collaboratively has led to the extensive deployment of network-based communications systems (connectivity). Increased connectivity is in turn expanding the need for technology to safeguard and manage the access to information available over these increasingly global networks.

Increase in connectivity

The network computing market has undergone three major transitions over the past decade which has contributed to the increase in global connectivity. The first of these transitions was the migration of corporate computing environments from centralized mainframe systems to dispersed client/server environments. The ability to access and share information through client/server technology has expanded the need for connectivity beyond workgroup Local Area Networks (LANs) to enterprise-wide networks spanning multiple LANs and Wide Area Networks (WANs). The second major transition has been the widespread adoption of the Internet for communications. Internet-based business applications have rapidly expanded beyond e-mail to a broad range of business applications and services including electronic publishing, direct to customer transactions, supply chain automation, product marketing, advertising and customer support. The emergence of increased reliance on the Internet for business communications and transactions increases the need for and associated challenges in providing secure access to information and applications. Finally, companies of all sizes in most industries are embracing and supporting increased connectivity for mobile and remote employees. This includes connectivity to corporate data and application resources, as well as general Internet access. Remote users are increasingly able to receive more and better information from a growing spectrum of devices, including laptops, personal digital assistants, and cell phones. The expansion of network access to mobile workers is driving demand to secure all devices with Internet access, as well as those connecting to the corporate network. These transitions and the need for secure, managed communications, have led to the broad acceptance of Virtual Private Networks (VPNs) through the use of the public Internet infrastructure and associated protocols and applications, sharing information and utilizing services both within the enterprise and with business partners and customers are now widely adopted. As a result, businesses are able to share internal information and to run enterprise applications across geographically dispersed facilities as well as enable customers, suppliers and other business partners to inexpensively link into their enterprise information systems. As Internet protocols and infrastructure gain increasingly widespread acceptance for global communication, new wide-area connectivity services continue to emerge at a rapid rate, such as database access, transaction-processing services, voice over IP services and video teleconferencing services. This expansion of services and applications is further accelerating the use of networks as global communication systems.

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The need for security

The growth of Internet connectivity among organizations of all sizes has increased the risk that an organization s Information Technology (IT) resources can be attacked via the Internet. Firms have recognized this risk and are deploying security solutions in an effort to protect organizational confidential information from unauthorized access.

The primary means of controlling access to organizational networks and protecting against attacks is the deployment of Internet firewalls. Firewalls are typically deployed at the demarcation of an organization s LAN and the Internet, and are used to strictly control traffic into and out of the organizational network. Firewall technology is currently undergoing an evolution, enabling it to detect and defeat highly sophisticated network and application-level attacks that are increasingly prevalent on the Internet today. Increasing numbers of organizations are deploying an additional layer of security by applying endpoint security. Endpoint security includes personal firewall, security and policy enforcement features specifically designed for internal and remote personal computing devices.

In addition to protecting an organization s IT assets from attack, organizations take steps to guard sensitive organizational information traversing untrusted networks, such as the Internet. Securing organizational information on the Internet is critical as more organizations are utilizing the Internet as their corporate network backbone to link company offices and employees. Putting sensitive information on the Internet without adequate security exposes confidential data to the public. To mitigate this risk, an increasing number of organizations are deploying VPNs to encrypt and authenticate their Internet-bound traffic. Leveraging standards-based VPN technology enables organizations to connect offices and remote employees via the Internet, while maintaining the privacy and integrity of communications.

Frequently, firewalls and VPNs are provided in an integrated manner or as a single product. Integrating firewall and VPN functionality delivers greater security for all traffic and eases the management burden on the security and network administrators.

IT security administrators within organizations have long focused on securing the network perimeter. With the rise of costly worms and other attacks introduced from within the internal network through mobile and wireless devices, organizations have realized the importance of securing their internal networks. But while many of the same principles used to construct and operate perimeter security solutions also apply to internal networks, internal networks are much more complex and have unique security requirements.

Technology

Check Point s Internet security solutions include various technologies that enable its customers to define their network and application security policies, enforce these policies across their networks, collect and correlate information, monitor the security and traffic flow and analyze and update configurations to reflect changes in the Internet security policies. The Company s products are packaged and marketed under different names and address security tasks in various environments at a variety of price points.

Stateful Inspection technologies

Check Point s VPN-1 product offerings are based upon the Company s patented Stateful Inspection technology that enables the screening of all communications attempting to pass through a gateway in a secure but efficient manner. By extracting and maintaining extensive state information from all relevant communication layers, the system can verify data for full compliance with the security and traffic policy and make intelligent security and traffic prioritization decisions. By extracting and analyzing data in place without making a copy, Stateful Inspection results in virtually no performance degradation, enabling VPN-1, Connectra and InterSpect scale effectively with increasing network bandwidth. In addition, Check Point s proprietary implementation of Stateful Inspection in a virtual machine enables it to be adapted to new protocols and applications and has proved to be adaptable to many security threats. The Company s implementation also provides upgradeability and enables the Company s products to be ported to a wide range of platforms. Furthermore, because Check Point s products reside at network access points, which are the critical convergence points for network security and traffic management, the Company is able to apply this same architectural foundation and inspect traffic only once for both critical network decisions and traffic management, resulting in increased network performance.

Security and network traffic enforcement technologies (based on Stateful Inspection)

Check Point s enforcement points are typically installed at the network perimeter as security gateways, on critical servers, on client platforms, as well as internally, to segment the corporate network. These varying enforcement points implement different patented technologies including the Company s INSPECT engine. The INSPECT engine scans all incoming and outgoing internet traffic against a customizable security policy. The INSPECT engine can be further enhanced by partners or customers by using the INSPECT programming language.

Network traffic can be dropped when the security policy has been violated, encrypt to create a secured VPN, prioritize for Quality of Service (QoS) purposes or sent for further analysis to perform specific security functions such as authentication, URL filtering or content inspection using Anti-Virus. Many of these security technologies are provided by third party vendors and are integrated with the various Check Point solutions through the OPSEC framework. In addition, technologies like Check Point s SecureXL allow third party accelerators and platforms to create Check Point based appliances and other solutions such as acceleration cards that further accelerate the performance of security and network operations.

Application Intelligence

Check Point s Application Intelligence is a set of advanced capabilities, integrated into the VPN-1, InterSpect, Connectra and Integrity product offerings, which detect and prevent application-level attacks. Some of the most serious threats in today s Internet environment originate from attacks that attempt to exploit application vulnerabilities. Since application-level attacks tend to be sophisticated in nature, effective defenses must be equally sophisticated and intelligent.

Security Management Architecture (SMART)

Check Point s products are based on its Security Management Architecture (SMART), which allows configuration and management of security policies from a single, centralized administrative workstation. Security policies can be defined and deployed for a single security gateway protecting a small business, for multiple gateways in an enterprise network environment, or for multiple security domains allowing a service provider to deliver security to a large number of customers, or subscribers. An object-oriented architecture allows for the efficient storage and specification of security policy elements (such as computers, users, networks and network devices, network services and security rules). Powerful management tools, such as object managers, audit and network activity logs, monitoring tools and policy editors are based on this unifying architecture. The Company s products contain extensive monitoring and reporting capabilities designed to maximize interoperability and improve the manageability of the system.