INTERNET GOLD GOLDEN LINES LTD
Form 20-F
June 30, 2008

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 20-F

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, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report ....
Commission file number: 0-30198

INTERNET GOLD GOLDEN LINES LTD.

(Exact name of Registrant as specified in its charter
and translation of Registrant s name into English)

Israel
(Jurisdiction of incorporation or organization)

1 Alexander Yanai Street, Petach Tikva 49277, Israel
(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 0.01 Par Value	**NASDAQ Global Market**

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

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

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary Shares, par value NIS 0.01 per share **23,372,953**
(as of December 31, 2007)

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

Yes o No x

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

Yes o No x

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

Yes x No o

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

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

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 x Item 18 o

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

Yes o No x

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INTRODUCTION

We are a leading communications and interactive media group in Israel with two principal operating activities. Our company s subsdiaries are 012 Smile.Communications Ltd. and Smile.Media Ltd.

012 Smile.Communications is a growth-oriented communication services provider in Israel with a leading market position, offering a wide range of broadband and traditional voice services. 012 Smile.Communications broadband services include broadband Internet access with a suite of value-added services, specialized data services and server hosting, as well as new innovative services such as local telephony via voice over broadband, or VoB, and a WiFi network of hotspots across Israel. Its traditional voice services include outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. As a growth-oriented company, 012 Smile.Communications continually focuses on introducing new broadband services that allow it to expand its penetration into the communication market segments in which it currently operates, as well as access new market segments such as the large Israeli local telephony and mobile markets. 012 Smile.Communications has frequently been a leader in introducing new and innovative services and is the first company in Israel to provide VoB services and is the first to be granted a license to provide WiMAX-based services on a trial basis. 012 Smile.Communications offers its services to residential and business customers, as well as to Israeli cellular operators and international communication services providers, or carriers, through its integrated multipurpose network, which allows it to provide services to almost all of the homes and businesses in Israel. As of December 31, 2007, 012 Smile.Communications provided services to approximately 1,041,000 registered household customers and approximately 78,000 registered business customers. 012 Smile.Communications enterprise customer base consists of many of Israel s leading companies, including 75 of the 100 largest companies in Israel which includes the two largest Israeli banks (as determined by Dun & Bradstreet) and the Government of Israel.

On December 31, 2006, 012 Smile.Communications acquired one of its principal competitors, 012 Golden Lines. We believe that the acquisition of 012 Golden Lines provides 012 Smile.Communications with the size and scale of operations necessary to effectively compete in its markets and with significant opportunities for cost savings and improved cash flow. Primarily as a result of this acquisition, 012 Smile.Communications is now one of the major communication services providers in Israel as well as one of the three largest providers of broadband and international telephony services.

Since 012 Smile.Communications initial public offering in October 2007, its ordinary shares have been listed on the NASDAQ Global Market (symbol:SMLC) and on the Tel Aviv Stock Exchange, or TASE. We currently own 72.44% of the ordinary shares of 012 Smile.Communications.

Smile.Media is a leading diversified Internet media company in Israel and its internet properties, which include MSN Israel, are among the most recognized and highly trafficked websites in Israel. As of March 31, 2008, Smile.Media had 18 Internet properties in its network, consisting of 13 online content websites and five eCommerce websites. Smile.Media also markets nine paid content or subscription services as part of its eCommerce business. In addition, it has exclusive rights to market advertising on a website owned by a third party.

Our shares are listed on the NASDAQ Global Market and on the TASE. As used in this annual report, the terms we, us and our mean Internet Gold - Golden Lines Ltd. and its subsidiaries, 012 Smile.Communications means 012 Smile.Communications Ltd. and Smile.Media means Smile.Media Ltd. unless otherwise indicated.

We are a foreign private issuer as defined in Rule 3b-4 under the Securities Exchange Act of 1934. As a result, we are eligible to file this annual report pursuant to Section 13 of the Securities Exchange Act of 1934 Act on Form 20-F and to file interim reports on Form 6-K.

Our historical consolidated financial statements have been prepared in accordance with generally accepted accounting policies in the Israel, or Israeli GAAP and our functional currency is the New Israeli Shekel, or NIS. Effective as of January 1, 2008, we prepare our consolidated financial statements in accordance with generally accepted accounting policies in the United States, or U.S. GAAP. All references in this annual report to dollars or $ are to U.S. dollars and all references in this annual report to NIS are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

Smile 012 and 012Mobile logos are registered trademarks in Israel. Smile.Media, Smile.Communications and GPG Network (an interactive advertising network owned by Smile.Media) activities are registered service marks in Israel. All other registered trademarks appearing in this annual report are owned by their holders.

We and our subsidiaries currently hold numerous Internet domain names, including the following: 012.co.il , 012.net , 012.net.il , 012bill.net , 012biz.net , 012code.co.il , 012fax.net , 012fun.net , 012mail.net , 012mobile.com , 012mobile.net , 012mobile.org , 01 012smile.co.il , 012smile.com , 012smile.mobi , 012smile.net , 012smile.net.il , 012smilecommunication.biz , 012-smilecommunication.biz 012smilecommunication.com , 012-smilecommunication.com , 012smile-communication.com , 012smilecommunication.info , 012-smilecommunication.info , 012smilecommunication.mobi , 012-smilecommunication.mobi , 012smilecommunication.net , 012-smilecommunication.net , 012smilecommunication.org , 012-smilecommunication.org , 012smilecommunications.biz , 012-smilecommunications.biz , 012smile-communications.com , 012smilecommunications.com , 012-smilecommunications.com , 012smilecommunications.info , 012-smilecommunications.info , 012smilecommunications.mobi , 012-smilecommunications.mobi , 012smilecommunications.net , 012-smilecommunications.net , 012smilecommunications.org , 012-smilecommunications.org , 012sms.co.il , 012sms.net , 012sms.net.il , 012webcam.net , 015.net.il , 015.co.il , 072.net.il , 072web.net , aquanet.co.il , casino.net.il , diamond01 doctor.net.il , gold.net.il , golden-lines.co.il , golden-lines.net.il , goldenline.net.il , goldenlines.co.il , goldenlines.net.il , goldtrade.co.il , htceoforum.co.il , igld.biz , igld.co.il , igld.com , igld.mobi , igld.net , index-limudim.co.il , index-limudim.com , inter.net.il , interne internettv.co.il , israel-plus.tv , ktantanim.co.il , limodim.us , limudim.info , limudim.org.il , limudim.us , lomdim.info , lomdim.net , lotto.net.il , nirsamim.co.il , nirsamim.com , nirsamim.us , nirshamim.co.il , nirshamim.com , nirshamim.us , nirshmim.co.il , nirshmim nirshmim.us , nolad3.co.il , mail.net.il , messenger.co.il , messenger.org.il , mnenia.co.il , mnenya.co.il , p1000.co.il , p1000.ru , p10 p2000.co.il , smile.co.il , smile.net.il , smile-media.co.il , smile-media.net , smile-net.co.il , smile-tv.co.il , smile012.biz , smile012.co.i smile012.com , smile012.mobi , smile012.net , smile012.net.il , smile012communication.com , smile012communications.com , smilebiz.co smilemail.net.il , smilemedia.co.il , smilemedia.net , smileshops.co.il , start.co.il , studies-us.com , studies-us.info , studies- usa.com , studies-usa.info , usa-studies.com , vgames.co.il , vgamers.co.il , Yahala.co.il , zahav.net.il , zahav.ru , zahav015.co.il , zahav015.net.il right to use the domain names msn.co.il, and hotmail.co.il. Domain names generally are regulated by Internet regulatory bodies. The regulation of domain names in Israel and other countries is subject to change. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names.

Except for the historical information contained in this annual report, the statements contained in this annual report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. We urge you to consider that statements which use the terms anticipate, believe, do not believe, expect, plan, intend, estimate, anticipate and sim expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Such forward-looking statements are also included in Item 4 Information on the Company and Item 5 Operating and Financial Review and Prospects. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3.D. Key Information - Risk Factors.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following selected consolidated financial data for and as of the five years ended December 31, 2007 are derived from our audited consolidated financial statements which have been prepared in accordance with Israeli GAAP. Israeli GAAP differs in certain significant respects from U.S. GAAP, as described in Note 23 to the financial statements.

The selected consolidated financial data as of December 31, 2007 and 2006 and for the three years ended December 31, 2007, 2006 and 2005 have been derived from our audited consolidated financial statements and notes included elsewhere in this annual report. The selected consolidated financial data as of December 31, 2005, 2004 and 2003 and for the years ended December 31, 2004 and 2003 have been derived from audited consolidated financial statements not included in this annual report.

The selected consolidated financial data set forth below should be read in conjunction with and is qualified by reference to Item 5. Operating and Financial Review and Prospects and our consolidated financial statements and notes thereto included elsewhere in this annual report.

The translation of NIS amounts into dollars has been made solely for the convenience of the reader at the representative rate of exchange at December 31, 2007 (NIS 3.846 = $1.00). The dollar amounts so presented should not be construed as representing amounts receivable, payable or incurred in dollars or convertible into dollars.

In 2007, we completed an internal restructuring transferring all of our broadband data and traditional voice services to our wholly-owned subsidiary, 012 Smile.Communications, and our Internet media activity to our wholly-owned subsidiary, Smile.Media. On December 31, 2006, our wholly owned subsidiary Smile.Communications Ltd. acquired 012 Golden Lines Ltd., a privately held communications company that was one of its principal competitors in Israel and in 2007 we renamed Smile.Communications Ltd. 012 Smile.Communications. As a result of this acquisition, 012 Smile.Communications is now one of the three largest providers of broadband Internet access and international telephony services in Israel.

In conformance with U.S. and Israeli generally accepted accounting principles, or GAAP, we included the assets and liabilities of 012 Golden Lines in our consolidated financial statements as of December 31, 2006 and included its operating results starting January 1, 2007.

Consolidated Statement of Operations Data:

	Convenience Translation into Dollars	Year Ended December 31,				
	2007	2007	2006	2005	2004	2003
	(In thousands, except share and per share data)					
Israeli GAAP:						
Revenues:						
Communications	286,832	1,103,157	342,506	246,579	184,844	157,892
Media	18,926	72,789	65,853	42,191	30,872	19,164
Total revenues	305,758	1,175,946	408,359	288,770	215,716	177,056
Operating expenses:						
Cost of revenues	208,605	802,296	252,413	154,781	93,019	90,285
Selling and marketing	45,827	176,250	75,576	71,935	73,095	41,393
General and administrative	18,160	69,843	33,957	33,156	24,258	21,908
Impairment and other charges	2,713	10,433	10,187	-	-	-
Total operating expenses	275,305	1,058,822	372,133	259,872	190,372	153,586
Operating income	30,453	117,124	36,226	28,898	25,344	23,470
Financial income (expenses), net	(14,298)	(57,412)	(5,615)	(9,403)	122	(3,235)
Other income (expenses), net	(1,080)	(4,153)	(2,626)	237	(1,077)	(2,592)
Gain from issuance of shares in a subsidiary	30,197	116,136	-	-	-	-
Income from continuing operations	44,642	171,695	27,985	19,732	24,389	17,643
Income tax (benefits) expenses, net	5,299	20,382	1,286	1,451	(301)	(1,935)
Income after income tax	39,343	151,313	26,699	18,281	24,690	19,578
Minority share in income	(329)	(1,267)	(34)	-	-	-
Company s share in net loss of investees from continued operations	-	-	(334)	-	(396)	(1,538)
Income from continued operations	39,014	150,046	26,331	18,281	24,294	18,040
Company s share in loss of investees from discontinued operations	-	-	-	-	(4,763)	(3,737)
Net income	39,014	150,046	26,331	18,281	19,531	14,303
Earnings per ordinary share - basic						
Net income per share from continued operations	1.80	6.94	1.43	0.99	1.32	0.98
Net loss per share from discontinued operations	-	-	-	-	(0.26)	(0.20)
	1.80	6.94	1.43	0.99	1.06	0.78
Weighted average number of shares used in the calculation	21,617	21,617	18,438	18,432	18,432	18,432

Earnings per ordinary share - diluted						
Net income per share from continued operations	1.68	6.48	1.43	0.99	1.32	0.98
Net loss per share from discontinued operations	-	-	-	-	(0.26)	(0.20)
	1.68	6.48	1.43	0.99	1.06	0.78
Weighted average number of shares used in the calculation	24,795	24,795	18,438	18,432	18,432	18,432
U.S. GAAP:						
Net income from continued operations	32,246	124,018	11,085	18,281	27,164	18,874
Net loss - discontinued operations	-	-	-	-	(6,588)	(6,803)
Net income	32,246	124,018	11,085	18,281	20,576	12,071

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Consolidated Balance Sheets Data:

	Convenience Translation into Dollars	As at December 31,				
	2007	2007	2006	2005	2004	2003
			(In thousands)			
Israeli GAAP:						
Total assets	554,656	2,133,206	1,683,597	502,018	300,023	214,004
Working capital (deficiency)	160,969	619,088	(636,547)	253,999	41,714	76,256
Total liabilities	416,777	1,602,924	1,493,354	353,345	178,130	95,933
Total shareholders equity	137,879	530,282	190,243	148,673	121,893	118,071
U.S. GAAP						
Total assets	559,434	2,151,583	1,691,937	508,567	305,554	244,682
Total shareholders equity	126,310	485,787	167,447	147,973	121,193	104,430

Exchange Rate Information

The following table sets forth, for the periods and dates indicated, certain information regarding the Bank of Israel representative rate of exchange for dollars, expressed in NIS per one dollar. The representative rate is the average between the buying rate and the selling rate of exchange. We do not use such rates in the preparation of our consolidated financial statements included elsewhere herein. See Note 2D to the consolidated financial statements included elsewhere in this Form 20-F.

Period	Average (1)	High	Low	At Period End
Year ended December 31, 2003	4.545	4.924	4.283	4.379
Year ended December 31, 2004	4.478	4.634	4.308	4.308
Year ended December 31, 2005	4.484	4.741	4.299	4.603

Year ended December 31, 2006	4.453	4.725	4.176	4.225
Year ended December 31, 2007	4.110	4.342	3.830	3.846

(1) Calculated based on the average of the representative rates on the last business day of each month during the relevant period.

Period	**High**	**Low**
November 2007	3.969	3.830
December 2007	4.008	3.841
January 2008	3.861	3.625
February 2008	3.655	3.578
March 2008	3.656	3.377
April 2008	3.640	3.425
May 2008	3.461	3.233

On June 23, 2008, the representative rate of exchange was NIS 3.373 = $1.00, as published by the Bank of Israel.

B. **Capitalization and Indebtedness**

Not applicable.

C. **Reasons for the Offer and Use of Proceeds**

Not applicable.

D. **Risk Factors**

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

Risks Related to Internet Gold Generally

We have experienced significant growth, which may be difficult to sustain and has placed a significant strain on our resources, and we may not be able to successfully implement our growth strategy, which could adversely affect our ability to continue to grow or sustain our revenues and profitability.

As part of our growth strategy, we acquired 012 Golden Lines on December 31, 2006. Since then, our total assets grew from approximately NIS 1.7 billion as at December 31, 2006 to NIS 2.1 billion ($555.6 million) as at December 31, 2007, and our revenues grew from NIS 408.4 million for the year ended December 31, 2006 to NIS 1.2 billion ($306.8 million) for the year ended December 31, 2007. We experienced significant growth prior to the acquisition of 012 Golden Lines, as our revenues grew to NIS 408.4 million ($106.2 million) for the year ended December 31, 2006 from NIS 288.8 million for the year ended December 31, 2005. Our organic growth and the acquisition of 012 Golden Lines have placed, and are likely to continue to place, a significant strain on our management as well as our operational, administrative and financial resources and our internal controls. The demand on our network infrastructure, technical and customer support staff and other resources has grown with our expanding customer base and is expected to continue to grow as we expand our business. There can be no assurance that we will be able to manage our expanding operations effectively or that we will be able to continue to grow, and any failure to do so could affect our ability to generate revenues, control expenses and sustain or increase our profitability.

We do not expect to sustain our recent revenue growth rate, which may reduce our share price.

Our revenues increased at a compound annual growth rate, or CAGR, of 61% from NIS 177.1 million for the year ended December 31, 2003 to NIS 1.2 billion ($306.8 million) for the year ended December 31, 2007. We do not expect to sustain our recent growth rate in future periods. You should not rely on our revenue growth in any prior quarterly or annual period as an indication of our future revenue growth. If we are unable to maintain adequate revenue growth, we may not have sufficient resources to execute our business objectives and our share price may decline. You must consider our business and prospects in light of the risks and difficulties we encounter as a rapidly growing communication services provider.

If we do not successfully continue to develop our brands, we may be unable to attract enough customers to our services to maintain or increase our market share.

We believe that we must maintain and strengthen awareness of our 012 Smile.Communications and Smile.Media brands. If we do not successfully continue to develop our brands, we may be unable to attract additional customers and increase our market share. Brand recognition may become even more important in the future if competition increases in the communications market. We intend to continue to pursue a brand-enhancement strategy, which may include mass market and multimedia advertising, promotional programs, public relations activities and joint marketing programs. These initiatives will involve significant expenses. If our brand enhancement strategy is unsuccessful, we may not be able to attract additional customers, our sales and marketing expenses may never be recovered and we may be unable to increase future revenues.

We are reliant on our management team and a loss of any key member of our management could have an adverse effect on our future.

Our future development is dependent upon our present and prospective management team, including our chief executive officer, Eli Holtzman, who also serves as chief executive officer of Smile.Media and vice chairman of 012 Smile.Communications, Doron Turgeman, our chief financial officer who also serves as deputy chief executive officer and chief financial officer of Smile.Media, Stella Handler, the chief executive officer of 012 Smile.Communications, and Doron Ilan, the chief financial officer and vice president finance of 012 Smile.Communications. We do not have key person life insurance policies covering any of our officers or employees. The loss of any key member of our management for any reason may have an adverse effect on our future. Our success depends on our ability to attract and retain highly qualified key management and employees. Competition for highly-skilled engineers and managers is intense in the industry in which we operate, and there can be no assurance that we will be successful in attracting, assimilating or retaining qualified engineers and project mangers to fulfill our current or future needs. This could adversely impact our results of operations or financial performance.

We may not be able to protect our intellectual property or successfully defend infringement claims.

We regard our trademarks, service marks, copyrights, domain names, trade secrets and similar intellectual property as critical to our success. We rely on trademark, copyright law, trade secret protection and confidentiality agreements with our employees, customers, partners and others to protect our proprietary rights. The efforts we have taken to protect our proprietary rights may not be sufficient or effective. Third parties may infringe or misappropriate our copyrights, service marks, trademarks and similar proprietary rights. If we are unable to protect our proprietary rights from unauthorized use, the image of our brands may be harmed and our business may suffer.

The protection of our trademarks, service marks, copyrights, domain names, trade secrets and other intellectual property may require the expenditure of significant financial and managerial resources. Moreover, the steps we take to protect these assets may not adequately protect our rights, or others may independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights. Such events could substantially diminish the value of our technology and property which could adversely affect our business.

Our share price has been volatile and may decline in the future.

The market price of our ordinary shares has been subject to significant price movements and could be subject to wide fluctuations in the future in response to factors such as the following, some of which are beyond our control:

- quarterly variations in our operating results;
- operating results that vary from the expectations of securities analysts and investors;

changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

changes in market valuations of other communications companies;

announcements of technological innovations or new services by us or our competitors;

announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

changes in the status of our intellectual property rights;

announcements by third parties of significant claims or proceedings against us;

additions or departures of key personnel;

future sales of our ordinary shares; and

stock market price and volume fluctuations.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events or hostilities in or surrounding Israel, could adversely affect the market price of our ordinary shares.

We may be subject to intellectual property infringement claims, which are costly to defend, could result in significant damage awards and could limit our ability to provide certain content or use certain technologies in the future.

Third parties may in the future assert claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition or violations of privacy rights or failure to maintain confidentiality of user data. In addition, third parties may make trademark infringement and related claims against us over the display of search results triggered by search terms that include trademark terms.

As we expand our business and develop new technologies, products and services, we may become increasingly subject to intellectual property infringement claims. In the event that there is a determination that we have infringed third-party proprietary rights such as patents, copyrights, trademark rights, trade secret rights or other third-party rights such as publicity and privacy rights, we could incur substantial monetary liability, be required to enter into costly royalty or licensing agreements or be prevented from using the rights, which could require us to change our business practices in the future and limit our ability to compete effectively. We may also incur substantial expenses in defending against third-party infringement claims regardless of the merit of such claims. In addition, many of our agreements with our customers or affiliates may require us to indemnify them for certain third-party intellectual property infringement claims, which could increase our costs in defending such claims and our damages. The occurrence of any of these results could harm our brand and negatively impact our operating results.

Future sales or distributions of our ordinary shares by Eurocom Communications Ltd. could depress the market price for our ordinary shares.

Eurocom Communications Ltd., our controlling shareholder, may sell all or part of the ordinary shares of our company that it owns or distribute those shares to its shareholders, including pursuant to demand registration rights described elsewhere in this annual report. Sales or distributions by Eurocom Communications of substantial amounts of our ordinary shares in the public market could adversely affect prevailing market prices for our ordinary shares. Eurocom Communications is not subject to any contractual obligation that would prohibit it from selling, spinning off, splitting off or otherwise disposing of any of our ordinary shares. Consequently, we cannot assure you that Eurocom Communications will maintain its ownership of our ordinary shares.

We may be unable to maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have an adverse effect on our financial results and the market price of our ordinary shares.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 governing internal controls and procedures for financial reporting, which started in connection with our Annual Report on Form 20-F for the year ended December 31, 2007, have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. We identified a material weakness in our assessments of our internal controls over financial reporting with respect to certain spreadsheets utilized in the period-end financial reporting process and initiated remediation of this deficiency. Failure to maintain effective internal controls over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

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

As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. A foreign private issuer that elects to follow a home country practice instead of such requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer s home country certifying that the issuer s practices are not prohibited by the home country s laws. In addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission or on its website each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. As an Israeli company listed on the NASDAQ Global Market, we may follow home country practice with regard to, among other things, composition of the board of directors, director nomination procedure, compensation of officers, distribution of annual reports to shareholders and quorum at shareholders meetings. In addition, we may follow Israeli law instead of the NASDAQ Marketplace Rules that require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity-based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company.

Risks Related to 012 Smile.Communications

012 Smile.Communications has experienced significant growth, which has placed a substantial strain on our resources. The failure to successfully implement our growth strategy could adversely affect our ability to continue to grow or sustain 012 Smile.Communications revenues and profitability.

As part of our growth strategy, 012 Smile.Communications acquired one of our principal competitors, 012 Golden Lines on December 31, 2006. 012 Smile.Communications total assets increased to NIS 1.6 billion ($404.0 million) as at December 31, 2007 from NIS 223.4 million as at December 31, 2006, and its revenues increased to NIS 1.1 billion ($286.7 million) for the year ended December 31, 2007 from NIS 343.1 million for the year ended December 31, 2006, primarily due to the acquisition of 012 Golden Lines at December 31, 2006. 012 Smile.Communications experienced significant growth prior to the acquisition of 012 Golden Lines, as its revenues increased to NIS 343.1 million for the year ended December 31, 2006 from NIS 244.4 million for the year ended December 31, 2005. The organic growth of 012 Smile.Communications and the acquisition of 012 Golden Lines have placed, and are likely to continue to place, a significant strain on 012 Smile.Communications management as well as its operational, administrative and financial resources and its internal controls. The demand on 012 Smile.Communications network infrastructure, technical and customer support staff and other resources has grown with its expanding customer base and is expected to continue to grow as 012 Smile.Communications expands its business. We cannot guarantee that 012 Smile.Communications infrastructure, technical and customer support staff, operational and billing systems and other resources will adequately accommodate or facilitate the growth of its business.

Another part of 012 Smile.Communications growth strategy is managing and reducing the costs associated with delivering its services, including recurring service costs such as communications and customer support costs as well as expenses incurred to add new customers, such as sales and marketing, installation and hardware costs. There can be no assurance that 012 Smile.Communications will be able to manage its expanding operations effectively or that it will be able to continue to grow, and any failure to do so could affect its ability to generate revenues, control expenses and sustain or increase its profitability.

Changes in the regulatory and legal compliance environment could adversely affect 012 Smile.Communications operations and business activities and could result in increased competition and reduced revenues and profitability.

012 Smile.Communications operates in a highly regulated industry in Israel, which limits its flexibility in managing its business. 012 Smile.Communications is subject to regulation regarding communications licenses, antitrust, and arrangements pertaining to interconnection and leased lines and its business and operations could be adversely affected by decisions by regulators, in particular the Ministry of Communications, as well as changes in laws, regulations or government policy affecting its business activities, such as the following:

- Deregulating the monopoly-based restrictions imposed on Bezeq, Israel s incumbent telephony operator, and its affiliates;
- Deregulating the restriction imposed on Bezeq and its affiliates, including on D.B.S. Satellite Services (1998) Ltd., which operates under the trade name YES, Israel s sole satellite television service provider, that prevents it from providing VoB services;
- Deregulating the restrictions imposed on cellular operators that currently prevent them from providing international telephony services;
- Changing the regulation that requires the incumbent infrastructure providers Bezeq and HOT to allow us open access enabling us to provide broadband data and traditional voice services, or deregulating the restrictions that currently prevent them from charging us for the use of their infrastructure;
- Changing the regulations affecting our interconnection arrangements with other operators;
- Changing call termination tariffs;
- Establishing regulations relating to initiation of WiMAX services and installation of WiMAX antennae, including environmental and land use regulation;
- Limiting the prices that we may charge our customers;
- Broadening or increasing the range of revenues on which royalties are paid; and
- Changing the regulations affecting our international and local telephony business.

Such actions could result in increased competition and expenses and reduced revenues and profitability.

The current legislation in Israel grants the Ministry of Communications extensive regulatory and supervisory authority with respect to 012 Smile.Communications business, as well as the authority to impose substantial sanctions, such as fines. As a result, the interpretation and implementation of laws and regulations as well as provisions of its licenses are subject to the administrative discretion of the Ministry of Communications.

Further risks and uncertainties result from the fact that changes in such laws, regulations or government policies may not be adopted or implemented in the manner that we expect and may be further amended, interpreted or enforced in an unexpected manner or in a manner adverse to our business.

The regulatory limitations on Bezeq, Israel s incumbent telephony operator, could change in the future and result in increased competition, and a reduction in 012 Smile.Communications revenues from interconnect fees.

Bezeq, The International Communications Corp. Ltd., the incumbent local telephony provider in Israel, or Bezeq, is currently subject to several regulatory limitations, including restrictions on its ability to provide bundled service offerings, restrictions to entry into the VoB market, and supervised tariffs. Under its license, Bezeq is also subject to the principle of structural separation in providing its various communication services. Once Bezeq s market share falls below certain thresholds, which is likely to occur in 2008, Bezeq may apply to the Ministry of Communications to begin providing bundled services, which could potentially include local and international telephony, broadband Internet access, Internet service provider, or ISP, services, cellular services and multi-channel TV. Bezeq International, a subsidiary of Bezeq, has already submitted a license request to the Ministry of Communication to provide VoB services. Bezeq may also apply to the Ministry of Communications to offer discounts on its supervised tariffs in the domestic fixed telephony market.

Bezeq pays 012 Smile.Communications interconnect fees with respect to calls being made from Bezeq fixed-lines to 012 Smile.Communications VoB lines. Bezeq has raised the claim that it should not be paying such interconnect fees because 012 Smile.Communications uses its infrastructure. Although the Ministry of Communications has determined that Bezeq should pay interconnect fees for calls originated from Bezeq fixed-lines to 012 Smile.Communications lines at the same tariff as it pays Bezeq, this determination will be reviewed by the Ministry of Communications in February 2009 and there is no certainty that the Ministry of Communications will not reverse its determination that Bezeq should pay 012 Smile.Communications interconnect fees at the current rate or at all.

Further deregulation of various segments of the communication services market may allow Bezeq to be released from regulatory limitations, allowing it to bundle services and compete directly with us. Bezeq and its subsidiaries are not allowed to enter the VoB market until Bezeq s market share falls under 85% of the fixed-line telephony market. According to data published by the Ministry of Communications, Bezeq s market share in the private segment in March 2008 was approximately 86%. Bezeq International has already submitted a license request to the Ministry of Communication to provide VoB services. If the Ministry of Communications releases Bezeq from the prevailing regulatory limitations, it would enjoy a competitive advantage because it will be able to bundle services through its affiliates or in conjunction with a third party. This could result in Bezeq becoming an even stronger competitor. Bezeq currently has an advantageous position in the market because it has a dominant presence in all segments and can easily provide its customers with access to a great variety of services. The Ministry of Communications will also examine the competitive position of YES and it may allow YES to enter the VoB market if its competitive position deteriorates.

012 Smile.Communications depends on maintaining and renewing its existing regulatory licenses in order to fully conduct its business. 012 Smile.Communications inability to maintain and renew its existing licenses would negatively impact its and our results of operations revenues and profitability.

012 Smile.Communications ability to offer its broadband and traditional voice services depends on its ability to maintain and renew the licenses it has received from the Ministry of Communications. Although 012 Smile.Communications is entitled to renew its licenses, such licenses are subject to many terms and conditions. Any renewal or extension is subject to the discretion of the Ministry of Communications and may be renewed or extended, if at all, on terms materially different to the terms under which 012 Smile.Communications now operates. Any such change in the terms and conditions of these licenses may materially and adversely affect our consolidated results of operations. Such licenses may be suspended or revoked by the Ministry of Communications if 012 Smile.Communications defaults under or violates their terms. Each license requires 012 Smile.Communications to adhere to certain requirements, which include the scope of services to be provided under the license, the amount of royalties to be paid to the Ministry of Communications, technical standards employed in providing the services, maintenance and support procedures and protocols, communications with customers and information to be provided to the Ministry of Communications on a regular basis.

The regulations promulgated under the Israeli Communications Law, 1982, or the Communications Law, restrict ownership of our shares and who can serve as our directors. The regulations provide that a majority of 012 Smile.Communications directors must be Israeli citizens and residents, Israeli citizens and residents must own at least 20% of its outstanding share capital and must have the right to appoint at least 20% of 012 Smile.Communications directors. In addition, 012 Smile.Communications licenses provide that, without the approval of the Ministry of Communications, no person may acquire shares representing 10% or more of its outstanding share capital. If these requirements are not complied with, 012 Smile.Communications will be found to be in breach of its licenses and its licenses could be changed, suspended or revoked and we may also incur substantial fines. See Government Regulation Licenses and Applications.

The domestic fixed-line, or DFL, license granted to 012 Smile.Communications wholly-owned subsidiary, 012 Telecom, in February 2007 requires it to provide the subscribers of its local telephony services the ability to place international calls through the international operators in Israel of their choice. Currently, due to technical limitations, 012 Telecom s subscribers cannot dial abroad through the international operators of their choice, but we expect that this issue will be resolved by July 2008. 012 Telecom received a letter from the Ministry of Communications stating that it is allegedly in breach of the license and requested its response.

While 012 Smile.Communications believes that it is currently in compliance with all other material requirements of its licenses, the technical standards used to measure these requirements as well as other license provisions are subject to interpretation and we cannot be certain of 012 Smile.Communications compliance. Accordingly, we cannot be certain that 012 Smile.Communications licenses will not be revoked, will be extended when necessary, or, if extended, on what terms an extension may be granted.

The communications industry is dynamic and 012 Telecom will need to seek additional licenses, including the license to provide WiMAX services on a commercial basis, in the future. The inability to obtain any such new license may negatively impact its growth opportunities and revenues.

The communications industry is constantly evolving. New technologies and processes may require additional licenses from the Ministry of Communications. We cannot be certain that any such future licenses, including the license to provide WiMAX services on a commercial basis, will be granted to 012 Telecom or that it will be granted to its competitors and not to 012 Telecom, or on what terms they may be granted to 012 Telecom or to its competitors. 012 Telecom s ability to introduce new services, such as those based on WiMAX technologies, depends upon its ability to receive the appropriate licenses. To date, no licenses to provide WiMAX services on a commercial basis have been granted. In September 2007, the Ministry of Communication announced its intention to publish, following a public hearing, its policy for the allocation of frequencies for broadband wireless access networks, which includes the frequencies used by the WiMAX technology. According to the draft policy, which may be materially amended in the future, new operators that do not hold licenses issued under the Communications Law will have priority in the allocation of the frequencies, which may be granted based on tenders or on a first request, first receive basis. The Ministry of Communications draft policy does not fully specify the method that will be used in the allocation of the frequencies, and it does not specify the weight that will be given to each consideration.

The introduction of any new licensed services under an existing license must be authorized by the Ministry of Communications and is subject to a review period of up to 60 days, which may be extended by the Ministry of Communications. Such review may cause 012 Smile.Communications and 012 Telecom to lose critical time in bringing new services to market. Furthermore, the Ministry of Communications may refuse to allow 012 Smile.Communications or 012 Telecom to introduce such new services or make the introduction of the services subject to various conditions. 012 Smile.Communications and 012 Telecom are also considering the expansion of their service offerings to include IPTV, as well as MVNO. 012 Smile.Communications and 012 Telecom have applied to the Ministry for a full MVNO license although the regulatory framework for the grant of such licenses has not yet been established. 012 Smile.Communications and 012 Telecom s inability to obtain any new license, including the license to provide WiMAX services, IPTV or MVNO on a commercial basis or to introduce new services under an existing license, may negatively impact its growth opportunities and revenues.

Recently, the Gronau Committee, which was appointed by the Ministry of Communications to consider and recommend the best way to evolve further sustainable competition in the communication market, has handed its recommendation to the Minister of Communications. These recommendations call for several structural changes within the markets, including Local Loop Unbundling of Bezeq s infrastructure, which, if accepted and implemented, will allow 012 Telecom to compete in the MVNO and IPTV sector and improve its competitive position in the VoB business and WiMax services, while worsening the position of 012 Smile.Communications in other segments, by allowing the cellular operators in Israel to compete in the traditional long distance voice market. To date, the Minister of Communications has yet to comment on this report and there can be no assurance that the report will be implemented as recommended, or at all.

012 Smile.Communications operates in the highly competitive communications industry with existing participants and potential participants that have significant resources and customers, and a regulatory authority that has encouraged new entrants, which could intensify price competition and limit its ability to maintain or increase its market share.

012 Smile.Communications is subject to intense competition, which it expects will continue in the future. Moreover, 012 Smile.Communications services are subject to regulation by the Ministry of Communications, whose policy is to encourage new entrants and not limit the number of licenses, which may continue to increase competition and may lead to further reductions in prices and fees charged to customers.

The Ministry of Communications has encouraged new entrants into the broadband access market. HOT, the incumbent local cable provider that offers cable-modem access, has been legally permitted since March 2002 to provide Internet services through its affiliates, but, has chosen not to do so. While we cannot predict if or when HOT will become an ISP, its entry into the market could significantly harm 012 Smile.Communications competitive position in the broadband access market.

The Ministry of Communications has also encouraged new entrants into the international telephony services sub-sector. Israel s cellular operators are currently not licensed to provide international telephony services. If this situation were to change, competition would be further intensified and could require 012 Smile.Communications to lower its prices, grant incentives to customers, increase selling and marketing expenses and related customer acquisition costs and could also result in increased customer churn. Furthermore, in 2007, the operations of several of its competitors, NetVision, Barak and Globcall were combined into a single entity by The IDB Group, a large Israeli investment and industrial group. In addition, in May 2008, NetVision announced that it signed an agreement to purchase 15% of the share capital of HOT by no later than August 2008. These developments, subject to the Gronau Committee s recommendations to enforce a structural separation in the HOT group, could create a more formidable competitor offering bundled international telephony, broadband Internet access, data, local telephony and mobile services, which could harm the competitive position of 012 Smile.Communications.

We expect other competitors, including companies that are not presently engaged in local and international telephony, to provide VoB services, as well as WiMAX services, when they receive the appropriate licenses from the Ministry of Communications, which could adversely impact 012 Smile.Communications ability to increase its market share.

012 Smile.Communications also competes against established alternative voice communication providers, such as Skype (a service of eBay Inc.), which is not subject to licensing restrictions in Israel, as well as independent voice over Internet protocol, or VoIP, service providers which may choose to sacrifice revenue in order to gain market share and may offer their services at lower prices or for free. Such competitive

environment could intensify price competition and limit 012 Smile.Communications ability to maintain or increase its market share of the local telephony market.

012 Smile.Communications hubbing services are subject to a high degree of volatility and any reduction in hubbing services customers could significantly reduce our revenues.

The profitability of 012 Smile.Communications hubbing services business is driven by the needs of its customers whose demand for hubbing services is constantly fluctuating. In late 2007, 012 Smile.Communications determined to reduce its hubbings services business because of its lower operating margin. As a result, its hubbing services business declined significantly in the last fiscal quarter of 2007 and the first fiscal quarter of 2008. 012 Smile.Communications hubbing business is likely to continue to be subject to a high degree of volatility and could result in fluctuations in 012 Smile.Communications reported revenues and net income on a quarterly basis. A significant reduction in hubbing services activity could have an adverse affect on its operating revenues.

012 Smile.Communications operates in a market which already exhibits maturity and high user penetration and it may have to offer price reductions and increase marketing efforts to attract and retain customers, which may have a negative impact on its profitability.

The Israeli communications market is mature, with both traditional voice and broadband access being particularly competitive segments of the communications market, as demonstrated by the estimated 99% household penetration of fixed telephone lines and 62% broadband access penetration rate as of February 2007 according to latest information published by the Ministry of Communications. 012 Smile.Communications future revenues will depend significantly on its ability to retain existing customers, to sell those customers additional services, such as local telephony, and to attract new customers from other providers, and it may not be successful in doing so. In addition, the competitive market environment has required it in the past and may require it in the future to adopt an aggressive marketing policy in order to attract a greater number of customers, including reducing its rates. If adopted in the future, 012 Smile.Communications cannot be certain that this strategy will be successful. Price reductions caused by increased competition, as well as the expenses associated with the marketing efforts required to attract and retain customers, may have a negative impact on its profitability.

012 Smile.Communications VoB services are not the same as traditional telephony services and may not be adopted by mainstream customers, which could harm our future growth.

012 Smile.Communications VoB services are not the same as traditional telephony services. The quality of VoB service is dependent to a great measure on the quality of broadband access provided by Bezeq and HOT over which we have no control. Among the differences between 012 Smile.Communications VoB service and traditional voice services are:

- If 012 Smile.Communications customers experience a loss of power, their services will be interrupted;
- 012 Smile.Communications VoB services will be interrupted if its customers experience interruption in broadband access; and
- Depending on the quality of the broadband access provided to 012 Smile.Communications customers, they may experience lower call quality than that experienced over traditional fixed-line telephones, including static, echoes and delays in transmission.

The growth of 012 Smile.Communications VoB business is dependent on the adoption of its services by mainstream customers and therefore the rate of adoption may have a significant effect on its growth. If customers do not accept these differences between VoB service and traditional voice service, they may choose to continue using traditional voice services or may choose to return to services provided by traditional telephone companies.

The operations of 012 Smile.Communications depend on its ability to successfully expand and upgrade its network and integrate new technologies and equipment into its network. Any future system failures or difficulty in expanding or upgrading its network, or making new features available, could increase 012 Smile.Communications expenses and negatively impact its financial results.

Capacity constraints within 012 Smile.Communications networks and those of its suppliers have occurred in the past and will likely occur in the future. As the number of its customers using broadband services and the amount and type of information they wish to transmit over the Internet increases, 012 Smile.Communications may need to expand and upgrade its technology, processing systems and network infrastructure, which could be expensive and involve substantial management resources and capital expenditures. We do not know whether 012 Smile.Communications will be able to accurately project the rate or timing of any such increases, or expand and upgrade 012 Smile.Communications systems and infrastructure in a timely and cost-efficient manner. Any future system failures or difficulty in expanding or upgrading its network, or making new features available could increase its expenses and negatively impact its financial results.

The broadband and traditional voice services markets are subject to rapid technological change, which could adversely affect 012 Smile.Communications ability to compete and increase expenses.

The markets in which 012 Smile.Communications competes are characterized by rapidly changing and converging technology, evolving industry standards, frequent new service announcements, introductions and enhancements and changing customer demands. New services and technologies may be superior to the services or technologies that 012 Smile.Communications uses and may render its services and technologies obsolete or require it to incur substantial expenditures to modify or adapt its services or technologies. The development and expansion of 012 Smile.Communications services is dependent upon adopting new technologies and updating its systems to meet new standards. This can be a lengthy process involving long and complex evaluations and decision-making procedures that can continue over a number of months or even years. 012 Smile.Communications future success will depend on its ability to continually improve the performance, features and reliability of its broadband data and traditional voice services in response to competitive service offerings and the evolving demands of the marketplace.

The cost of implementing major infrastructure upgrade projects may fluctuate due to a number of variables over which 012 Smile.Communications has little or no control and, even though it estimates the cost of such projects based on its previous experience, costs may exceed its estimations. Such fluctuations may be due to a lengthy or complex implementation process and/or the lack of commitment of sufficient resources of, or delays caused by, the ultimate supplier and could increase its expenses and have a negative impact on our consolidated results of operations or financial performance.

012 Smile.Communications may not be successful in its introduction of WiMAX services, which could adversely affect our growth strategy.

In March 2007, 012 Smile.Communications was awarded the first technology experimental license to conduct fixed WiMAX trials in Israel which was later amended to also include mobile WiMAX trials. 012 Smile.Communications has commenced fixed and mobile WiMAX trials and intends to broaden its trials. WiMAX technology delivers transmissions via a wireless broadband connection from a single point to multi-points. The use of mobile WiMAX is not widespread and only a few operators in other countries have had any experience in operating such services in a commercial basis. If 012 Smile.Communications is not successful in its introduction of WiMAX services or such services do not achieve customer acceptance, our growth strategy may be adversely affected.

012 Smile.Communications may not be able to retain its present customers who use its legacy 015 international telephony prefix when it attempts to transfer them to its 012 international telephony prefix in accordance with regulatory requirements.

In connection with 012 Smile.Communications obtaining regulatory approval for the acquisition of 012 Golden Lines, the Ministry of Communications required 012 Smile.Communications to cease offering its legacy 015 international telephony prefix by January 2008 and later extended the period to January 2009. For the years ended December 31, 2006 and 2007, 012 Smile.Communications had NIS 13.4 million and NIS 27 million ($7 million) of revenues, respectively, from this service and we believe 012 Smile.Communications has substantially retained the 015 prefix customer base since the acquisition. 012 Smile.Communications may not be able to retain the customers who continue to use the 015 prefix when it attempts to transfer them to its 012 prefix, which we expect to occur prior to January 2009. This could have a negative impact on 012 Smile.Communications recurring revenues.

On January 10, 2008, Netvision Ltd., Netvision 013 Barak Ltd. and GlobeCall Communications Ltd. filed a petition and a request for a temporary restraining order against the Ministry of Communications, our company and Internet Gold. Netvision and 013 Barak, who merged their operations, claim that the Ministry of Communications decision to grant our company an additional year to operate the 015 international telephony access code in parallel with our 012 international telephony access code unjustly discriminates against them and provides our company a competitive and economic advantage, that the extension period is unreasonably long and that the process under which the decision was made was unfair since petitioners were not given a chance to be heard on the issue. The petitioners are seeking a court order that would nullify the extension and are also seeking to suspend the extension until a decision is rendered regarding their petition. A hearing was held on June 12, 2008 and we are waiting for the court s decision. The earlier termination of the period in which we can continue to offer the 015 prefix may negatively impact its ability to transfer these accounts to its 012 prefix and have a negative impact on its revenues.

If 012 Smile.Communications does not successfully continue to develop its brand, it may be unable to attract enough customers to its services to maintain or increase its market share or to recover its selling and marketing expenses, which could harm its future revenues or its ability to implement its growth strategy and its net income may be adversely affected.

We believe that 012 Smile.Communications must maintain and strengthen awareness of its 012 Smile brand. If it does not successfully continue to develop its brand, it may be unable to attract additional customers and increase its market share. Brand recognition may become even more important in the future if competition increases further in the communications market. 012 Smile.Communications intends to continue to pursue a brand-enhancement strategy, which may include mass market and multimedia advertising, promotional programs, public relations activities and joint marketing programs. These initiatives will involve significant expenses. If 012 Smile.Communications brand enhancement strategy is unsuccessful, it may not be able to attract additional customers, its sales and marketing expenses may never be recovered and it may be unable to increase future revenues or implement its growth strategy and its net income may be adversely affected.

012 Smile.Communications is dependent on certain suppliers and, if any of its arrangements with these suppliers are terminated, it may be unable to replace them on commercially reasonable terms or at all, which could increase its expenses and reduce our profitability.

012 Smile.Communications relies on a number of third-party computer systems, networks and service providers, including local and international telephony and cable companies. All broadband Internet access by its customers is, and will continue to be, connected through the infrastructure of local access providers, Bezeq and HOT, and is dependent on the open access policy of the Ministry of Communications.

At present, the Ministry of Communications does not permit HOT and Bezeq to charge for use of their infrastructure. If such restriction is deregulated, 012 Smile.Communications may incur substantial costs, which may adversely affect our profitability.

012 Smile.Communications ISP services are also dependent on the communications infrastructure owned and maintained by local access providers. Bezeq has suffered work stoppages on several occasions in recent years as a result of conflicts with its unionized employees. These work stoppages resulted in several days of interruption to the services that 012 Smile.Communications provides. In addition, Bezeq, HOT and other infrastructure providers have suffered technical network failures in the past. A disruption in customer access to Israel s fixed-line communications infrastructure could significantly impact the services that 012 Smile.Communications provides to its customers. An increase in 012 Smile.Communications cost of access to Israel s fixed-line communications infrastructure could adversely impact its results of operations. 012 Smile.Communications also depends on third parties for the physical repair and maintenance of leased lines. If an interruption or deterioration in the performance of these third-party services occurs, 012 Smile.Communications services may be disrupted.

Many of 012 Smile.Communications services are dependent on the submarine infrastructure made available by Med Nautilus, which is owned by Telecom Italia and connects countries bordering the Mediterranean Sea to all major Western European countries and to the United States. Med Nautilus has an effective monopoly over the provision of international submarine services to the Israeli communications industry. Although prices in respect of maintenance and current capacity are agreed on a long term basis and 012 Smile.Communications contract with Med Nautilus sets out the prices to be paid by 012 Smile.Communications for additional capacity for approximately two years, Med Nautilus has the ability to raise prices without 012 Smile.Communications being able to seek an alternative supplier for additional capacity.

Many of 012 Smile.Communications relationships with third party providers are terminable upon short notice. In addition, many of its third party suppliers and communications carriers sell or lease services to 012 Smile.Communications competitors and may be, or in the future may become, competitors themselves. If any of their arrangements with third parties is terminated, 012 Smile.Communications may not be able to replace them on commercially reasonable terms or at all, which could increase our expenses and reduce our profitability.

012 Smile.Communications is exposed to risks in connection with its network infrastructure and is dependent on services received from external suppliers. If the level of service received by 012 Smile.Communications from its external suppliers decreases, it may not be able to maintain the quality and breadth of its services, which could reduce its revenues and harm its operations.

012 Smile.Communications network platform is highly complex. Multiple faults occurring at the same time could severely affect its service. Although 012 Smile.Communications engineering staff is trained to operate and maintain its systems, there are numerous functions that they are unable to perform without external support. In addition, if the level of service we receive from our external suppliers decreases, it may adversely impact 012 Smile.Communications ability to properly maintain and operate its systems and therefore have a direct effect on its service. Also, as VoB technology continues to evolve, 012 Smile.Communications will be faced with the risks associated with the use of new software.

012 Smile.Communications does not have a direct network connection to all the possible call destinations around the world and depends on its business partners to connect calls generated by its customers to their final destinations worldwide. 012 Smile.Communications level of service is largely dependent on the level of service it receives from its international partners with respect to both call completion as well as call quality. Although 012 Smile.Communications makes extensive efforts to ensure the quality of calls as well as the breadth of its services, it cannot be sure that its partners will provide an adequate level of service, that it would be able to successfully replace a partner should that become necessary or that it will be able to maintain and increase the quality and breadth of its services.

012 Smile.Communications products and services may become obsolete, and it may not be able to develop competitive products or services on a timely basis or at all.

The communications services industry is characterized by rapid technological change, competitive pricing, frequent new service introductions, evolving industry standards and changing regulatory requirements. Each of these development efforts faces a number of continuing technological and operational challenges. 012 Smile.Communications believes that its success will depend on its ability to anticipate and adapt to these and other challenges and to offer competitive services on a timely basis. 012 Smile.Communications faces a number of difficulties and uncertainties associated with its reliance on future technological development, such as:

Other service providers may use more traditional and commercially proven means to deliver similar or alternative services or use more efficient, less expensive technologies;

Consumers may not subscribe for its services;

012 Smile.Communications may be unable to respond successfully to advances in competing technologies in a timely and cost-efficient manner;

012 Smile.Communications may lack the financial and operational resources necessary to enable migration toward mobile WiMAX technology and the development and deployment of network components and software that do not currently exist and that may require substantial upgrades to or replacements of existing infrastructure; and

Existing, proposed or undeveloped technologies may render 012 Smile.Communications existing or planned services less profitable or obsolete.

012 Smile.Communications systems and operations are vulnerable to damage or interruption, which could adversely affect its business.

012 Smile.Communications systems and operations are vulnerable to damage or interruption due to human error, natural disasters, power loss, communications failures, break-ins, sabotage, computer viruses, intentional acts of Internet vandalism and similar events. Any of these events could expose 012 Smile.Communications to a material risk of loss or litigation. In addition, if a computer virus, sabotage or other failure affecting 012 Smile.Communications systems is highly publicized, its reputation could be damaged and customer growth could decrease. While 012 Smile.Communications currently has partially redundant systems, it does not have full redundancy, a formal disaster recovery plan or alternative providers of hosting services. In addition, 012 Smile.Communications does not have a formal disaster recovery plan, and does not carry sufficient natural disaster or business interruption insurance to compensate for losses that could occur.

012 Smile.Communications may be exposed to substantial liabilities arising out of its broadband data and traditional voice services which could increase its costs, divert management time and resources and adversely affect its results of operations.

The law relating to the liability of ISPs for activities of their users is currently unsettled both within Israel and internationally. Claims by private or governmental entities may be brought against 012 Smile.Communications for defamation, negligence, copyright or trademark infringement, unlawful activity, tort, including personal injury, fraud, or other theories based on the nature and content of information that may be posted online or generated by its customers. The defense of any such actions could be costly and involve significant time and attention of management and other resources. In addition, 012 Smile.Communications professional liability insurance policy may not provide sufficient protection or cover all such exposure. Furthermore new legislation and court decisions may expose 012 Smile.Communications to liabilities or affect its services. Additional laws and regulations may be adopted with respect to the Internet, covering issues such as content, user privacy, pricing and other controls. For example, the Ministry of Communications is currently considering the implementation of broadcast content regulation with respect to electronic distribution of video content, including content distributed over the Internet, which would, among other things, block violent and sexual content for the protection of minors.

It is also possible that if any information provided directly by 012 Smile.Communications contains errors or is otherwise negligently provided to users, third parties could make claims against 012 Smile.Communications. For example, 012 Smile.Communications offers Web-based e-mail services, which expose it to potential risks, such as liabilities or claims resulting from unsolicited e-mail, lost or misdirected messages, illegal or fraudulent use of e-mail, or interruptions or delays in e-mail service. In the event that 012 Smile.Communications is found responsible for any such liability and is required to pay damages, our results of operation and financial performance may be adversely affected. Even if 012 Smile.Communications ultimately succeeds, legal actions would divert management time and resources, could be costly and are likely to generate negative publicity. 012 Smile.Communications may also be forced to implement costly measures to alter the way its services are provided to avoid any further potential liability.

Concern about alleged health risks relating to radio frequency radiation from wireless and WiMAX antennae may subject 012 Smile.Communications to litigation, discourage the use of its services and have an adverse effect on its business and revenues.

There have been suggestions that radio frequency radiation from wireless and WiMAX antennae may be linked to health concerns, including increased incidences of cancer. Although medical reviews have concluded that evidence does not support a finding of adverse health effects as a result of wireless and WiMAX antennae, some studies have suggested that radio frequency emissions may cause certain adverse biological effects. Research on these and other health concerns is ongoing and may demonstrate a link between radio frequency radiation and health concerns. 012 Smile.Communications and other wireless communications providers may be subject to litigation relating to these and other health concerns. Concerns over radio frequency radiation may discourage the use of 012 Smile.Communications services and have an adverse effect on its business and revenues.

012 Smile.Communications VoB emergency calling service is different from the traditional emergency calling service and may expose us to significant liability.

012 Smile.Communications VoB emergency calling service is different from the traditional emergency calling service in ways that may cause significant delays, or even failures, in callers receipt of the emergency assistance they need. The only location information that 012 Smile.Communications VoB emergency calling service can transmit to a dispatcher at a public safety answering point is the information that its customers have registered with it. A customer s registered location may be different from the customer s actual location at the time of the call because customers can make calls almost anywhere a broadband connection is available. In these instances, emergency callers must verbally advise the operator of their location at the time of the call and, in some cases, provide a call back number so that the call can be handled or forwarded to an appropriate emergency dispatcher.

Moreover, if a customer experiences a broadband or power outage, or if a network failure occurs, the customer will not be able to reach an emergency services provider. Customers may attempt to hold 012 Smile.Communications responsible for any loss, damage, personal injury or death suffered as a result.

012 Smile.Communications may need to raise additional funds in the future, which may subject us to dilution, and it may be unable to do so on favorable or acceptable terms or at all, which may harm its ability to expand, develop new or enhanced services, or respond to competitive pressures.

If cash generated from 012 Smile.Communications operations is insufficient to meet its operating and strategic needs, it may need to raise additional funds in order to expand, develop new or enhanced services, or respond to competitive pressures. The availability of funds for future expansion and the development of new or enhanced services will depend on a number of factors, including 012 Smile.Communications operating performance, its ability to issue equity and market conditions. If 012 Smile.Communications raises additional funds by issuing equity or convertible debt securities, our holdings and those of its other shareholders will be diluted and our ownership percentage will be reduced. Furthermore, new securities could have rights, preferences and privileges senior to those of the ordinary shares that we hold. We cannot be certain that additional financing will be available to 012 Smile.Communications when and to the extent required or that, if available, it will be on acceptable terms.

Risks Related to Smile.Media

Smile.Media generates a substantial part of its revenue from MSN Israel, which is owned by it and Microsoft Corporation, and the termination of its agreements with Microsoft Corporation relating to MSN Israel could seriously harm its business.

For the years ended December 31, 2007, 2006 and 2005, approximately 43%, 50% and 54% of our media division s total revenue, respectively, was attributable to its 50.1% owned portal subsidiary, MSN Israel Ltd., which is owned by Smile.Media and Microsoft Corporation. Under the terms of the agreements we entered into with Microsoft Corporation, it may terminate the agreements in the event that Smile.Media is in default of its obligations under such agreements and may terminate the portal agreement with or without cause upon 90 days written notice and may terminate the shareholders and brand license agreement with or without cause upon 60 days written notice. In the event the portal agreement is terminated, Smile.Media would be required to remove the MSN Israel portal from the Internet, would lose all revenue derived from MSN Israel and Smile.Media s business would be adversely affected. In the event the shareholders and brand license agreement is terminated prior to the repayment of the MSN Israel loan, the remaining balance of the loan would not be repaid.

Under the terms of the agreement with Microsoft Corporation, we agreed to provide the financing for the activities of MSN Israel by means of loans in accordance with a business plan and budget approved by the board of directors of MSN Israel from time-to-time and/or guarantees for bank loans. In connection with our assignment to Smile.Media of our rights in and obligations to MSN Israel, Smile.Media also assumed the rights and responsibilities with respect to funds received by MSN Israel from us and the interest accrued on those funds. Smile.Media, as our assignee, has the right to terminate the agreements in the event that MSN Israel s cumulative losses are $10 million or more. Until such time as the loan is repaid in full, MSN Israel is required to pay Microsoft Corporation a fee equal to 17% of its operating income. The termination of the MSN Israel agreements would have a material adverse effect on Smile. Media's results of operations.

Smile.Media faces significant competition from companies that provide content, eCommerce services, search services and advertising to Internet users and Internet service providers.

Smile.Media faces significant competition in every aspect of its business, principally from Google, Walla Communications Ltd., Ynet, Tapuz and Nana10, which have aggregated a variety of Internet content, eCommerce services and relevant advertising services. Some of Smile.Media s competitors have longer operating histories and more established relationships with customers as well as more resources than it does. Smile.Media s competitors can use their experience and resources in a variety of ways, including acquisitions, research and development and by competing more aggressively for advertisers and online publishers. Some of Smile.Media s competitors may also have a greater ability to attract and retain users than it does because they operate larger Internet properties with a broader range of content, products and services.

In addition, some of the portals and websites that Smile.Media competes with may be operated by Internet service providers, other than 012 Smile.Communications. Because users need to access the Internet through Internet service providers, or ISPs, users have direct relationships with these providers. If an ISP or, for that matter, a computer or computing device manufacturer offers online services that compete with Smile.Media, the user may find it more convenient to use the services of the ISP or manufacturer. Also, because the ISP gathers information from the user in connection with the establishment of a billing relationship, the ISP may be more effective than we are in tailoring services and advertisements to the specific tastes of the user.

Smile.Media s operating results are likely to fluctuate significantly.

Smile.Media s operating results are likely to fluctuate significantly on a quarterly and annual basis as a result of a number of factors, many of which are outside of its control. Some of the factors that may cause these fluctuations include the following:

Smile.Media s ability to continue to attract users to its websites;

Smile.Media s ability to continue to operate its MSN Israel joint venture with Microsoft Corporation;

The generation of revenue from traffic on Smile.Media s websites;

The amount and timing of operating costs and capital expenditures related to the maintenance and expansion of Smile.Media s businesses (including new websites, projects and services), operations and infrastructure;

Smile.Media s ability to effectively integrate newly acquired Internet properties or marketing relationships for third-party content;

General economic conditions and those economic conditions specific to the Internet, online advertising and eCommerce;

Smile.Media s ability to keep its websites operational at a reasonable cost and without service interruptions; and

Geopolitical events such as war, threat of war or terrorist actions.

For these reasons, comparing Smile.Media s operating results on a period-to-period basis may not be meaningful, and its past results may not be indicative of its future performance.

Smile.Media generates the majority of its revenue from online advertising, and the reduction in spending by or loss of current or potential advertisers would cause its revenue and operating results to decline.

For the years ended December 31, 2007, 2006 and 2005, our media division generated approximately, 70%, 77% and 70% of its total revenue, respectively, from its advertisers. Smile.Media s ability to continue to retain and grow its advertising revenue depends upon:

Its ability to maintain current users and continue to attract new users to its websites;

Its ability to offer advertisers a diverse range of vertically and demographically targeted audiences;

Its ability to successfully evolve its advertising formats to those preferred by advertisers, such as the emergence of lead generation and pay-per-click, which includes self-service paid search;

Widening the continued acceptance of the Internet as an advertising medium by advertisers;

Broadening its relationships with advertising agencies and small and medium-size advertisers; and

Attracting advertisers to its user base.

In many cases, advertisers can terminate their contracts with Smile.Media at any time. In addition, advertisers may make smaller or shorter-term purchases, and market prices for online advertising may decrease due to competition or other factors. For example, in the late 1990s, advertisers began to spend heavily on online advertising, however, this growth in online advertising was followed by a lengthy downturn in such spending. Advertisers will not continue to do business with Smile.Media if their advertisements on Smile.Media s websites do not generate sales leads, and ultimately customers, or if Smile.Media does not deliver their advertisements in an appropriate and effective manner. If Smile.Media is unable to remain competitive and provide value to its advertisers, it may lose its existing advertisers and fail to attract new advertisers, which would cause its revenue to decrease and have a negative effect on our business.

Acquisitions and strategic investments could result in operating difficulties and unanticipated liabilities.

We made several strategic investments related to Smile.Media since 2005, and Smile.Media expects to pursue additional investments and acquisitions in the future. This investment and future investments and acquisitions may result in use of cash resources, incurrence of debt and amortization of expenses related to intangible assets. The successful integration of this and future acquisitions into Smile.Media s business faces a number of risks, including:

Difficulty of assimilating the operations and personnel of newly acquired companies and business units into its operations;

Potential disruption of Smile.Media s ongoing business and distraction to management;

Difficulty of integrating acquired technology and rights into existing services and unanticipated expenses related to such integration;

Failure to successfully further develop acquired technology resulting in the impairment of amounts currently capitalized as intangible assets;

Potential for patent and trademark infringement claims against the acquired company;

Impairment of relationships with customers and partners of the acquired companies or existing customers and partners as a result of the integration of acquired operations;

Impairment of relationships with employees of the acquired companies or current employees as a result of integration of new management personnel;

Difficulty of integrating the acquired company s accounting, management information, human resources and other administrative systems; and

Impact of known potential liabilities or unknown liabilities associated with the acquired companies.

Any failure in addressing these risks or other problems encountered in connection with past or future acquisitions could cause Smile.Media to fail to realize the anticipated benefits of its acquisitions, incur unanticipated liabilities and harm our business generally.

If Smile.Media fails to successfully develop and introduce new products and services, or is unable to develop, license or acquire compelling content at reasonable costs, its competitive position and ability to retain and attract users to its websites may be harmed.

Smile.Media s future success depends in part upon its ability to retain and attract new users to its websites by offering compelling content and new products and services. Smile.Media is continuously developing new products and services for its users and developing or acquiring compelling content. The planned timing or introduction of new products and services is subject to risks and uncertainties. Unexpected technical, operational, distributional or other problems could delay or prevent the introduction of one or more new products or services. Moreover, Smile.Media cannot be sure that any of its new products and services will achieve widespread market acceptance or generate incremental revenue.

Most of Smile.Media s Internet properties license much of the content on their properties from third parties. Such content may require substantial payments to third parties from whom Smile.Media s Internet properties license or acquire such content. Smile.Media s ability to maintain and build relationships with third-party content providers will be critical to its success. In addition, as new methods for accessing the Internet become available, including through mobile devices, Smile.Media may need to enter into amended content agreements with existing third-party content providers to cover the new devices. Also, to the extent that Smile.Media develops content of its own, current and potential third-party content providers may view such services as competitive with their own, and this may adversely affect their willingness to license their content to Smile.Media or to its Internet properties. Smile.Media may be unable to enter into new, or preserve existing, relationships with the third parties whose content is sought. In addition, as competition for compelling content increases both domestically and internationally, Smile.Media s content providers may increase the prices at which they offer their content to it, and potential content providers may not offer their content on agreeable terms. Further, many of Smile.Media s content licenses with third parties are non-exclusive. Accordingly, other websites and other media such as radio or television may be able to offer similar or identical content.

If Smile.Media is unable to license or acquire compelling content at reasonable prices, if other companies broadcast content that is similar to or the same as that provided by it, if it does not develop compelling editorial content or personalization services, or it fails to successfully develop and introduce new products and services on a timely and efficient basis, the number of users of its services may not grow as anticipated, or may decline, which could harm our operating results.

Smile.Media may be exposed to substantial liabilities arising out of its Internet activities.

Smile.Media hosts a wide variety of services that enable individuals and businesses to exchange information, generate content, advertise products and services, conduct business and engage in various online activities on an international basis. The law relating to the liability of providers of these online services for the activities of their users is currently unsettled both within Israel and internationally. Claims may be brought against Smile.Media for defamation, negligence, copyright or trademark infringement, unlawful activity, tort, including personal injury, fraud or other theories based on the nature and content of information that it provides links to, that may be posted online or generated by its users, or with respect to auctioned materials. Smile.Media is especially susceptible to claims arising from its websites that are geared to other cultures and are in other languages that it cannot easily review or may have difficulty in fully understanding. Smile.Media s defense of any such actions could be costly and involve significant time and attention of its management and other resources. Smile.Media generally does not exercise editorial control over the content appearing on websites that its users may be directed to from Smile.Media s websites and may be subject to claims that it has not exercised sufficient control over such content. In the event that Smile.Media is found to be responsible for any such liability or required to pay for any damages resulting from any such responsibility, its business may be adversely affected.

Smile.Media also enters into arrangements to offer third-party products, services, or content on its websites and portals. Smile.Media may be subject to claims concerning these products, services or content by virtue of its involvement in marketing, branding, broadcasting or providing access to them, even if it does not host, operate, provide or provide access to these products, services or content. While its agreements with these parties often provide that Smile.Media will be indemnified against such liabilities, such indemnification may not be adequate.

It is also possible that if any information provided directly by Smile.Media contains errors or is otherwise negligently provided to users, third parties could make claims against it. For example, Smile.Media offers web-based email services which expose it to potential risks, such as liabilities or claims resulting from unsolicited email, lost or misdirected messages, illegal or fraudulent use of email, or interruptions or delays in email service. Investigating and defending any of these types of claims is expensive, even to the extent that the claims do not ultimately result in liability.

Changes in regulations or user concerns regarding privacy and protection of user data could adversely affect Smile.Media s business.

Local and international laws and regulations may govern the collection, use, sharing and security of data that Smile.Media receives from its users and partners. In addition, Smile.Media has and posts on its websites its own privacy policies and practices concerning the collection, use and disclosure of user data. Any failure, or perceived failure, by Smile.Media to comply with its posted privacy policies or with any data-related consent orders, local, state or international privacy-related laws and regulations could result in proceedings or actions against it by governmental entities or others, which could potentially have an adverse effect on its business.

Further, failure or perceived failure to comply with Smile.Media s policies or applicable requirements related to the collection, use, sharing or security of personal information or other privacy-related matters could result in a loss of user confidence in Smile.Media and ultimately in a loss of users, partners or advertisers, which could adversely affect its business.

There are a number of legislative proposals pending before various legislative bodies in Israel concerning privacy issues which may affect Smile.Media s business. It is not possible to predict whether or when such legislation may be adopted. Certain legislation, if adopted, could impose requirements that may result in a decrease in Smile.Media s user traffic and revenue. In addition, the interpretation and application of user data protection laws are in a state of flux. These laws may be interpreted and applied inconsistently from country to country and inconsistently with Smile.Media s current data protection policies and practices. Complying with these varying international requirements could cause Smile.Media to incur substantial costs or require Smile.Media to change its business practices in a manner adverse to its business.

Risks Related to Our Operations in Israel

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

We and our subsidiaries are incorporated, based in and currently derive substantially all of our revenues from markets within the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Major hostilities between Israel and its neighbors may hinder Israel s international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business. There has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2007. The future effect of this deterioration and violence on the Israeli economy and our operations is unclear. Recently, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups, as well as extensive hostilities along Israel s northern border with Lebanon in the summer of 2006, and extensive hostilities along Israel s border with the Gaza Strip since June 2007 when the Hamas effectively took control of the Gaza Strip, which have intensified since February 2008. Ongoing violence between Israel and the Palestinians as well as tension between Israel and the neighboring Syria and Lebanon may have a material adverse effect on our business, financial conditions and results of operations.

Our businesses may be impacted by NIS exchange rate fluctuations.

Most of our communications and advertising costs are quoted in dollars. As of June 13, 2002 we are required by law to state our prices in NIS to our residential and small office and home office, or SoHo, customers. Furthermore, if we expand our business into other countries, we may earn additional revenue and incur additional expenses in other currencies. We also have U.S. dollar denominated liabilities (rights of use leasing obligations for our international lines). In future periods, our dollar assets (deposits) and our dollar denominated liabilities might commercially serve as partial economic hedges against future exchange rate fluctuations. Because all foreign currencies do not fluctuate in the same manner, we cannot quantify the effect of exchange rate fluctuations on our future financial condition or results of operations.

A substantial devaluation of the NIS in relation to the dollar would substantially increase the cost of our services to Israelis, who pay us in NIS, and is likely to result in subscriber cancellations and a reduction in Internet use and eCommerce in Israel.

Our operating results may be adversely affected if inflation in Israel is not offset on a timely basis by a devaluation of the NIS against the foreign currencies to which we are exposed, by our currency hedging position and by changes in the Israeli Consumer Price Index.

Some of 012 Smile.Communications purchases of international bandwidth and other international agreements expose us to fluctuations in foreign currencies, principally the U.S. dollar. Most of our sales are denominated in NIS. When the Israeli inflation rate exceeds the rate of the NIS devaluation against foreign currencies, our NIS expenses will increase to the extent of the difference between the rates. A significant disparity of this kind may have a material adverse effect on our operating results.

We engage in currency hedging transactions to reduce the impact on our cash flows and results of operations of currency fluctuations. We recognize freestanding derivative financial instruments as either assets or liabilities in our balance sheet and we measure those instruments at fair value. Changes in fair value are recognized in our income statement without any reference to the change in value of the related budgeted expenditures. These differences could result in fluctuations in our reported net income on a quarterly basis.

Further, as the principal amount of, and interest that we pay on, our debentures are linked to the Israeli Consumer Price Index, any increase in the Israeli Consumer Price Index will increase our financial expenses and could adversely affect our results of operations.

Our 012 Smile.Communications subsidiary may be restricted in the conduct of its operations during periods of national emergency.

During periods of national emergency, the Israeli government may take control of 012 Smile.Communications network, and it may be ordered by the Prime Ministry of Communications of Israel to provide services to security forces. In addition, the Israeli Equipment Registration and IDF Mobilization Law, 1987 permit the registration, taking and use of engineering equipment and facilities by Israel s Defense Forces. These actions could adversely affect our business operations.

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

Generally, all non-exempt male adult citizens and permanent residents of Israel under the age of 45, including many of our executive officers and employees in Israel, are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

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

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company s articles of association, increases in a company s authorized share capital, mergers and interested party transactions requiring shareholder approval. A shareholder also has a general duty to refrain from oppressing any other shareholder of his or her rights as a shareholder. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or who, under our articles of association, has the power to appoint or prevent the appointment of a director or executive officer in the company, has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness, but provides that the remedies generally available upon a breach of contract will apply also in the event of a breach of the duty to act with fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

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

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain provisions that may make it more difficult to acquire our company, such as provisions establishing a classified board. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. See Description of Share Capital Approval of Related Party Transactions and Israeli Taxation for additional discussion about some anti-takeover effects of Israeli law.

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

Investors and our shareholders generally may have difficulties enforcing a U.S. judgment against us, our executive officers and directors or asserting U.S. securities laws claims in Israel.

We are incorporated in Israel and all of our executive officers and most of our directors reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, all of our assets and most of the assets of our executive officers and directors are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were incorporated under the laws of the State of Israel in April 1992 under the name Euronet Golden Lines (1992) Ltd. In June 1999 we changed our name to Internet Gold - Golden Lines Ltd. We are a public limited liability company under the Israeli Companies Law 1999 and operate under this law and associated legislation. Our registered offices and principal place of business are located at 1 Alexander Yanai Street, Petach Tikva, Israel, and our telephone number is 972-72-2003-848. Our addresses on the Internet are www.smile.net.il or www.smile.msn.co.il. We also maintain an investor information site at www.igld.com. The information on our websites is not incorporated by reference into this annual report on Form 20-F.

We are a leading communications and interactive media group in Israel with two principal operating activities. Our company s subsdiaries are 012 Smile.Communications Ltd. and Smile.Media Ltd.

012 Smile.Communications is a growth-oriented communication services provider in Israel with a leading market position, offering a wide range of broadband and traditional voice services. 012 Smile.Communications broadband services include broadband Internet access with a suite of value-added services, specialized data services and server hosting, as well as new innovative services such as local telephony via voice over broadband, or VoB, and a WiFi network of hotspots across Israel. 012 Smile.Communications traditional voice services include outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. 012 Smile.Communications offers its services to residential and business customers, as well as to Israeli cellular operators and international communication services providers, or carriers, through our integrated multipurpose network, that allows us to provide services to almost all of the homes and businesses in Israel.

Smile.Media is a leading diversified Internet media company in Israel and its Internet properties, which include MSN Israel, are among the most recognized and highly trafficked websites in Israel. As of December 31, 2007, Smile.Media had 18 Internet properties in its network, consisting of 13 online content websites and five eCommerce websites. Smile.Media also markets nine paid content or subscription services as part of its eCommerce business. In addition, it has exclusive rights to market advertising on a website owned by a third party.

We began providing Internet access services in 1996, and began offering broadband services in 2001 and traditional voice services in 2004. As part of our internal restructuring in 2006, we transferred our broadband and traditional voice services businesses to 012 Smile.Communications, and our media operations to Smile.Media.

On December 31, 2006, 012 Smile.Communications acquired one of its principal competitors, 012 Golden Lines. We believe that the acquisition of 012 Golden Lines provides 012 Smile.Communications with the size and scale of operations necessary to effectively compete in its markets, and with significant opportunities for cost savings and improved cash flow. Primarily as a result of this acquisition, 012 Smile.Communications is now one of the major communication services providers in Israel as well as one of the three largest providers of broadband and international telephony services. Since the acquisition, 012 Smile.Communications has been granted a license to provide VoB local telephony services on a commercial basis without any limitation on the number of subscribers, as well as the first license to conduct fixed WiMAX technology trials, which was later amended to also include mobile WiMAX trials.

Since 012 Smile.Communications initial public offering in October 2007, its ordinary shares have been listed on the NASDAQ Global Market (symbol:SMLC) and on the TASE. We currently own 72.44% of the ordinary shares of 012 Smile.Communications.

We face competition in all segments of our operations and we believe we maintain our competitive position based on the quality of our services and competitiveness of our pricing.

Our capital expenditures totaled NIS 59.3million ($15.4 million), in the year ended December 31, 2007, (not including the purchase of rights of use of international fiber optic lines), NIS 20.8 million in the year ended December 31, 2006 (not including our acquisition of 012 Golden Lines and the purchase of rights of use of international fiber optic lines), and NIS 12.1 million (not including the purchase of rights of use of international fiber optic lines) in the year ended December 31, 2005. Of the NIS 59.3 million of capital expenditures in 2007, NIS 41.8 million ($10.8 million), was invested in network equipment and computers, NIS 3.4 million ($0.8 million) was invested in furniture and office equipment and NIS 14.2 million ($3.7million), was invested in leasehold improvements.

During 2008, we expect to incur capital expenditures of about NIS 73.5 million (approximately $19.11 million) (not including the purchase of rights of use of the international fiber optic lines), mostly for network equipment and computers.

B. Business Overview

Overview

We are a leading communications and interactive media group in Israel with two principal operating activities. Our companie s subsdiaries are012 Smile.Communications Ltd. and Smile.Media Ltd.

012 Smile.Communications is a growth-oriented communication services provider in Israel with a leading market position, offering a wide range of broadband and traditional voice services. 012 Smile.Communications broadband services include broadband Internet access with a suite of value-added services, specialized data services and server hosting, as well as new innovative services such as local telephony via voice over broadband, or VoB, and a WiFi network of hotspots across Israel. 012 Smile.Communications traditional voice services include outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. As a growth-oriented company, 012 Smile.Communications continually focuses on introducing new broadband services that allow it to expand its penetration into the communication market segments in which it currently operates, as well as access new market segments such as the large Israeli local telephony and mobile markets. 012 Smile.Communications has frequently been a leader in introducing new, innovative services and is the first company in Israel to provide VoB services and the first to be granted a license to provide WiMAX-based services on a trial basis.

012 Smile.Communications offers its services to residential and business customers, as well as to Israeli cellular operators and international communication services providers, or carriers, through its integrated multipurpose network, which allows it to provide services to almost all of the homes and businesses in Israel. As of December 31, 2007, 012 Smile.Communications estimates that its market share of the international telephony market was 33% based on the number of incoming and outgoing minutes in Israel. 012 Smile.Communications estimates that its market share of the broadband Internet access market as of December 31, 2007 was 32% based on data contained in Bezeq and HOT s 2007 annual reports and the number of broadband access customers it had. As of December 31, 2007, 012 Smile.Communications provided services to approximately 1,041,000 registered household customers and approximately 78,000 registered business customers. 012 Smile.Communications enterprise customer base consists of many of Israel s leading companies, including 75 of the 100 largest companies in Israel, which includes the two largest Israeli banks (as determined by Dun & Bradstreet) and the Government of Israel.

Smile.Media is a leading diversified Internet media company in Israel and its Internet properties, which include MSN Israel, are among the most recognized and highly trafficked websites in Israel. As of December 31, 2007, Smile.Media had 18 Internet properties in its network, consisting of 13 online content websites and five eCommerce websites. Smile.Media also markets nine paid content or subscription services as part of its eCommerce business. In addition, it has exclusive rights to market advertising on a website owned by a third party.

Our Strategy

We are committed to our long-term goal of enhancing our position as a leading communications and media company in Israel and believe that there are significant opportunities to continue to grow both of our principal businesses through our subsidiaries, 012 Smile.Communications and Smile.Media.

Growth strategy for 012 Smile.Communications

We believe that there are significant opportunities for 012 Smile.Communications to continue to grow its business. The sources of potential growth include 012 Smile.Communications ability to (i) increase its average revenue per user, or ARPU, from existing customers by providing bundled services, cross-selling services, and upgrading bandwidth, (ii) attract new customers by offering advanced services based on new technologies and cost-effective bundled services and (iii) leverage its network to offer new services, such as WiMAX based services. 012 Smile.Communications growth strategy is to:

Maximize customer satisfaction, retention and growth. We believe that the key factors contributing to customer satisfaction are network performance, reliability and availability of services, customer service and technical support and the range and quality of our services. 012 Smile.Communications will continue to focus on its strong commitment to customer satisfaction to keep churn rates low and achieve customer growth through customer referrals.

Increase penetration and cross-selling of services to existing customer base. 012 Smile.Communications intends to leverage its large residential and business customer base of broadband data and traditional voice customers and its strong brand recognition to increase its ARPU by cross-selling its existing services, including broadband Internet access, traditional voice and VoB local telephony. We believe that bundling attracts new customers, adds value for current customers and increases the share of our customers expenditures on communications services and significantly increases customer retention.

Expand penetration into the local telephony market. 012 Smile.Communications intends to leverage its receipt of a commercial license to offer VoB services, and to continue to increase the number of its local telephony customers and achieve a greater share of the local telephony market. We believe that 012 Smile.Communications VoB services provide an innovative and complementary service for new customers and for its existing customer base of over 1,119,000 households and businesses. 012 Smile.Communications VoB services allow it to cost-effectively expand its penetration into the large local telephony market with a versatile, feature-rich, low cost service that can be bundled with other services that its offers its customers.

Utilize advanced technologies to expand 012 Smile.Communications services and enter new markets. 012 Smile.Communications is continually broadening its service offerings by leveraging advanced technologies, specifically VoB and wireless solutions such as WiMAX and WiFi. With the use of the 2.5, 3.5 and 3.7 gigahertz WiMAX spectrums that have been licensed to it by the Ministry of Communications, on a trial basis, 012 Smile.Communications is positioned to deliver a wide range of services over an independent infrastructure able to support future mobility applications, such as VoIP in conjunction with WiFi technology, and provide last-mile wireless broadband access for its business customers. 012 Smile.Communications will also consider expanding its service offerings to include Internet protocol television, or IPTV, services, as well as mobile virtual network operator, or MVNO, services.

Selectively pursue growth opportunities. In addition to adding customers through its sales and marketing efforts, 012 Smile.Communications plans to pursue growth opportunities through acquisitions or strategic alliances that will increase its customer base, allow it to take advantage of the unused capacity of its network, enhance its ability to sell and deliver value-added services and add revenues with minimal incremental costs. There are no current plans, proposals or arrangements with respect to any such acquisition.

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Growth strategy for Smile.Media

Smile.Media strives to offer the most diverse and comprehensive range of Internet offerings in the markets it serves and seeks to develop new properties and acquire, improve and increase revenue generation from existing underdeveloped properties both in Israel and internationally, by implementing the following strategies:

Increase revenue from Smile.Media s existing properties. Smile.Media intends to increase its current user traffic and page views by offering more compelling content, increased functionality and additional services, such as community websites, social networking and user-generated content. Another opportunity to leverage its existing content and expand its advertising inventory comes through the extension of such content onto mobile platforms, adding to those currently offered by MSN Israel, Tipo, Seret and Vgames. Smile.Media also intends to continue to increase the advertising yield and transaction conversion rates of its existing Internet properties. We believe that improving the experience for users, advertisers, merchants and content providers, as well as expanding and enhancing its marketing initiatives to these groups, will enable Smile.Media to increase its market share.

Leverage Smile.Media s experience in identifying, acquiring and improving the financial performance of Internet properties. Smile.Media has experience in defining areas of demographic interest, identifying selective underperforming Internet properties, acquiring them and improving their financial performance. During the last four years, Smile.Media acquired controlling interests in seven Internet properties and was able to realize cross-selling synergies and improve their operational results. We believe that similar Internet properties exist that might benefit from Smile.Media s brand recognition, management experience and economies of scale and that Smile.Media could turn them into performing assets under its network.

Leverage Smile.Media s demographic know-how to establish community based portals. We believe that Smile.Media s extensive understanding of different consumer groups, cultures and characteristic of some of the ethnic user groups serves to enable Smile.Media to facilitate online communities. A virtual community or online community is a group of people that primarily or initially communicate or interact via the Internet, rather than face to face using portals or Internet-based social networks. We believe that this form of socio-technical behavior will provide significant advertising and eCommerce revenue opportunities as the proliferation of Internet-based social networks increases.

Pursue direct advertising relationships. Smile.Media plans to pursue more direct relationships with advertisers. In the year ended December 31, 2007, approximately 30% of its advertising revenues were derived from businesses to which Smile.Media directly sold advertising on its properties and the remaining revenue was derived from advertising agencies. Smile.Media intends to expand its direct sales force and provide incentives for them to focus on building more direct advertiser relationships. We believe that selling directly to more advertisers will reduce Smile.Media s commissions and increase its margins, while improving its relationships and ability to cross-sell.

Expand through international and domestic acquisitions and partnerships. Our goal is to expand Smile.Media s presence in Internet markets internationally and in Israel through the acquisition of, or partnership with, compatible Internet or other media businesses. We believe that applying Smile.Media s online revenue generation expertise to emerging markets outside of Israel is critical to the growth and diversification of its business. In addition, we believe that Smile.Media s experience in acquiring and integrating a broad range of Internet properties in Israel that address distinct languages and cultures, as well as niche vertical properties dedicated to servicing diverse demographics, make Smile.Media uniquely qualified to identify, acquire and successfully integrate properties in under-penetrated, under-developed Internet markets internationally. Within Israel, we believe the fragmented nature of website ownership provides opportunities to acquire smaller publishers who have had difficulty converting their user traffic into significant revenue.

Business of 012 Smile.Communications

The Israeli Communications Industry

Development and History of the Israeli Communications Industry

Israel s communications market has undergone significant changes in the past decade and, although still highly-regulated, has grown rapidly and is highly competitive in nearly every segment. The government has encouraged competition in all facets of the communications market and has been a significant driver of the market s development.

Another major driver of growth in the Israeli communications market is Israel s strong economy. According to the Israeli Central Bureau of Statistics, gross domestic product, or GDP, growth in 2007 was 5.0%, placing it ahead of the developed Western European nations and in line with developing Eastern European nations. At the same time, GDP per capita was approximately $23,500 placing it in a comparable range with developed nations.

An additional factor behind the industry s growth is the Israeli population, who we believe generally tends to adopt new technology more quickly than other societies. According to the Ministry of Communications, as of the end of 2006, fixed telephony lines passed 99% of Israeli homes, the broadband penetration rate was 62% of households, and the individual mobile telephone penetration rate was 106%, which demonstrates the significant utilization of multiple communication services by the Israeli population.

Regulatory Changes

Israel traditionally had one telecom provider, the state-owned monopoly, Bezeq, which provided fixed-line services as well as cellular communications and international communications services. In 1994, the government began to break apart this monopoly and Bezeq was obligated to transfer parts of its operations, which were expected to be subject to competition, to independent subsidiaries. Although the communications industry continues to be highly regulated and participants must operate under license restrictions and conditional permissions, the rules are designed to reduce barriers to entry and make the market more competitive.

In 1994, the government opened the cellular market for competition. In December 1994, Cellcom began operations in competition with Bezeq s cellular subsidiary, Pelephone Communications Ltd. In 1998, a third cellular operator, Partner, began operations, and in 2001, a fourth license was granted to MIRS.

In 1996, the international telephony market was opened to competition and in 2004, the government opened the international market to additional licensees while continuing to preclude the cellular operators from offering international telephony services.

In furtherance of the government s decision to open the domestic fixed-line communications sector to competition, the Ministry of Communications has issued several special licenses for the provision of transmission services beginning in 2000.

The Ministry of Communications granted HOT a license in 2000 for the provision of broadband access services to ISPs, which was replaced with a license to provide fixed-line domestic services, including telephony, data communications, transmissions and infrastructure and access to Internet provides in nationwide deployment.

The Ministry of Communications policy requires Bezeq and HOT to provide ISPs with open access to their infrastructure. Since 2005 several unique general licenses were granted for the provision of fixed-line domestic services without a geographical deployment or universal service obligations. The Ministry of Communications has also issued a number of limited experimental marketing VoB licenses. In 2005, the government privatized Bezeq, further opening the market by allowing full competition in the fixed-line telephony market and issuing domestic fixed-line, or DFL, licenses to other market participants.

On January 31, 2007, the Ministry of Communications published its regulatory guidelines regarding regulation of VoB services. The main principles of the policy are as follows: Bezeq, or any of its subsidiaries, may not provide VoB services until such time as Bezeq s market share in the fixed-line telephony market falls below 85% in either the residential or business sub-sector at which time Bezeq may seek permission from the Ministry of Communications to provide VoB services to that sub-sector. According to data published by the Ministry of Communications, Bezeq s market share in the private segment in March 2008 was approximately 86%, and Bezeq International has already submitted a license request to the Ministry of Communication to provide VoB services. The Ministry of Communications will consider granting a VoB license to YES, Israel s satellite television service provider, which is an affiliate of Bezeq, after February 2008, subject to deterioration in its competitive position and in light of the state of competition in the fixed-line local telephony market in general. For a period of two years, the interconnect tariffs between the VoB operators and Bezeq and HOT will be symmetrical, after which the Ministry of Communications will review the issue again. On February 5, 2007, Bezeq International, a wholly-owned subsidiary of Bezeq, filed an administrative appeal with the Israeli Supreme Court with respect to the Ministry of Communications policy on VoB services that was issued on January 31, 2007. Bezeq International petitioned the Supreme Court to cancel this restriction and to order the Ministry of Communications to grant it a permanent VoB license, or in the alternative, it requested that it be granted a provisional license that the Ministry of Communications would be able to revoke if it found compelling evidence that Bezeq International was abusing the license in order to hinder competition. On September 5, 2007, the Supreme Court denied Bezeq International s appeal.

In March 2007, the Ministry of Communications issued 012 Telecom the first license in Israel to test fixed WiMAX technology on a trial basis, which license was later amended to also include mobile WiMAX trials. The Ministry of Communications is currently developing its WiMAX policy, and in September 2007, it announced its intention to publish its policy for the allocation of frequencies for broadband wireless access networks, which includes the frequencies used by the WiMAX technology, to be published following a public hearing. According to the draft policy, which may be materially amended in the future, new operators that do not hold licenses issued under the Communications Law will have priority in the allocation of the frequencies, which may be granted based on tenders or on a first request, first receive basis. The Ministry of Communications draft policy does not fully specify the method that will be used in the allocation of the frequencies and it does not specify the weight that will be given to each consideration. The Ministry of Communications is expected to publish its policy on MVNOs later this year.

In December 2007, the Ministry of Communications number portability program became affective. Pursuant to such program, all Israeli telecommunications operators are required to enable customer to retain their existing telephone numbers when switching to different providers.

Recently, the Gronau Committee, which was appointed by the Ministry of Communications to consider and recommend the best way to evolve further sustainable competition in the communications market, has handed its recommendation to the Minister of Communications. These recommendations call for several structural changes within the markets, including Local Loop Unbundling of Bezeq s infrastructure, which, if accepted and implemented, will allow 012 Telecom to compete in the MVNO and IPTV sector and improve its competitive position in the VoB business and WiMax services, while worsening the position of 012 Smile.Communications in other segments, by allowing the cellular operators in Israel to compete in the traditional long distance voice market. To date, the Minister of Communications has yet to comment on this report and there can be no assurance that the report will be implemented as recommended, or at all.

Market

According to the Ministry of Communications, the Israeli communications market grew by 5.3% to approximately NIS 27.3 billion, 50% of which was from cellular services, 24% from local fixed-line and data, 12% from multi-channel TV, 7% from international telephony, 5% from ISPs and 2% from endpoint network services. The sector leading the growth in the market was the International Telephony sector which grew by 13%, followed by the ISP sector which grew by 12.3%, followed by the Multi-channel TV sector which grew by 8.5%. The remaining sectors had growth rates of less than 5%.

The Israeli communications market today is dominated by three main groups: Eurocom, our controlling shareholder, The IDB Group and Bezeq Group, each with interests in the main communications sub-sectors. Of the three groups, Eurocom Communications is the only group that does not have a major interest in a cellular operator.

The three largest ISPs in Israel are us, Netvision 013 Barak (a company held by The IDB Group) and Bezeq International (a company held by Bezeq group). Collectively, we believe that we, along with NetVision and Bezeq International, hold substantially all of the Israeli broadband Internet access market.

The international long distance, or ILD, market in Israel is also highly competitive. This market was historically dominated by 012 Golden Lines, which we acquired in December 2006, Bezeq International and Barak. In 2004, the Ministry of Communications further deregulated the market by issuing ILD licenses to us, Xfone and NetVision. As a result of our acquisition of 012 Golden Lines, and NetVision s acquisition of Barak, there are currently three dominant competitors in the market, us, NetVision and Bezeq International. The fourth competitor, Xfone, has a minor share of the market.

According to data published by the Ministry of Communications in November 2007, Bezeq, which traditionally controlled the fixed-line communications market, has lost control of approximately 11.8% of the residential fixed line market and 7.4% of the business fixed line market as of September 30, 2007. In 2001, the Ministry of Communications issued us a point-to-point fixed-line special license for data services. In 2003, the Ministry of Communications issued a DFL license to HOT on the condition that it builds out a national infrastructure within three years and provide its services on a universal basis. In December 2005, 012 Telecom was granted a DFL license (which superseded our point-to-point fixed-line special license for data services) without universal service and autonomous infrastructure obligations. Similar licenses have been issued to Cellcom and Globcall, both respectively subsidiaries of IDB Group, and Partner, which is a major cellular operator that is not affiliated with any of the main groups. Bezeq is currently not allowed to bundle multi-channel TV, local telephony or other communications services. If, however, Bezeq s fixed-line telephony s market share drops below 85% in either the residential or business sub-sector, Bezeq may seek permission from the Ministry of Communications to begin bundling these services in such sector. According to data published by the Ministry of Communications Bezeq s market share in the private segment in March 2008 was approximately 86%, and therefore we now estimate that Bezeq will be allowed to offer bundled services in the residential fixed line sub-market by the end of 2008.

There are four companies presently providing cellular service in Israel: Cellcom (a subsidiary of IDB Group), Partner, controlled by Hutchison, Pelephone (wholly-owned by Bezeq) and MIRS Communications Ltd. (wholly-owned by Motorola).

The Ministry of Communications has been encouraging competition in the communications market by imposing restrictions and limitations on Bezeq and its subsidiaries, including:

- a prohibition on the abuse of its monopoly power and dominant position;
- restricting the entry of Bezeq and its subsidiaries into the local VoB services market until Bezeq s market share in the fixed-line telephony market falls below 85%;
- an obligation to maintain complete structural separation between Bezeq and its subsidiaries pertaining to corporate structure and management systems, including finance, marketing, manpower, assets and data;
- supervision of most of Bezeq s tariffs; and
- an obligation to provide open access infrastructure services to other licensees on an equal, non-discriminatory basis and a prohibition on granting its subsidiaries advantageous terms when providing such services.

The Ministry of Communications has also supported competition by:

- separating infrastructure and service providers;
- granting new licenses and encouraging new and innovative technologies such as VoB; and

mandating number portability.

Services

012 Smile.Communications is a leading communications services provider in Israel offering a growing range of services, which currently include broadband and traditional voice services. 012 Smile.Communications broadband services include broadband Internet access with a suite of value-added services, specialized data services, local telephony via VoB, PRI services, IP Centrex, server hosting and a WiFi network of hotspots across Israel. Traditional voice services include outgoing and incoming international telephony, hubbing services for international carriers and roaming and signaling services for cellular operators. 012 Smile.Communications offers broadband and traditional voice services to a wide audience, which includes residential and business customers, including small office-home office, or SoHo, customers, small-medium size enterprise, or SME, customers, and large corporate customers, as well as international carriers and cellular operators. These services are offered through 012 Smile.Communications integrated multipurpose network that is deployed through points of presence, or PoPs, throughout Israel and in England, Germany and the U.S.

Broadband Services

As of December 31, 2007, 012 Smile.Communications had over 508,000 active residential, business and carrier customers for its broadband services, including many of the largest companies in Israel, the Government of Israel and the two largest Israeli banks.

Access and Value-Added Services

012 Smile.Communications is one of Israel s three leading ISPs providing high speed broadband access to the Internet via ADSL and cable networks. 012 Smile.Communications estimates that its market share of the broadband Internet access market as of December 31, 2007, was 32.2% based on data contained in Bezeq s 2007 annual report and the number of 012 Smile.Communications broadband access customers. 012 Smile.Communications offers high-speed continuous access connections employing digital leased lines at various bandwidths to meet customer needs. 012 Smile.Communications offers broadband access at speeds of up to 10 Megabits per second. In addition to Internet access, 012 Smile.Communications offers a diverse suite of value-added services that are incremental to its core Internet access service. 012 Smile.Communications value-added services are focused on enhancing customers Internet experience by providing additional features and applications and by increasing access security. 012 Smile.Communications value-added services help retain and strengthen its relationship with our customers.

Residential Customers

012 Smile.Communications provides a suite of value-added services, to residential Internet access customers, including:

- e-mail
- wireless and wired home networking
- unified messaging
- on-line backup

- global remote access
- security services, including firewall and intrusion prevention, attack prevention, anti-virus, anti-spam
- parental content filtering
- content services

Business Customers

012 Smile.Communications provides business Internet access customers with a suite of value-added services, including:

various security services, such as firewall and intrusion prevention, attack prevention, anti-virus, anti-spam, content filtering, secure socket layer communications protocol providing end-point authentication

on-line backup

unified messaging, networking

virtual private network, or VPN services

e-mail, including single, multiple and large mailboxes and domains

IP roaming

wireless and wired links

Specialized data services

Specialized data services are provided to bandwidth-intensive organizations and international carriers, allowing them to transmit electronic data from point to point or from point to multi-points. The fee structure for these services depends on three main factors: volume of capacity, distance and the type of technology used. Most services are provided under one to two year contracts. These services are provided using a variety of technological solutions, including:

International private line communication, or leased line, allows customers to purchase bandwidth point to point for exclusive use. Leased lines are based on E1 (2 Megabits per second), T1 (1.5 Megabits per second), DS-3 (45 Megabits per second), STM-1 (155 Megabits per second) and STM-4 (625 Megabits per second) transmission volume;

Ethernet over Synchronous Digital Hierarchy, or SDH, allows customers to connect to sites around the globe with a private LAN connection. Speed rates range from 2 Megabits per second up to 625 Megabits per second. Since SDH networks have bandwidth guarantees, the connection is suitable for video, voice and data information;

Asynchronous transfer mode, or ATM, connections offer four different quality of service levels, and speed rates up to DS-3 (45 Megabits per second), which is suitable for video, voice and data information;

Frame Relay connections based on the ATM backbone offer speed rates up to E1 (2 Megabits per second) for voice and data information; and

Multi protocol label switching, or MPLS, offers four different qualities of service levels. MPLS also enables us to offer performance levels, efficient network management, traffic engineering and VPN services.

VoB Services

In September 2004, 012 Smile.Communications was granted an experimental license to provide trial VoB services and subsequently began offering service to a limited number of subscribers in 2005. Under the license, 012 Smile.Communications was precluded from providing this service to more than 13,000 subscribed lines until February 2007, at which point it received authorization to provide VoB local telephony services without any limitation through a wholly owned subsidiary, 012 Telecom. As of December 31, 2007, 012 Telecom had approximately 33,297 VoB local telephony lines.

012 Telecom s VoB local telephony customers can make and receive calls using a standard telephone plugged into a specialized VoB unit that can be used almost anywhere a reliable broadband Internet connection is available. 012 Telecom transmits these calls using VoIP technology, which converts voice signals into digital data packets for transmission over the Internet and provide its service by using its

customers existing broadband Internet connections. We believe that 012 Telecom s VoB service can be a replacement for or a complementary alternative to fixed-line telephony services, allowing us to cost-effectively enter the Israeli local telephony market with a product that can be bundled with the other services we offer.

PRI Services

012 Smile.Communications began offering primary rate interface, or PRI, services to business customers in December 2005. This service, which offers high quality point-to-point PRI ISDN communications lines, over which up to 30 calls can be transferred simultaneously, is primarily used by large corporate customers, including some of Israel s largest corporations. Following the grant of the unique general license for domestic telephony to 012 Telecom in February 2007, this business was transferred from 012 Smile.Communications to it s wholly owned subsidiary 012 Telecom.

IP-TRUNKING Services

IP-TRUNKING services which provide interconnections between service providers using session initiation protocol, or SIP, have been offered to business customers since February 2007. This service, which offers high quality point-to-point IP communications lines, over which up to 60 calls can be transferred simultaneously, is offered to business users. 012 Telecom was the first communication services provider in Israel to supply IP-TRUNKING to the business community.

IP Centrex

Since 2005, 012 Smile.Communications has provided business customers with an IP-based PBX, or telephone switching system, which connects to the customer through a broadband connection, IP Central Office Exchange Service, or IP Centrex, and offers VoIP and other IP-based services as well as connectivity to the regular telephone system. Among the IP-based services offered are 4-digit internal calling, web-administration portal, free calls between different branches world-wide, conference bridging, Interactive Voice Response, or IVR (auto attendant), call hold, call transfer, last number look-up and redial, call forward and three-way calling. This service is offered today by 012 Telecom in accordance with the license granted by the Ministry of Communications.

Server Hosting and Co-Location Services

012 Smile.Communications operates three server hosting facilities with approximately 16,000 square feet of space. Its newest hosting facility, opened in June 2007, is designed to provide and support the most advanced set of communications services, where it houses web servers and related software and provide connectivity to the Internet for business customers. Many customers utilize 012 Smile.Communications services to manage their web servers, which generate a considerable amount of traffic, ranging from thousands to hundreds of thousands of hits a day. Clients are able to configure and operate their servers remotely and save on router, Internet connection, security system and network administration costs. 012 Smile.Communications also offers co-location services to its business customers at its server hosting facilities. As part of its co-location services, 012 Smile.Communications houses the back-up servers used by businesses to ensure that their systems do not lose data or suffer a lengthy interruption of service because of a power outage, computer fault, or other reasons. 012 Smile.Communications supplies power, lights, network bandwidth and the physical security of the site and its facilities have multiple power backups that are able to provide power during lengthy power outages.

WiFi Network

012 Smile.Communications currently operates a comprehensive network of hotspots covering hotels, hospitals, other public areas and all commercial airports throughout Israel. 012 Smile.Communications has entered into contracts with many of the entities that sponsor the service in their facilities or communities and is the exclusive provider in their premises. Many of these contracts provide for revenue sharing arrangements. 012 Smile.Communications also provides open public access WiFi services throughout central Jerusalem and plans to continue to expand its WiFi footprint by adding additional hotspots at various locations in Israel.

WiMAX Services

In March 2007, 012 Telecom received a license from the Ministry of Communications to conduct fixed WiMAX technology trials in several locations in Israel, including the largest high-tech business center in the Tel Aviv area. The license was amended in August 2007 to also include mobile WiMAX technology trials. WiMAX stands for Worldwide Interoperability for Microwave Access.

WiMAX technology has the capacity to support value-added applications, including live video broadcasting, high-speed data, high quality voice and multimedia content to a wide coverage area. 012 Telecom expect that a WiMAX network will create new communication paths into homes or offices as well as provide a broadband connection any time and anywhere in our coverage area.. This will also provide support for wireless transmissions for future mobility applications as well as devices offering VoIP in conjunction with WiFi technology, and providing last-mile wireless broadband access as an alternative to cable and ADSL service.

The Ministry of Communications has licensed 012 Telecom the use of the 2.5, 3.5 and 3.7 gigahertz spectrums for a period of one year on a trial basis. The trial will provide 012 Telecom with valuable technical and feasibility insights for future WiMAX project roll-outs. 012 Telecom intends to test fixed WiMAX technology, which delivers transmissions via a wireless broadband connection from a single point to multi-points. 012 Telecom intends to test broadband and traditional voice services that can be accessed by a user s handheld device or handset, such as a mobile phone, personal digital assistant, or PDA, or laptop. In addition it intends to test mobile WiMAX technology to establish local broadband wireless systems that will provide coverage over a large geographic area.

Traditional Voice Services

012 Smile.Communications offers traditional voice services to residential and business customers throughout Israel and to international carriers and local cellular operators. As of December 31, 2007, 012 Smile.Communications had approximately 807,000 customers registered in its database, of which approximately 392,000 customers used its services and were billed by 012 Smile.Communications in the prior 12 months. In addition, 012 Smile.Communications bills Israeli carriers for their customers use of its services, which in the last 12 months were generated from over 770,000 lines. 012 Smile.Communications traditional voice services include incoming and outgoing international telephony, hubbing services for international carriers and roaming and signaling services for cellular operators.

Incoming and outgoing International Telephony Services

012 Smile.Communications is one of the three largest international telephony services providers in Israel, providing international telephony services to over 240 countries through direct connections with approximately 100 carriers. 012 Smile.Communications believes that as of December 31, 2007, it accounted for approximately 33% of the total international telephony traffic in Israel.

The outgoing international telephony services offered to 012 Smile.Communications residential and business customers include direct international dialing services, international and domestic pre-paid and post-paid calling cards and call-back services. Post-paid cards offer the customer the ability to use an international calling card, which is paid for through the customer s account with us. Pre-paid cards allow the customer to purchase call time in advance. Pre-paid cards are sold to distributors, which are treated as business customers, for distribution in the residential market. In addition, business customers are offered international toll-free numbers and the 012Mobile service. 012Mobile is an international GSM cellular service offering fixed rates on calls from anywhere in the world**.**

012 Smile.Communications offers incoming international telephony services to international carriers, which include termination services for telephone calls originating outside of Israel.

Hubbing Services

012 Smile.Communications provides hubbing-traffic routing between approximately 100 network operators. Hubbing is defined as architecture where several network operators connect to a peering point, or a hub, from where they are rerouted.

Roaming and Signaling Services

012 Smile.Communications provides roaming and signaling services for cellular operators. Signaling messages indicate a mobile user s location while roaming within Israel through our signal transfer point, or STP, or when traveling abroad. 012 Smile.Communications bills the cellular operators based on the number of signaling messages sent and received.

Marketing and Sales

012 Smile.Communications focus is to present a One-stop Shop solution to its residential and business customers by offering a diverse basket of solutions and a unique service experience in a competitive environment. 012 Smile.Communications seeks to strengthen its brand awareness and to create a unified branding approach among its voice and data customers for its various service offerings. 012 Smile.Communications also actively promotes and cross-sell services to existing customers with special bundled offerings aimed at servicing their communications needs and enhancing customer loyalty. 012 Smile.Communications current marketing focus, in line with its overall strategy, is on offering a wide range of broadband bundles, including VoB local telephony provided by 012 Telecom.

The marketing and communications strategy is executed through all levels of the business. Marketing teams targets the business and residential sub-sectors separately. Each marketing team includes specialists who focus on marketing communications and product development, and has an economics control manager who ensures that all marketing activities are cost effective.

012 Smile.Communications engages in a variety of marketing and promotional activities to stimulate awareness of its broadband access services, traditional voice services and VoB telephony services provided by 012 Telecom. These efforts are directed both to consumers who have not previously subscribed to its services and to users who may switch to 012 Smile.Communications services after learning of their affordability and reliability. 012 Smile.Communications principally employs targeted high-visibility media, including television, radio, Internet and printed media advertising to solicit new customers. 012 Smile.Communications uses data mining as well as targeted market research and surveys to properly focus its marketing efforts to its segmented customer base and to enable it to react swiftly to new demands from customers and changes in the market.

012 Smile.Communications target customer segments are residential and business customers. 012 Smile.Communications has identified within the residential market several groups of customers and target marketing and sales accordingly. The business customer base marketing and sales focus is segmented according to business size: SoHo, SME and corporate. 012 Smile.Communications also separately markets its traditional voice services to carriers.

012 Smile.Communications channel marketing program involves the promotion of its services by its marketing partners to their own customers. These joint marketing programs provide 012 Smile.Communications with distinct advantages, including the ability to gain leverage from the marketing partner s brand through joint advertising and promotions and cost-savings from contributions from marketing partners to our advertising and promotion budget. Marketing partners typically display 012 Smile.Communications applications and logos in their retail stores, distribute promotional materials with their own products and services, and engage in joint promotion and co-marketing activities. Registering a new customer is easily performed through an on-line registration w