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INTERNET GOLD GOLDEN LINES LTD  
Form 20-F  
June 28, 2004

SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

FORM 20-F

[ ] 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, 2003

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-30198

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, 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
None	N/A

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

Ordinary Shares, NIS 0.01 Par Value  
(Title of Class)

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

None  
(Title of Class)

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

Ordinary Shares, par value NIS 0.01

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as of December 31, 2003.....18,431,500

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

Yes  No

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

Item 17  Item 18

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This Annual Report on Form 20-F contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward-looking statements usually include the verbs "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "understands" and other verbs suggesting uncertainty. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak

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only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

We have attempted to identify additional significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section which appears in Item 3 "Key Information."

### 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 financial data presented in the table below has been derived from our audited consolidated financial statements as of and for each of the five years in the period ended December 31, 2003. The selected financial data should be read in conjunction with our consolidated financial statements, and the related notes, which are included elsewhere in this FORM 20-F.

The translation of New Israel Shekel, or NIS, amounts into U.S. dollars has been made solely for the convenience of the reader at the representative rate of exchange at December 31, 2003 (NIS 4.379= \$1.00).

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	Year Ended December 31,				
	1999	2000	2001	2002	2003
	NIS	NIS	NIS	NIS	NIS
	(In thousands, except per share data)				
Israeli GAAP information					
Consolidated Statement of Operations Data:					
Revenues					
Access revenues	96,836	119,848	139,850	156,335	146,007
Other revenues	14,744	19,684	48,473	27,983	33,635
Total revenues	111,580	139,532	188,323	184,318	179,642
Cost and expenses:					
Cost of revenues	58,711	95,335	116,135	99,564	92,871
Selling and marketing expenses	41,981	73,014	51,299	37,125	41,393
General and administrative expenses	23,539	46,844	38,884	21,209	21,908

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Total cost and expenses	124,231	215,193	206,318	157,898	156,172
Income (loss) from operations	(12,651)	(75,661)	(17,995)	26,420	23,470
Financing (expenses) income, net	699	3,842	7,308	2,151	(3,235)
Other income (expenses), net	(6)	(21)	(2,332)	(3)	(2,592)
Income (loss) from continuing operations	(11,958)	(71,840)	(13,019)	28,568	17,643
Income tax benefits	--	--	--	--	1,935
Net income (loss) after income tax benefits	(11,958)	(71,840)	(13,019)	28,568	19,578
Company's share in net loss of investees	--	(2,193)	(682)	(2,187)	(5,275)
Minority interest in loss of a subsidiary	864	1	963	--	--
Loss of a subsidiary which the Company does not intend to bear	--	--	383	--	--
Net income (loss) from continued operations	(11,094)	(74,032)	(12,355)	26,381	14,303
Loss from discontinued operations	--	(7,355)	(8,843)	--	--
Company's share in loss of a subsidiary from discontinued operations	--	--	--	(6,423)	--
Net income (loss)	(11,094)	(81,387)	(21,198)	19,958	14,303
Income (loss) per share, basic and diluted					
Net income (loss) per NIS 0.01 per value of shares (in NIS) from continued operations	(0.69)	(4.02)	(0.67)	1.43	0.78
Net income (loss) per NIS 0.01 per value of shares (in NIS) from discontinued operations	--	(0.40)	(0.48)	(0.35)	--
	(0.69)	(4.42)	(1.15)	1.08	0.78
Weighted average number of shares outstanding (in thousands)	16,068	18,432	18,432	18,432	18,432

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As at December 31,

	1999	2000	2001	2002	2003
	NIS	NIS	NIS	NIS	NIS

(In thousands, except per share data)

Consolidated Balance Sheets Data:

Total assets	241,563	251,765	228,322	169,052	214,004
Working capital	154,239	41,743	48,615	80,904	76,256
Total debt	55,171	146,760	144,510	65,284	95,933
Total shareholders' equity	186,392	105,005	83,811	103,768	118,071

US GAAP information

Consolidated Statement of operations data:

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Net income (loss) from continued operations	(12,454)	(76,527)	(10,603)	23,140	14,960
Net Loss - discontinued operations	--	(7,355)	(8,843)	(6,423)	--
Net income (loss)	(12,454)	(83,882)	(19,446)	16,717	14,960

Consolidates Balance sheets date:

Total assets	243,370	255,102	231,394	173,053	218,952
Total shareholders equity	186,391	105,004	83,810	101,057	115,908

\* The translation of New Israel Shekel, or NIS, amounts into U.S. dollars has been made solely for the convenience of the reader at the representative rate of exchange at December 31, 2003 (NIS 4.379= \$1.00).

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 U.S. dollars, expressed in NIS per one dollar. The representative rate is the average between the buying rate and the selling rate of exchange.

Such rates are provided solely for the convenience of the reader and should not be construed as a representation that NIS amounts actually represent such dollar amounts or that such NIS amounts could have been, or could be, converted into dollars at that rate or at any other rate. We do not use such rates in the preparation of our consolidated financial statements included elsewhere herein. See Note 2 to the consolidated financial statements included elsewhere in this Form 20-F.

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Period	Average (1)	High	Low	At Period End
-----	-----	-----	-----	-----
Year ended December 31, 1999 .....	NIS 4.414	NIS 4.288	NIS 4.013	NIS 4.153
Year ended December 31, 2000 .....	4.078	4.198	3.967	4.041
Year ended December 31, 2001 .....	4.203	4.416	4.067	4.437
Year ended December 31, 2002 .....	4.736	4.994	4.416	4.737
Year ended December 31, 2003 .....	4.545	4.924	4.283	4.379

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

	High	Low
	NIS	NIS
-----	-----	-----
2003		
December .....	4.441	4.352
2004		
January .....	4.483	4.371
February .....	4.493	4.437
March .....	4.535	4.483
April .....	4.599	4.515

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May ..... 4.634 4.555

On June 17, 2004, the representative rate was NIS 4.499 = \$1.00.

### 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.

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#### Risks Relating to Internet Gold

We have experienced operating losses in the past and may incur losses in the future.

Although we operated profitably since the third quarter of 2001, we cannot assure you that we will continue to be profitable. Most of our revenues have been derived from Internet access fees. As contemplated by our business plan, we intend to increase revenues derived from our access fees, and specifically, access fees for broadband services, advertising on our portals and from e-commerce activities conducted through our affiliated e-commerce company, Gold-Trade (Electronic Commerce) Ltd., or Gold Trade. These activities are expected to involve substantial sales and marketing expenses, and other costs. On June 2, 2004 the Israeli Ministry of Communications granted us a license to provide international telephony services. In connection with this new activity we will be required to make investments, which will impair our profitability and no assurance can be given that the international telephony services to be provided under the license will be profitable in the future.

We cannot assure you that we will be able to continue to successfully implement our business plan in the future.

Our operating results are likely to fluctuate significantly and may cause our share price to be volatile.

Our revenues and operating results may vary significantly from quarter to quarter. As a result, you should not rely on quarter-to-quarter comparisons of our revenues and operating results as an indication of our future performance. In addition, due to the volatility in our market we cannot predict our future revenues or results of operations accurately. It is possible that in one or more future quarters our operating results will fall below the expectations of securities analysts and investors. If this happens, the trading price of our ordinary shares is likely to fall.

We expect to be heavily dependent on revenues from subscribers using our Internet access services for the foreseeable future. As a result, our revenues will be affected by our ability to retain current subscribers and

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attract new profitable subscribers. Our residential subscribers have the option of discontinuing their subscriptions for any reason at any given month and our leased line subscribers have the option of discontinuing their subscriptions for any reason upon 30-days' written notice. As a result, revenues can fluctuate from month to month without much advance notice. Some of our expense levels, such as selling and marketing expenses, are based, in part, on our expectations as to future revenues. To the extent our actual revenues are below expected revenues, we may be unable to adjust spending quickly enough to offset the shortfall in revenue, which may cause our business and financial results to suffer.

Regulatory and legal uncertainties could adversely affect the terms of our license to provide Internet access services and could harm other aspects of our business.

There have been various regulations and lawsuits, mainly in the United States, relating to the liability of Internet service providers for information carried on or through their services. The law in this area is unsettled and there may be new legislation and court decisions that expose companies such as ours to liabilities or affect their services. Additional laws and regulations may

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be adopted with respect to the Internet, covering issues such as content, user privacy, pricing, commerce, export and other controls. Regulatory developments could harm our business.

Our Internet access business is subject to a license granted by the Israeli Ministry of Communications, which was renewed in January 2002 for an additional period of five years. The license grants us the right to provide Internet and related services, subject to several conditions mentioned in the license. The tendency of the Ministry of Communications not to limit the number of Internet service licenses is likely to increase competition, and may lead to a reduction in fees charged to subscribers. In April 2002 the Ministry of Communications granted the cable television network providers licenses permitting them to supply infrastructure for the provision of Internet access through the current ISPs, but does not allow them to become ISPs themselves. However, we cannot predict whether the cable television network providers will be allowed to become ISPs in the future or if their licenses may be amended in any way, and how this will affect us. In addition, we cannot assure you that unfavorable regulations would not adversely affect our business.

In June 2004, we received a license to provide international telephony services.

We may be exposed to substantial liabilities arising out of our business, especially those liabilities that are related to Internet activities. Currently, we do not have any insurance policy covering such exposure. In the event that we are found to be responsible for any such liability and/or required to pay for any damages resulting from any such responsibility, our business may be adversely affected.

The markets in which we operate are highly competitive and have low barriers to entry; accordingly, we may be unable to compete successfully.

We operate in the Internet access services markets, which by their nature have low barriers to entry and are extremely competitive. We expect intense competition in our markets to continue in the future. Increased competition could require us to lower our prices, provide free hours, gifts to



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subscribers and increase our selling and marketing expenses and related subscriber acquisition costs, and could also result in increased subscriber cancellations, loss of visitors to our portals and lower advertising revenues. We may not be able to offset the effect of these increased costs through an increase in the number of our subscribers, subscriber revenues or revenues from other sources.

In March 2000, the Israeli Ministry of Communications acted to eliminate pricing differentiations within area codes in Israel. This action eliminated a competitive advantage that we and other large Internet service providers, ISPs, obtained by having a significant number of points of presence throughout Israel. Additionally, Bezeq, Israel's domestic telecommunications monopoly, eliminated another competitive advantage by offering unlimited calling plans.

ISP market. The ISP market in Israel is characterized by many participants. We also expect to face competition from telephone and cellular phone companies, cable television and DBS providers, wireless voice and data service providers and others. These companies could exploit their current established network infrastructure, high rate of penetration of households, and their ability to provide Internet access at significantly faster speeds and potentially include Internet access in their basic bundle of services or offer access for a nominal additional charge. In

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April 2002, the Ministry of Communications granted the cable television network providers licenses permitting supply of infrastructure for the provision of Internet access through the current ISPs. However, we cannot predict whether the cable television network providers will become ISPs and consequently our competitors in the future or how these licenses may be amended in the future and how this will affect us. Additional international ISPs may also enter the Israeli market.

Portal advertising. In order to attract advertisers, we need to continue to increase the amount of user traffic on our portals, including the portal of our subsidiary, MSN Israel Ltd., or MSN Israel. Currently, there are other popular portals in Israel and many Israeli Internet users also use international portals, such as Yahoo! and MSN.com. We compete with these other portals, as well as other media, such as television, radio and print, for advertisers.

E-commerce. In 2003 there was extensive activity in the e-commerce market in Israel. The market is principally comprised of large retailers, financial institutions and manufacturers offering their own products and services over the Internet through their websites. There currently are very few companies that engage solely in e-commerce. Competition in e-commerce is intense and is likely to grow significantly as the e-commerce market evolves. We cannot guarantee that Gold Trade will be successful, or that we will be able to compete effectively and succeed in this market.

Our failure to manage growth effectively could impair our business.

Our growth has placed, and is likely to continue to place, a significant strain on our operational, administrative and financial resources, including our system of internal controls that we have modified or are in the process of modifying to accommodate the expansion of our business. The demand on our network infrastructure, technical and customer support staff and other resources has grown with our expanding subscriber base and is expected to continue to grow as we expand our portal and our e-commerce business. In

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addition, we may be required to make capital contributions and possibly share some of our resources with MSN Israel and Gold Trade.

We cannot guarantee that our infrastructure, technical and customer support staff, operational and billing systems and other resources will adequately accommodate or facilitate the growth of our business. While we believe we have made adequate allowances for the costs and risks associated with our growth and activities, there is no guarantee that these allowances will be adequate, that our systems, procedures or controls will be sufficient to support our operations or that our management will be able to successfully offer and expand our services in Israel or internationally.

Our strategy may not succeed in the future.

From the end of 2000 until the fourth quarter of 2002, we concentrated on a strategy focused on profitability rather than market share. During the fourth quarter of 2002, the significant increase in demand for broadband was coupled with intense competition between all ISPs, which resulted in price reductions for services offered by all ISPs. Due to this market environment, we adopted a more aggressive marketing policy in order to attract a greater number of broadband customers while continuing to keep tight control on our expenses. This strategy yielded a 224% increase in the number of broadband customers in 2003 as compared to 2002. We have continued this policy in 2004. Although this strategy has been successful to date, we cannot

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assure you that this strategy will be successful in the future. Due to the price reductions, caused by the aggressive competition in the broadband market as well as the expenses associated with our marketing efforts to attract customers, our profitability may be negatively impacted.

We may also face difficulties in increasing online advertising because full acceptance of the Internet as an advertising medium has yet to occur in Israel. Since we only have a 50.1% equity interest in MSN Israel and a 48.27% interest in Gold Trade we will only have the benefit of a proportionate share of the profits, if any, from their operations.

If we do not successfully develop the Internet Gold brand we may be unable to attract sufficient traffic to our portals to become successful.

We must establish and strengthen awareness of the Internet Gold brand. If we fail to create and maintain brand awareness, we are unlikely to attract sufficient traffic to our portal to become attractive to advertisers and suppliers of products and services. Brand recognition may become even more important in the future with the growing number of Internet sites and Internet-based communications providers.

We intend to continue to pursue a brand-enhancement strategy, which may include joint marketing programs and mass market and multimedia advertising, promotional programs and public relations activities. These initiatives will involve significant expenses. If our brand enhancement strategy is unsuccessful, our sales and marketing expenses may never be recovered and we may be unable to increase future revenues. Successful positioning of our brand and the other brands associated with each of our services will largely depend on:

- . the success of our joint marketing programs, advertising and promotional efforts; and
- . our ability to design and maintain attractive, user-friendly portals.

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Failure to establish and maintain strategic, marketing and other third-party relationships could limit our ability to attract and retain users.

We have focused on and expect to continue to focus on the establishment of relationships with technology providers, financial institutions, retailers and other suppliers of products and services that we may sell. These relationships include our relationship with Eurocom Communications Ltd. and its affiliates, our partners in Gold Trade and the various parties to our joint marketing programs. Our business depends on these relationships for its success. Because our agreements with third parties are generally short-term and non-exclusive, our competitors may seek to use the same partners that we do or attempt to adversely impact our relationships with our partners. In addition, some of our joint marketing agreements are based on oral understandings and not written agreements and so may be terminated at any time. We may not be able to maintain our third-party relationships or replace them on favorable terms. If our relationship partners fail to perform their obligations, reduce their business with us, choose to compete with us or provide their services to a competitor, we may have more difficulty building our subscriber base and attracting and maintaining visitors to our portals, and as a result our business and financial results may suffer. Also, our efforts to establish new relationships in the future may not be successful, which could affect the growth of our business.

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There can be no assurance that our investments in cooperation agreements will be successful.

A key element of our strategy is to enter into cooperation agreements in Israel. To date, we have entered into various cooperation agreements, including our establishment of the MSN Israel portal with Microsoft Corporation and the establishment of Gold Trade. Our future success depends in part on the ultimate success of these cooperation agreements. The failure of one or more of our key joint venture investments could have a material adverse effect on our business, financial condition and results of operation.

Although we view our joint venture investments as key factors in our overall business strategy, there can be no assurance that the other parties to these agreements view their relationships with us as significant to their ongoing business or that they will not reassess their commitment to us at any time in the future. Our results of operations could be materially adversely affected by changes in the financial condition of a key joint venture participant.

If we lose our key personnel or cannot recruit additional personnel, our business may suffer.

Our success depends, to a significant extent, upon the continuing performance and services of our executive officers and other key employees. Specifically, Eli Holtzman, our chief executive officer, has been with us since our inception and has considerable experience in managing our business. Since we launched our Internet business in 1996, we (excluding our subsidiaries) have expanded from 99 employees as of December 31, 1996 to 649 full-time and part-time employees as of December 31, 2003, including a number of key managerial, marketing, planning, financial, technical and operations personnel. Most of these individuals have not previously worked together and need to be integrated as management and technology teams. As a result, our senior managers and technical personnel may not work together effectively as a team to successfully manage our growth. Our performance is substantially dependent on

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our ability to retain, motivate and successfully integrate our senior management and other key employees. We do not have "key person" life insurance policies on any of our key personnel.

Network capacity constraints may impede our service to subscribers and require us to expand our network and systems.

Capacity constraints within our network and those of our suppliers have occurred in the past and will likely occur in the future. Such constraints may prevent subscribers from gaining access to our system and system-wide services such as e-mail and news group services and cause subscriber cancellations and adverse publicity.

As the number of our subscribers using broadband services and the amount and type of information they wish to transmit over the Internet increases, we will need to significantly expand and upgrade our technology, processing systems and network infrastructure, which could be expensive and involve substantial management time. We do not know whether we will be able to accurately project the rate or timing of any such increases, or expand and upgrade our systems and infrastructure on time. The operation of broadband services through ADSL and cable technology is affecting our international bandwidth needs. As of March 15, 2004 our international bandwidth infrastructure had grown by 1200% from the time we started to provide broadband services. In order to preserve the current service level to an increasing number of

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broadband customers, we may be required to extend our bandwidth by additional 25% by the end of 2004. Since most of our international capacity from Israel is controlled by one company (a de facto monopoly), the prices for bandwidth infrastructure may rise.

A system failure could interrupt service to our subscribers and may result in subscriber cancellations.

Our business depends on the efficient and uninterrupted operation of our computer and hardware and software systems. In addition, sophisticated information systems are vital to our growth and our ability to monitor costs, bill and receive payments from customers, reduce credit exposure and achieve operating efficiencies. Any system failure that causes an interruption in service or decreases the responsiveness of our network, could impair our reputation, damage our brand name, lead to subscriber dissatisfaction and cancellations and reduce our revenues. Our systems and equipment are subject to hardware defects, software bugs and network failures that may be beyond our control. At times, for example, our systems and equipment have experienced failures, which temporarily prevented customers from using our services or accessing the Internet. We are currently in the process of replacing our billing and CRM systems and may incur problems in the transition period.

Our operations depend on our ability to successfully expand our network and integrate new technologies and equipment into our network. Accordingly, we face an increased risk of system failure and difficulty in making new features available.

We use network components located both in Israel and abroad, which must interact successfully without delay or interruption to provide service to subscribers. Our systems and operations are vulnerable to damage or interruption from human error, natural disasters, power loss, telecommunications failures, break-ins, sabotage, computer viruses, intentional acts of vandalism and similar events. Any of these events could expose us to a material risk of loss or

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litigation. In addition, if a computer virus, sabotage or other failure affecting our system is highly publicized, our reputation could be damaged and subscriber growth and portal visits could decrease. While we currently have partially redundant systems, we do not have full redundancy, a formal disaster recovery plan or alternative providers of hosting services. In addition, we do not carry sufficient natural disaster or business interruption insurance to compensate for losses that could occur.

We depend on third-party systems and service providers for our network to provide our customers with our services.

We rely on certain third-party computer systems, networks and third-party service providers, including local and long distance telecommunications companies such as Bezeq, Bezeq International, Barak, UUNET, Worldcom PCCW and Med1 for leased lines. All Internet access by our customers is, and will continue to be, connected through leased lines from local and long distance telecommunications carriers and a leased satellite transponder.

Internet access by our customers is dependent on the telecommunications infrastructure owned and maintained by Bezeq and the local cable companies. 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 we

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provide. In addition, at times Bezeq and the local cable companies have suffered technical network failures. If our subscribers' access to Israel's fixed-line telecommunications infrastructure was disrupted, it would significantly impact the services that we provide to our subscribers and could result in a substantial reduction in Internet access volume and revenue. An increase in our cost of access to Israel's fixed-line telecommunications infrastructure could also adversely impact our results of operations. We also depend on third parties for physical repair and maintenance of leased lines. If an interruption or deterioration in performance in these third-party services occurs, our services may be disrupted or become less profitable.

Many of our relationships with third party providers are terminable upon short notice. In addition, many of our third party suppliers and telecommunications carriers sell or lease products and services to our competitors and may be, or in the future may become, competitors themselves. Subject to various government regulations, our third party suppliers and telecommunications carriers could enter into exclusive arrangements with our competitors or stop leasing or selling products and services to us. If any of our arrangements with third parties is terminated, we may not be able to replace them, on commercially reasonable terms, or at all.

If we require additional capital, we may be unable to raise it on favorable terms or at all.

In the future, we may need to raise additional funds in order to fund expansion, 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 upon a number of factors including our operating performance, investor interest and marketing conditions. If we raise additional funds by issuing equity or convertible debt securities, the holdings of our shareholders will be diluted and their ownership percentage will be reduced. Furthermore, any new securities could have rights, preferences and privileges senior to those of the ordinary shares.

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In addition, Gold Trade may require in the future additional substantial funding to develop and expand its business. As one of the two major shareholders of Gold Trade, we have contributed capital and provided other resources to the e-commerce company and may be required to do so in the future. These costs could be substantial, and may not result in significant returns in the near future, or at all. We cannot be certain that additional financing will be available when and to the extent required or that, if available, it will be on acceptable terms. If we do not invest additional funds, if and when required, our interest in Gold Trade may be diluted.

The industry in which we operate is characterized by rapid technological changes and frequent new product and service introductions; we may not be able to keep up with these rapid technological and other changes.

The Internet-related markets in which we compete are characterized by rapidly changing technology, evolving industry standards, frequent new product and service announcements, introductions and enhancements and changing consumer demands. These new products, services and technologies may be superior to the services and technologies that we use, and may render our services and technologies obsolete or require us to incur substantial expenditures to modify or adapt our products, services or technologies. Our future success will depend on our ability to continually improve the performance, features and reliability of our Internet and other services in response to competitive service and product offerings and the evolving demands of the marketplace.

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Our future success depends on the continued growth in the use of the Internet, VOIP (Voice Over IP) and other related services in Israel.

We rely on revenues generated from the sale of Internet-access and related services, and, to a limited extent, portal advertising and e-commerce. To date, revenues generated from e-commerce and online advertising in Israel have been relatively insignificant and we cannot assure you that revenues from these services will grow. If acceptance and growth of Internet use and services do not occur or Internet use declines, our business and financial results will suffer. Alternatively, if Internet usage grows, the Internet infrastructure may not be able to support the demands placed on it by such growth or its performance or reliability may decline.

We may not achieve broad market acceptance of our services due to concerns about the reliability and security of Internet communications.

The secure transmission of confidential information, such as credit card numbers, over the Internet is essential in maintaining users' confidence in our services. We rely on licensed encryption and authentication technology to securely transmit confidential information, including credit card numbers. It is possible that advances in computer capabilities, new discoveries or other developments could result in a compromise or breach of the technology used by us to protect user transaction data. We incur substantial expenses to protect against and remedy security breaches and their consequences. A party that is able to bypass our security systems could steal proprietary information or cause interruptions in our operations. Security breaches also could damage our reputation and expose us to a risk of loss or litigation and possible liability. Our insurance policies have coverage limits, which may not be adequate to reimburse us for losses caused by security breaches. We cannot guarantee that our security measures will prevent security breaches.

We also face risks associated with security breaches affecting third parties conducting business over the Internet. Users generally are concerned

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with security and privacy on the Internet and any publicized security problems could inhibit the growth of the Internet and therefore our services, as a means of conducting commercial business transactions.

We face potential liability for information accessed and products and services sold through our portals.

We could become liable for false or misleading information accessed through our portals and for defective products and services sold as part of our business. The potential liability of ISPs and portals such as ours for information accessed through their portals is uncertain. It is possible that claims may be filed against us based on defamation, obscenity, negligence, copyright or trademark infringement or other theories. These types of claims have been brought, sometimes successfully, against providers of Internet services in the past.

Gold Trade is involved in the sale, by way of electronic tenders, of products and services by third parties. If these products or services were defective or were manufactured or supplied in breach of others' intellectual property rights, Gold Trade could be liable to customers who purchase these products or services or to the owners of the intellectual property.

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Although we attempt to reduce our liability through contractual indemnification from our suppliers and disclaimers, there is no guarantee that we would be successful in protecting ourselves against this type of liability. Even if we ultimately succeeded, legal action against us would divert management time and resources, could be costly and is likely to generate negative publicity for our portal and our business generally. We may also be forced to implement expensive measures to alter the way our services are provided to avoid any further liability.

Inadequate intellectual property protection could prevent us from enforcing or defending our intellectual property.

We have various trademark applications, trade secrets and copyrightable materials, as well as domain names and licenses to use third party software. If we are not successful in protecting our intellectual property, our business and financial results could suffer.

Trademarks. In order to refresh our image, as well as part of our preparations for the provision of international telephony services, we changed our logos and applied for their registration as trademarks in Israel. There is no guarantee that these trademarks will be registered or that we will obtain registration of other trademarks for which we may seek protection in the future.

Domain Names. We currently hold the Internet domain names: "zahav.net.il," "inter.net.il," "internet-zahav.net.il," "zahav.msn.co.il," "igld.com," "gold.net.il," "access.net.il," "smile.net.il," "Vgames.co.il" "hicareer.co.il" and various other related names. MSN Israel holds the Internet domain names: "msn.co.il," "start.msn.co.il," "start.co.il," "smsn.co.il," "mediacenter.co.il," "igold.net.il," "msn.net.il", "msnone.net.il," "msnnews2.co.il," "msnmobile.co.il," "hero.co.il," "ilovemessenger.co.il" and "zahav.ru" and has the right to use the domain name "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.

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Licenses. We have obtained licenses to bundle various third party software products in our front-end configuration software product. We cannot guarantee that renewals of these licenses or any licenses of additional software, which may be required, will be available as needed. While third party licensors have represented to us that they have the right to license such software and in some cases agreed to indemnify us, we cannot guarantee that our use of third party software does not infringe the rights of others. Any infringement claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

### Risks Relating to Our Relationship with the Eurocom Group

Our principal shareholder owns a controlling interest in our company and is able to exercise significant influence over our business, including ways which may be adverse to our public shareholders.

Our controlling shareholder, Euronet Communications Ltd., holds 68.81% of our ordinary shares. Euronet Communications is a wholly owned subsidiary of Eurocom Communications Ltd., which is a 50.3% owned subsidiary of Eurocom Holdings Ltd. (an additional 0.7% interest is

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owned by Mr. Shaul Elovitch, our chairman, and the chairman of the board of directors of Eurocom Holdings Ltd.). As a result, Eurocom Communications and Eurocom Holdings will continue to be able to exercise considerable influence over our operations and business strategy and control the outcome of all matters involving shareholder approval, including:

- . the composition of our board of directors including the appointment and removal of officers;
- . mergers or other business combinations involving us;
- . acquisitions or dispositions of our assets;
- . future issuances of our ordinary shares or other securities;
- . our incurrence of debt;
- . various amendments, waivers and modifications to the agreements between Eurocom Communications and its affiliates and us; and
- . payments of dividends on our ordinary shares.

There may be conflicts of interest between our controlling shareholder and us.

Our relationship with Eurocom Communications may eliminate or reduce some opportunities for revenue growth and reducing costs. Eurocom Communications, which indirectly controls us, or its affiliates could prevent us from entering into commercial relationships with third parties, such as its competitors, additionally its competitors may choose not to enter into commercial relationships with us because of our close relationship with Eurocom Communications and its affiliates.

We also obtain various strategic advantages from our affiliation with Eurocom Communications. We expect these relationships to continue and for us to enter into additional contractual relationships with Eurocom Communications or its affiliates in the future. However, there can be no guarantee that our existing relationships will continue or that additional relationships will



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develop. Specifically, if Eurocom Communications were to dispose of all or a significant proportion of its shares in our company or decided to pursue its Israeli Internet business through another entity, it may be less willing to enter into or continue contractual and strategic relationships with us. The termination of some or all of our relationships with Eurocom Communications could impede the growth of our business and increase our training and network costs and other costs of operations.

Some of our directors are also directors, officers or employees of Eurocom Communications and own its equity securities. Accordingly, conflicts of interest may arise from time to time between their interests in Eurocom Communications and us particularly with respect to our contractual relationships and the pursuit of overlapping corporate opportunities. We have not adopted any formal plan or arrangement to address such potential conflicts of interest and intend to review related-party transactions with Eurocom Communications or any of its affiliates in accordance with the provisions of the law, on a case-by-case basis.

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Because we have interlocking directors with Eurocom Communications, there also may be inherent conflicts of interest when such directors make decisions related to transactions between Eurocom Communications or its affiliates and us. We could lose valuable management input from such conflicted directors and officers. See also Item 7A "Major Shareholders" and Item 7B "Related Party Transactions."

### Risks Related to Our Operation in Israel

Conducting business in Israel entails special risks.

We are incorporated and based in, and currently derive all our revenues from markets within the State of Israel. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by 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.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. There is no indication as to how long the current hostilities will last or whether there will be any further escalation. Any further escalation in these hostilities or any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. Furthermore, there are a number of countries that restrict business with Israel or Israeli companies. Restrictive laws or policies of those countries directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

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Many of our executive officers and employees in Israel are obligated to perform up to 36 days, depending on rank and position, of military reserve duty annually and are subject to being called for active duty under emergency circumstances. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

The economic conditions in Israel have not been stable in recent years.

In recent years Israel has gone through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Our operations could be adversely affected if the economic conditions in Israel continue to deteriorate. In addition, due to significant economic measures proposed by the Israeli Government, there have been several

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general strikes and work stoppages in 2003 and 2004, affecting all banks, airports and ports. These strikes have had an adverse effect on the Israeli economy and on business, including our ability to deliver products to our customers. Following the passage by the Israeli Parliament of laws to implement the economic measures, the Israeli trade unions have threatened further strikes or work-stoppages, and these may have a material adverse effect on the Israeli economy and on us.

Our business may be impacted by NIS exchange rate fluctuations.

Most of our communications and advertising costs are quoted in U.S. dollars. As of June 13, 2002 we are required by law to state our prices in NIS to our residential and SOHO (small office and home office) customers. Furthermore, if we expand our business into other countries, we may earn additional revenue and incur additional expenses in other currencies. We do not currently hedge against foreign currency transaction risks. We have U.S. dollar denominated liabilities (rights of use leasing obligations for the international lines). In future periods our dollar assets (deposits) and our dollar denominated liabilities might cross hedge 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 e-commerce in Israel.

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

Service of process upon our directors and officers and the Israeli experts named herein, all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, since substantially all of our assets, all of our directors and officers and the Israeli experts named in this report are located outside the United States, any judgment obtained in the United States against us or these individuals or entities may not be collectible within the United States.

There is doubt as to the enforceability of civil liabilities under the

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Securities Act and the Securities Exchange Act in original actions instituted in Israel. However, subject to certain time limitations and other conditions, Israeli courts may enforce final judgments of United States courts for liquidated amounts in civil matters, including judgments based upon the civil liability provisions of those Acts.

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

Provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult a merger with, or other acquisition of, us. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market

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prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

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

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, our 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 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.

### Risk Related to Our Ordinary Shares

Our share price has been very volatile, and may decline.

The market price of our ordinary shares is likely to be highly volatile and could be subject to wide fluctuations 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 Internet or online service 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

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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.

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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.

Since the latter part of 2000, many Internet companies have suffered from a substantial decrease in their market value. Our share price plunged from a high of \$30.00 in March 2000 to below \$1.00 in April 2001 and closed at \$4.62 on June 23, 2004.

Our share price could be adversely affected by the sale or the perception that certain shareholders could require us to sell their shares.

Prior to our IPO we granted Euronet Communications and other shareholders, who together hold 69.7% of our ordinary shares, registration rights under the Securities Act with respect to their shares, giving them rights to:

- . include their shares in any registration statement filed by us following our 1999 initial public offering excluding any registration of employees' shares on Form S-8 or a similar form; and
- . demand registration of their shares at any time after February 2000, in each case subject to certain conditions.

Following such registration, these shares will be available for sale in the open market. We cannot predict if future sales of our ordinary shares, or the availability of our ordinary shares for sale, will adversely affect the market price of our ordinary shares or our ability to raise capital by offering equity securities.

Anti-takeover provisions could negatively impact our shareholders.

Provisions of Israeli law, our articles of association and the terms of our licenses may have the effect of delaying, preventing or making more difficult a merger or other acquisition of us, even if doing so would be beneficial to our shareholders. Specifically, under the terms of our licenses, any change of control requires the consent of the Israeli Ministry of Communications. In addition, the approval of the General Director of the Israeli Antitrust Authority may be required.

Under our articles of association, directors elected at the annual general meeting of our shareholders are classified into three classes. At each annual general meeting of shareholders, only directors for the class whose term

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is expiring will be up for election, and upon election such directors will serve a three-year term. The outside directors are not classified into the three classes stated above, and their term of appointment expires as provided by the Israeli Companies Law. See Item 6.A. "Directors and Senior Management."

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Israeli law regulates mergers, votes required to approve a merger, acquisition of shares through tender offers and transactions involving significant shareholders. Anti-takeover provisions could negatively impact our shareholders. Some of the provisions of Israeli law could:

- . discourage potential acquisition proposals;
- . delay or prevent a change in control over us; and
- . limit the price that investors might be willing to pay in the future for our ordinary shares.

Generally, under Israeli corporate law, a merger must be approved by the board of directors and the shareholders of each of the merging companies. If the share capital of the non-surviving company consists of more than one class of shares, the approval of each class is also required. Further, if the company was incorporated before February 1, 2000, as we were, the approval of the merger requires a majority of 75% of the shareholders present and voting at a meeting, unless such company amends its bylaws to require a different voting requirement. In certain cases, court approval is also required. Under the Companies Law, a merger may be completed only after 70 days have elapsed from the date all the necessary approvals and the merger proposals have been submitted to the Israeli Companies Registrar. The Companies Law also provides that an acquisition of shares of a public company must be made by means of a tender offer if, as a result of such acquisition, the purchaser would become a 25% or more shareholder of the company. This rule does not apply if there is already another 25% shareholder of the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of tender offer if, as a result of the acquisition, the purchaser would become a 45% shareholder of the company, unless someone else already holds a majority of the voting power of the company. The purchase of shares leading to a 90% holding or more requires a full tender offer. These rules do not apply if the acquisition is made by way of a merger. Regulations promulgated under the Companies Law provide that, generally, these provisions do not apply to companies whose shares are listed for trading outside of Israel in certain stock exchanges. The requirements of Israeli corporate law generally make these forms of acquisition significantly more difficult than under United States corporate laws. Other potential means of acquiring a public Israeli company might involve significant obstacles, such as a requirement for court approval for the acquisition. In addition, a body of case law has not yet developed with respect to the Companies Law. Until this happens, uncertainties will exist regarding its interpretation.

Finally, Israeli tax law treats some acquisitions, particularly stock-for-stock swaps between an Israeli company and a foreign company, less favorably than United States tax law. Israeli tax law may, for instance, subject a shareholder who exchanges his or her shares in us for shares in a foreign corporation to immediate taxation.

These provisions of Israeli corporate and tax law and the uncertainties surrounding such law may have the effect of delaying, preventing or making more difficult a merger or acquisition involving our company. This could prevent a change of control in our company and depress the market price of our ordinary shares that might otherwise rise as a result of such change of

control.

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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 972-3-939-9999. Our address on the Internet is [www.zahav.net.il](http://www.zahav.net.il) or [www.zahav.msn.co.il](http://www.zahav.msn.co.il). We also have an investor information site, at [www.igld.com](http://www.igld.com). The information on our websites is not incorporated by reference into this annual report.

We began our Internet access business in January 1996 under the brand name "Internet Gold." We provide a wide array of Internet services tailored to meet the needs of our residential, SOHO and business subscribers, including Internet access and related value-added services, as well as content and e-commerce activities through portals. Our Internet access packages include basic access accounts, ISDN dial-up accounts, leased and frame relay lines, dial-up networking, ADSL and cable services. We also provide hosting and value-added solutions. In July 2003 we won a government tender to provide IT services to Israeli government ministries.

From December 31, 2002 to December 31, 2003, our business subscriber base grew from 3,505 business subscribers to 4,144 business subscribers and our residential and SOHO subscriber base remained at the same level with 312,256 subscribers.

In July 2003, we entered into a long-term agreement with Barak I.T.C. (1995) Ltd., one of Israel's long distance carriers, to purchase rights of use, for 14 international fiber optic lines until 2017, with the option to extend the agreement for an additional five year period. Until August 2003 we leased international lines on a monthly basis at higher rates from various long-distance carriers. According to the agreement, we are obliged to connect all of the 14 international lines in the next three years. As of April 2004, we had connected eight of these lines. The total capacity of the lines is 2.2 Gigabits. This increased capacity was required to meet the demand of our rapidly growing broadband customer base.

In April 2004 we entered into a long-term agreement with Bezeq International Ltd, one of Israel's long distance carriers, to purchase rights of use in one international fiber optic line for at least 13 years beginning on May 2004. In May 2004, we entered into an additional agreement with Bezeq International Ltd. for an additional fiber optic line on the same terms. This increased capacity is required to meet the demand of our rapidly growing broadband customer base.

In June 2004, in accordance with the trends of liberalization of the communication market in Israel and opening the international telephony market to competition, the Israeli Ministry of Communications granted us a license to provide international telephony services with an international prefix code of 015. We expect to commence provision of the services during the third quarter of 2004. We will use professional and support staff, as well as our substantive VOIP experience and infrastructure to ensure provision of first-quality

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international telephony at competitive prices to Israeli individual consumers and enterprises.

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In January 2000, we established Gold Mind Ltd., or Gold Mind, as a wholly owned Israeli subsidiary. Initially, Gold Mind had two major activities: developing Internet-content ventures and constructing sites. Currently, Gold Mind is engaged in the marketing and sale of Internet contents and technologies, such as an anti-virus service, value added services and virtual magazines and develops selected Internet content ventures. In May 2003, Gold Mind entered into an exclusive agreement with Play-TV, Playboy's official representative in Israel, for the distribution of Playboy's content on the Internet. In addition Gold Mind develops Internet interactive games and maintains an interactive Internet games website, Vgames. In March 2004, Gold Mind entered into a web-games collaboration with Partner Communications Ltd., an Israeli cellular operator, regarding the launch of a WAP version of Vgames for Partner's customers.

In January 2000, we established another wholly owned Israeli subsidiary, Internet Gold International Ltd., or IGI. IGI was formed with the goal of becoming a regional Internet group through the acquisition of, and establishment of partnerships with, local Internet service providers, IT companies and media groups in emerging markets. We withdrew from this activity in late 2000 except, with respect to a small investment in a Greek ISP in which we have a 15.2% interest. Since the beginning of 2002, IGI has engaged in the promotion and advancement of cooperation activities with international corporations. Within the framework of such activities, IGI provides UUNET with Internet infrastructure segments for the benefit of UUNET's customers in Israel.

In June 2000, we established MSN Israel Ltd., a 50.1% owned Israeli subsidiary, together with Microsoft Corporation (49.9%). MSN Israel launched its portal in April 2000, offering Hebrew-reading Internet users state-of-the-art MSN features such as personalized services, "Hotmail," "Messenger," "Passport," instant messaging, news, an Internet search engine, business services and e-commerce services. We agreed to invest in MSN Israel and be responsible for up to \$10 million of its operating losses and capital expenditures. Microsoft and us will be proportionately responsible for any losses and capital expenditures exceeding \$10 million. As of December 31, 2003, MSN Israel had incurred consolidated losses of NIS 33.8 million (\$7.7 million) and we had recorded NIS 0.05 million (\$0.01 million) of capital investment in MSN Israel in compliance with the agreement.

In November 2001, MSN Israel entered into an agreement with Zeevi Computers & Technology Ltd. and Start Net Ltd. pursuant to which MSN Israel undertook to operate, at its expense, the Israeli portal "Start.co.il" for a period of 36 months and to provide it with certain services. MSN Israel has the right to cease operating the portal under certain circumstances and it will not be responsible for any liabilities incurred prior to the date of the agreement. In November 2002, MSN Israel exercised the option granted to it under the agreement, to acquire 50% of Start Net Ltd., and as a result now holds 50% of Start Net Ltd. Zeevi Computers & Technology Ltd. is currently under a dissolution process, and MSN Israel is currently negotiating the purchase the remaining 50% interest in Start Net Ltd. In July 2002, MSN Israel was granted an ISP license, which was extended until the end of May 2004. MSN Israel has decided not to apply for the extension of the license. In 2003, MSN Israel reached operating profitability as it developed new revenue channels such as Hosted Exchange, Hotmail's successful mail platform, and Messenger, which more than doubled its instant-messaging user base during the year. These new services provide unique added value for MSN's customers and provide new revenue sources

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for us.

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In January 2000, we, along with Bank Hapoalim, Isracard, Superpharm and Eurocom Marketing, established Gold Trade to provide e-commerce services. In accordance with Gold Trade's primary intended activity, Gold Trade launched the "P1000" mega-mall in June 2000. In May 2000, Gold Trade acquired the business of Best Deal Ltd., an Israeli company engaged in mail order catalogue sales. Since the end of 2001, Gold Trade's main activity is the sale of products and services by means of electronic tenders and outgoing telemarketing. In May 2002 Gold Trade ceased producing and mailing catalogues, which was a separate line of business from Gold Trade's other activities, and ceased importing products in relation to such activity. Since then, Gold Trade has focused on its e-commerce activity, continuing telemarketing sales to its large customer database, and operating a call center for certain third parties and for the sale of products offered by Gold Trade. Since January 1, 2002 we ceased to consolidate the operations of Gold Trade in our financial statements and account for it on an equity basis. In April 2003, Gold Trade published a rights offering. In September 2003 we invested under the rights offering \$2.4 million in cash and by means of waiver of debt, and raised our ownership interest in Gold Trade to 48.27%.

We made capital expenditures of NIS 11.9 million (\$2.7 million) in the year ended December 31, 2003, NIS 12.6 million (\$2.9 million) in the year ended December 31, 2002 and NIS 18 million (\$4.1 million) in the year ended December 31, 2001.

In the year ended December 31, 2003, we invested NIS 8.7 million (\$2 million) in new network equipment and computers, NIS 2.9 million (\$0.7 million) in furniture and office equipment and NIS 0.2 million (\$0.06 million) in leasehold improvements.

During 2004, we expect to incur capital expenditures of approximately NIS 14 million (\$3.2 million), mostly for network equipment and computers. As of June 1, 2004, we are bound by contractual undertakings for \$0.6 million of such amount, mostly for network equipment and computers.

### B. Business Overview

#### Industry Overview

#### Internet Services

Growth of the Internet and E-Commerce. The Internet is an increasingly significant global medium for communications, information and online commerce. The Internet has grown rapidly in recent years both in terms of the number of users and the number of websites. In April 2004, there were over 750 million Internet users worldwide, compared to approximately 360 million in 2000. According to a Yankee Group survey, European broadband users already spend more time with the Internet than watching TV. For many businesses, the Internet has created a new communications and sales channel, enabling large numbers of geographically dispersed organizations and consumers to be reached quickly and cost-effectively.

Evolution of the Internet Services Market. Today, Internet services consist primarily of Internet access, web hosting, co-location services and e-commerce solutions. Access services represent the means by which ISPs interconnect business and consumer users to the resources on the Internet. Access services vary from dial-up and broadband access for individuals and small



businesses to high-speed dedicated access primarily for larger organizations, and can range from simple dial-up access to highly organized, personalized access coupled with value-added services. ISPs vary widely in geographic coverage, subscriber focus and the nature and quality of services provided to subscribers. In our experience, consumers are generally focused on speed and reliability of access, ease of use, subscriber service and price as they evaluate an ISP. In addition to speed and reliability of access, we believe many business subscribers want all their Internet-based requirements, such as access, web hosting, content and services offering and e-commerce applications, met by a single provider that can provide integrated Internet solutions, including a single billing statement for all services.

An increasing number of companies provide information and conduct e-commerce over the Internet, and as a result, Internet operations are increasingly becoming critical to the commercial and communications operations of many enterprises. However, many businesses lack the resources and expertise to develop, maintain and enhance, on a cost-effective basis, the facilities and network systems necessary for successful Internet access and operations. Accordingly, businesses increasingly seek outsourcing arrangements to enhance their website reliability and performance, provide continuous operation of their Internet solutions and reduce related operating expenses.

As a result, there is increasing demand for ISPs to offer "turnkey" Internet services. An increasing number of ISPs are beginning to supplement their basic Internet access services with a variety of commercial services that facilitate e-commerce, including web hosting, server co-location, remote account management, and other value-added services. These services expand an ISP's potential revenue streams from basic monthly access fees to other fees, including set-up and maintenance charges.

The Israeli Market. One of Israel's most important resources is its experienced and highly educated work force (one third of Israel's labor force has high education qualifications). Israel has a population of more than 6.4 million people and approximately 2 million households. With a highly educated population, Israel has developed an export-oriented, technology-based, industrialized economy. The Israeli market adapts quickly to new technologies, especially in the communications technologies field. According to the Israeli Ministry of Communications, in 2003 Israel had a cellular penetration rate of 94% (compared to a penetration rate of approximately 91% in 2002) and a multi-channel television (cables and satellite) penetration of approximately 70% (compared to a penetration rate of approximately 65% in 2002).

Today, Internet services in Israel consist primarily of Internet access, web hosting, co-location services, content services and e-commerce solutions. Access services vary from dial-up and broadband access for individuals and small businesses to high-speed dedicated access primarily for larger organizations, and can range from simple dial-up access to highly organized, personalized access coupled with value-added services.

The Israeli market experienced an impressive growth of the broadband Internet market, which had more than tripled to 640,000 subscribers in 2003, since 2002. In 2003, 430,000 new subscribers were added, more than twice the number of new subscribers in 2002. The Ministry of Communications reported that the broadband access penetration rate for households had risen

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from 11% in 2002 to 30% in 2003, giving Israel one of the highest rates of broadband access in the world.

This growth was mainly attributed to attractive prices, competition and marketing efforts by ISPs and competition between Internet infrastructure providers. This competition led to massive advertising. The combined effect was the rapid recruitment of new subscribers for broadband Internet, some of whom did not have Internet access before at all, although most migrated from dial-up to broadband service. Market surveys estimate that in the end of 2003 more than 60% of Israeli Internet subscribers had broadband access.

### International Telephony Services

Since the opening of the international telephony market to competition in 1996, only three companies (Bezeq International, 012 Golden Lines and Barak) have provided international telephony services in Israel. The market, estimated to be two billion minutes and \$440 million per year, is equally divided between the three companies. On June 2, 2004, we received a license to provide international telephony services. We believe that Netvision Ltd. as well as Xphone, a British company, will also be granted licenses.

### Our Strategy

From the end of 2000 until the fourth quarter of 2002, we concentrated on a strategy focused on profitability rather than market share. During the fourth quarter of 2002, the significant increase in demand for broadband was coupled with intense competition between all ISPs, which resulted in price reductions for services offered by all ISPs. Due to this market environment, we adopted a more aggressive marketing policy in order to attract a greater number of broadband customers while continuing to keep tight control on our expenses. This strategy yielded a 224% increase in the number of broadband customers in 2003 as compared to the year 2002. We have decided to continue this policy during 2004. Due to the price reductions, caused by the aggressive competition in the broadband market and our marketing efforts to attract customers, our profitability may be impaired.

### Services

We offer a wide range of Internet access alternatives to meet the needs of our residential and business subscribers. We also offer a broad array of basic and value-added Internet services to attract and retain subscribers, increase usage and create additional revenue streams. By offering high-quality, price-competitive Internet access and related services, we seek to develop both our residential and business subscriber base.

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Internet Access. We offer our high-speed continuous access connections employing digital leased lines at various bandwidths to meet customers' needs, as well as ADSL and cable TV access services. In addition, we offer dial-up modem subscribers Internet access via our 6 points of presence at speeds of up to 56Kbps for regular analog telephone lines or at 64Kbps (or 128Kbps) for Integrated Services Digital Network or ISDN. The following table summarizes several of our most popular Internet access packages in Israel:

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Access Services	Summary Description	Target Customers	Current Pricing In
ADSL Accounts	Broadband services using ADSL technology.	Small business subscribers and residential users.	Average monthly fee of NIS depending on the services
Cable Accounts	Broadband services using cable technology	Small business subscribers and residential users.	Monthly fee of NIS 39 to depending on the services
Basic Access Account Standard Plan	Internet access using modems to dial-up our network.	Small business subscribers and residential users.	Unlimited Package - month 55 to NIS 69 (subject to contract). Hour Based Package - fee NIS 59.9 for four to twenty per month. Additional ho 2.5 each.
ISDN Dial-up Accounts	Basic Account with digital service, which provides faster access, also known as ISDN access.	Small business subscribers and residential users.	Monthly fee of NIS 55 to (subject to period of con
64Kbps and up leased Frame Relay Line	Twenty-four hour high speed dedicated Internet access to carry data traffic at a speed of 64Kbps and up.	Business subscribers.	Monthly fee of \$99 to \$13 on the services provided.
Dial-Up Network (ISDN, ADSL & Cables)	Enterprises can connect their entire PC network to the Internet via one router (analog or digital).	Business subscribers.	Monthly fee of \$ 29 to \$3 on the number of network office and the services p

Value-Added Services. We introduced a variety of enhanced, value-added services that enable our residential and business subscribers to obtain high-speed Internet access, outsource their Internet facilities and systems requirements and undertake e-commerce initiatives. The following table summarizes the current offering of residential and business value-added services:

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Business Service	Summary Description	Target Customers
Commercial website Hosting and Server Co-Location	Through this service, a subscriber's website is "hosted" on our servers or its computer is installed in our network operations center. In either case, the subscriber benefits from our existing management facilities and receives a high-speed, full-time connection to the Internet; direct access to our high speed network; use of our backed-up power supply,	Business subscribers.

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network monitoring system and daily data back-up; a secure climate-controlled environment; and 24/7 technical support. All access to these websites via our servers or the co-located servers are processed on our servers.

Global Roaming	Our systems are connected to the iPass roaming system, which enables our subscribers to access their Internet accounts while on the road, without incurring long distance access charges. iPass provides secure connections to corporate networks, e-mail and the Internet in approximately 150 countries. iPass contracts with over 200 global tier-one network providers to deliver on-demand local connectivity.	Business and residential subscribers.
Integrated Expert services	Installing and maintaining LAN & WAN infrastructures with full technical support.	Business subscribers.
Security services and products	Penetration tests for networks and applications, security assessments, internet fraud investigations and security maintenance, content filtering service. Installing and maintaining of firewall machines.	Business subscribers.
Unified Message	Allows a subscriber to receive faxes from anywhere to his mailbox at Internet Gold.	Business and residential subscribers.
Virtual Magazines	Variety of virtual magazines in many different fields (news, economics, children, food, sports, computers, lifestyle and leisure, etc.).	Residential subscribers.
Gold Mail	This service allows a subscriber to gain access to his e-mail from any computer.	Business and residential subscribers.
Call Me	This service enables a subscriber to receive telephone messages while surfing the net, using only one telephone line.	Business and residential subscribers.

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Business Service	Summary Description	Target Customers
Vgames	Vgames.co.il, Israel's first and largest gaming website, operated since October 1999 by our wholly owned subsidiary, Gold Mind. It supplies Israeli gamers with daily information about the interactive entertainment industry: news, previews, reviews and downloads. Since April 2001, Vgames operates an online gaming community called "Vgamers Club," where paying members receive a semi-weekly online gaming magazine.	Residential subscribers.
Anti-Virus	Integrated anti-virus service which protects the	Business and residential subscribers.

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	mail box from virus threats. The anti- virus program detects and removes viruses from e-mail attachments.	subscribers.
Anti-Spam	This service enables users to deal better with the proliferation of "junk mail" (spam), saves time, prevents waste of storage space and prevents exposure by children to inappropriate content.	
Web Sites	Variety of paid portals and websites in varied topics (sports, children, leisure & life style).	Residential subscribers
On Line Backup	This service enables the users to automatically backup files and save them for long periods with the ability to retrieve them immediately	Business and residential subscribers.

E-Commerce. Through Gold Trade we offer a vast variety of products and services by way of electronic tenders, as well as online shopping and transactional opportunities for a wide range of other products and services. We emphasize expanding and refining our services to enhance our subscribers' Internet experience. Our research and development staff is engaged in a variety of technical development and service enhancement activities and continuously evaluates new and innovative ideas and third-party software products and technology for potential incorporation into our systems and services. We also regularly update and expand the online services provided through our portals, organize content and develop online guides, help screens and other user services and resources.

### Customers

Generally, we have been successful in attracting and acquiring new subscribers and retaining existing subscribers. Subscribers are those customers to whom we provide dial-up, broadband or dedicated Internet access, and include customers paying full rates as well as those with special introductory packages. From December 31, 2002 to December 31, 2003, our business subscriber base grew from 3,505 business subscribers to 4,144 and our residential and SOHO subscriber base remained at the same level with 312,256 subscribers, representing a 18%

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growth rate in our business subscribers. Our broadband subscriber base grew from 32,977 broadband subscribers to 106,573, representing a 242% growth rate. Our monthly churn rate decreased from 1.7% in 2002 to an average of approximately 1.4% in 2003. Churn rate represents the number of subscribers canceling during a month as a percentage of the number of subscribers at the beginning of the month. There has been an increase in our residential and SOHO subscriber base in the first quarter of 2004 and in our business subscriber base, and as of March 31 2004 we had 318,448 residential and SOHO subscribers (126,095 are broadband users) and approximately 4,150 business subscribers (most of them are broadband users).

### Certain Strategic and Other Relationships.

As part of our strategy, we have entered into strategic and other relationships with reputable Israeli and international companies. Our principal relationships are as follows:

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Microsoft Corporation. MSN Israel is jointly owned by us 50.1% and Microsoft Corporation 49.9%. The MSN Israel portal provides the same look and feel as MSN Worldwide and uniquely combines leading Israeli content and e-commerce providers and integrates them with Microsoft's leading network services.

Eurocom Group. Our principal beneficial shareholder, Eurocom Holdings Ltd., is an Israeli company, which holds interests in various telecommunications and satellite communications companies. One of our principal strategic relationships is with companies affiliated with Eurocom Holdings:

In September 1999 we established Gold Trade, an e-commerce affiliated company, in which we own a 48.27% interest, together with Eurocom Communications, a subsidiary of Eurocom Holdings, by its fully owned subsidiary Eurocom Marketing (which holds 48.36% in Gold Trade) and three additional minority shareholders.

International Operations. In March 2000, IGI acquired a 19.9% equity interest in Compulink Network S.A., an ISP in Greece. To date, IGI has invested \$950,000 in Compulink Network and currently holds a 15.2% interest in that company. In the third quarter of 2003, IGI recorded an impairment charge of NIS 2.6 million (\$0.6 million). In the first quarter of 2004 IGI recorded an additional impairment charge of NIS 0.7 million (\$0.16 million). As of June 1, 2004 the value of IGI's investment in Compulink is estimated to be NIS 0.9 million (\$0.2 million). We are constantly evaluating the value of our interest in Compulink. Currently we do not expect any improvement in Compulink's financial situation. Accordingly, we will probably be required to make additional impairment charges in the foreseeable future.

Since the beginning of 2002, IGI has engaged in the promotion and advancement of cooperation activities with international corporations. Within the framework of such activities, IGI provides UUNET with Internet infrastructure segments for the benefit of UUNET's customers in Israel.

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### Marketing and Sales

Our marketing and sales strategy combines brand building and demand increasing advertising with multi-channel marketing. We use multiple distribution channels: authorized dealers and networks, cooperation with business partners and mass distribution. We continually evaluate the effectiveness of our sales and marketing programs, primarily by analyzing sales statistics such as call volumes, sales volumes, and incentive offer response, in order to refine our marketing campaigns. We currently employ 157 sales representatives, 126 who focus on the residential subscriber market and 31 who focus on the business subscriber market.

#### Marketing to Residential Subscribers

Our integrated marketing and sales efforts for residential customers include the following elements:

Marketing Activities. We engage in a variety of marketing and promotional activities to stimulate awareness of our broadband access services. These efforts are directed both to consumers who have not previously subscribed to Internet access services and to Internet users who may switch to our services after learning of their affordability and reliability. We principally employ targeted high-visibility media, including television, radio, Internet and printed media advertising, to solicit new subscribers. Our advertisements

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include a toll free 800 number (for regular phones), to allow potential customers to contact our sales staff.

In addition, 8% of our new subscribers in 2003 came from referrals by existing customers. Accordingly, we believe that our delivery of superior customer service and support and our associated high levels of customer satisfaction have led to positive customer referrals. To attract additional subscribers and encourage existing subscribers to subscribe for additional services, we also make special offers and offer promotional discounts on one-time registration fees for dial-up subscribers. Our sales staff handles calls from prospective subscribers and follows up on leads generated by current service promotion packages, advertising at unique events and by proprietary database searches specific to particular service promotions.

We engage in several activities to increase customer usage of our services by upgrading their surfing packages to broadband access and offering them a variety of value added services and products. Our marketing and sales staff is using our customer database in order to approach relevant segments and offer them incentives to upgrade their packages to broadband access. Our after-sale activities include offering value-add services such as anti-virus or anti-spam services as well as a variety of newsletters and content services such as Vgames.

We recently renewed our logo and changed our slogan to "Surf with a smile." We strongly believe that as a leading ISP we should focus on enriching customers' experience. As such, our TV campaigns feature a popular stand-up comedian who mentions our Internet activities such as the downloading files, chatting and upgrading into broadband access. We have a new channel under the MSN portal ([www.smile.net.il](http://www.smile.net.il)) to promote the very same points and publish, by mail, a colorful and informative monthly newsletter named "Home Page" to our subscribers.

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Joint Marketing Programs. Our channel marketing program involves the promotion of our services by our marketing partners to their own customers. We believe that the subscribers obtained through our relationships with joint marketing partners accounted for at least 10% of our new subscribers in 2003. These joint marketing programs provide us with distinct advantages, including:

- . 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 promotions budget.

Our marketing partners typically display our applications and logos in their retail stores, distribute our literature and promotional materials with their own products and services, and engage in joint promotion and co-marketing activities with us. Registering a new customer is easily performed through our unique on-line registration web accessed platform. The sources through which we obtain customers include:

- . Israel's major consumer clubs like IDF personnel ([www.mcc.co.il](http://www.mcc.co.il)) and Israel's Teachers Union ([www.itu.org.il](http://www.itu.org.il)) to which we offer specially tailored Internet packages.
- . home PC retail chains such as BUG ([www.bug.co.il](http://www.bug.co.il)) located in the largest shopping malls in Israel, offering our Internet services accompanied with relevant software, hardware and communication

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products; and

- . many dozens of stand-alone PC stores that promote our Internet service for a success fee.

Marketing to Business Customers.

In marketing our services to business customers, our integrated marketing and sales approach is based on a one-stop-shop concept with an end-to-end solution for our business customers' communication needs, including:

Direct Sales. We offer our products and services through a consultative sales approach, which enables us to better understand customers' needs and provides a variety of bundled Internet and IP application and communication solutions. We offer a broad portfolio of data-security solutions, Web sites and servers hosting & co-locations solutions, data VPN and global IP communication solutions as well as professional services and whole system support services. Our approach is specifically designed to meet the budget and quality specifications of each business customer. We believe that our individualized approach allows us to provide our business customers with comprehensive solutions and superior ongoing support. We employ business sales representatives who have strong technical backgrounds and training. This approach helps us to better understand the needs of each customer's local business community and become familiar with the products, personalities and corporate identities of individual local companies. We also use direct marketing, including direct mail, telemarketing, seminars and trade show exhibits to target these business customers.

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Marketing Partners. We have entered into business-oriented product development and marketing alliances with partners. In addition we have built a network of authorized dealers, mainly business computer network integrators, which generates considerable amount of business leads and contracts.

Customer Retention Program. We have a team of experienced representatives specializing in residential and business customer retention. This team handles all incoming calls from customers and utilizes a series of specially designed "retention tools" to help the representatives convince customers to stay connected.

Marketing of International Telephony Services.

We plan to leverage our customer base as well as our partners and Internet channels in order to penetrate to the international telephony market. We also intend to offer better pricing schemes than the ones offered today by our competitors and will provide new services to customers.

Subscriber Service

We have a strong commitment to subscriber satisfaction. Subscriber satisfaction has contributed to our efforts to keep churn rates low and achieve subscriber growth through subscriber referrals. We believe that the key factors contributing to subscriber satisfaction are network performance -- primarily the reliability and speed of the Internet access service -- subscriber technical support and the range and quality of our products and services.

Technical Support. Knowledgeable and experienced support teams able to efficiently diagnose subscriber problems and prescribe corrective measures staff our technical support team. Technical support is available to all subscribers,



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24 hours-a-day, seven days-a-week, 364 days a year. In order to efficiently service the different levels of support required, we maintain two separate technical support telephone banks staffed by two separate groups of technical support representatives to field calls from residential and business subscribers respectively. In addition, our technical support staff for residential subscribers is divided into sub-specialized teams, one dealing with first time connection and the other providing ongoing support to previously connected customers. This system enables us to more efficiently address a wide range of technical problems for a variety of systems. Every subscriber can access our service and technical support by telephone, e-mail or fax. We also publish printed reference materials and maintain on our websites comprehensive descriptions of our subscriber care services, as well as troubleshooting tips and configuration information. In addition, technical support is available not only in Hebrew, but also in English, Russian and Arabic. Currently, we have about 193 technical support personnel for residential subscribers and 22 technical support personnel for business subscribers.

Subscriber Service. Our subscriber service department answers subscriber account, registration and other post-sale questions. Subscribers can also utilize our extranet to obtain real-time interactive subscriber service, and we have developed an online account information system that enables subscribers to view their bills and usage records on the Internet. Currently,

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we have 147 service personnel for residential subscribers and 20 service personnel for business subscribers.

Non-technical subscriber support for our business subscribers is also provided by our business sales team, which works closely with the subscriber support group in handling pre- and post-installation questions raised by business subscribers. The business sales team also works with the business technical support group to ensure that subscriber's expectations are met.

### Network and Technology

Our network infrastructure is designed to provide subscribers with reliability and speed and to minimize our costs through efficient use of our international and domestic bandwidth and implementation of a scalable infrastructure. Reliability is primarily achieved through redundancy in mission critical systems that minimizes the number of "single points of failure," i.e., points where the failure of a single component of the network could interrupt service to customers. Speed is achieved through clustered systems, diverse network architecture, multi-peered Internet backbone connections, aggressive load balancing and high-speed switching cores. Efficient bandwidth use is attained through policy-based routing and enhanced Internet web caching that optimize traffic through our multiple Internet connections.

Network Infrastructure. Subscribers access our services by connecting to a network with their PCs or other terminal devices using local telephone service or cable infrastructure. Network connections are made through communications hardware, such as telephone lines, as well as routers, switches and modems, which we own and which serve to direct data and enable communication among a variety of computer operating systems. The network infrastructure which is utilized, consists of three primary tiers: local points of presence; a middle tier, which connects the points of presence to regional network operations centers; and an international bandwidth tier, which connects the network operations centers to the Internet backbone. The network currently includes six points of presence and has the capability to provide dial-up access, with local telephone calls, to the entire Israeli population. We lease the land on which

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the points of presence are located from various landowners. The network operations centers are currently connected to the Internet through the following links:

Bandwidth: Incoming and outgoing - Total of (1,395 MB/sec)

Current Service:

- . 7 X 155 MB/sec (STM-1) leased fiber-optic line from Petach Tikva to London.
- . 2 X 155 MB/sec (STM-1) leased fiber-optic line from Petach Tikva to New York.

We use only digital incoming lines. We provide 56Kbps (V.90 and V92) surfing capabilities at all ports, and use the leading RAS -(remote access server) technology from 3Com, as well as Cisco routers at all of our points of presence. We are the first Israeli Internet service provider to use ATM wide-area-network technology in its connection centers. We continuously monitor capacity demands on our network, so network resources grow ahead of market demands. Generally, when the network reaches 70% to 80% utilization, which may occur at peak hours, we

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either order new capacity from third-party vendors or buy the necessary new systems and equipment in order to handle the current and forecast higher rates of use.

Network Design. Each of our points of presence includes hardware along with routing equipment and associated leased-telephone line interface devices. Modems are interconnected to switched telephone networks serving the local area and high-speed telephone lines connect the point of presence router to other sites within our network. The hardware and software deployed at each physical facility allow us to analyze the performance of the network and perform limited maintenance remotely. Based on subscriber growth and demands, we lease new high-speed telephone lines and install hardware into our network. This allows additional traffic to travel over the network in a more efficient fashion.

Network Centers. We currently operate through fully redundant network centers in Israel. In order to ensure reliable service, our network centers monitor network traffic, quality of service and security issues, as well as the performance of the equipment located at each of our physical locations. These facilities also serve as the primary site for our delivery of business services and communications between our physical locations and external service providers. We monitor our network centers on a 24 X 7 basis. Our monitoring systems are connected to a paging system that automatically warns the appropriate technical support staff of potential network faults, overcapacity or other problems. We intend to continue to enhance the capabilities of our network centers as our subscriber base grows.

We acquired an advanced international switching system (soft switch) in order to provide international telephony services. The soft switch will be connected to the local Bezeq (PSTN) network and to all the cellular operators in Israel. We will connect to international communication operators for the purpose of receiving and sending voice traffic, via our existing IP network, using our network support in MPLS protocol to guarantee quality of service (QOS) for voice traffic on the Internet. We intend to use our two existing points of presence in New York and London in order to activate efficient and quality links to international communication operators.

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In addition, we purchased an anti-fraud system, which continuously monitors all voice traffic on the net and are establishing a network operation center designated for fraud prevention. This center will be manned 24 hours a day by anti-fraud experts who will frequently monitor the voice traffic in order to prevent fraud.

### Competition

The market for the provision of Internet access and value added services is competitive and highly fragmented. As there are no significant barriers to entry, we expect that competition in this market will intensify and that we may not be able maintain our strong position in the Israeli market.

We believe that the primary competitive factors determining success as an Internet service provider are:

- . pricing;

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- . a reputation for reliability and high-quality service;
- . effective customer support;
- . access speed;
- . effective marketing techniques for customer acquisitions; and
- . ease of use.

We believe that, to date, we have competed favorably, based on these factors, particularly due to:

- . our strong brand recognition, achieved principally through innovative marketing programs; and
- . our emphasis on providing fast and reliable, high quality services and superior customer service and support.

### Access Services

Our current principle competitors are four other major ISPs in Israel. These competitors are: (i) Bezeq International Ltd., our principal competitor, a subsidiary of Bezeq, Israel's domestic telephone monopoly; (ii) NetVision Ltd., is affiliated with IDB, one of the largest holding companies in Israel; (iii) 012 Golden Lines, an affiliate of an Israeli cable company; and (iv) Barak ITC Ltd. Except for NetVision Ltd., the other three competitors are international telecommunications carriers that provide services in Israel. Following the opening of the international telecommunications market for competition in April 2004, we, as well as Netvision Ltd., applied to the Ministry of Communications for a license to provide international telephony services. On June 2, 2004, we received our license. We believe that Netvision, as well as Xphone, a British company, will also be granted licenses.

In the future we may have additional competition from new local telecommunication operators, such as Cellcom, Partner and Pelephone, the major cellular carriers in Israel which have already received ISP licenses and from international ISPs. We do not know at present to what extent the entrance of such new competitors will affect our business.

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Moreover, we expect to face competition in the future from companies that provide connections to consumers' homes, such as telecommunications providers, DBS and cable companies. For example, advances in technology have enabled cable television operators to offer Internet access through their cable facilities at significantly faster speeds than existing analog modem speeds. These companies could exploit their current high rate of penetration of households and potentially include Internet access in their basic bundle of services or offer access for a nominal additional charge.

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### Portals

MSN Israel, currently competes with three other major portals in Israel: Walla, which is its principal competitor, affiliated with Bezeq International Ltd. (a subsidiary of Bezeq, Israel's domestic phone monopoly); Ynet, which is affiliated with the largest media group in Israel - Yedioth Ahronoth; and Nana, which is affiliated with NetVision Ltd.

### E-Commerce

Gold Trade competes through the brand name "P1000" with three other major e-commerce providers in Israel. These competitors are: (i) Netaction, which is affiliated with NetVision; (ii) Olsale, which is a private company; and (iii) Walla Shops, which is affiliated with Walla and Bezeq International. There are additional small companies that are active in this area as well. In addition, Israelis are able to purchase products and services (including on-line brokerage services) on international e-commerce websites, such as E-Bay and Amazon.

Currently, most revenues from e-commerce in Israel are derived from auctions and group sales. We believe this trend will continue in 2004 as well.

### Advertising on Portals

Israel's other domestic portals include Walla, Nana, Ynet and TheMarker. Walla is a Yahoo! style portal, that provides news and mail services. Nana is a NetVision portal. Ynet is a portal owned by Yedioth Ahronoth, a major Israeli daily newspaper, and TheMarker is owned by Ha'aretz, another major Israeli daily newspaper. In addition, many Israelis use international portals such as Yahoo! and MSN.com.

### International Telephony Services

Since the opening of the international telephony market to competition in 1996, only three companies (Bezeq International, 012 Golden Lines and Barak ITC) have provided international telephony services in Israel. The market, estimated to be two billion minutes and \$440 million per year, is equally divided between the three companies. We plan to leverage our customer base as well as our partners and Internet channels in order to penetrate to the international telephony market. We also intend to offer better pricing schemes than the ones offered today by our competitors and will provide new services to customers.

### General

Some of our competitors and potential competitors have better brand recognition and greater financial, technical and marketing resources than us. In addition, Bezeq and the cable television companies have established network

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infrastructure which could provide them with lower cost access to subscriber homes for a range of competing applications and technologies.

Increased competition could result in:

- . limited subscriber growth, increased subscriber cancellations and loss of market share;
- . lower pricing for subscriber access and portal advertising and the need to offer more free access packages;
- . the need to increase sales and marketing expenses;
- . difficulty in attracting online advertisers resulting in lower advertising revenues;
- . loss of visitors to our portals, including MSN Israel, and fewer page views; and
- . our inability to develop a viable e-commerce business through Gold Trade.

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We cannot guarantee that we will be able to continue to compete successfully against current or future competitors or that competitive pressures faced by us will not harm our business and financial results.

### Proprietary Rights

General. Although we believe that our success is more a function of our technical and marketing expertise and subscriber service than our proprietary rights, our success and ability to compete depends in part upon our technology. We rely on a combination of copyright and trade secret laws, and contractual restrictions to establish and protect our brand and other proprietary rights. It is our policy to require employees and consultants and, when possible, suppliers to execute confidentiality agreements upon the commencement of their relationships with us. These agreements provide that confidential information developed or made known during the course of a relationship with us must be kept confidential and not disclosed to third parties except in specific circumstances.

Trademarks. . In order to refresh our image, as well as part of our preparations for the provision of international telephony services, we changed our logos and applied for their registration as trademarks in Israel. There is no guarantee that these trademarks will be registered or that we will obtain registration of other trademarks for which we may seek protection in the future.

Domain Names. Domain Names. We currently hold the Internet domain names: "zahav.net.il," "inter.net.il," "internet-zahav.net.il," "zahav.msn.co.il," "igld.com," "gold.net.il," "access.net.il," "smile.net.il," "Vgames.co.il" "hicareer.co.il" and various other related names. MSN Israel holds the Internet domain names: "msn.co.il," "start.msn.co.il," "start.co.il," "smsn.co.il," "mediace