INTERNET GOLD GOLDEN LINES LTD
Form 6-K
March 18, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 OR 15d-16 UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the month of March 2005

INTERNET GOLD-GOLDEN LINES LTD.
(Name of Registrant)

1 Alexander Yanai Street Petach-Tikva, Israel
(Address of Principal Executive Office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F x Form 40-F o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): o

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No x

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82- __________

Internet Gold-Golden Lines Ltd.

6-K Items

1. Financial Statements of Internet Gold -Golden Lines Ltd. as of December 31, 2004

2. Operating and Financial Review and Prospects

3. Exhibit 12.1-Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended

4. Exhibit 12.2-Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended

5. Exhibit 13.1-Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

6. Exhibit 13.2-Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Item 1

Internet Gold - Golden Lines Ltd.

Financial Statements
As at December 31, 2004

Financial Statements as at December 31, 2004

[LOGO]

Somekh Chaikin
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Report of Independent Registered Public Accounting Firm
The Board of Directors and Shareholders of
Internet Gold - Golden Lines Ltd.

We have audited the accompanying consolidated and company balance sheets of Internet Gold - Golden Lines Ltd. (hereinafter - the “Company”) as of December 31, 2004 and 2003, and the related consolidated and company statements of operations, changes in shareholders’ equity and cash flows, for each of the years in the three year period ended December 31, 2004. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated and company financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003 and the results of its operations, the changes in shareholders’ equity and its cash flows for each of the years in the three year period ended December 31, 2004, in conformity with generally accepted accounting principles in Israel.

As explained in Note 2C the financial statements for dates and reporting periods subsequent to December 31, 2003 are stated in reported amounts, in accordance with the accounting standards of the Israel Accounting Standards Board. The financial statements for dates and reporting periods that ended up to the aforementioned date are stated in values that were adjusted to that date according to the changes in the general purchasing power of the Israeli currency, in accordance with opinions of the Institute of Certified Public Accountants in Israel.

Accounting principles generally accepted in Israel vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 21 to the consolidated financial statements.

As discussed in Note 21 to the consolidated financial statements, the Company adopted Financial Standards Board Interpretation No. 46(R) "Consolidation of Variable Interest Entities" in 2004 by restating the consolidated financial statements of 2003 and 2002 with a cumulative effect adjustment as of the beginning of 2002 in the amount of NIS 4,382 thousand.

/s/ Somekh Chaikin
Somekh Chaikin
Certified Public Accountants (Isr.)
Member Firm of KPMG International
Tel Aviv, Israel

February 17, 2005

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Balance Sheets - Consolidated and Company

		Consolidated		Company		Convenience translation into US Dollars (Note 2E) Consolidated
		December 31 2004 Reported Amounts*	December 31 2003 Adjusted Amounts**	December 31 2004 Reported Amounts*	December 31 2003 Adjusted Amounts**	December 31 2004
	Note	NIS thousands				US$ thousands
Current assets						
Cash and cash equivalents	3	**75,637**	81,891	**75,323**	81,660	**17,557**
Trade receivables, net	4	**52,682**	35,569	**37,723**	26,601	**12,231**
Other receivables	5	**8,948**	12,769	**7,408**	10,539	**2,077**
Deferred taxes	16	**2,564**	1,914	**-**	-	**595**
Total current assets		**139,831**	132,143	**120,454**	118,800	**32,460**
Investments						
Investments in investee companies	6	**-**	1,550	**16,821**	8,287	**-**
Deferred taxes	16	**22**	21	**-**	-	**5**
		22	1,571	**16,821**	8,287	**5**
Property and equipment, net	7	**40,583**	29,160	**36,075**	26,796	**9,420**
Other assets and deferred charges	8	**114,956**	51,130	**112,253**	49,895	**26,684**
Assets allocated to discontinued operation	20	**4,631**	-	**-**	-	**1,075**
Total assets		**300,023**	214,004	**285,603**	203,778	**69,644**

/s/ Eli Holtzman
Eli Holtzman
Chief Executive Officer and Director

/s/ Doron Turgeman
Doron Turgeman
Chief Financial Officer

Date of signature: February 17, 2005

* With respect to discontinuance of adjustment to the effect of inflation as from the CPI of December 2003 (see Note 2C).
** Amounts adjusted to reflect inflation in terms of NIS at December 31, 2003.

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

		Consolidated		Company		Convenience translation into US Dollars (Note 2E) Consolidated
		December 31 2004 Reported Amounts*	**December 31 2003 Adjusted Amounts****	**December 31 2004 Reported Amounts***	**December 31 2003 Adjusted Amounts****	**December 31 2004**
	Note	**NIS thousands**				**US$ thousands**
Liabilities						
Current liabilities						
Short-term bank loans	9	**10,950**	5,259	**7,668**	2,459	**2,542**
Accounts payable	10	**73,383**	***36,591	**69,414**	***33,915	**17,034**
Other payables	11	**13,784**	***14,037	**8,742**	***9,888	**3,200**
Total current liabilities		**98,117**	55,887	**85,824**	46,262	**22,776**
Long-term liabilities						
Excess of liabilities over assets in investees	6	**-**	7,706	**-**	7,706	**-**
Long-term loans and other long-term obligations	12	**72,117**	27,389	**72,111**	27,193	**16,740**
Deferred revenues		**3**	23	**3**	23	**1**
Liability for severance pay, net	13	**6,240**	4,928	**5,772**	4,523	**1,448**
Total long-term liabilities		**78,360**	40,046	**77,886**	39,445	**18,189**
Liabilities allocated to discontinued operation	20	**1,653**	-	-	-	**384**
Shareholders' equity						
Ordinary shares, NIS 0.01 par value (501,000,000 shares authorized; 18,431,500 shares issued and fully paid as at December 31, 2004)		**197**	197	**197**	197	**46**
Additional paid in capital		**215,040**	215,040	**215,040**	215,040	**49,916**
Accumulated deficit		**(93344)**	(97166)	**(93344)**	(97166)	**(21667)**
Total shareholders' equity		**121,893**	118,071	**121,893**	118,071	**28,295**

Total liabilities and Shareholders' equity	**300,023**	214,004	**285,603**	203,778	**69,644**

* With respect to discontinuance of adjustment to the effect of inflation as from the CPI of December 2003 (see Note 2C).
** Amounts adjusted to reflect inflation in terms of NIS of December 31, 2003.
*** Reclassified

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

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Statements of Operations - Consolidated and Company

		Consolidated			Company			Convenience translation into US Dollars (Note 2E) Consolidated
		Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004
	Note	NIS thousands (except for per share data)						US$ thousands
Revenues	15A	**219,577**	179,642	184,318	**180,343**	157,394	169,052	**50,970**
Costs and expenses:								
Cost of revenues	15B	**96,820**	92,871	99,564	**80,819**	78,008	85,798	**22,474**
Selling and marketing expenses	15C	**73,155**	41,393	37,125	**65,842**	42,538	37,981	**16,981**
General and administrative expenses	15D	**24,258**	21,908	21,209	**19,810**	18,959	18,712	**5,631**
Total costs and expenses		**194,233**	156,172	157,898	**166,471**	139,505	142,491	**45,086**
Income from operations		**25,344**	23,470	26,420	**13,872**	17,889	26,561	**5,884**
Financing income (expenses), net	15E	**122**	(3,235)	2,151	**2,452**	587	3,701	**28**
Other (expenses) income, net		**(1,077)**	(2,592)	(3)	**503**	17	(110)	**(250)**
Income from continued operations before income taxes		**24,389**	17,643	28,568	**16,827**	18,493	30,152	**5,662**
Income tax benefit	16	**301**	1,935	-	**-**	-	-	**70**
Income after income tax		**24,690**	19,578	28,568	**16,827**	18,493	30,152	**5,732**
Company's share in net income (loss) of investees		**(396)**	(1,538)	(1,530)	**7,467**	(453)	(3,114)	**(92)**
Income from continued operations		**24,294**	18,040	27,038	**24,294**	18,040	27,038	**5,640**
Company's share in loss of a subsidiary								

from discontinued operations	20	**(4,763)**	(3,737)	(7,080)	**(4,763)**	(3,737)	(7,080)	**(1,106)**
Net income		**19,531**	14,303	19,958	**19,531**	14,303	19,958	**4,534**
Income (loss) per share, basic and diluted								
Net income per NIS 0.01 par value of shares (in NIS) from continuing operations		**1.32**	0. 98	1. 47	**1.32**	0.98	1.47	**0.31**
Net loss per NIS 0.01 par value of shares (in NIS) from discontinued operation		**(0.26)**	(0. 20)	(0.39)	**(0.26)**	(0.20)	(0.39)	**(0.06)**
Net income per NIS 0.01 par value of shares (in NIS)		**1.06**	0.78	1.08	**1.06**	0.78	1.08	**0.25**
Weighted average number of shares outstanding (in thousands)		**18,432**	18,432	18,432	**18,432**	18,432	18,432	**18,432**

* With respect to discontinuance of adjustment to the effect of inflation as from the CPI of December 2003 (see Note 2C).

** Amounts adjusted to reflect inflation in terms of NIS at December 31, 2003.

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

Internet Gold - Golden Lines Ltd.

Statements of Changes in Shareholders' Equity

	Share capital * Number of shares	Amount	Additional paid-in capital	Accumulated Deficit	Total
	Amounts adjusted to the effect of inflation in terms of NIS of December 2003				
	NIS 0.01 par value			NIS thousands	
Balance as of January 1, 2002	18,431,500	197	215,040	(131427.00)	83,810
Changes during 2002					
Net income for the year	-	-	-	19,958	19,958
Balance as of December 31, 2002	18,431,500	197	215,040	(111469.00)	103,768
Changes during 2003:					
Net income for the year	**-**	**-**	**-**	14,303	14,303
Balance as of December 31, 2003	18,431,500	197	215,040	(97166.00)	118,071

	Share capital (*) Number of shares	Amount	Additional paid-in capital	Accumulated Deficit	Total
			Reported Amounts**		
	NIS 0.01 par value			NIS thousands	
Balance as of December 31, 2003	18,431,500	197	215,040	(97166.00)	118,071
Changes during 2003:					
Capital reserve from purchase of investee company	**-**	**-**	**-**	**(15709.00)**	**(15709.00)**
Net income for the year	**-**	**-**	**-**	**19,531**	**19,531**
Balance as of December 31, 2004	**18,431,500**	**197**	**215,040**	**(93344.00)**	**121,893**

* Number of authorized shares - 501,000,000

** With respect to discontinuance of adjustment to the effect of inflation as from the CPI at December 31, 2003 (see Note 2C).

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

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Internet Gold - Golden Lines Ltd.

Statements of Cash Flows - Consolidated and Company

	Consolidated			Company			Convenience translation into US Dollars (Note 2E) Consolidated
	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004
	NIS thousands						US$ thousands
Cash flows from operating activities:							
Net income	**19,531**	14,303	19,958	**19,531**	14,303	19,958	**4,534**
Adjustments to reconcile net income to net cash provided by operating activities:							
Net loss from discontinued operations	**4,763**	3,737	7,080	**4,763**	3,737	7,080	**1,106**
Depreciation and amortization	**21,856**	16,219	15,333	**19,445**	13,621	13,754	**5,072**
Increase in liability for termination of employer - employee relations, net	**1,284**	1,147	202	**1,249**	1,060	2	**298**
Company's share in net loss (income) of investees	**396**	1,538	1,530	**(7,467)**	453	3,114	**92**
Interest on long -term loans	**(2,161)**	(374)	(644)	**1,196**	(4,012)	(1,043)	**(502)**
(Gain) loss on sale of property and equipment	**(382)**	16	110	**(413)**	16	110	**(89)**
Impairment of investments	**1,551**	2,609	-	**-**	-	-	**360**
Deferred taxes	**(301)**	(1,935)	-	**-**	-	-	**(70)**
Changes in assets and liabilities, net of effect of acquired companies and discontinued operations:							
Increase in trade receivables	**(15,041)**	(4,362)	(2,939)	**(11,122)**	(918)	(675)	**(3,491)**
	(2,158)	(2,548)	1,987	**(2,962)**	(1,189)	3,815	**(501)**

(Increase) decrease in other receivables							
(Decrease) increase in accounts payable	**11,774**	***(3,290)	***(656)	**12,610**	(775)	(675)	**2,733**
(Decrease) increase in other payables	**(2,927)**	***2,112	***(758)	**(1,166)**	(797)	(5,067)	**(679)**
Net cash provided by continued operating activities	**38,185**	29,172	41,203	**35,664**	25,499	40,373	**8,863**
Net cash used in discontinued operating activities	**-**	-	-	**-**	-	-	**-**
Net cash provided by operating activities	**38,185**	29,172	41,203	**35,664**	25,499	40,373	**8,863**

* With respect to discontinuance of adjustment to the effect of inflation as from the CPI of December 2003 (see Note 2C).
** Amounts adjusted to reflect inflation in terms of NIS at December 31, 2003.
*** Reclassified
The accompanying notes are an integral part of the financial statements.

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Internet Gold - Golden Lines Ltd.

Statements of Cash Flows - Consolidated and Company (cont'd)

	Consolidated			Company			Convenience translation into US Dollars (Note 2E) Consolidated
	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004
	NIS thousands						US$ thousands
Cash flows from investing activities:							
Acquisition of property and equipment	**(22,830)**	(13,450)	(11,153)	**(23,210)**	(13,119)	(10,202)	**(5,299)**
Proceeds from sales of property and equipment	**1,266**	65	248	**1,046**	65	248	**294**
Grant of long-term loans to investee company	**(30,500)**	-	-	**-**	-	-	**(7,080)**
Grant of long-term loans	**-**	-	(1,266)	**-**	-	(1,266)	**-**
Repayment of long-term loans	**4,741**	1,079	956	**4,741**	1,079	956	**1,101**
Investment in investee companies	**-**	(6,474)	-	**(32,540)**	(9,624)	(16,364)	**-**
Investment in other assets	**(69,220)**	(51,926)	(1,048)	**(67,898)**	(50,598)	-	**(16,068)**
Acquisition of formerly investee company (Appendix A)	**(1,122)**	-	116	**-**	-	-	**(261)**
Net cash used in continued investment activities	**(117,665)**	(70,706)	(12,147)	**(117,861)**	(72,197)	(26,628)	**(27,313)**
Net cash used in discontinued operations investment activities	**-**	-	(1)	**-**	-	-	**-**
Net cash used in investment activities	**(117,665)**	(70,706)	(12,148)	**(117,861)**	(72,197)	(26,628)	**(27,313)**
Cash flows from financing activities:							
Changes in short-term bank loans	**3,549**	(4,717)	(29,983)	**5,844**	4	(15,095)	**824**
Receipt of long-term loans under lease agreement	**81,039**	60,181	-	**81,039**	60,181	-	**18,811**

Receipt of long-term loans from bank	**30,500**	-	-	**30,500**	-	-	**7,080**
Repayment of long-term loans under lease agreement	**(41,862)**	(17,184)	(1,545)	**(41,523)**	(16,869)	(1,226)	**(9,717)**
Net cash provided by (used in) continued financing activities	**73,226**	38,280	(31,528)	**75,860**	43,316	(16,321)	**16,998**
Net cash provided by discontinued operations financing activities	**-**	-	-	**-**	-	-	**-**
Net cash provided by (used in) financing activities	**73,226**	38,280	(31,528)	**75,860**	43,316	(16,321)	**16,998**

* With respect to discontinuance of adjustment to the effect of inflation as from the CPI of December 2003 (see Note 2C).

** Amounts adjusted to reflect inflation in terms of NIS at December 31, 2003.

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

Internet Gold - Golden Lines Ltd.

Statements of Cash Flows - Consolidated and Company (cont'd)

	Consolidated			Company			Convenience translation into US Dollars (Note 2E) Consolidated
	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004 Reported Amounts*	Year ended December 31 2003 Adjusted Amounts**	Year ended December 31 2002 Adjusted Amounts**	Year ended December 31 2004
	NIS thousands (except for per share data)						US$ thousands
Changes in cash and cash equivalents	(6,254)	(3,254)	(2,473)	(6,337)	(3,382)	(2,576)	(1,452)
Cash and cash equivalents at beginning of year	**81,891**	85,145	87,618	**81,660**	85,042	87,618	**19,009**
Cash and cash equivalents at end of year	**75,637**	81,891	85,145	**75,323**	81,660	85,042	**17,557**
Non-cash investing activities:							
Accounts payable in respect of fixed assets	**3,337**	2,352	3,952	**3,283**	2,255	3,952	**775**
Investment in subsidiary	**-**	(4,252)	-	**-**	-	-	**-**
Cash reserve from purchase of investee company from a related party	**15,709**	-	-	**15,709**	-	-	**-**
Cash paid for interest, net	**323**	553	1,592	**247**	323	1,592	**75**
Appendix A							
Consolidation of formerly investee company							
Operating capital, net of cash	**3,878**	-	181	**-**	-	-	**900**
Property and equipment, net	(2,125)	-	(173)	**-**	-	-	(493)
Other assets	(700)	-	104	**-**	-	-	(162)
Assets allocated to discontinued operations	(4,631)	-	-	**-**	-	-	(1,075)
Liabilities allocated to discontinued operations	**1,653**	-		**-**	-	-	**384**
Long-term liabilities	**28**	-	4	**-**	-	-	**6**
	(15,709)	-	-	**-**	-	-	(3,646)

Capital reserve from purchase of investee company from a related party							
Investment in investee	**16,484**	-	-	**-**	-	-	**3,825**
	(1,122)	-	116	**-**	-	-	(261)
Appendix B -							
Exit from consolidation of a previously consolidated subsidiary							
Working capital, net of cash	**-**	-	(31,735)	**-**	**-**	**-**	**-**
Property and equipment, net	**-**	-	13,248	**-**	**-**	**-**	**-**
Long-term liabilities	**-**	-	(12,598)	**-**	**-**	**-**	**-**
Customer list, net	**-**	-	9,638	**-**	**-**	**-**	**-**
Minority interest	**-**	-	16,621	**-**	**-**	**-**	**-**
Company's share in excess of liabilities over assets in investees	**-**	-	4,825	**-**	**-**	**-**	**-**
	-	-	(1)	**-**	**-**	**-**	**-**

* With respect to discontinuance of adjustment to the effect of inflation as from the CPI of December 2003 (see Note 2C).

** Amounts adjusted to reflect inflation in terms of NIS at December 31, 2003.

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

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 1 - General

Internet Gold - Golden Lines Ltd. (hereinafter “the Company”) was incorporated in Israel in 1992. From 1996, the Company has operated as a provider of internet services, tailored to meet the needs of residential and business subscribers, including internet access and related value-added services, as well as content through portals. The Company launched its international Telephone Service (ITS) under the brand "015" in august 2004. The license to provide ITS was granted for 20 years.

Internet Gold is a public company and its ordinary shares currently trade on the NASDAQ national market.

Note 2 - Reporting Principles and Accounting Policies

A. Basis of preparation of financial statements

These financial statements are prepared in accordance with generally accepted accounting principles in Israel. See Note 21 for a reconciliation to generally accepted accounting principles in the United States.

B. Definitions

In these financial statements -

(1) The Company Internet Gold - Golden Lines Ltd.

(2) The Group - Internet Gold - Golden Lines Ltd. and its investee companies as specified in Annex A list of Group Companies.

(3) Subsidiary - A company, including a partnership or joint venture, the financial statements of which are fully consolidated, directly or indirectly, with the financial statements of the Company.

(4) Affiliated company - A company, other than a subsidiary and including a partnership or joint venture, the Company's investment in which is stated, directly or indirectly, under the equity basis.

(5) Investee company - A subsidiary or affiliated company

(6) Related party - As defined in Opinion No. 29 of the Institute of Certified Public Accountants in Israel (hereinafter - the ICPAI).

(7) Interested party as defined in Paragraph (1) of the definition of an "interest party" in Section 1 of the Securities Law - 1968.

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Reporting Principles and Accounting Policies

B. Definitions (cont'd)

(8) Controlling shareholder - As defined in the Securities Regulations (Financial Statement Presentation of Transactions between a company and its controlling shareholder) - 1996.

(9) CPI - The Consumer Price Index as published by the Central Bureau of Statistics.

(10) Adjusted amount - the nominal historical amount adjusted in accordance with the provisions of Opinions 23 and 34 and Opinions 36 and 37.

(11) Reported amount - The adjusted amount as at the transition date (December 31, 2003), with the addition of amounts in nominal values that were added after the transition date and less amounts eliminated after the transition date.

(12) Adjusted financial reporting - Financial reporting based on the provisions of Opinions 23, 34, 36, 37 and 50.

(13) Nominal financial reporting - Financial reporting based on reported amounts.

C. Financial statements in reported New Israeli Shekels (NIS)

In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12, "Discontinuance of Adjustment of Financial Statements". Pursuant to this standard and in accordance with Accounting Standard No. 17 that was published in December 2002, the adjustment of financial statements was discontinued as of January 1, 2004. Up to December 31, 2003, the Company continued to prepare adjusted financial statements in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in the financial statements as at December 31, 2003 constitute the starting point for the nominal financial report as of January 1, 2004. The Company has implemented the provisions of the standard and has accordingly discontinued the adjustments as of January 1, 2004.

1. In the past the Company prepared its financial statements on the basis of historical cost adjusted for the changes in the Consumer Price Index. The adjusted amounts that are included in the financial statements as at December 31, 2003 constitute the starting point for the nominal financial report as of January 1, 2004. Any additions made during the period are included according to their nominal values.

2. Amounts of non-monetary assets do not necessarily reflect their realizable value or updated economic value, but only the reported amounts of such assets.

3. The term "cost" in these financial statements means the reported amount of cost.

4. All the comparative data for prior periods is stated adjusted to the index at December 31, 2003.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Reporting Principles and Accounting Policies

C. Financial statements in reported New Israeli Shekels (NIS) (cont'd)

Balance sheets:

a. Non-monetary items are stated at reported amounts.

b. Monetary items are stated in the balance sheet at their nominal historical values as at balance sheet date.

Statement of operations:

A. Income and expenses deriving from non-monetary items from provisions included in the balance sheet are derived from the difference between the reported amounts of the opening balance and the reported amounts of the closing balance.

B. The other income and expense items (such as: sales, purchases, current manufacturing costs, etc.) are presented at their nominal values.

D. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

E. Convenience translation

For the convenience of the reader, the reported NIS figures of December 31, 2004 have been presented in U.S. Dollars thousands, translated at the representative rate of exchange as of December 31, 2004 (NIS 4.308 = U.S. Dollar 1.00). The U.S. Dollar (hereinafter - $) amounts presented in these financial statements should not be construed as representing amounts receivable or payable in U.S. Dollars or convertible into U.S. Dollars, unless otherwise indicated.

F. Principles of consolidation

The consolidated financial statements include those of the Company and all its subsidiary companies. All material intercompany transactions and balances have been eliminated in the consolidated financial statements.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Significant Accounting Policies (cont'd)

G. Exchange rate and Consumer Price Index data

1. Transactions in foreign currency

Transactions denominated in foreign currency are recorded upon their initial recognition according to the exchange rate in effect on the date of the transaction. Exchange rate differences arising upon the settlement of monetary items or upon reporting the Company's monetary items at exchange rates that are different than those by which they were initially recorded during the period, or reported in previous financial statements, are charged to income or expenses.

2. Representative rates of exchange (as published by the Bank of Israel) and Consumer Price Indices (as published by the Israeli Central Bureau of Statistics) are as follows:

	Exchange rate of the $	Consumer Price Index
As of December 31, 2002	4.737	182.01 points
As of December 31, 2003	4.379	178.58 points
As of December 31, 2004	4.308	180.74 points
Changes during the:		
Year ended December 31, 2002	7.27%	6.49%
Year ended December 31, 2003	(7.56%)	(1.88%)
Year ended December 31, 2004	(1.625%)	1.21%

H. Cash and cash equivalents

The Company considers as cash equivalents all highly-liquid investments, including short-term bank deposits with an original maturity of three months or less, which are not encumbered by a lien.

I. Allowance for doubtful accounts

The allowance for doubtful accounts represents management's estimate of the aged receivable balance considered uncollectible, based on past experience.

J. Investments

Investee companies

Investments in investee companies, in which the Company has significant influence (affiliated companies) are stated under the equity method, that is, at cost plus the Company's share of the post-acquisition gains or losses.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Significant Accounting Policies (cont'd)

K. Property and equipment

Property and equipment are stated at cost less depreciation.

Depreciation is calculated using the straight-line method, over the assets estimated useful lives.

Annual depreciation rates are as follows:

	%
Network equipment and computers	25 - 33
Motor vehicles	15
Furniture and office equipment	6 - 15
Leasehold improvements	10

The cost of maintenance and repairs is charged to expenses as incurred. The cost of significant renewals and improvements is added to the carrying amount of the respective asset.

L. Other assets

1. Special content web sites

Certain costs relating to self construction of special content web-sites have been capitalized according to EITF-00-02 and amortized over a period of 18 months from completion of construction. Such capitalized costs are presented as part of other assets.

2. Rights of Use (ROU) of international fiber optic lines

The Company signed a long-term agreement with two of its suppliers (see Note 14F). The ROU purchase is presented in the financial statements as a capital lease. Amortization is computed by the straight-line method over the term of the agreement (15 years) subject to technological obsolescence effects.

3. Deferred charges

The Company defers costs incurred relating to the expansion of customer base by long-term contracts granting the customers incentives such as Routers, firewall, etc. The consideration in such long-term contracts is refundable. The Company amortizes such costs over the term of the agreement. The Company reflects long-term deferred charges net of current maturities that are presented as prepaid expenses.

In addition, the company granted the Ministry of Communication in Israel a guarantee related to the International telephoning services license. The commission regarding this guarantee is amortized over the term of the guarantee.

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Significant Accounting Policies (cont'd)

M. Deferred income

The deferred income in the consolidated financial statements is derived from Post Contract Customer Support ("PCS") and from advertising services. Those revenues are recognized ratably over the period that services are provided (see also Note 2N).

N. Revenue recognition

(1) Sales of products

Revenues from sales of products are recognized upon the delivery to the customer and the transfer of the principal risks and rewards arising from ownership over the sold products.

Revenues from the electronic commerce and "after sale" activity are recognized as the services are performed or when the goods are delivered, as applicable.

(2) Revenues from services

Revenues from services are recognized proportionately over the period of the agreement or upon the performance of the service if it is certain that the economic benefits attributed to the performance of the service will be received.

Most of the Company's revenues from services are derived from Internet access. These revenues are recognized ratably over the period that services are provided. Other revenues include website hosting, advertising revenues and recently international telephony services. Revenues from website hosting are recognized as the services are performed. Advertising revenues are recognized on a straight-line over the term of the contract. Revenues from international carrier services are recognized according to minutes of traffic.

(3) Multiple element sale agreements

Revenues from sale agreements which do not include a general right of return and which include a number of elements such as: hardware, software and support agreements, are split into separate accounting units and are recognized separately with respect to each accounting unit. An element constitutes a separate accounting unit if, and only if, it has a separate value to the customer and there is reliable and objective evidence regarding the fair value of all the elements of the agreement/the fair value of undelivered elements. Elements that not split into an accounting unit due to non-fulfillment of the conditions specified above are grouped together under one accounting unit. Revenues from the various accounting units are recognized when the conditions for recognizing the revenues from the elements included in that same accounting unit according to their type have been fulfilled, and only up to the amount of the consideration that is not contingent upon the completion/execution of the other elements of the contract.

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Significant Accounting Policies (cont'd)

N. Revenue recognition (cont'd)

(4) Revenues from the sale of software

Revenues from the sale of software are recognized in accordance with American Statement of Position SOP 97-2 "Software Revenue Recognition" (as amended by SOP 98-9). According to the standard, revenues from the sale of software licenses are recognized when all the following conditions have been met: the software has been delivered to the customer, collection of the payment is probable, the amount of the contract has been or can be determined and there is objective and persuasive evidence of the contract and of the Company's ability to allocate the consideration between the elements of the contract.

O. Income taxes

Income taxes are provided on the basis of the liability method of accounting. Under the liability method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between the carrying amounts of existing assets and liabilities and their respective tax bases, as well as tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years when these temporary differences are expected to be recovered or settled.

In the reporting period, the Company has reported profits and utilized a portion of the tax loss carryforward but, due to the uncertainty inherent in the intense competition in the market which has developed in recent months, the Company's management cannot be reasonably assured as to the Company's ability to further utilize the tax asset in the foreseeable future. Therefore, a valuation allowance has been provided to the full amount of these losses.

The Company believes that two of its subsidiaries will utilize their carryforward tax losses and therefore a deferred tax asset has been recorded in those subsidiaries (See Note 16B).

P. Financial instruments

The financial statements include disclosures relating to the fair value of financial instruments.

With regard to current financial assets and liabilities and long-term liabilities, there is no material difference between the value recorded in the Company's books of account and their fair value.

Q. Income (loss) per share

Income (loss) per share is computed based on the weighted average number of shares outstanding during each period not including share options granted, in accordance with Opinion No. 55 of the ICPAI.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 2 - Significant Accounting Policies (cont'd)

R. Impairment of assets

In February 2003, the Israel Accounting Standards Board (hereinafter - IASB) published **Accounting Standard No. 15 - "Impairment of Assets"**. The Standard provides procedures which a company must apply in order to ensure that its assets in the consolidated balance sheet, are not presented at an amount which is in excess of their recoverable value, which is the higher of the net selling price or the present value of the estimated future cash flows expected to be derived from use and disposal of the asset. In addition, the Standard provides rules for presentation and disclosure with respect to assets whose value has declined.

The Standard applies to financial statements for periods beginning January 1, 2003. The Standard provides that in most cases the transition will be effected by means of the "from hereon" method.

According to the Standard, Internet Gold International Ltd., a wholly-owned subsidiary of the Company, has fully written off its investment in an Internet group in Greece (see Note 6A(3)). The impairment charges of NIS 2,609 in 2003 and NIS 1,555 in 2004 are presented as other expenses.

The adoption of the Standard had no impact on the operations of the former affiliated company as the client list was partially impaired prior to the release of the standard.

S. Segment reporting

Segment reporting is represented according to Accounting Standard No. 11 of the IASB.

T. Discontinued operation

Discontinued operations are presented in accordance with Accounting Standard No. 8 and are separated from the information regarding continuing operations.

U. Disclosure of effect of new accounting standards in the period prior to their implementation

In July 2004, the Israeli Accounting Standards Board published Accounting Standard No. 19, "Taxes on Income". The Standard provides that a liability for deferred taxes is to be recorded for all temporary differences subject to tax, except for a limited number of exceptions. In addition, a deferred tax asset is to be recorded for all temporary differences that may be deducted, losses for tax purposes and tax benefits not yet utilized, if it is anticipated that there will be taxable income against which they can be offset, except for a limited number of exceptions. The new Standard applies to financial statements for periods beginning on January 1, 2005. The Standard provides that it is to be implemented by means of a cumulative effect of a change in accounting method. In the Company's estimation, the impact of the Standard on its results of operations, financial position and cash flows will not be material.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 3 - Cash and Cash Equivalents

The Company holds its available funds in US$ dollar short-term deposits bearing interest rates ranging from 1% to 2%.

Note 4 - Trade Receivables, Net

Trade receivables consist of:

	Consolidated		Company	
	As at December 31, 2005 2004	As at December 31, 2005 2003	As at December 31, 2005 2004	As at December 31, 2005