

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2008

OR

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

OR

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

Date of event requiring this shell company report.....

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

Commission File No. 000-51694



**IncrediMail Ltd.**

(Exact Name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

**Israel**

(Jurisdiction of incorporation or organization)

**4 HaNechoshet Street**

Tel Aviv, Israel 69710

(Address of principal executive offices)

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

Title of Each Class  
Ordinary shares, par value NIS 0.01 per share

Name of Each Exchange on which Registered  
NASDAQ Stock Market LLC

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

None  
(Title of Class)

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

None  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report.

As of December 31, 2008, the Registrant had outstanding 9,271,159 ordinary shares, par value NIS 0.01 per share.

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

Yes  No

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

U.S. GAAP

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

Other

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

Item 17  Item 18

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

Yes  No

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## PRELIMINARY NOTES

### Terms

As used herein, and unless the context suggest otherwise, the terms "IncrediMail," "Company," "we," "us" or "ours" refer to IncrediMail Ltd.

### Forward-Looking Statements

This annual report on Form 20-F contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our, or our industry's, actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed, implied or inferred by these forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "could," "would," "expects," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "projects," "potential" or "continue" or the negative of such terms and other comparable terminology.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we do not know whether we can achieve positive future results, levels of activity, performance, or goals. Actual events or results may differ materially from our current expectations. All forward-looking statements included in this report are based on information available to us on the date of this report. Except as require by applicable law, we undertake no obligation to update or revise any of the forward-looking statements after the date of this annual report to conform those statements to reflect the occurrence of unanticipated events, new information or otherwise.

You should read this annual report and the documents that we reference in this report completely and with the understanding that our actual future results, levels of activity, performance and achievements may be materially different from what we currently expect.

Factors that could cause actual results to differ materially from those expressed or implied by the forward-looking statements contained in this annual report include:

- our ability to establish and increase market acceptance of our products;
- our ability to continually enhance our existing products and to develop new products that achieve widespread market acceptance;
- our ability to maintain substantial revenues from "search" activities and further increase these revenues;
- our dependence on a limited number of possible customers in general and one dominant customer in particular for search generated revenues;
- our ability to cause continued and increasing installation of our products;
- our ability to manage our growth;
- our ability to establish a strong brand name;
- our ability to develop additional ways to distribute and sell our products;
- our ability to maintain substantial revenues from advertisers and further increase these revenues;
- our ability to hire and retain key personnel;
- our ability to protect our intellectual property rights;
- the development and future nature of the Internet;
- the volatility and liquidity of the financial markets;
- restrictions imposed in connection with our international operations; and
- political, economic and military conditions in the Middle East.

Assumptions relating to the foregoing involve judgment with respect to, among other things, future economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In light of the significant uncertainties, inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives or plans will be achieved. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties relating to our business described in this annual report at "Item 3.D Risk Factors." Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time and it is not possible for our management to predict all risks, nor can we assess the impact of all risks on our business or the extent to which any risk, or combination of risks, may cause actual results to differ from those contained in any forward-looking statements.

We obtained statistical data, market data and other industry data and forecasts used in preparing this annual report from market research, publicly available information and industry publications. Industry publications generally state that they obtain their information from sources that they believe to be reliable, but they do not guarantee the accuracy and completeness of the information. Similarly, while we believe that the statistical data, industry data and forecasts and market research are reliable, we have not independently verified the data, and we do not make any representation as to the accuracy of the information.

Unless otherwise indicated, the information in this annual report:

- Reflects the increase in our authorized share capital to 15 million ordinary shares and a 38-for-one ordinary share split effected as a dividend on our ordinary shares outstanding effective immediately prior to the effectiveness of the registration statement on Form F-1 relating to the initial public offering of our ordinary shares, which became effective on January 30, 2006; and
- Reflects the automatic conversion of all of our outstanding redeemable convertible preferred shares, on a 38-for-one basis, into 1,764,948 ordinary shares upon the closing of our initial public offering on February 3, 2006.

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**PART I**

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

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**

**A. SELECTED FINANCIAL DATA**

The following tables present selected financial data and should be read in conjunction with “Item 5 – Operating and Financial Review and Prospects” and our financial statements and related notes appearing elsewhere in this annual report. We derived the selected financial data below for the years ended December 31, 2006, 2007 and 2008 and as of December 31, 2007 and 2008 from our audited financial statements included elsewhere in this report. We derived the selected financial data below for the years ended December 31, 2004 and 2005 and as of December 31, 2004, 2005 and 2006 from our audited financial statements not included in this report. Our financial statements are prepared and presented in U.S. dollars and in accordance with accounting principles generally accepted in the United States, or U.S. GAAP.

	Year ended December 31,				
	2004	2005	2006	2007	2008
	(in thousands)				
<b>Statement of Operations Data:</b>					
Revenues					
Advertising and other services	\$ 665	\$ 784	\$ 3,066	\$ 9,597	\$ 12,748
Products	5,543	6,618	7,785	9,078	9,158
	6,208	7,402	10,851	18,675	21,906
Cost of products	473	570	858	1,740	1,795
Gross profit	5,735	6,832	9,993	16,935	20,111
Operating expenses:					
Research and development costs	1,321	2,040	3,251	6,125	7,589
Selling and marketing expenses	576	925	1,767	4,682	7,343
General and administrative expenses	1,271	922	2,717	3,693	3,806
Goodwill impairment and other charges	-	-	-	163	1,153
Total operating expenses	3,168	3,887	7,735	14,663	19,891
Operating income	2,567	2,945	2,258	2,272	220
Financial income (expenses), net	75	(14)	984	(3,641)	4,494
Income (loss), before taxes on income	2,642	2,931	3,242	(1,369)	4,714
Taxes on income (tax benefit)	(154)	845	765	1,393	289
Tax expense in respect of dividend paid out of tax-exempt income	-	937	-	-	-
Net income (loss)	\$ 2,796	\$ 1,149	\$ 2,477	\$ (2,762)	\$ 4,425

Year ended December 31,

	2004	2005	2006	2007	2008
	(in thousands)				
Net earnings (loss) per share (1):					
Basic	\$ 0.44	\$ 0.17	\$ 0.27	\$ (0.29)	\$ 0.47
Diluted	\$ 0.39	\$ 0.16	\$ 0.27	\$ (0.29)	\$ 0.46
Weighted average number of shares used in net earnings (loss) per share (1):					
Basic	4,606,657	4,869,698	8,982,201	9,442,658	9,427,424
Diluted	5,197,558	5,280,003	9,146,393	9,442,658	9,516,477

As of December 31,

	2004	2005	2006	2007	2008
	(in thousands)				
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 4,342	\$ 2,428	\$ 8,366	\$ 4,611	\$ 7,835
Working capital	6,238	2,966	21,561	19,756	25,143
Total assets	8,264	8,460	31,424	31,766	37,651
Total short-term debt	12	4	-	-	-
Total liabilities	2,349	5,465	8,847	10,995	12,107
Redeemable convertible preferred shares	3,063	3,030	-	-	-
Shareholders' equity (deficiency)	2,852	(35)	22,577	20,771	25,544

(1) All references to shares and per share amounts have been retroactively restated to reflect our 38-for-one ordinary share dividend on January 30, 2006, as if such event had occurred as of the beginning of the earliest period presented.

**B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

**C. REASONS FOR OFFER AND USE OF PROCEEDS**

Not applicable.

**D. RISK FACTORS**

*Investing in our ordinary shares involves a high degree of risk. You should consider carefully the following risk factors, as well as the other information in this annual report before deciding to invest in our ordinary shares. Our business, financial condition or results of operations could be affected adversely by any of these risks. The trading price of our ordinary shares could decline due to any of these risks and you might lose all or part of your investment in our ordinary shares.*

**Risks Related to Our Business**

**If we are unable to continually enhance our existing products and develop new products that achieve widespread market acceptance, our ability to attract and retain customers could be impaired, our competitive position may be harmed and we may be unable to generate additional revenues.**

We believe that the number of downloads of our free products indicates that many consumers are interested in having a customized and entertaining email or instant messaging experience. Our future revenue and profit growth will depend, in part, on increasing the number of downloads and acceptance of the search properties offered with them, and subsequently, the percentage of registered or active users of our free product who become actual purchasers of our products and services, as well as making our products and services attractive to new users. In order to induce those consumers to use our products, accept the search properties offered, and subsequently, to a certain extent, purchase or license our products, we must continually enhance our existing products by offering additional features and content and we must continue to introduce novel products. The enhancement of existing products and the development and commercialization of new products can be very complex. Software product development and commercialization depends upon a number of factors, including:

- accurate prediction of market requirements, market preferences and content trends and evolving standards;
- development of advanced technologies and capabilities;
- timely completion and introduction of new product designs and features that incorporate market requirements and preferences;
- our ability to recruit and retain highly qualified personnel;
- our ability to market our new products; and
- market acceptance of the enhanced and new products.

We may be unable to enhance our existing products or to develop new products. Furthermore, we may not develop or introduce new products or product enhancements in time to take advantage of market opportunities or achieve a significant or substantial level of acceptance in new or existing markets. If we fail to do so, our ability to attract and retain customers could be impaired, our competitive position may be harmed and we may be unable to generate substantial revenues.

**If we are unable to establish and increase market acceptance of our products, we will not expand our business and our revenues could decline.**

Our basic software products are currently supplied to our customers free of charge. We will be able to increase product revenues only if we can create and maintain a substantial market demand for our products, including acceptance of the search properties offered with them, and to a certain extent our enhanced software products, for which we currently charge a one-time license, or subscription fee.

Many email users have multiple email clients and accounts, many of which are likely provided to them free of charge by large Internet and software companies. Many instant messaging software providers, offer a graphic and entertaining user experience. Therefore, our ability to execute our business strategy depends on market demand for software programs that create a customized and entertaining email, instant messaging or computer desktop experience of the kind provided by our products. The rate of adoption and acceptance of our products may be affected adversely by changing consumer preferences, product obsolescence, technological change, market competition, development and acceptance of non-Internet mediums of communication and our products' quality and novelty.

**If the Google AdSense program is terminated or significantly changed by Google, we would be forced to immediately seek an alternative keyword search provider, in which case we would be susceptible to a certain transition period during which we may experience a material reduction in our search generated revenues and, possibly a long-term decrease in search generated revenues and, in turn, an adverse effect on our financial condition.**

Our business is very dependent on keyword advertisement, currently utilizing primarily the Google AdSense program, pursuant to which, we receive a portion of the amount paid by advertisers to Google for the activity performed through the Company's applications. This dependence continues to grow and we obtain over 70% of our revenues for the year ended December 31, 2008 from this venue, and this percentage is growing.

On July 1, 2008, we entered into an agreement with Google relating to the AdSense program which has a one year term. The Company is negotiating with Google renewal of this agreement. While Google has limited termination rights, if this agreement was terminated, or not renewed on favorable terms, we would be forced to seek an alternative keyword search provider. There are very few companies in the market that provide Internet ad services similar to those provided by Google and Google is one of the most dominant players in this market. If we fail to quickly locate, negotiate and finalize alternative arrangements, or if the alternatives do not provide for terms that are as favorable as those provided for by the AdSense program, or if the alternative arrangement will not attract the same attention as the attention attracted by the Google AdSense program, or if the termination by Google effects our ability to contract other providers, we may experience a material reduction in our revenues and, in turn, our business, financial condition and results of operations would be adversely affected. The failure of IncrediMail to retain existing, or attract new users, as well as generate traffic to its search properties, could adversely affect our business, financial condition and results of operations.

**The generation of revenues from searches has become subject to fierce competition. We obtain a significant portion of our revenues from searches made through our homepage and other search properties. If we cannot compete effectively in this market, our revenues are likely to decline.**

We obtain a significant and growing portion of our revenues from searches made through the Company's home page (*MyStart*), as well as offering other search properties. We therefore are constantly looking for ways to convince our users to make *MyStart* their homepage and accept the other search properties offered. Since there are a growing number of companies that generate an increasing amount of their revenues from searches, some of them with a more significant presence than ours and with greater capability to offer substantially more content, our ability to attract more users to install IncrediMail's home page could suffer, preventing or delaying us in increasing our revenues.

**We may have difficulty managing our growth, which could limit our ability to increase our sales and control our costs.**

We have been experiencing significant growth in the scope of our operations. This growth, required in order to achieve our business objectives, has placed increased demands on our management and on our financial and operational resources. This growth has, and continues to increase the challenges involved in:

- implementing appropriate operational and financial systems and controls;
- expanding our sales and marketing infrastructure and capabilities; and
- maintaining the commitment of our employees.

If we cannot scale and manage our business appropriately, we will not experience our projected growth and our financial results will suffer.

**Our results of operations and financial condition may be adversely impacted by worldwide economic conditions.**

Our primary user base is composed of individual consumers. The current overall weakness in the U.S. and European economies, have resulted in considerable negative pressure on consumer spending and have impacted consumers in our territories in ways that could negatively affect our business. In the event the current economic downturn in the United States and Europe continues or worsens, our current and potential software license subscribers may be unable or unwilling to purchase our licensing services as well as have a negative impact on consumer internet spending and search generated revenues. Both of which would negatively impact our sales and revenue generation, margins and operating expenses, and consequently have a material adverse effect on our business, results of operations and financial condition.

**Due to our limited history of operations, evolving business model and rapid changes in the Internet, we may not be able to predict our future performance or continue our revenue growth or profitability.**

We were incorporated in November 1999 and commercially launched our first product in the third quarter of 2000. Since then, we have introduced new products almost every year. Consequently, we have a limited history of operations from which to predict our future performance. Since then we have introduced numerous products and marketing initiatives, addressing these changes some of which have been unsuccessful. The future viability of our business will depend on our ability to increase product sales, introduce new products appealing to the Internet market, increase search generated and advertising revenues, exploit our brand name and control our costs, which we may be unable to do. As a result, we may not be able to continue our revenue growth or profitability.

**Our continuing “viral growth” could be adversely affected if we do not increase the number of our registered users or if users stop using our software.**

To date, we have relied primarily on “viral growth” to increase our user base. This method is of relatively low cost, while its effectiveness has been decreasing. Other marketing methods, while effective, are far more costly. If users of our products stop, reduce, or limit their usage, our viral growth will be diminished because they will no longer be forwarding links to our site via their emails, and our market share and revenues may decrease. Our historical experience with usage of our products indicates that usage of products declines rapidly, currently estimated to be up to six years. Therefore, in order to induce our existing users to continue to use our products, we must continuously enhance our existing products and develop new ones. If we cannot offer such products, because of lack of resources, competition or other reasons described elsewhere in these Risk Factors, our distribution, revenues and results of operations will be adversely affected.

**The market for email software products and services is highly competitive, and if we cannot compete effectively, our revenues will decline and we will be unable to gain or retain market share.**

Our products compete in the market for email software products and services that aim to offer a customized and entertaining email experience for consumers, including features such as graphic email notifiers, software skins, email backgrounds and multimedia content. Our main competitors among specialized providers of email services offer the following products: FunWeb Products™, Hotbar® and WikMail, all of which incorporate special features that provide a personalized email experience. In addition, our products also face competition from general email software programs offered to the private market by large Internet and software companies, such as AOL9 by America Online, Inc., Thunderbird® by Mozilla Foundation and Outlook Express and MSN9 by Microsoft Corporation (Nasdaq: MSFT), some of which may also incorporate certain special features that provide a personalized email experience. Many of the large Internet and software companies offer their email software programs free of charge. Competition with these products could result in fewer downloads of our product, reduced prices and margins, fewer purchases of our products and services and loss of market share.

Many of our competitors have more established brands, products and customer relationships than we do, which could inhibit our market penetration efforts even if they may not offer a customized and entertaining email experience similar to *IncrediMail*®. For example, consumers may choose to receive an extensive package of Internet and email services from a more dominant and recognized company, such as Microsoft Corporation (Outlook Express or MSN®) or America Online, Inc. (AOL®). If we are unable to achieve continued market penetration, we will be unable to compete effectively.

**In addition, many of our other current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. These competitors could use their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as to develop new technologies, products or features that could effectively compete with our existing product lines. Demand for our products could be diminished by equivalent or superior products and technologies offered by competitors. See “Item 4.B Business Overview – Competition” for additional discussion of our competitive market. We face significant competition from large-scale web-based email providers, principally Google, Yahoo and Microsoft.**

Our products also compete in the market for web-based email software products and services, such as Google’s Gmail, Yahoo! Mail and Microsoft’s Hotmail. The web based email market is characterized with significant competition, changing technologies and evolving products and services enhancements.

Google, Yahoo! and Microsoft are each offering a web-based e-mail service in addition to the many other services they provide, such as desktop search, local search, instant messaging, photos, maps, video sharing, mobile applications and so on. We expect these competitors to increasingly use their financial and engineering resources to compete with our client-based e-mail service, if we are unable to successfully compete with them, our results of operations may be adversely affected.

**We are increasingly relying on the ability to offer our search properties to users of our software products and subsequently retain them. Should this offering be blocked, constrained or made redundant, by the providers of the underlying platform, our ability to generate revenues from search could be materially reduced.**

Over 70% of our revenues for the year ended December 31, 2008 were generated from the acceptance and subsequent retention of our search properties by the users of our software products. The market for offering and retaining these search properties is very competitive. In addition, some companies offer a browser without a homepage, which is one of our main search properties. Should the companies providing the internet browsers effectively restrict other companies from offering or changing the search properties, or should those providing browsers without a homepage increase their market share, there could be a material adverse affect on our search generating revenue model and our financial results.

**The market for wallpapers, screensavers and photograph management tools is highly competitive, and if we cannot compete effectively, we may not be able to generate revenues or achieve significant market share.**

Our Magentic product is a desktop enhancer and offers brand-new graphically enriched ways to view and enjoy personal photos. Our PhotoJoy product focuses on further enhancing the capability for enjoying personal photos. These products were first introduced in 2006, and subsequently enhanced in 2008, currently compete in the market for wallpapers, screensavers and PC software managing and presenting personal photographs, aiming to offer a creative, personal and entertaining experience for PC users. Our main competitors in these areas include Screensavers.com and webshots© by American Greetings Corp. (NYSE: AM). Competition with these products, as well as the new concept, could result in increased investments in R&D and Marketing expenses as well as fewer downloads and registrations of our product.

Many of our competitors have more established brands, products and customer relationships than we do, which could inhibit our market penetration efforts even if they may not offer a similar variety, currently free of charge, such as American Greetings Corp. (webshots©). If we are unable to achieve continued market penetration, we will not be able to compete effectively.

In addition, many of our other current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. These competitors could use their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as to develop new technologies, products or features that could effectively compete with our product. Demand for our products could be diminished by equivalent or superior products and technologies offered by competitors. See "Item 4.B Business Overview – Competition" for additional discussion of our competitive market.

**The market for creative instant messaging enrichment tools is highly competitive, and if we cannot compete effectively, we may not be able to generate revenues or achieve significant market share.**

In May, 2008, we launched HiYo™, our creative enhancement tool for instant messaging. HiYo is currently available for users of the instant messenger software Windows Live Messenger®, and we believe HiYo will bring in new customers and demographics into the *IncrediMail*® experience. Our main competitors in this area include SweetIM, Badoo and SmileyCentral by IAC/InterActiveCorp (Nasdaq: IACI) as well as the built in graphic capabilities, albeit limited, of Windows Live Messenger®. Competition with these products could result in increased investments in R&D and Marketing expenses as well as fewer downloads and registrations of our product.

Many of our competitors have more established brands, products and customer relationships than we do, which could inhibit our market penetration efforts even if they may not offer a similar variety, currently free of charge, such as IAC/InterActiveCorp (SmileyCentral). If we are unable to achieve continued market penetration, we will not be able to compete effectively.

In addition, many of our other current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. These competitors could use their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as to develop new technologies, products or features that could effectively compete with our product. Demand for our products could be diminished by equivalent or superior products and technologies offered by competitors. See "Item 4.B Business Overview – Competition" for additional discussion of our competitive market.

**We may use a substantial portion of our invested resources to acquire an unspecified business. These acquisitions could divert our resources, cause dilution to our shareholders and adversely affect our financial results.**

We may use a portion of our invested resources to acquire complementary products, technologies or businesses. In December 2006, we acquired the assets of a transaction processing company called BizChord Consulting Corporation and, although a relatively small acquisition, in December 2008, we decided to terminate BizChord's independent activities and restrict its activity to processing the Company's own transactions. As a result, since the acquisition, we have written off our entire investment. Prior to such acquisition our management had no experience making acquisitions or integrating acquired businesses. Negotiating potential acquisitions or integrating newly-acquired products, technologies or businesses could divert our management's attention from other business concerns and could be expensive and time-consuming. Acquisitions could expose our business to unforeseen liabilities or risks associated with the business or assets acquired or with entering new markets. In addition, we might lose key employees while integrating new organizations. Consequently, we might not effectively integrate any acquired products, technologies or businesses, and might not achieve anticipated revenues or cost benefits. In addition, future acquisitions could result in customer dissatisfaction, performance problems with an acquired product, technology or company, or issuances of equity securities that cause dilution to our existing shareholders. Furthermore, we may incur contingent liability or possible impairment charges related to goodwill or other intangible assets or other unanticipated events or circumstances relating to the acquisition, and we may not have, or may not be able to enforce, adequate remedies in order to protect our Company. If any of these or similar risks relating to acquiring products, technologies or businesses should occur in the future on a scale that is larger than the effect of the acquisition described above, our business could be materially harmed.

**Our investment portfolio may be impaired by disruptions in the financial and credit markets.**

Our investment portfolio currently consists of securities of US government agencies as well as corporate debt securities, which the Company classified at December 31, 2008 as “available-for-sale”. As of December 31, 2008, we hold approximately \$8.4 million in corporate debt securities and and \$10.4 million securities of US government agencies.

Due to recent significant disruptions in the financial and credit markets, corporate debt securities in our portfolio are subject to a possible increased risk of default due to bankruptcy, lack of liquidity, operational failure or other factors affecting the issuers of those securities. In addition, securities in our portfolio are subject to other risks, such as credit, liquidity, market and interest rate risks, which may be exacerbated by the recent market disruptions. We may be required to adjust the carrying value of our investment securities due to a default, lack of liquidity or other event, if the event constitutes an impairment which is considered to be other-than-temporary.

Any such adjustment would be recorded in our consolidated statement of operations which could materially adversely impact our consolidated results of operations and financial condition.

**If we are deemed to be not in compliance with applicable data protection laws, our operating results could be materially affected.**

We collect and maintain certain information about our customers in our database. Such collection and maintenance of customer information is subject to data protection laws and regulations in Israel, the United States and other countries. A failure to comply with applicable regulations could result in class actions, governmental investigations and orders, and criminal and civil liabilities, which could materially affect our operating results.

Although we strive to comply with all applicable regulations and use our best efforts to inform our customers of our business practices prior to any installations of our software, it is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which in turn could have a material effect on our business. See “Item 4.B Business Overview – Government Regulation” for additional discussion of applicable regulations.

**If there are privacy or security concerns regarding our collection, use and handling of personal information, we could incur substantial expenses.**

Although we take all reasonable steps to insure the security of personal information, concerns may be expressed, from time to time, about whether our products compromise the privacy or confidentiality of the information of users and others. Concerns about our collection, use, sharing or handling of personal information or other privacy related matters, even if unfounded, could damage our reputation and operating results. See “Item 4.B Business Overview – Government Regulation” for additional discussion of applicable regulations.

**We rely on online payment for our products and any limitations imposed on online payment services could increase our costs associated with the collection of payment and could adversely affect our business.**

Payment for our products is processed online. We engage third parties to process online payment for our products. Credit card companies could change their policies with respect to acceptance of online payments, refunds and charge-backs or in response to any change in government regulations. Any of these changes could result in increased costs for providing online payment services. Furthermore, implementation of an alternative method for collection of payment would entail substantial expenses and may not be feasible for our business.

**We depend on a third party Internet and telecommunication provider to operate our website and securing alternate sources for these services could significantly increase our expenses.**

We depend on Bezeq International Ltd., a third party provider of Internet and related telecommunication services, including hosting and location facilities, to operate our website. This company may not continue to provide services to us without disruptions in services, at the current cost or at all. While we believe that there are many alternative providers of hosting and other communication services available to us, the costs associated with any transition to a new service provider could be substantial and require us to reengineer our computer systems and telecommunications infrastructure to accommodate a new service provider. This process could be both expensive and time consuming and could result in lost business both during the transition period and after.

Our servers and communications systems could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins and similar events or disruptions. Although we maintain back-up systems for our servers, any of these events could cause system interruption, delays, loss of critical data and lost registered users and revenues.

We currently rely solely on the Internet as a means to sell our products. Accordingly, if we, or our customers, are unable to utilize the Internet due to a failure of technology or infrastructure, terrorist activity or other reasons, we could lose current or potential customers and revenues. While we have backup systems for most aspects of our operations, our systems are not fully redundant and our disaster recovery planning may not be sufficient for all eventualities. In addition, we may have inadequate insurance coverage or insurance limits to compensate us for losses from a major interruption. Furthermore, interruptions in our website could materially impede our ability to attract new companies to advertise on our website and to maintain relationships with current advertisers. Difficulties of this kind could damage our reputation, be expensive to remedy and curtail our growth.

**Termination of our agreement with Commtouch could result in lost revenues and loss of market share.**

We launched our anti-spam solution *JunkFilter Plus* in the third quarter of 2005. This solution has been providing an increasingly significant portion of our revenues in the past. If our agreement to use the anti-spam software development kit developed by Commtouch Ltd. were to terminate, we would be required to redevelop our *JunkFilter Plus* anti-spam product, or retain a new provider of a development kit, and, as a result, we may have to refund some of the outstanding subscription fees, we would likely suffer lost revenues and the potential loss of market share.

**Our products operate in a variety of computer configurations and could contain undetected errors or defects that could result in product failures, lost revenues and loss of market share.**

Our software may contain undetected errors, failures or defects, especially when the products are first introduced or when new versions are released. Our customers' computer environments are often characterized by a wide variety of standard and non-standard configurations that make pre-release testing for programming or compatibility errors very difficult and time-consuming. Therefore, there could be errors or failures in our products. In addition, despite testing by us and beta testing by some of our registered users, errors, failures or bugs may not be found in new products or releases until after commencement of commercial sales. In the past, we have discovered software errors, failures and defects in certain of our product offerings after their introduction and have likely experienced delayed or lost revenues during the period required to correct these errors.

Errors, failures or defects in products released by us could result in negative publicity, product returns, loss of or delay in market acceptance of our products, loss of competitive position or claims by customers. Alleviating any of these problems could require significant expense and could cause interruptions.

**A decline in market acceptance for Microsoft technologies on which our products rely could have a material adverse affect on us.**

Our products currently run on Microsoft Windows operating systems. Our web client interfaces are supported on certain browsers which run on Windows, Mac and Linux. A decline in market acceptance for Microsoft technologies or the increased acceptance of other server technologies could cause us to incur significant development costs and could have a material adverse effect on our ability to market our current products. Although we believe that Microsoft technologies will continue to be widely used by businesses, we cannot assure you that businesses will adopt these technologies as anticipated or will not in the future migrate to other computing technologies that we do not currently support. In addition, our products and technologies must continue to be compatible with new developments in Microsoft technologies. We cannot assure you that we can maintain such compatibility or that we will not incur significant expenses in connection therewith.

**More individuals are using non-PC devices to access the Internet, and our online services may not be accepted by such users.**

The number of individuals who access the Internet through devices other than personal computer, such as mobile phones, has increased dramatically. Our products were designed for rich, graphic environments such as those available on desktop and laptop computers. The lower resolution, slower communication, functionality and memory associated with alternative devices currently available may make the use of our products through these devices difficult. If consumers find our products difficult to access, we may fail to capture a sufficient share of an increasingly important portion of the market for online services and may fail to attract advertisers and web traffic.

**Exchange rate fluctuations may decrease our earnings if we are not able to hedge our currency exchange risks effectively.**

A majority of our revenues are denominated in U.S. dollars. However, most of our costs, mainly personnel expenses, are incurred in New Israeli Shekels (NIS). Inflation in Israel may have the effect of increasing the U.S. dollar cost of our operations in Israel. If the U.S. dollar declines in value in relation to the New Israeli Shekel, it will become more expensive for us to fund our operations in Israel. A revaluation of one percent of the NIS as compared to the U.S. dollar could reduce our income before taxes by approximately \$0.1 million. During 2006 the exchange rate of the U.S. dollar to the New Israeli Shekel decreased, and continued to further decrease in 2007 and in the first half of 2008, and this trend reversed in the second half of 2008.

In addition, a significant portion of our sales is in currencies other than the U.S. dollar. In 2008, approximately 21% of our revenues were in these currencies. To the extent such sales are not immediately exchanged for US dollars, we bear a foreign currency fluctuation risk. As of December 31, 2008, we had a net foreign currency liability of approximately \$2.9 million and our total foreign exchange income was approximately \$3 thousand for the year ended December 31, 2008. In addition, in territories where our prices are based on local currencies, fluctuations in the dollar exchange rate could affect our gross profit margin. To assist us in hedging the risks associated with fluctuations in currency exchange rates, we have contracted a consultant proficient in this area, and are implementing his proposals. However, due to the market conditions, volatility and other factors, his proposals occasionally prove to be ineffective or worse, and the implementation of his proposals ineffective. We may incur losses from unfavorable fluctuations in foreign currency exchange rates. See "Item 11 Quantitative and Qualitative Disclosure of Market Risks" for further discussion of the effects of exchange rate fluctuations on earnings.

**A loss of the services of our senior management and other key personnel could adversely affect execution of our business strategy.**

We depend on the continued services of our senior management, particularly Ofer Adler our Chief Executive Officer, Chief Product Officer and co-founder. Our business and operations to date have been mainly implemented under the direction of our current senior management. The loss of the services of these personnel could create a gap in management and could result in the loss of management and technical expertise necessary for us to execute our business strategy and thereby, adversely affect execution of our business strategy. Although we have obtained "key person" life insurance on the life of Ofer Adler in the amount of \$1.5 million, we do not expect to obtain "key person" life insurance with respect to our other officers.

Further, our ability to execute our business strategy also depends on our ability to continue to attract, retain and motivate qualified and skilled technical and creative personnel and skilled management, marketing and sales personnel. If we cannot attract and retain additional key employees or lose one or more of our current key employees, our ability to develop or market our products could be adversely affected. See "Item 6 Directors, Senior Management and Employees."

**Under current U.S. and Israeli law, we may not be able to enforce covenants not to compete and, therefore, may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.**

We have entered into non-competition agreements with all of our professional employees. These agreements prohibit our employees, if they cease working for us, from competing directly with us or working for our competitors for a limited period. Under current U.S. and Israeli law, we may be unable to enforce these agreements, in whole or in part, and it may be difficult for us to restrict our competitors from gaining the expertise that our former employees gained while working for us. For example, Israeli courts have recently required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer which have been recognized by the courts, such as the secrecy of a company's confidential commercial information or its intellectual property. If we cannot demonstrate that harm would be caused to us, we may be unable to prevent our competitors from benefiting from the expertise of our former employees.

**Our international operations involve special risks that could increase our expenses, adversely affect our operating results and require increased time and attention of our management.**

We derive and expect to continue to derive a substantial portion of our revenues from customers outside United States. Our international sales and related operations are subject to a number of inherent risks, including risks with respect to:

- potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights than those of the United States;
- costs and delays associated with translating and supporting our products in multiple languages;
- foreign exchange rate fluctuations and economic instability, such as higher interest rates and inflation, which could make our products more expensive in those countries;
- costs of compliance with a variety of laws and regulations;
- restrictive governmental actions such as trade restrictions;
- limitations on the transfer and repatriation of funds and foreign currency exchange restrictions;
- compliance with different consumer and data protection laws and restrictions on pricing or discounts;
- lower levels of adoption or use of the Internet and other technologies vital to our business and the lack of appropriate infrastructure to support widespread Internet usage;
- lower levels of consumer spending on a per capita basis and fewer opportunities for growth in certain foreign market segments compared to the United States;
- lower levels of credit card usage and increased payment risk;
- changes in domestic and international tax regulations; and
- geopolitical events, including war and terrorism.

***Risks Related to Our Intellectual Property***

**If we are unable to protect our intellectual property rights, our competitive position could be harmed.**

Our ability to execute our business strategy and compete depends in part upon our ability to protect our intellectual property. In 2003, we submitted national phase patent applications in the United States, the European Community and Israel with respect to certain processes that we employ in our products. These applications benefited from a priority date of a provisional application filed in the year 2000. One patent has been issued in the United States under these applications to date. Our pending and future patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Any issued patents may be challenged, invalidated or legally circumvented by third parties. We cannot be certain that our patents will be upheld as valid and enforceable or prevent the development of competitive products. Consequently, competitors could develop, manufacture and sell products that directly compete with our products, which could decrease our sales and diminish our ability to compete. If our intellectual property does not adequately protect us from our competitors' products and methods, our competitive position could be adversely affected and we could be precluded from operating all or a portion of our business.

In addition, we exploit our brand name *Incredi* by applying it to products offered through collaborations with third parties. We have registered INCREDIMAIL as a trademark only in the United States. Our ownership and use of the *Incredi* brand name may be challenged, invalidated or legally circumvented by third parties, in which case our ability to generate revenues from its exploitation will suffer.

We have registered, or have rights to, various domain names relating to our brand, including incredimail.com, incredidate.com, incredigames.com magentic.com, photojoy.com and hiyo.com. If we fail to maintain, or to enforce our rights to these registrations, it will be difficult for us to implement our strategy to increase recognition of our brand. Third parties have registered domain names similar to ours and if such parties engage in a business that may be harmful to our reputation or confusing to our customers, our revenue may decline and we may incur additional expenses in maintaining our brand.

We rely on a combination of patent and other intellectual property laws and confidentiality, non-disclosure and assignment of inventions covenants as appropriate, with our employees and consultants, to protect and otherwise seek to control access to, and distribution of, our proprietary information. These measures may not be adequate to protect our property from unauthorized disclosure, third-party infringement or misappropriation. We also rely on trade secret protection for our technology, in part through confidentiality covenants with our employees, consultants and third parties. However, these parties may breach these covenants and we may not have adequate remedies for any breach. Also, others may learn of our trade secrets through a variety of methods. In addition, the laws of certain countries in which we sell our products may not protect our intellectual property rights to the same extent as the laws of the United States or Israel. See “Item 4.B Business Overview –Intellectual Property.”

**Third party claims of infringement or other claims against us could require us to redesign our products, seek licenses, or engage in future costly intellectual property litigation, which could adversely affect our financial position and our ability to execute our business strategy.**

The appeal of our products is largely the result of the graphics, sound and multimedia content that we incorporate in our products. We enter into licensing arrangements with third parties for these uses. However, other third parties may from time to time claim that our current or future use of content, sound and graphics infringe their intellectual property rights, and seek to prevent, limit or interfere with our ability to make, use or sell our products. For example, in 2002 and again in 2004, a third party had contacted us to demand that we remove certain “Smiley” graphics from our website, claiming that he had registered a trademark with respect to these graphics and that our use infringed his rights. We believe this claim to be without any merit and intend to vigorously defend any suit filed against us in this matter.

If it appears necessary or desirable, we may seek to obtain licenses for intellectual property rights that we are allegedly infringing, may infringe or desire to use. Although holders of these types of intellectual property rights often offer these licenses, we cannot assure you that licenses will be offered or that the terms of any offered licenses will be acceptable to us. Our failure to obtain a license for key intellectual property rights from a third party for technology or content, sound or graphic used by us could cause us to incur substantial liabilities and to suspend the development and sale of our products. Alternatively, we could be required to expend significant resources to re-design our products or develop non-infringing technology. If we are unable to re-design our products or develop non-infringing technology, our revenues could decrease and we may not be able to execute our business strategy.

We may become involved in litigation not only as a result of alleged infringement of a third-party’s intellectual property rights, but also to protect our own intellectual property rights. If we do not prevail in any third-party action for infringement, we may be required to pay substantial damages and be prohibited from using intellectual property essential to our products.

We may also become involved in litigation in connection with the brand name rights associated with our Company name or the names of our products. We do not know whether others will assert that our Company name or brand name infringes their trademark rights. In addition, names we choose for our products may be claimed to infringe names held by others. If we have to change the name of our Company or products, we may experience a loss in goodwill associated with our brand name, customer confusion and a loss of sales. Any lawsuit, regardless of its merit, would likely be time-consuming, expensive to resolve and require additional management time and attention.

**Unlawful copying of our products or other third party violations of existing legal protections or reductions in the legal protection for intellectual property rights of software developers or use of open source software could adversely affect our revenue.**

The software products that we sell incorporate a technology that reduces the ability of third parties to copy the software without having paid for it. Unlicensed copying and use of software and intellectual property rights represents a loss of potential revenue to us, which could be more significant in countries where laws are less protective of intellectual property rights. Continued educational and enforcement efforts may not affect revenue positively and further deterioration in compliance with existing legal protections or reductions in the legal protection for intellectual property rights of software developers could adversely affect our revenue.

In addition, certain of our products or services may now or in the future incorporate open source software, which are typically distributed “as-is” without warranties, such as warranties of performance or ownership or indemnities against intellectual property infringement claims. Moreover, to the extent that we incorporate open source software into our products or services, although we do not currently intend ever to incorporate open source software that would require us to do so, the license for such open source software may obligate us, among other things, to pass on to our licensees without charge the rights to use, copy, modify and redistribute the underlying software source code, both with respect to the original open source code and any modifications to such code created by us.

**If we fail to detect and stop misrepresentations of our site and products, we could lose confidence of our customers, thereby causing our business to suffer.**

We are exposed to the risk of domains using our brand names (such as “IncrediMail”) in various ways, and attracting in this manner our potential or existing users. Many times these domains are engaged with fraudulent or spam activities and using our brand names can result in damaging our reputation and losing our clients’ confidence in our products. If we are unable to detect and terminate effectively this misrepresentation activity, we may lose users and our ability to produce revenues will be harmed.

***Risks Related to Our Industry***

**The Internet as a medium for commerce and communication is subject to uncertainty and a decline in the number of Internet users or users of email could cause our revenues to decrease and our products to become obsolete.**

The Internet and electronic communication industry is rapidly evolving, as new means for electronic communication are offered to the public. Our ability to execute our business strategy is dependent upon the continued predominance of email as a means of electronic communication and upon the continued use of the Internet.

Although email software programs and services and instant messaging programs and services currently enjoy a large market, the development and consumer acceptance of other means of electronic communication, such as text messaging over phone networks, chat-boards, blogs and web-based social networks, could result in a substantial decrease in the size of this market, in which case our revenues could decrease and our products could become obsolete.

In addition, our products may only be used on personal computers that can be and are connected to the Internet. While the number of Internet users has been rising, the Internet infrastructure may not expand fast enough to meet the increased levels of demand. In addition, activity that diminishes the experience for Internet users, such as spyware, spoof emails, viruses and spam directed at Internet users, as well as viruses and “denial of service” attacks directed at Internet companies and service providers, may discourage people from using the Internet, including for communications and commerce. Furthermore, newer users of the Internet could be less active email users compared to our earlier users. If use of the Internet as a medium for communication and commerce grows at a slower rate than we anticipate, our sales would be less than expected. In addition, the development and acceptance of new technologies and platforms could divert our targeted customers from the use of the Internet, in which case our results of operations will be adversely affected.

**New laws and regulations applicable to e-commerce, Internet advertising, privacy and data collection, and uncertainties regarding the application or interpretation of existing laws and regulations, could harm our business.**

Our business is conducted through the Internet and therefore, among other things, we are also subject to the laws and regulations that apply to e-commerce. These laws and regulations are becoming more prevalent in the United States, Israel and elsewhere and may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, user privacy, data protection, pricing, content, copyrights, electronic contracts and other communications, Internet advertising, consumer protection, the provision of online payment services, broadband residential Internet access, and the characteristics and quality of products and services.

Many areas of the law affecting the Internet remain largely unsettled, even in areas where there has been some legislative action. It is difficult to determine whether and how existing laws, such as those governing intellectual property, privacy and data protection, libel, data security and taxation, apply to the Internet and our business. New laws and regulations may seek to impose additional burdens on companies conducting business over the Internet. We are unable to predict the nature of the limitations that may be imposed.

For example, legislation has been enacted to regulate the use of “cookie” technology. Upon installation of our software, certain cookies generated by us and our advertisers are placed on our customers’ computers. It has been argued that Internet protocol addresses and cookies are intrinsically personally identifiable information that is subject to privacy standards. We cannot assure you that our current policies and procedures would meet these restrictive standards.

In addition, technology is changing constantly and data security regulations and standards are in a state of flux. Changes in law or regulations may require that we materially change the way we do business. For example, we may be required to implement physical, administrative and technological security measures different from those we have now, such as different data access controls or encryption technology. We may incur substantial expenses in implementing such security measures.

In addition, although current decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales made over the Internet, the U.S. Congress and a number of states have been considering or adopted various initiatives that could limit or supersede these decisions. If any of these initiatives result in a reversal of the Court’s current position, we could be required to collect sales and use taxes on our U.S. sales. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

The EU has already enacted legislation regarding Value Added Tax imposed on certain software sold by companies outside the EU to consumers in the EU over the Internet. This legislation could be interpreted to include other parts of the Company’s business not yet accrued for by the Company, which could result in additional significant tax exposure, or alternatively, reduce the competitiveness of the Company’s pricing of its products.

The cost of compliance with taxation, consumer and privacy related regulations could be material and we may not be able to comply with the applicable regulations in a timely or cost-effective manner. In response to evolving legal requirements, we may be compelled to change our business model and practices, which could reduce our sales, and we may not be able to replace the revenues lost as a consequence of the change. These changes could also require us to incur significant expenses, subject us to liability and require increased time and attention of our management. See “Item 4.B Business Overview – Government Regulation” for additional discussion of applicable regulations affecting our Company.

#### ***Risks Related to Our Operations in Israel***

##### **Political, economic and military instability in the Middle East may impede our ability to operate and harm our financial results.**

Our principal executive offices are located in Israel. Accordingly, political, economic and military conditions in the Middle East may affect our business directly. Since the establishment of the State of Israel in 1948, a number of armed conflicts have occurred between Israel and its Arab neighbors. During the winter of 2008, Israel was engaged in an armed conflict with Hamas, a militia group and political party operating in the Gaza Strip, and during the summer of 2006, Israel was engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group and political party. These conflicts involved missile strikes against civilian targets in various parts of Israel, and negatively affected business conditions in Israel. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could affect adversely our operations. Although Israel has entered into various agreements with the Palestinian Authority, Israel has been and is subject to civil unrest and Palestinian terrorist activity, with varying levels of severity, since October 2000. Tension among the different Palestinian factions may create additional unrest and uncertainty. Ongoing and revived hostilities and the attempts to resolve the conflict between Israel and its Arab neighbors often results in political instability that affects the Israeli capital markets and can cause volatility in interest rates, exchange rates and stock market quotes. These or other Israeli political or economic factors could harm our operations and product development and cause our sales to decrease. Furthermore, several countries, principally those in the Middle East, still restrict business with Israel and Israeli companies and, although the impact of these restrictions is not as important for a company such as ours that sells its products through the Internet, it may nevertheless have an adverse effect on our results of operations.

**Our operations may be disrupted by the obligations of our personnel to perform military service.**

Many of our male employees in Israel, including members of senior management, are obligated to perform up to 36 days of military reserve duty annually until they reach age 48 and, in the event of a military conflict, could be called to active duty. Our operations could be disrupted by the absence of a significant number of our employees related to military service or the absence for extended periods of military service of one or more of our key employees.

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

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

**The tax benefits available to us require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs and taxes.**

We have generated income and therefore, are able to take advantage of tax exemptions and reductions resulting from the “Approved Enterprise” status of our facilities in Israel. To remain eligible for these tax benefits, we must continue to meet certain conditions stipulated in the Law for the Encouragement of Capital Investments, 1959 (the “Investment Law”), and its regulations and the criteria set forth in the specific certificate of approval. If we fail to meet the required conditions in the future, the tax benefits would be canceled and we could be required to refund any tax benefits we have received with interest and adjustment for change in Israeli consumer price index. These tax benefits may not be continued in the future at their current levels or at any level.

Effective April 1, 2005, the Investment Law was amended. As a result, the criteria for investments qualified to receive tax benefits as an Approved Enterprise were revised. No assurance can be given that we will, in the future, be eligible to receive additional tax benefits under this law. The termination or reduction of these tax benefits would increase our tax liability in the future, which would reduce our profits or increase our losses. Additionally, if we increase our activities outside of Israel, for example, by future acquisitions, our increased activities might not be eligible for inclusion in Israeli tax benefit programs. As a result of the amendment and recent interpretations, tax-exempt income generated under the provisions of the new law will subject us to taxes upon distribution or liquidation and we may be required to record deferred tax liability with respect to such tax-exempt income, possibly affecting our results in the future. See “Item 10.E Taxation – Israeli Taxation – Law for the Encouragement of Capital Investments, 1959” for more information about these programs.

***Risks Related to our Ordinary Shares and their Listing on a Stock Exchange***

**We incur significant costs as a result of being a public company.**

As a public company, we incur significant legal, accounting and other expenses. We incur costs associated with our public company reporting requirements as well as costs associated with corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, the rules of the Nasdaq Stock Market, the provisions of the Israeli Securities Law that apply to dual listed companies (companies that are listed on the Tel Aviv Stock Exchange (“TASE”) and another recognized stock exchange) and the provisions of the Israeli Companies Law that apply to public companies. For example, as a public company, we have created additional board committees and are required to have two external directors pursuant to the Israeli Companies Law. We have also contracted an internal auditor and a consultant for implementation of and compliance with the requirements under the Sarbanes-Oxley Act. See “Item 5 Operating and Financial Review and Prospects – Overview – General and Administrative Expenses” for a discussion of our increased expenses as a result of being a public company.

**A small number of existing shareholders hold a significant percentage of our outstanding ordinary shares and can exercise significant influence over our actions.**

As of May 31, 2009, our directors and officers beneficially owned (including shares issuable upon exercise of options exercisable within 60 days of such date) approximately 42% of our outstanding ordinary shares in the aggregate. The interests of these shareholders may differ from your interests. These shareholders, acting together, could exercise significant influence over our operations and business strategy and will have sufficient voting power to influence all matters requiring approval by our shareholders, including the ability to elect or remove directors, to approve or reject mergers or other business combination transactions, the raising of future capital and the amendment of our articles of association, which govern the rights attached to our ordinary shares. In addition, this concentration of ownership may delay, prevent or deter a change in control, or deprive you of a possible premium for your ordinary shares as part of a sale of our Company.

**The rights and responsibilities of our shareholders are 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. See “Item 16.G Corporate Governance.” 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. See “Item 10.B Memorandum and Articles of Association – Approval of Related Party Transactions” for additional information concerning this duty. Our shareholders generally may find it difficult to comply with the provisions of Israeli law.

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

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain provisions that may make it more difficult to acquire our Company, such as provisions establishing a classified board. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. See “Item 10.B Memorandum and Articles of Association – Approval of Related Party Transactions” and “Item 10.E – Taxation – Israeli Taxation” for additional discussion about some anti-takeover effects of Israeli law.

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

**Future sales of our ordinary shares could reduce our stock price.**

Sales by shareholders of substantial amounts of our ordinary shares, or the perception that these sales may occur in the future, could materially and adversely affect the market price of our ordinary shares. In addition, our executive officers, directors and certain large shareholders are no longer subject to contractual restrictions on the sale by them of shares, resulting in a substantial number of shares held by them or issuable upon exercise of options currently eligible for sale in the public market. Furthermore, the market price of our ordinary shares could drop significantly if our executive officers, directors, or certain large shareholders sell their shares, or are perceived by the market as intending to sell them.

**Although we have paid dividends in the past, and we expect to pay certain dividends in the future, our ability to pay dividends may be adversely affected by the risk factors described in this report; if we fail to, or to extent we do not, pay dividends the return on investment will be limited to the value of our stock.**

We have paid dividends in the past, and on March 25, 2009, we announced that our board of directors had approved a cash dividend of approximately \$4.6 million, or \$0.50 per share, subject to Israeli court approval and a tax pre-ruling from the Israeli Tax Authority as required by Israeli law. Our ability to declare a dividend, and the amount of any dividend if declared, may be adversely affected by the risk factors described in this report. The declaration of a dividend and the amount of any dividend will depend on our earnings, financial condition and other business and economic factors affecting us at the time as our board of directors may consider relevant. We may pay dividends in any fiscal year only out of “profits,” as defined by the Israeli Companies Law, unless otherwise authorized by an Israeli court, and provided that the distribution is not reasonably expected to impair our ability to fulfill our outstanding and expected obligations. If we do not pay dividends, our stock may be less valuable because a return on your investment will only occur if our stock price appreciates. See “Item 8.A Consolidated Statements and Other Financial Information – Policy on Dividend Distribution” for additional information regarding the payment of dividends.

**U.S. investors in our Company could suffer adverse tax consequences if we are characterized as a passive foreign investment company.**

If, for any taxable year, our passive income or our assets that produce passive income exceed levels provided by law, we may be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. This characterization could result in adverse U.S. tax consequences to our shareholders. If we were classified as a passive foreign investment company, a U.S. holder of our ordinary shares could be subject to increased tax liability upon the sale or other disposition of ordinary shares or upon the receipt of amounts treated as “excess distributions.” Under these rules, the excess distribution and any gain would be allocated ratably over the U.S. holder’s holding period for the ordinary shares, and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a passive foreign investment company would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. The tax liability with respect to the amount allocated to years prior to the year of the disposition, or “excess distribution,” cannot be offset by any net operating losses. In addition, holders of shares in a passive foreign investment company may not receive a “step-up” in basis on shares acquired from a decedent. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares, as well as the specific application of the “excess distribution” and other rules discussed in this paragraph. For a discussion of how we might be characterized as a PFIC and related tax consequences, please see “Item 10.E Taxation – United States Federal Income Tax Considerations – Passive Foreign Investment Company Considerations.”

**ITEM 4. INFORMATION ON THE COMPANY**

**A. HISTORY AND DEVELOPMENT OF THE COMPANY**

**Our History**

We were incorporated in the State of Israel in November 1999 under the name Verticon Ltd. We changed our name to IncrediMail Ltd. in November 2000 to better reflect the nature of our business. We operate under the laws of the State of Israel. Our headquarters are located at 4 HaNechoshet Street, Tel-Aviv 69710, Israel. Our phone number is (972-3) 769-6100. Our agent for service of process in the United States is Puglisi & Associates, located at 850 Library Avenue, Suite 204, Newark, Delaware 19715. Our website addresses are [www.incredimail-corp.com](http://www.incredimail-corp.com) and [www.incredimail.com](http://www.incredimail.com). The information on our websites does not constitute part of this annual report.

We completed the initial public offering of our ordinary shares in the United States on February 3, 2006, whereby we became a “limited liability public company” under the Israeli Companies Law. The registration statement on Form F-1 relating to our initial public offering became effective on January 30, 2006. Immediately prior to the effectiveness of our registration statement, we increased our authorized share capital to 15 million ordinary shares and completed a 38-for-one ordinary share split affected as a dividend on our ordinary shares. In addition, upon the closing of our initial public offering, our then outstanding redeemable convertible preferred shares were automatically converted, on a 38-for-one basis, into an aggregate of 1,764,948 ordinary shares.

Since November 20, 2007 the Company’s ordinary shares are also traded on the Tel Aviv Stock Exchange.

**Principal Capital Expenditures**

We had capital expenditures of \$0.6 million in 2008, \$1.4 million in 2007 and \$0.8 million in 2006. We currently expect that our capital expenditures will be approximately \$0.5 million in 2009. We have financed our capital expenditures with cash generated from operations.

Our capital expenditures during 2006, 2007 and 2008 consisted primarily of leasehold improvements and furnishings, as well as investments in computer hardware and software. In 2009, we expect these investments to consist primarily of acquiring computer hardware, software, peripheral equipment and installation, all which are expected to be financed by the Company’s resources.

## Recent Developments

On February 5, 2009, we entered into an amendment to our licensing and promotion agreement with Oberon Media Inc. relating to the use of our brand name and marketing of their products and services to revise the terms of payment and extend the agreement until July 14, 2011. See Item 4.B – “Business Overview – Advertising and Search Generated Revenue.”

On March 25, 2009, we announced that our board of directors had approved a cash dividend of approximately \$4.6 million, or \$0.50 per share, subject to Israeli court approval and a tax pre-ruling from the Israeli Tax Authority as required by Israeli law. Previously, on March 12, 2009, we announced that our board of directors and management determined that the Company’s interest for enhancing shareholder value is best served by changing our dividend policy and instituting a revised dividend policy whereby at least 50% of annual net income of the Company will be paid out as a dividend beginning with the net income for 2009. According to our dividend policy, the declaration and issuance of the dividend will be subject to our board’s review of the Company’s financial conditions at the time. See Item 1A – Risk Factors – “Although we have paid dividends in the past, and we expect to pay certain dividends in the future, our ability to pay dividends may be adversely affected by the risk factors described in this report; if we fail to pay dividends the return on investment will be limited to the value of our stock.”

On January 23, 2008 the Company announced that its Board of Directors had resolved to adopt a share buyback plan, and on March 25, 2009, the Company announced that it had elected to continue with the second phase of this plan that authorizes the purchase of up to an additional \$1 million of its ordinary shares, subject to approval from the Israeli Tax Authority which has not yet been received. As of May 31, 2009, the Company repurchased 346,019 ordinary shares in open market transactions.

On June 2, 2009, the Company provided notice to its shareholders of an extraordinary general meeting to approve a proposal to elect an external director of the Company in the place of an external director whose term had expired, and to amend the terms of options granted to the external directors and the directors of the Company. The meeting is scheduled to be held on July 9, 2009 with such terms as provided in the Notice of Meeting filed on Form 6-K with the SEC. See “Item 10.H – Documents on Display” for information on accessing the Company’s SEC filings. If the proposals relating to compensation of our directors are approved, our directors’ recurring annual stock option grants will have a vesting period of three years (instead of four years) from the date of their annual stock option grant. Also, upon termination or expiration of the applicable director’s service with the Company, provided that the termination or expiration is not “for Cause” and not resulting from the director’s resignation, the stock options granted to such director shall retain their original termination dates, and shall not terminate 90 days after the applicable termination date, and the next upcoming tranche of stock options, of each grant, that are scheduled to vest immediately subsequent to the termination date, if any, shall automatically vest and become exercisable immediately prior to the termination date. In addition, to avoid a possible conflict of interest while discussing a Change of Control of the Company (which may result in the termination of the director’s term of office), all unvested options held by the director, shall automatically vest and become exercisable upon such “Change of Control” event. “Change of Control” is defined for these purposes as: (i) merger, acquisition or reorganization of the Company with one or more other entities in which the Company is not the surviving entity, (ii) a sale of all or substantially all of the assets of the Company; (iii) a transaction or a series of related transactions as a result of which more than 50% of the outstanding shares or the voting rights of the Company are held by any party (whether directly or indirectly).

## B. BUSINESS OVERVIEW

### Overview

We are an Internet content and media company, whose products we believe bring a new level of fun, personality and convenience to email, desktops and screen savers, and have been downloaded more than eighty million times. Having secured a large active email user base, Incredimail is now branching out into Instant Messaging, using its unique content and approach to enhance the user experience.

Since we began operations in 2000, our products have been downloaded in more than 100 countries, and in 2008 we recorded on average approximately 1.7 million registered downloads each month. As of December 31, 2008, we had approximately 11 million active users, and currently, more than 350 million Incredimail® emails are sent by our users each month. Our users typically use our products for as long as six years. Through December 31, 2008, we have sold more than 1.7 million products and content licenses worldwide to our registered users. We believe our historical track record of converting registered users to purchasing customers represents a convincing validation of our business strategy.

We generate revenue primarily by:

- advertising, including primarily generating searches and sharing in the revenues with the provider of the search engine; and
- selling our premium software products.

For a breakdown of total revenues by category of activity, see “Item 5.A Operating Results – Revenues.”

To date, we have relied primarily on “viral growth” to grow our user base. Our “viral growth” has resulted from recipients of our users’ emails clicking on the link at the bottom of emails sent with *IncrediMail@ Xe* and then downloading our products and also from word of mouth. Our revenues were \$10.9 million in 2006, \$18.7 million in 2007 and \$21.9 million in 2008. Our operations have been profitable since 2002, with a gross profit margin of over 90% .

When we use the term “registered user” in this annual report, we mean an IncrediMail® user who has downloaded one of our products and completed the registration process. Registrations are not necessarily indicative of the number of individual users as a user may register more than one time. In addition, the term “active user” as used in this annual report means a registered user who has performed any activity using any IncrediMail® product or service, including opening or sending emails using IncrediMail®, logged into his instant messaging with a HiYo client, downloading content or updating the product, in the 90 days prior to the measurement date.

## **Our Market**

*Email Market Opportunity.* In recent years, email has become one of the most important forms of electronic communication worldwide. The email market may be divided into two segments: the consumer, or home user, market and the business, or corporate, market. Our products target the consumer market. Both the consumer and the business markets are serviced by many of the same popular email software programs, such as Microsoft Outlook, and by web-based email services, such as Hotmail, Yahoo!® Mail and Gmail.

Security remains a critical concern for the consumer market as viruses, worms and identity theft continue to grow. Spam also continues to rise. Any new email software product should provide an effective and secure product that satisfies users’ concerns.

*Evolution of the Specialized Email Software Programs.* In order to be viable, email systems must function as an effective means of communication. In addition, we believe that many in the consumer or home user market are seeking an entertaining experience and a way to express their creativity and individual personalities. We believe that consumer email users are ready to accept email software products that offer users a customizable and entertaining email experience together with security and anti-spam features.

## **The IncrediMail Solution**

We employ an innovative approach to enhancing our users’ email experience. Our IncrediMail products provide the following benefits:

- *Variety and Amount of Content.* Our products offer users access to an extensive and continually growing pool of content that we believe is one of the largest collections of creative and diverse graphics, sound and multimedia content available online for email communications. We began assembling our content in 1999.
- *Creative Technology.* Our proprietary technology, which is based on advanced software development standards, is designed to produce robust quality products that provide the functionality expected in an email client packaged in a friendly, less technologically-oriented and entertaining environment.
- *Customization.* The diversity of our graphics, sound and multimedia content enables our users to customize and personalize their email messages and letters easily and quickly.
- *Flexibility and Ease of Use for Both Sender and Recipient.* We strive to offer a simple and intuitive user interface that enables our users to create different experiences depending on the nature or recipient of the email or letter. Users can easily change one or more features for a specific email. Further, recipients of *IncrediMail@* emails can easily open them, using most available email clients and can see all the features without the need for special software.

## Our Strategy

Our objective is to become the market leader in entertaining and creative email systems for the consumer and home user market. Based on our survey of downloads of our products and those of competitors from third party websites, we believe that *IncrediMail® Xe* is one of the most downloaded free products providing an entertaining and creative email system, and our strategy will include building on its popularity and seeking to convert free users to paying customers. The key elements of our strategy are to:

- *Maintain and grow our user base.* Our effective viral marketing has resulted in millions of registered users who spread the word about our products and services at relatively low marketing costs to us. For that reason, we expect a significant part of our products and services offering will remain free. In order to increase the size of our user base, we have broadened our product offering to instant messaging with new demographics and intend to supplement the viral growth of our products with media buying and other advertising and marketing activities, primarily online. We plan to continue, and further increase the size of the team charged with optimizing the marketing of our products, increasing the effectiveness of our online marketing activity, and monetize user registrations and active user base.
- *Increase the use of our products by our users and the searches performed by them through our products.* With the increasing monetization possibilities of search generation, the strategic importance of enabling search through and because of our products has grown significantly. This is further emphasized by the demographics of our users and the relatively high revenues they generate while searching over the Internet. We therefore intend to increase the availability of search generating channels to our users through numerous points in each and throughout our products and to leverage the large active user base, primarily, those that are using our free products.
- *Enhance product offerings and increase user sales.* We plan to stimulate growth of our sales and enhance our cross-sale capabilities by improving our existing product and service offering. We will continue to seek to convert free users into paying customers by marketing the paid products and services to our large user base.
- *Avoid offensive market tools.* We design our products to address users' aversion to spam, spyware and other perceived offensive Internet marketing tools, which we believe encourages more use of them and increases user loyalty.
- *Continue to focus on the online consumer market.* Email and instant messaging continue to grow as communication mediums. The Internet allows us to reach potential users throughout the world quickly and easily as well as reduces the costs associated with sales and distribution of our products and services.
- **Advertising and search generated revenues**

Advertising revenues consist almost entirely of revenues generated through search. We offer our users the ability to search by collaborating with premium search companies, primarily Google Inc., and receive a portion of the revenues generated by these companies through the search process.

On March 19, 2008 we also signed a search distribution agreement with InfoSpace Inc. and most recently signed an amendment to that agreement on December 24, 2008, which automatically renews the agreement for one year terms unless either party gives the required notice of termination prior to the end of the applicable term.

In addition, we have licensing and promotion arrangements with Oberon Media Inc. for the use of our brand name and marketing of their products and services.

Under our agreement with Oberon Media Inc., effective since 2004 Oberon Media sells its gaming software through a website using our *Incredi* brand for the domain name *IncrediGames* and our website's graphical external envelop. In addition, we market and promote the *IncrediGames*' website, among other things, through a link in our website's main toolbar. In consideration for our brand and promotional activity, we share the net license fees (as defined in the agreement) Oberon Media receives from end-users in connection with the purchase of its software through the *IncrediGames* website. We have since amended the original agreement enabling us to broaden the cooperation between the companies, incorporating our HiYo product as well as our search properties. We expect these features to begin contributing revenues in 2009.

- **Our Products**

Our products are currently available in nine languages in addition to English. Prices and license fees for our premium products range between \$10 and \$60, varying based on market, length of license period and whether the products are offered together. We offer the following products, all of which may be downloaded over the Internet through a personal computer running on a Microsoft Windows operating system:

*IncrediMail® Xe*, launched in September 2000, is our flagship product that is available over the Internet free of charge. It offers a variety of features that the user can apply to email messages including:

- pre-prepared backgrounds and letterheads;
- animated notifiers (animated indications that mail has been received);
- emoticons (animations that are intended to convey emotions);
- 3D effects;
- handwritten signatures;
- a web gallery with additional animations, notifiers and email backgrounds;
- sound effects; and
- virtual e-cards.

*IncrediMail® Premium*, launched in the first quarter of 2001, is an enhanced version of *IncrediMail® Xe*. Users who upgrade their free version of *IncrediMail® Xe* through the purchase of *IncrediMail® Premium* benefit from the following features:

- no advertising banners displayed in the product;
- the ability to change the appearance of the product through the use of software skins;
- voice message recorder;
- no promotional link at the bottom of outgoing emails;
- enhanced notifiers;
- a web gallery with additional animations, notifiers and email backgrounds;
- advanced account access; and
- email-based user support.

The advanced account access system allows a user to download a specific email from an account without necessarily downloading all emails that have been delivered to the account. In addition, it allows a user to preview the email details residing on the server and delete email messages from the account without first having to download them. This software feature is built into *IncrediMail® Premium* and does not require the user to download or install any additional software. Users are therefore able to remove undesirable emails that they suspect may be infected with viruses or that may otherwise compromise their computers without downloading them.

*IncrediMail® Letter Creator*, also launched in the first quarter of 2001, is an application that enables *IncrediMail® Xe* and *IncrediMail® Premium* users to design and create their own personalized email letters and ecards. Such users can create their own letterheads, customize their emails with 3D effects, font styles, images and pictures and add personalized backgrounds. *Emoticon Super Pack*, launched in the first quarter of 2005, is a special package of emoticons sold separately.

Through December 31, 2008, we have sold approximately 1.1 million licenses for *IncrediMail® Premium*, *IncrediMail® Letter Creator*, or up-sale downloads, or combinations of this products.

*The Gold Gallery*, launched in February 2004, is a license-based content product. It offers additional *IncrediMail®* content files in the form of email backgrounds, animations, sounds, graphics and email notifiers. Through December 31, 2008, we have sold approximately 0.3 million licenses for *The Gold Gallery* of which approximately two thirds were for a one year license and one third for a lifetime license for use of the content database.

*JunkFilter Plus*, launched in July 2005, is an advanced anti-spam product, based on the Recurrent Pattern Detection Technology (RPD™) that we license from Commtouch Ltd. *JunkFilter Plus* offers a filtering technique to manage unwanted email, including offensive content, viruses, hoax emails and identity theft scams. This anti-spam product is designed to automatically identify and block undesirable mail from the user's inbox and protect against fraudulent and malicious emails. It detects and blocks spam in the first few minutes of an outbreak, unlike other anti-spam approaches. Through December 31, 2008, we have sold approximately 0.3 million licenses for *JunkFilter Plus*.

*Magentic*, was launched as a Beta in April 2006 and fully released a few months later. *Magentic* enhances and enriches the computer desktop by adding enhanced graphics enabling users to easily personalize the working environment. *Magentic* offers hundreds of high quality wallpapers and screensavers and has already over 8.5 million registered downloads. In 2008 we suspended further development marketing of this product, although we continue to support it and may renew marketing efforts in the future. In addition, the Company has developed *PhotoJoy* a product entirely focused on providing brand-new graphically enriched ways to view and enjoy personal photos. *PhotoJoy* provides 3D Photo Screensavers enriched with a variety of styles and designs, fun desktop widgets that display photos in the most creative and playful ways (named "PhotoToys"), and Collage Wallpapers presenting photos within various themes, sceneries, and illustrations. *PhotoJoy* is designed to reveal on a user's desktop all chosen photos saved on a user's personal computer. In addition, the software allows users to take photos from photo hosting web sites (such as Flickr and Picasa) and continue viewing new photos once uploaded to these sites directly in *PhotoJoy* as well, thereby enabling the user to enjoy photos on the computer desktop.

*HiYo*, launched in May 2008, is a graphic enhancement tool for enriching instant messaging products, by adding enhanced graphics and enabling users to personalize their messages. Such users can customize their messages with 3D effects, font styles, images and pictures and add personalized backgrounds content. *HiYo* is available for users of the instant messenger tool, Windows Live Messenger® and we believe *HiYo* will bring in new users and demographics into the *IncrediMail*® experience.

#### Products under Development

Our research and development activities are conducted internally by our Chief Technology Officer and a 47-person research and development staff. Our research and development efforts are focused on the development of upgraded software, new features and the enhancement of our existing product suite.

In the past we had initiated numerous other projects such as branded content and a social community site for *IncrediMail*® users, however, these efforts have been discontinued while we focus on our core competencies. Recently we have also suspended further development of our *Magentic* and *PhotoJoy* products. Management is constantly reassessing its initiatives, in an effort to optimize and leverage its added value and competitive advantages. Although the above projects are the initiatives currently identified by our management, we cannot assure you that these projects will be completed as currently contemplated or at all. In addition, future initiatives may take priority over the development of these projects.

#### Sales, Marketing and Distribution

Our products are sold throughout the world in more than 100 countries. The following table shows the distribution of our registered email users and products sold by territory in 2008:

	Registrations	Products Sold
Europe	53%	36%
North America	22%	52%
South America	11%	2%
Oceania	2%	6%
Other	11%	4%

To date, we have relied mainly on “viral growth,” arising from recipients of our users’ emails clicking on the link at the bottom of emails sent with *IncrediMail*<sup>®</sup> *Xe* and then downloading our products and from word-of-mouth. In addition, during 2008 we employed traditional marketing strategies, consisting primarily of online advertising, which efforts were met to our satisfaction. In 2009 in light of the current market conditions and our focus on profitability, we plan to reduce employing these marketing efforts. We have designed our products to address users’ aversion to spam, spyware and other perceived offensive Internet marketing tools. To date, we have not been affected by the growing number of installations by Internet users of “filter” software programs that allow them to block “pop up” advertisements or to prevent installation of software components that act as spying agents. The growth of our revenues would be adversely affected if our products, while not doing any of these things, were subject to being “filtered” by consumers.

During 2006 we opened an office in the United States, which is charged with local corporate communications, business development efforts and our marketing effort in China. In 2008 as we suspended business development activity in general and in China in particular, in order to focus on our core competencies the US office has been reduced accordingly.

We have typically experienced stronger sales in the first and fourth quarters, principally because our products are purchased in holiday sales in December or in the after-holiday sales in January. This is in addition to the general seasonality of the Internet as well as e-commerce, being more active in the winter months. However, as search generated revenues account for a growing and now dominant portion of our revenues, the seasonality of our revenues has decreased.

We currently have a Vice President – Marketing and 11 employees in our sales and marketing department.

## **Intellectual Property**

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality and invention assignment agreements to protect our intellectual property rights.

Most of the components of our software products were developed solely by us. We have licensed certain components of our software, such as a speller function, from third parties. Except for our agreement with Commtouch Ltd. (described below), all of these licenses entailed a one-time fee or are freeware. We believe that these components are not material to the overall performance of our software and may be replaced without significant difficulty.

In 2001, we submitted patent applications in the United States, Europe and Israel for the following two inventions:

- system and method for visual feedback of command execution in electronic mail systems; and
- system and method for intelligent transmission of digital content embedded in electronic mail messages.

In 2003, we submitted national phase patent applications in the United States, the European Community and Israel with respect to these processes that we employ in our products.

In July 2006, a patent was awarded in the US for the first invention; a patent has not yet been issued for the second invention.

In 2007 an international application was filed for the invention “interactive message editing system and method”.

We enter into licensing arrangements with third parties for the use of graphic, sound and multimedia content integrated into our products.

We have registered INCREMAIL as a trademark in the United States. All other trademarks, trade names and service marks appearing in this annual report are the property of their respective owners.

All professional employees and technical consultants are required to execute confidentiality covenants in connection with their employment and consulting relationships with us. We also require them to agree to disclose and assign to us all inventions conceived in connection with their services to us. However, there can be no assurance that these arrangements will be enforceable or that they will provide us with adequate protection.

*JunkFilter Plus* was developed using an anti-spam software development kit developed by Commtouch Ltd. Under our December 2004 agreement with Commtouch, Commtouch granted us a nonexclusive right and license to copy the software development kit and related software and documentation for purposes of further development or modification in connection with the design, development and sale of products that integrate the spam identification and classification services of Commtouch’s Detection Center, and to sell products incorporating such software and documentation. Under the agreement, we pay Commtouch an annual fee for each customer who purchases *JunkFilter Plus* based on the number of purchasers. The agreement had a one-year initial term, beginning with the commercial launch date of the *JunkFilter Plus* in July 2005 and was extended most recently for another two years, ending July 2010. Commtouch will continue to provide customers with accessibility to its software and our integrated products following termination of the agreement, and the licenses granted to our customers will also survive such termination.

## Competition

Our industry is subject to intense competition. Our products compete in the specialized market for email software products and services that aim to offer a personalized and entertaining email experience for consumers. IncrediMail was among the first companies to offer to the consumer email market a solution that combines an email product with an online gallery of creative content. Compiling content is a lengthy process and we have been doing it since 1999. We consider ourselves a pioneer in this market and we believe that we have an “early mover” advantage over many of our competitors. We believe that IncrediMail has one of the largest collections of creative and diverse graphics, sound and multimedia content available online for email communications.

Our ability to compete effectively depends upon our ability to distinguish our Company and our products from our competitors and their products, and includes the following factors:

- the creativity, variety and volume of content accessible through our software;
- product quality;
- product pricing;
- success and timing of new product development and introductions;
- quality of customer support;
- maintaining our reputation for fighting spam and offering spyware-free products;
- intellectual property protection; and
- development of successful marketing channels.

Our main competitors among specialized providers of email services offer the following products: Arcsoft Multimedia Email™ 3, LetterMark™ email, FunWeb Products™, Hotbar® and WikMail 2005. In addition, our products also face competition from general email software programs offered to the private market by large Internet and software companies, such as AOL9 by America Online, Inc., Eudora® by QUALCOMM Incorporated (Nasdaq: QCOM), Thunderbird® by Mozilla Foundation and Outlook Express and MSN9 by Microsoft Corporation (Nasdaq: MSFT), some of which may also incorporate certain special features that provide a personalized email experience. Many of the large Internet and software companies offer their email software programs free of charge. Our Magentic and PhotoJoy products’ main competitors, in area of providers of wallpapers and screensaver offer the following products: webshots.com and screensavers.com, which offer wallpapers and screensavers both free and premium products for a fee. Our HiYo product’s main competitors in the area of creative instant messenger tools, are SweetIM and SmileyCentral by IAC/InterActiveCorp. Competition with these products could result in reduced prices and margins, fewer purchases of our products and services, increased research and development costs as well as marketing expenses and loss of market share with regard to our traditional products, or not achieving adequate market share with our new products and those currently being developed.

Our products also compete in the market for web-based email software products, such as Google’s Gmail, Yahoo! Mail and Microsoft’s Hotmail. The web based email market is characterized with significant competition, changing technologies and evolving products and services enhancements.

Google, Yahoo! and Microsoft are each offering a web-based e-mail service in addition to the many other services they provide, such as desktop search, local search, instant messaging, photos, maps, video sharing, mobile applications and so on. We expect these competitors to increasingly use their financial and engineering resources to compete with our client-based e-mail service, if we are unable to successfully compete with them, our results of operations may be adversely affected.

Many of our competitors have more established brands, products and customer relationships than we do, which could inhibit our market penetration efforts even if they may not offer a customized and entertaining email experience similar to *IncrediMail*<sup>®</sup>. For example, consumers may choose to receive an extensive package of Internet and email services from a more dominant and recognized company, such as Microsoft Corporation (Outlook Express or MSN<sup>®</sup>) or America Online, Inc. (AOL<sup>®</sup>). If we are unable to achieve continued market penetration, we will be unable to compete effectively.

In addition, many of our other current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. These competitors could use their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as to develop new technologies, products or features that could effectively compete with our existing product lines. Demand for our products could be diminished by products and technologies offered by competitors, whether or not their products and technologies are equivalent or superior.

## Government Regulation

Our database, which includes a database of registered users, falls within the definition of a database that requires registration under the Israeli Protection of Privacy Law 1981. Maintaining a database other than in compliance with this law may subject the owner, holder, manager and operator to criminal liability and civil liability. We registered our database with the Data Base Registrar on June 20, 2004. BizChord's database has been registered and is in the process of completing additional aspects of its database registration.

There are still relatively few laws or regulations specifically addressing the Internet. As a result, the manner in which existing laws and regulations should be applied to the Internet in general, and how they relate to our business in particular, is unclear in many cases. Such uncertainty arises under existing laws regulating matters, including user privacy, defamation, pricing, advertising, taxation, gambling, sweepstakes, promotions, content regulation, quality of products and services, and intellectual property ownership and infringement.

However, to resolve some of the current legal uncertainty, it is possible that new laws and regulations will be adopted that will be directly applicable to our activities. Any existing or new legislation applicable to us could expose us to liability, including significant expenses necessary to comply with such laws and regulations, and could dampen the growth in use of the Internet in general. Several new U.S. federal laws have already been adopted that could have an impact on our business. The CAN-SPAM Act of 2003 is intended to regulate spam and create criminal penalties for unmarked sexually-oriented material and emails containing fraudulent headers. The USA Patriot Act is intended to give the government greater ability to conduct surveillance on the Internet by allowing it to intercept communications regarding terrorism and computer fraud and abuse. The Digital Millennium Copyright Act is intended to reduce the liability of online service providers for listing or linking to third-party Websites that include materials that infringe copyrights or other rights of others. The Children's Online Protection Act, the Children's Online Privacy Protection Act, and the Prosecutorial Remedies and Other Tools to End Exploitation of Children Today Act of 2003, are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children from Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances. Under the U.K. Data Protection Act and the European Union Data Protection Directive, a failure to ensure that personal information is accurate and secure or a transfer of personal information to a country without adequate privacy protections could result in criminal or civil penalties. Such legislation may impose significant additional costs on our business or subject us to additional liabilities. When users visit our website or install and use our software, certain "cookies" (pieces of information sent by a web server to a user's browser) may be generated by us and our advertisers and may be placed on our customers' computers. While we believe that our use of cookies does not result in personal identification, it has been argued that Internet protocol addresses and cookies are intrinsically personally identifiable information that is subject to privacy standards. We cannot assure you that our current policies and procedures would meet these restrictive standards. We post our privacy policy and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policy, Federal Trade Commission requirements or other domestic or international privacy-related laws and regulations could result in proceedings by governmental or regulatory bodies that could potentially harm our business, results of operations and financial condition. In this regard, there are a large number of legislative proposals before the European Union, as well as before the United States Congress and various state legislative bodies regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could harm our business through a decrease in user registrations and revenues. These decreases could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

## C. ORGANIZATIONAL STRUCTURE

During 2006, we formed a wholly-owned subsidiary in Delaware, operating out of New York, for marketing and other activities, and formed another wholly owned subsidiary in Israel to acquire the business of our transaction processing provider, operating primarily out of Israel. The current activity in these subsidiaries is minimal. Except for such subsidiaries, we do not have other subsidiaries.

## D. PROPERTY, PLANTS AND EQUIPMENT

We lease our facility, located in Tel Aviv, Israel, pursuant to a lease that was entered into during 2006 and expires in 2011, with an option to extend the lease for 2 more years. The lease is for a total area of 2,300 square meters, at a monthly rent of approximately \$22.9 per square meter.

We own 63 servers that are hosted in a server farm by Bezeq International Ltd., which we refer to herein as "Bezeq". Our servers include mainly web servers, application servers, ad servers, mail servers and database servers. Bezeq provides the Internet and related telecommunications services, including hosting and location facilities, needed to operate our website. Bezeq is Israel's largest provider of such services and is a member of Bezeq Group, Israel's national telecommunications provider. Bezeq provides these services through standard purchase orders and invoices. We add servers and expand our systems located at their facilities as our operations require. We have no current intention to replace Bezeq or to employ an additional provider for these services. We believe there are many alternative providers of these services both within and outside of Israel.

## ITEM 4.A UNRESOLVED STAFF COMMENTS

Not applicable.

## ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

*The following discussion of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes to the financial statements included elsewhere in this annual report. In addition to historical financial information, the following discussion and analysis contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding the Company's expectations, beliefs, intentions, or future strategies that are signified by the words "expects," "anticipates," "intends," "believes," or similar language. These forward looking statements involve risks, uncertainties and assumptions. Our actual results and timing of selected events may differ materially from those anticipated in these forward looking statements as a result of many factors, including those discussed under "Item 3.D Risk Factors" and elsewhere in this annual report.*

### A. OPERATING RESULTS

#### Overview

We design and market an integrated suite of customized and entertaining email software products for the consumer or home user markets. We believe we are a global technology leader in enriching email interactions by offering users the ability to design highly personalized email presentations. We believe that our innovations in entertaining email technology, along with our large collection of multimedia content for email communication, have made our website one of the top Internet destinations in the world for downloading entertaining email solutions.

Since we began operations in 2000, we have recorded approximately 110 million registered downloads of our free products in more than 100 countries, and in 2008, we recorded an average of approximately 1.7 million registered downloads each month. As of December 31, 2008, we had approximately 11 million active users, and currently, our email users send over 300 million IncrediMail® emails each month. We define an "active" user as any user who has performed any activity using any IncrediMail® product or service, including opening or sending emails using IncrediMail®, sending a message utilizing our HiYo tool, downloading content or updating the product, in the 30 days prior to the measurement date. Our users typically use our products for as long as five years, based on current statistics (this was estimated in the past as three years). Through December 31, 2008, we have sold over 1.7 million products and content licenses worldwide to our registered users. We believe our historical track record of converting registered users to purchasing customers, as well as the use of our search properties, represent a convincing validation of our business strategy.

Prices and license fees for our products vary based on market, length of license period and whether the products are offered together. Our prices and fees range from less than \$10 to about \$60. These prices can vary in currencies, other than the US dollar.

### **Revenues**

We generate our revenues primarily from two major sources: (i) advertising, primarily through search generated revenues and other services, and (ii) software products and solutions; licensing our *IncrediMail® Premium*, email software, *The Gold Gallery*, our content database and *JunkFilter Plus*, our anti-spam solution. In addition, we generate revenues from advertising in our email client, our content database and on our website, as well as a collaboration arrangement with a websites operator who uses our *Incredi* brand name and to whom we refer users, IncrediGames.com, an online computer games site. The following table shows our revenues by category (in thousands of US Dollars):

	Year Ended December 31,		
	2006	2007	2008
Advertising, primarily through search, and other services	\$ 3,066	\$ 9,597	\$ 12,748
Products	7,785	9,078	9,158
<b>Total revenues</b>	<b>\$ 10,851</b>	<b>\$ 18,675</b>	<b>\$ 21,906</b>

### **Cost of Revenues**

Our cost of revenues consists primarily of salaries and related expenses, license fees and payments for content and server maintenance, all related to our product revenues. Our revenues relating to advertising, primarily search, do not have direct cost associated with them.

### **Research and Development Expenses**

Our research and development expenses consist primarily of salaries and other personnel-related expenses for employees primarily engaged in research and development activities. We expect our research and development expenditures to remain at their current level as our current strategy is to focus on our core competencies and continue enhancing our existing suite of products.

### **Selling and Marketing Expenses**

Our selling and marketing expenses consist of salaries and other personnel-related expenses for employees primarily engaged in marketing activities, media buying, payments to our PR firm, credit card commissions and fees to our payment gateway providers that provide secure Internet payment processes. Credit card commissions vary between 1.9% and 3.0% based on the credit card, currency of payment and location of clearing agency. We expect our selling and marketing expenses to decrease as we reduce our investment in media buying from their current level of investment in the last quarter of 2008. During 2008 we employed traditional marketing strategies, including primarily online advertising, which efforts were met to our satisfaction, and in light of the current market conditions and our increasing focus on profitability, we plan to reduce this investment in 2009.

### **General and Administrative Expenses**

Our general and administrative expenses consist primarily of salaries and other personnel-related expenses for executive, accounting and administrative personnel, professional fees and other general corporate expenses. We do not currently expect a significant increase in our general and administrative expenses in 2009.

### ***Income Tax Expense (Benefit)***

In 2001 and 2003, we were granted the status of “Approved Enterprise” and in 2008 we received approval for continued “Privileged Enterprise” status, all with respect to three separate investment programs, entitling us to a tax exemption for a period of two years and to a reduced tax rate of 10%-25% for an additional period of five to eight years (depending on the level of foreign investment in our Company). The “Approved Enterprise” status and the “Privileged Enterprise” status allow for 0% corporate tax for a limited period of time on undistributed profits generated from operations, and preferential taxation of the distributed portion, requiring regular Israeli corporate tax on income generated from other sources. To the extent the Company distributes dividends from profits generated under this program, the distributed sum would not benefit from this program. See “Israeli Taxation—Law for the Encouragement of Capital Investments, 1959” and Item 8. Financial Information A. Consolidated Statements and Other Financial Information – Policy on Dividend Distribution, for more information about these programs and the Company’s dividend policy.

### ***Critical Accounting Policies and Estimates***

The discussion and analysis of our financial condition and results of operation are based on our financial statements, which have been prepared in conformity with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate these estimates on an on-going basis. We base our estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying amount values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Under U.S. GAAP, when more than one accounting method or policy or its application is generally accepted, our management selects the accounting method or policy that it believes to be most appropriate in the specific circumstances. Our management considers some of these accounting policies to be critical.

A critical accounting policy is an accounting policy that management believes is both most important to the portrayal of our financial condition and results and requires management’s most difficult subjective or complex judgment, often as a result of the need to make accounting estimates about the effect of matters that are inherently uncertain. While our significant accounting policies are discussed in Note 2 to our financial statements, we believe the following accounting policies to be critical:

#### ***Revenue recognition***

Revenues from email software license sales are recognized when all criteria outlined in Statement of Position (“SOP”) 97-2, “Software Revenue Recognition” (as amended), are met. Revenues from software license are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collectability is probable.

For substantially all of our software arrangements, we evaluate each of these criteria as follows:

*Evidence of an arrangement:* We consider a clicking on “acceptance” of the agreement terms to be evidence of an arrangement.

*Delivery:* Delivery is considered to occur when the license key is sent via email to the customer or alternatively the customer is given access to download the licensed key.

*Fixed or determinable fee:* Fees are determinable at the time of sale. Customers are charged immediately through credit cards. In addition, the fees are subject to a refund policy period, currently up to 30 days, and we consider collection to be probable as our historical experience shows that refunds are less than 5% of our revenues.

*Collection is probable:* We are subject to a minimal amount of collection risk related to our customers as these are either from very profitable global market leader or obtained through credit card sales.

Revenues from licensing *The Gold Gallery* content database are recognized over the term of the licensing period. We offer one year, two year and lifetime licenses for *The Gold Gallery* content database for a one-time, upfront payment. The different term licenses constituted less than 8% of our revenues in 2008. Our estimation of the lifetime usage of *The Gold Gallery* is based on historical data collected. We continually track usage patterns, and as we gather more user information, we may update this estimated useful life. If the lifetime usage of *The Gold Gallery* is demonstrated to be shorter or longer than the current estimate, we would recognize revenues earlier or later. Based on our current revenue streams, such an adjustment would not have a significant effect on our revenues.

Revenues from our *JunkFilter Plus* solution are recognized over one year, which is the term of the license period.

Our deferred revenue consists of the unamortized balance of *The Gold Gallery* and the *JunkFilter Plus* license fees, which totaled \$4.3 million as of December 31, 2008, of which \$2.6 million was classified as short-term deferred revenues and the balance as long-term deferred revenue on our balance sheet.

Revenues from advertising, whether from keyword search, advertising on our website or in our email client, are recognized when we are entitled to receive the fee. Advertisers are charged and pay monthly, based on the number of clicks generated by users clicking on these ads.

In accordance with EITF No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Product," the Company accounts for cash consideration given to customers, for which it does not receive a separately identifiable benefit or cannot reasonably estimate fair value, as a reduction of revenue rather than as an expense.

Collaboration arrangements are established with other websites who use our brand name *Incredi* and to whom we refer users. Under the agreement the collaborators provide their products and services and manage, host and maintain the websites that provide games or matchmaking services to Internet users, using our *Incredi* brand for the domain names *IncrediGames.com* and *IncrediMailPersonals.com* and our website's graphical external envelop. We promote these websites, among other things, through promotions on our website and email client. In consideration for our brand and promotional activity, we are entitled to share the net or gross revenues, (as provided in each agreement) generated from these websites, including subscription and advertising fees. Revenues from these collaboration arrangements are recognized when earned and based on reports received from the collaborating party.

With regard to arrangements involving multiple elements, the Company's revenues should be allocated to the different elements in the arrangement under the "relative fair value method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all elements in accordance with SOP No. 97-2. Under the relative fair value method, we allocate revenue proportionally based on the fair value of its delivered and undelivered elements. Any discount in the arrangement is allocated pro rata to the different elements in the arrangements.

### **Stock-Based Compensation**

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. As of December 31, 2008, the total compensation cost, related to options granted to employees, not yet recognized, amounted to \$1.2 million. This cost is expected to be recognized over a weighted average period of 2.43 years. Our stock-based compensation to employees was allocated as follows (in thousands):

	Year Ended December 31,		
	2006	2007	2008
Cost of revenues	\$ 7	\$ 11	\$ 16
Research and development	94	79	293
Selling and marketing	53	60	137
General and administrative	371	524	584
Other charges	-	-	135

We selected the Binomial method option-pricing model as the most appropriate fair value method for our stock-options awards. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon an average between historical volatilities of the Company, similar entities and industry sector index similar to the Company's characteristics, since it does not have sufficient company specific data. The expected option term was calculated based on the Company's assumptions of early exercise multiples which were calculated based on comparable companies and termination exit rate which was calculated based on actual historical data. The expected option term represents the period that the Company's stock options are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term.

### **Taxes on Income**

We record income taxes using the asset and liability approach. Management judgment is required in determining our provision for income taxes. The provision for income tax is calculated based on our assumptions as to our entitlement to various benefits under the applicable tax laws. The entitlement to such benefits depends upon our compliance with the terms and conditions set out in these laws. Although we believe that our estimates are reasonable and that we have considered future taxable income and ongoing prudent and feasible tax strategies in estimating our tax outcome, there is no assurance that the final tax outcome will not be different than those which are reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision, net income and cash balances in the period in which such determination is made.

On January 1, 2007, we adopted FIN No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48"), which contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. Prior to January 1, 2007, we estimated our uncertain income tax obligations in accordance with SFAS No. 109 and SFAS No. 5 "Accounting for Contingencies."

We recorded interest on late paid taxes as tax expenses. Our policy for interest related to income tax exposures was not impacted as a result of the adoption of the recognition and measurement provisions of FIN No. 48.

As a result of the implementation of FIN No. 48, the Company recognized a \$83 thousand increase in liability for unrecognized tax benefits, which was accounted for as an decrease to the January 1, 2007 balance of retained earnings.

#### ***Impairment of investments in marketable securities.***

We regularly review our investments for factors that may indicate that a decline in the fair value of an investment below its cost or amortized cost is other-than-temporary. Some factors considered in evaluating whether or not a decline in fair value is other-than-temporary include: our ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value; the duration and extent to which the fair value has been less than cost; and the financial condition and prospects of the issuer. Such reviews are inherently uncertain in that the value of the investment may not fully recover or may decline further in future periods resulting in realized losses.

#### ***Impairment of Long-Lived Assets.***

Our long-lived assets include property and equipment, goodwill and other intangible assets. In assessing the recoverability of our property and equipment and other intangible assets, we make judgments regarding whether impairment indicators exist based on legal factors, market conditions and operating performances of our business and products. Future events could cause us to conclude that impairment indicators exist and that the carrying values of the intangible assets or goodwill are impaired. Any resulting impairment loss could have a material adverse impact on our financial position and results of operations.

We are required to assess the impairment of long-lived assets, tangible and intangible, other than goodwill, under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," on a periodic basis, when events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment indicators include any significant changes in the manner of our use of the assets or the strategy of our overall business, significant negative industry or economic trends and significant decline in our share price for a sustained period. For the year ended December 31, 2007 and the year ended December 31, 2008, we recorded an impairment charge resulting from technology associated with BizChord in the amount of \$153 and \$44 thousand, respectively.

Upon determination that the carrying value of a long-lived asset may not be recoverable based upon a comparison of aggregate undiscounted projected future cash flows to the carrying amount of the asset, an impairment charge is recorded for the excess of fair value over the carrying amount. We measure fair value using discounted projected future cash flows.

Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. We operate in two operating segments, Incredimail and BizChord, and these segments comprise our reporting units. Goodwill is allocated to the reporting unit of BizChord. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair value is determined using discounted cash flows. Significant estimates used in the fair value methodologies include estimates of future cash flows, future growth rates and the weighted average cost of capital of the reporting unit. In 2007 and 2008, the Company recorded an impairment loss in the amounts of \$163,000 and \$125,000 in respect of BizChord reporting unit, respectively.

***Recently issued accounting pronouncements:***

In February 2008, the FASB issued FASB Staff Position (“FSP”) FAS No. 157-2, “Effective Date of FASB Statement No. 157” (“FSP 157-2”), to delay the effective date of FASB Statement 157 for one year for certain nonfinancial assets and nonfinancial liabilities, excluding those that are recognized or disclosed in financial statements at fair value on a recurring basis (that is, at least annually). For purposes of applying the FSP 157-2, nonfinancial assets and nonfinancial liabilities include all assets and liabilities other than those meeting the definition of a financial asset or a financial liability in FASB Statement 159. FSP 157-2 defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP 157-2. The adoption of FAS 157 to nonfinancial assets and nonfinancial liabilities under the scope of FSP 157-2 did not have a material impact on the Company’s financial position, results of operations or cash flows.

In March 2008, the FASB issued Statement 161 “Disclosures about Derivative Instruments and Hedging Activities” (“SFAS 161”) an amendment to FASB No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why and entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. The adoption of SFAS 161 did not have a material impact on the Company’s financial position, results of operations or cash flows.

In April 2008, the FASB issued FSP 142-3, “Determination of the Useful Life of Intangible Assets” (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets”. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP 142-3 did not have a material impact on the Company’s financial position, results of operations or cash flows.

In April 2009, the FASB issued FSP, No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, or the FSP. The FSP is intended to provide greater clarity to investors about the credit and noncredit component of an other-than-temporary impairment event and to more effectively communicate when an other-than-temporary impairment event has occurred. The FSP applies to fixed maturity securities only and requires separate display of losses related to credit deterioration and losses related to other market factors. When an entity does not intend to sell the security and it is more likely than not that an entity will not have to sell the security before recovery of its cost basis, it must recognize the credit component of an other-than-temporary impairment in earnings and the remaining portion in other comprehensive income. Upon adoption of the FSP, an entity will be required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to accumulated other comprehensive income. The FSP will be effective for us for the quarter ending June 30, 2009. The Company is currently evaluating the impact of adopting the FSP.

In April 2009, the FASB issued FSP No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, or FSP 157-4. FSP 157-4 provides additional authoritative guidance to assist both issuers and users of financial statements in determining whether a market is active or inactive, and whether a transaction is distressed. The FSP will be effective for us for the quarter ending June 30, 2009. The Company does not expect the adoption of FSP 157-4 to have a material impact on our consolidated financial position and results of operations.

The following table sets forth, for the periods indicated, our statements of operations expressed as a percentage of total revenues (the percentages may not equal 100% because of the effects of rounding):

	Year Ended December 31,		
	2006	2007	2008
Revenues from advertising, primarily search, and other services	28%	51%	58%
Revenues from products	72	49	42
Revenues, net	<b>100%</b>	<b>100%</b>	<b>100%</b>
Cost of revenues	8	9	8
<b>Gross profit</b>	<b>92</b>	<b>91</b>	<b>92</b>
Operating expenses			
Research and development costs	30	33	35
Selling and marketing expenses	16	25	34
General and administrative expenses	25	20	17
Goodwill impairment and other charges	-	1	5
Total operating expenses	71	79	91
<b>Operating income</b>	<b>21</b>	<b>12</b>	<b>1</b>
Financial income (expense) and other, net	9	(19)	21
<b>Income (loss) before taxes on income</b>	<b>30</b>	<b>(7)</b>	<b>22</b>
Income tax expense	7	8	1
<b>Net income (loss)</b>	<b>23%</b>	<b>(15)%</b>	<b>21%</b>

As shown in the above table, our operations are characterized by high margins, which are attributable mainly to two factors: (i) we do not have manufacturing costs for our products, and (ii) we sell our products online and rely primarily on viral marketing, although in 2007 and 2008, we increased our investment in non-viral marketing. The continued decrease in our operating margin in 2008 compared to 2007 and 2006, resulted primarily from our increased investment in media buying marketing expenses and goodwill impairment and other charges, as a result of our refocusing on our core competencies, terminating and suspending others. If our revenues increase (as we expect), and we maintain a lower level of operating expenses, as a result of the measures taken on 2008 and the subsequent reduction of our investment in media buying, we expect our operating margins to increase already in 2009, although they may not reach the levels we had experienced in the past.

#### *Year Ended December 31, 2008 Compared to Year Ended December 31, 2007*

*Revenues from advertising, primarily search, and other services.* These revenues increased by 33%, from \$9.6 million in 2007 to \$12.7 million in 2008. The increase in revenues was due to a \$3.9 million increase in search generated revenues, partially offset by a \$0.8 million decrease in other advertising and other revenues. In 2008 we diversified our collaboration with search providers, with approximately 90% of search generated revenues being provided by our partnership with Google and the remaining 10% coming from other search providers, primarily InfoSpace. The continued increase in search generated revenues, reflect the success of our strategy to leverage our large user base, primarily those using our free products. In 2009 we expect to further increase our search generated revenues through our new HiYo user base, which in 2008 did not generate revenues and by further optimizing our offering to our IncrediMail and Magentic users.

*Revenues from products.* These revenues remained relatively stable, increasing less than \$0.1 million. We believe the decrease in growth is attributable to decreasing popularity in purchasing downloadable software, general market conditions and the need to offer a more current application. A new version of our backbone IncrediMail Xe product is expected to be fully released in 2009.

*Cost of Revenues.* Cost of revenues from products in 2008 was \$1.8 million, increasing by less than \$0.1 million, compared to 2007 and as a result, the gross profit margin in 2008 increased to 92%, as compared to 91% in 2007. The increased gross profit margin was a result of the increased portion of search generated revenues, which have no direct costs associated with it, as part of total sales. As search generated revenues continue to account for a growing portion of our revenues, we expect the gross profit margin to remain at its current level and as long as this remains the trend, possibly further improve.

*Research and Development Expenses ("R&D").* R&D increased by \$1.5 million, from \$6.1 million in 2007 to \$7.6 million in 2008. The increase was primarily attributable to an increased investment in products introduced in 2008 as well as in products that further development was recently suspended. In 2006 we released *Magentic*, a desktop enhancing solution, currently providing wallpapers and screensavers. In 2007 we began developing a new version of *Magentic*, dramatically enhancing its personal photograph tools, and released *PhotoJoy* in 2008. Although *Magentic* has accumulated over 8 million registered downloads since introduction, it is not as viral as we had expected, with the average number of downloads increasing less than 300,000 a month. We therefore decided to suspend our R&D and marketing efforts for these products. In December 2008 we did a Beta release of a totally new version of our back-bone email client product *IncrediMail*®. We expect a full release of this new version in the first half of 2009. Although we have released numerous upgrades to this product in the past, this is the first full makeover, improving the graphics and numerous user friendly functions, bringing a much more graphically advanced user interface. As a result of our suspending certain development initiatives as well as completing the major makeover of our *IncrediMail* product, we expect R&D to decrease in 2009, after continuing to increase in 2008. As a percentage of revenues, R&D increased from 33% in 2007 to 35% in 2008.

*Selling and Marketing Expenses.* Selling and marketing expenses, increased by \$2.6 million, or 57%, from \$4.7 million in 2007, to \$7.3 million in 2008. This increase was primarily attributable to the increase in our investment in media buying which accounted for \$3.5 million in 2008, compared to \$1.4 million in 2007. We expect to reduce this investment significantly in 2009 and as a result, reduce selling and marketing expenses.

*General and Administrative Expenses ("G&A").* G&A increased marginally from \$3.7 million in 2007 to \$3.8 million in 2008. As a percentage of sales, G&A decreased from 20% in 2007 to 17% in 2008. We expect to be able to maintain this level of G&A expenditure as a percentage of sales in 2009.

*Goodwill impairment and other charges.* In 2008 the Company realigned its strategy and decided to focus on its core competencies. As a result it reorganized and suspended certain activities. These expenses included \$0.5 million compensation expenses, \$0.1 million goodwill impairment and \$0.5 million of other expenses related to activities suspended.

*Financial Income (Expense), net.* We recorded \$4.8 million, net, in financial income from receiving in October 2008 the proceeds from the sale of an Auction Rate Security, which had been written-off in the fourth quarter of 2007. This income was partially offset by \$0.3 million of finance expenses, resulting primarily from negative net returns on our investments in 2008. In light of the current economic situation in general and the financial markets in particular, we have further tightened our investment policy so that a majority of our investments are in US treasury or US government backed securities, with the balance in debentures of a limited sum and relatively short-term maturity, rated at AA and higher and dollar denominated or linked. We are gradually changing our portfolio to reflect this new policy, however, given the current interest rates, we expect this policy to produce minimum returns, if at all, in 2009.

*Income (Loss) before Tax.* The income before tax in 2008 was \$4.7 million, compared to a loss before tax of \$1.4 million in 2007. The income in 2008 was primarily attributable to the aforementioned \$4.8 million financial income, while the loss in 2007 was primarily attributable to the write-down of that investment, as described above, partially offset by other financial income.

*Taxes on Income.* Income tax in 2008 was \$0.3 million, compared to \$1.4 million in 2007. Although the Company had a loss before tax in 2007, it still recorded a tax expense. This is due to our recording a valuation allowance with respect to deferred tax assets related to other-than-temporary impairment on marketable securities and ARS, due to current uncertainty of whether we will produce sufficient capital gains in the future, which are considered a source of income required to offset losses from marketable securities under the Israeli Tax Law. Similarly, in 2008, being that the income before tax was primarily due to the proceeds from selling this same ARS at cost, there was no tax incurred. In addition, in 2007, the effective tax rate on the other income increased, as the benefits from the Company's Approved Enterprise program were greatly reduced in 2007. As the Privileged Benefit Program for 2008 has already been approved, we expect these benefits to return to a great extent in 2009.

*Net Income (Loss).* The Net Income in 2008 was \$4.4 million, compared to a Net Loss of \$2.8 million in 2007. The Net Income in 2008 was primarily attributable to the aforementioned financial income from the sale of our auction rate security. The cause of the Net Loss in 2007, was primarily attributable to the aforementioned \$4.9 million other-than-temporary loss from our investment, and creating valuation allowance against the deferred tax asset from that expense.

*Year Ended December 31, 2007 Compared to Year Ended December 31, 2006*

*Revenues from advertising, primarily search and other services.* These revenues increased three fold, from \$3.1 million in 2006 to \$9.6 million in 2007. The increase in revenues was primarily due to a \$6.4 million increase in search generated revenues, as well as a \$0.1 million increase in other advertising and other revenues. The increase in search generated revenues reflects the success of our strategy to migrate from product sales to subscriptions and leverage the growth potential of search generated revenues and our large user base, comprised primarily of those using our free products. As our products mature and search availability expands, we expect search generated revenues to increase in the future at a faster pace than our other revenue streams, and as such, to account for a larger portion of our revenues.

*Revenues from products.* These revenues increased by \$1.3 million, or 17%, from \$7.8 million in 2006, to \$9.1 million in 2007. This was achieved by a 39% increase in our *Gold Gallery* and *JunkFilter Plus* subscription revenues, partially offset by a 10% decrease in our revenues from product sales of *IncrediMail*® Premium.

*Cost of Revenues.* Cost of revenues from products increased by \$0.9 million, from \$0.9 million in 2006 to \$1.8 million in 2007. The increase was primarily due to a \$0.8 million increase in salaries and related expenses, caused by the increase in support and creative staff, as well as a \$0.2 million increase in payments for our anti-spam software, as *JunkFilter Plus* sales increased. As a result, in parallel with the increase in revenues, our gross profit margin was 91% in 2007, compared to 92% in 2006. Together with the growth in our search generated revenues, we expect the gross profit margin to remain at its current level and as long as this remains the trend, possibly improve. The entire cost of revenues is associated with revenues from our software products and solutions, as there are no direct costs associated with revenues from search, advertising and other services.

*Research and Development Expenses ("R&D").* R&D increased \$2.8 million, from \$3.3 million in 2006 to \$6.1 million in 2007. The increase was primarily attributable to an increased investment in products recently introduced and those planned for future release in 2008. In 2006 we released *Magentic*, a desktop enhancing solution, currently providing wallpapers and screensavers. As of the end of March 2008, *Magentic* has drawn over 6.0 million registered users. In 2007 we began developing a new version of *Magentic*, dramatically enhancing its personal photograph tools, and we expect to release *Magentic2* during the second quarter of 2008. In addition, we are working on a totally new version of our back-bone email client product *IncrediMail*®. Although we have released numerous upgrades to this product, this will be the first full makeover, improving the graphics and numerous user friendly functions, bringing a much more graphically advanced user interface. These initiatives, together with our ongoing effort to continuously improve our existing suite of products, are expected to cause our R&D expenses to further increase in 2007. As a percentage of revenues, R&D increased from 30% in 2006 to 33% in 2007.

*Selling and Marketing Expenses.* We more than doubled our selling and marketing expenses, increasing them from \$1.8 million in 2006, to \$4.7 million in 2007. The increase in selling and marketing expenses was primarily attributable to new marketing initiatives, including media buying which accounted for \$1.4 million in 2007, and we expect to further increase the expenditure in this venue significantly in 2008. In 2007, we also invested in numerous other online marketing initiatives, such as branded content, our social community website – *IncrediWorld*, as well as off-line marketing and advertising. These other online and offline initiatives have been since curtailed, as we focus on our core competencies for growing our user base and revenues in the future. In 2007 we continued to increase the staffing of our marketing department, and we expect to continue and do so in 2008, focusing on optimization and media buying proficiencies.

*General and Administrative Expenses ("G&A").* G&A increased by \$1 million, from \$2.7 million in 2006 to \$3.7 million in 2007. This increase was caused primarily due to increased staffing to accommodate the Company's growth; as well as a \$0.2 million increase in costs of investor relations and other public company-related professional fees. Finally, the Company incurred in 2007 a \$0.5 million expense incurred by stock based compensation in accordance with FASB 123(R), compared to \$0.4 million in 2006. As a percentage of revenues, G&A decreased from 25% in 2006 to 20% in 2007.

*Financial Expense, net.* The financial expense was due to our recording a \$4.9 million expense from the other-than-temporary impairment of our investment in Auction Rate Securities currently not liquid. Recent uncertainties in the credit markets have adversely affected the liquidity of auction rate securities as potential buyers have been unwilling to purchase these securities, adversely affected by the existing conditions in the mortgage securities market. The liquidity of these investments has been significantly impacted by these conditions, and the specific security held by the Company was recently downgraded from AAA to CCC by S&P, although we continue to receive interest payments every 28 days. During recent months, the Company tried to sell such security, with no success. The Company received from its banker a valuation of this security, resulting in it recording an, other-than-temporary impairment of \$4.9 million. The Company has no other auction rate securities. This expense was partially offset by financial income of \$1 million of interest income and net return on our investments. Our investment policy was updated in 2007 so as to purchase debentures of a limited sum and relatively short-term maturity, rated at A and higher, dollar denominated or linked. This policy was further updated in 2008 as indicated above and in addition, we sold the ARS for its cost in the fourth quarter of 2008 as mentioned above.

*Income (Loss) before Tax.* The loss before tax in 2007 was \$1.4 million, compared to income before tax of \$3.2 million in 2006. The loss in 2007 was primarily attributable to the \$4.9 million expense to the write-down of our investment, as described above, partially offset by other financial income.

*Taxes on Income.* Income tax in 2007 was \$1.4 million, compared to \$0.8 million in 2006. Although the Company had a loss before tax in 2007, it still recorded a tax expense. This is due to our recording a valuation allowance with respect to deferred tax assets related to other-than-temporary impairment on marketable securities and ARS, due to current uncertainty of whether we will produce sufficient capital gains in the future, which are considered a source of income required to offset losses from marketable securities under the Israeli Tax Law. In addition, the effective tax rate on the other income increased, compared to 2006, as the benefits from the Company's Approved Enterprise program were greatly reduced in 2007, compared to 2006. As the Approved Benefit Program for 2008 has already been approved, we expect these benefits to return to a great extent in 2008.

*Net Income (Loss).* The Net Loss in 2007 was \$2.8 million, compared to Net Income of \$2.5 million in 2006. The Net Loss in 2007 was primarily attributable to the aforementioned \$4.9 million other-than-temporary loss from our investment, and creating valuation allowance against the deferred tax asset from that expense.

## **B. LIQUIDITY AND CAPITAL RESOURCES**

From inception until consummation of our initial public offering we funded our operations principally from private placements of ordinary and preferred shares that resulted in aggregate net proceeds of approximately \$3.3 million and cash flow from operations. We received net proceeds of \$16.8 million from our initial public offering, consummated in February 2006.

As of December 31, 2008, we had working capital of \$25.1 million and our primary source of liquidity was \$26.6 million in cash, cash equivalents, deposits and marketable securities. As of December 31, 2007, we had working capital of \$19.8 million, and our primary source of liquidity was \$23.4 million in cash, cash equivalents and marketable securities. The increase in working capital and cash, cash equivalents and marketable securities was primarily due to the \$4.8 million net proceeds from the sale of our Auction Rate Security in October 2008, previously written-off in 2007 as described above, in addition to working capital generated by our operations.

We believe that our cash balances and cash generated from operations will be more than sufficient to meet our anticipated cash requirements for at least the next 12 months.

*Net Cash Provided By Operating Activities.* Net cash provided by operating activities was \$5.2 million, \$4.0 million and \$0.9 million for 2006, 2007 and 2008, respectively. The change in net cash provided by operating activities reflects primarily a \$3.8 million net change in the carrying value of marketable securities.

*Net Cash Provided By (Used In) Investing Activities.* Net cash provided by (used in) investing activities was (\$16.1) million, (\$7.9) million and \$3.0 million in 2006, 2007 and 2008, respectively. In 2008, net cash provided by investing activities consisted primarily from the net proceeds from the sale of marketable securities and short term deposits of \$3.8 million, net of \$0.6 million investment in property and equipment.

*Net Cash Provided by (Used In) Financing Activities.* Net cash provided by (used in) financing activities was \$16.8 million in 2006 resulting from issuance of shares in our initial public offering in January 2006, \$0.3 million in 2007, and (\$0.7) million used in 2008, primarily for the repurchase of the Company's shares.

## C. RESEARCH, DEVELOPMENT, PATENTS AND LICENSES, ETC.

Our research and development activities are conducted internally by our Chief Technology Officer and a 47-person research and development staff. Our research and development efforts are currently focused on the completing the development of new products and upgrading the software and new features for existing products. In 2008 this included developing a new version of *Magentic*, *PhotoJoy*, development activity which has been substantially completed and continuing development efforts have been currently suspended in order to focus on our core competencies. In addition, in 2008 we launched *HiYo*, our graphic and communication enhancement tool for instant messaging products. In December 2008, we also released the Beta of a new version of our back-bone email client product IncrediMail®. Although we have released numerous upgrades to this product, this will be the first full makeover, improving the graphics and numerous user- friendly functions, bringing a much more graphically advanced user interface.

Our research and development expenditures were \$3.2 million, \$6.1 million and \$7.6 million, in the years ended December 31, 2006, 2007 and 2008, respectively. Although we intend to continue our investment in product development, with the suspension of continued development of some of our products and the completion of others, we expect our expenditures on research and development to decrease in 2009.

## D. TREND INFORMATION

*Sales.* The increase in sales in 2008 compared to 2007 was due to the continued increase in search generated revenues. We continue to believe that the potential for growth in search generated revenues is much greater than product sales. This is based on the introduction of our search model in our recently introduced HiYo product as well as optimizing these revenues from our other products. These revenues are less seasonal than revenue from products and we therefore expect that our total revenues will be less seasonal than in past years. In June 2008 we launched *HiYo*, our graphic and instant messaging enhancement tool, and in December 2008 we also released the Beta of a new version of our back-bone email client product IncrediMail®, with a prospective launch in 2009. We expect these products to contribute to our revenues in the upcoming year.

*R&D.* R&D expenses have increased over the last few years. We expect this trend to slightly reverse next year as we have discontinued some of our development efforts and will have completed some of the others. We currently do not intend to develop new products, so that future R&D investments will be devoted to further enhancing and improving our existing products.

*Sales and Marketing Expenses.* Our sales and marketing expenses increased significantly in 2007 and even more so in 2008. The increase in 2008 was primarily a result of media buying expenses, which totaled \$3.5 million in 2008, as well as increasing the marketing staff. The investment in media buying was to “jump-start” registrations in our recently released HiYo product as well as maintain the registration level of our IncrediMail email product. In 2009 we have discontinued all media buying for our HiYo product, having achieved the goals set out and able to rely on entirely viral marketing. In addition we have reduced our investment in media buying for our IncrediMail email product in light of the current economic conditions and our increased focus on profitability. As a result, we can expect selling and marketing expenses to decrease in 2009.

*General and Administrative expenses.* G&A expenses increased over the last few years, however, in 2008 we have succeeded in maintaining the same level of expenditure as in 2007, and as a percentage of sales, these expenses decreased from 20% in 2007 to 17% in 2008. We expect to be able to maintain the 2008 level of expenditure in 2009, so that G&A expenses will continue to representing a decreasing percentage of our revenues.

*Industry trends expected to affect our revenues, income from continuing operations, profitability and liquidity or capital resources:*

1. In recent years, we have witnessed an increase in the use of web-based e-mail solutions such as MSN Hotmail and Yahoo! Mail. Google's Gmail, a relatively new addition to this market, is becoming increasingly popular, and home users are gradually choosing Gmail as their preferred web-based solution over other solutions. Unlike Hotmail and Yahoo! Mail, which do not support the POP3 mail protocol and are therefore not compatible with e-mail clients, Gmail fully supports POP3 and is compatible with e-mail clients such as IncrediMail®. We believe that IncrediMail will benefit from Gmail's growing popularity, as users are able to access their Gmail accounts via IncrediMail® and are likely to choose this option.
2. The storing of digital photos on personal computers, and on photo hosting sites such as Flickr.com, has increased substantially in recent years. The convenience of such online storage of photos has caused a decrease in usage of regular printed picture albums. However, a problem often experienced by people that store their photos on their hard disk or on a photo-hosting site is that they simply do not enjoy their photos as they had previously. In the past, people spent time looking through their photo albums, but today photos are saved in a computer folder and easily forgotten about or lost. Access to photos saved on personal computers is not immediate and is somewhat tedious; hence, old favorite photos are neglected over time. *PhotoJoy*, which we have completed developing, is aimed to address this problem, by enabling users to enjoy all the photos that they have stored on their computer or online using new capabilities, with no effort from the user. Photos can be revealed on the users' desktop constantly, in more creative and high-quality ways than those available on the web. Some examples of *PhotoJoy's* features are 3D Photo Screensavers showing the users' photos and enriched with a variety of styles and designs, fun desktop widgets that display users' photos in creative and playful ways (nicknamed “PhotoToys”), and Collage Wallpapers presenting photos within various themes, sceneries, and illustrations. In addition, the software lets users take photos stored on other photo web sites (such as Flickr and Picasa) and enjoy them using *PhotoJoy's* fun capabilities.

3. In recent years, we have witnessed an increased use by younger customers of Instant Messaging and various social networks as their preferred means of communication. In May 2008 we launched *HiYo*, a graphic and communication enhancement tool for instant messaging products, which is aimed to enhance the Instant Messaging experience and make it much more enjoyable for today's teens and young adults. *HiYo* offers IncredIMail's high-quality creative content incorporated seamlessly within *Windows Live Messenger*, thus enabling users to customize and personalize their conversations, express themselves and most importantly generate enjoyment from chatting with friends on *Windows Live Messenger*. We believe that *HiYo*, which is aimed to the younger audience, will enable us to effectively reach this significant demographic segment. Since its launch in May 2008, the number of registered downloads has passed 4.5 million.
4. With the growing usage of e-mail as a form of daily communication, Spam has become a major threat to home users, and as a result methods of blocking and avoiding Spam have become commonly used by home users. As e-mail usage is continuing to grow with time, so is the usage of Anti-Spam mechanisms. IncredIMail's subscription-based Anti-Spam tool, *JunkFilter Plus* created especially for IncredIMail's e-mail client, blocks such Spam from entering IncredIMail® >users' Inboxes. As Spam threats are consistently rising, we believe that the need to purchase IncredIMail's Anti-Spam mechanism will sustain the current level of revenue from sales of our *JunkFilter Plus* product.
5. As part of the Company's strategy to focus on its core competencies, we decided in December 2008 to discontinue BizChord's independent activities and restrict its activity to processing the Company's own transactions. As a result we expect to be able to further reduce our operating expenses in 2009.

#### E. OFF-BALANCE SHEET ARRANGEMENTS

We do not have off-balance sheet arrangements (as such term is defined by applicable SEC regulations) that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial conditions, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

#### F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual commitments as of December 31, 2008 and the effect those commitments are expected to have on our liquidity and cash flow in future periods:

Contractual Commitments	Total	Payments Due by Period			
		Less than 1 year	1-3 Years	3-5 Years	More than 5 Years
		<i>(in thousands)</i>			
Accrued severance pay	\$ 1,385				\$ 1,385
Uncertain Income Tax Positions(*)	\$ 1,357				
Operating leases	\$ 1,738	\$ 490	\$ 1,248	\$ -	\$ -
Total	\$ 4,480	\$ 490	\$ 1,248	\$ -	\$ 1,385

(\*) Uncertain income tax positions under FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), are due upon settlement and we are unable to reasonably estimate the ultimate amount or timing of settlement. See Note 9(f) of our Consolidated Financial Statements for further information regarding our liability under FIN No. 48.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth information regarding our executive officers and directors as of May 31, 2009:

Name	Age	Position
Ofer Adler	38	Chief Executive Officer and Director
Yaron Adler	38	Director and President
Dan Blumenfeld	35	Vice President - Marketing
Keren Elkin	34	Vice President - Human Resources and Administration
Tamar Gottlieb	52	Director and Chairperson of the Board
Yuval Hamudot	35	Chief Technologies Officer
Jeff Holzmann	34	Executive Vice President - Delaware subsidiary
David Jutkowitz *	58	External Director, member of Audit Committee
Yacov Kaufman	51	Chief Financial Officer
Arik Ramot	57	Director, member of the Audit Committee
Yair M. Zadik	52	Director, member of Audit Committee

\* "Independent" for Nasdaq Stock Market purposes.

Ofer Adler and Yaron Adler are cousins. There are no other familial relationships among our executive officers and directors. Yair M. Zadik was initially appointed to the board by our founders, Ofer Adler and Yaron Adler, pursuant to provisions of the articles of association that were in effect prior to our initial public offering. Tamar Gottlieb was initially appointed to the board by the board of directors, and David Jutkowitz were elected to serve as our external directors by our shareholders as required by Israeli law. No shareholder has special voting rights with respect to the election of directors or otherwise.

*Ofer Adler* co-founded Incredimail and has been our Chief Product Officer and a director since our incorporation. Since February 5, 2008 Ofer Adler serves as the Company's Chief Executive Officer. As a Chief Executive Officer he is responsible for our day-to-day operations, business development and the overall management of Incredimail. As a Chief Product Officer he had overall responsibility for the design and development of Incredimail products, website and graphic content. Mr. Adler had direct responsibility for the design of all major Incredimail applications and websites. Before co-founding Incredimail, Mr. Adler worked as a trader and portfolio manager at Clal Insurance from 1997 to 1999, and as a trader and technical analysis expert at Batucha, Israel's largest private brokerage firm, from 1994 to 1997.

*Yaron Adler* co-founded Incredimail in November 1999. Has served as a director since our incorporation, as our Chief Executive Officer since our incorporation and until February 5, 2008, and since February 5, 2008 serves as the Company's President. In 1999, prior to founding Incredimail, Mr. Adler consulted Israeli startup companies regarding Internet products, services and technologies. Mr. Adler served as a Product Manager from 1997 to 1999, and as a software engineer from 1994 to 1997, at Tecnomatix Technologies Ltd., a software company that develops and markets production-engineering solutions to complex automated manufacturing lines that fill the gap between product design and production, and which was acquired by UGS Corp. in April 2005. In 1993, Mr. Adler held a software engineer position at Intel Israel. He has a B.A. in computer sciences and economics from Tel-Aviv University.

*Dan Blumenfeld* joined us in May 2004 and serves as our Vice President – Marketing. He is responsible for in-depth analysis of our market and industry, implementation of appropriate market positioning, development of pricing and overall marketing strategies. Prior to joining us Mr. Blumenfeld gained more than ten years experience, working primarily as a Product Manager or a Creative Manager, in planning, designing and marketing of computer software in several positions including at Hotbar Ltd. from 2003 to 2004, at DVDemand Ltd. from 2000 to 2003 and at Waves Ltd. from 1997 to 1999.

*Keren Elkin* has been the Vice President of HR and Administration since 2000. She is responsible for the planning, recruitment, organizational development, training, compensation, benefits, and social activities of company personnel. Keren also served as Incredimail's Purchase Manager for several years. Keren Elkin holds a B.A. in Business Administration, majoring in Human Resources, from Ruppin College.

*Tamar Gottlieb* has served as our director since 2001 and became Chair of the Board of Directors on February 3, 2006, the closing date of our initial public offering. She is a Managing Director of Harvest Capital Markets Ltd., an investment banking and financial consulting firm that she founded in January 2001. Prior to 2001, Ms. Gottlieb held Managing Director or Senior Manager positions in several investment banking institutions, including Investec Clali – Management & Underwriting Ltd. (from July 1997 to January 2001), Oscar Gruss (1996) Ltd. (from February 1996 to May 1997) and Leumi & Co. Investment Bankers Ltd. (from 1980 to 1991). From August 1991 to June 1994, Ms. Gottlieb served as the Founding Managing Director of Maalot – The Israeli Securities Rating Company Ltd., Israel's first credit rating agency. She currently serves as a board member of several Israeli public and private companies, including Emilia Development Ltd., Leumi Mortgage Bank Ltd., Hasin-Esh Ltd., N.R. Spuntech Industries Ltd., Reit 1 Ltd. and T.R.A Radio Tel Aviv Ltd. In the past she has also served as a director of, among others, El Al Israeli Airlines Ltd. and "Dan" the Company for Public Transport Ltd. Ms. Gottlieb public service activities include serving as a member of the Statutory Committee for the approval of Directors and General Managers of Israeli Government Companies and Statutory Authorities and until 2007 as a member of the Advisory Committee to the Israeli Anti-Trust Authority. Ms. Gottlieb has a B.A. in international relations from the Hebrew University of Jerusalem and an M.A. in economics from Indiana University.

*Yuval Hamudot* is our Chief Technology Officer since March 2007, and is responsible for the technological design and development of our products and online system. In that capacity he manages our research and development team as well as our quality assurance and information technology departments. Mr. Hamudot joined us in 2000, and since 2003, and until his recent appointment, was Vice President – Research and Development. Prior to joining us, Mr. Hamudot worked for two years in the research and development at Commonsense Ltd., a software company that outsourced hi-end technology solutions. Mr. Hamudot served in the IDF computer unit ("Mamram") and has a B.Sc. in Computer Science from Tel Aviv University and an M.B.A. from Bar-Ilan University.

*Jeff Holzmann* was engaged as Executive Vice President and General Manager of Incredimail USA in April 2006. Prior to joining Incredimail Mr. Holzmann was the CEO of Genius Technologies, a high tech venture capital fund. Mr. Holzmann also served as the CEO of GREY Interactive in Israel, an interactive advertising agency, as Vice Chairman of the board of M.L.L Software (TASE:MLL), an Israeli publicly traded IT software company, and a director with a venture capital fund at Koor Technologies (NYSE:KOR), an Israeli publicly traded holding company. Mr. Holzmann is a certified systems analyst and holds a B.A. in Business Administration and Information Technologies from the Interdisciplinary Center Herzliya.

*David Jutkowitz* was elected to serve as an "external director" at our shareholders meeting on December 27, 2007. David Jutkowitz serves as a director of Arad Investment and Industrial Development since 2006. From 2001 until October 2007, Mr. Jutkowitz has served as an external director of Carmel Investment Group Ltd., and was a member of the audit, investment and portfolio committees of Carmel Investment Group Ltd. Between 2000 and 2003, Mr. Jutkowitz held the position of CEO at BXS Ltd., where his responsibilities included managing all stages in development of the business, including the raising of funds from investors and building a local and international distribution. From 1995 until 2002, Mr. Jutkowitz held the position of CEO at E.L. Advanced Science Ltd., where his responsibilities included identifying and acquiring appropriate companies and taking an active part in the management of such companies. From 1976 to 2001, Mr. Jutkowitz held the position of CFO at Etz Lavud Ltd.

*Yacov Kaufman* was engaged to serve as our Chief Financial Officer in 2005. From 1996 to November 2005, Mr. Kaufman was the Chief Financial Officer of Data Systems & Software Inc. (OTCBB: DSSI.OB) that, through its subsidiaries, provides software consulting and development services and serves as an authorized dealer and a value-added-reseller of computer hardware. At Data Systems, Mr. Kaufman established and subsequently managed the accounting and financial departments of the company and its subsidiaries. His responsibilities included financial analysis and implementation of procedures for internal control over financial reporting. Mr. Kaufman also served as the comptroller of dsIT Technologies Ltd., a subsidiary of Data Systems since 1986 and as its Chief Financial Officer since 1990. From 1993 to 1999, Mr. Kaufman served as a director of Tower Semiconductor Ltd. (Nasdaq: TSEM), an integrated circuits manufacturer and then subsidiary of Data Systems & Software Inc. Mr. Kaufman is an Israeli Certified Public Accountant and has a B.A. in accounting and economics from the Hebrew University of Jerusalem and an M.B.A. in business finance from Bar-Ilan University.

*Mr. Arik Ramot* was elected as a director at our annual meeting of shareholders held on December 24, 2008. Mr. Ramot is the founder and has been the CEO of Ramot & Co, Investment House since 1996. From 1988 to 1996, Mr. Ramot served as legal advisor and manager at Kaszierer International, working in more than 20 countries. Prior to that, Mr. Ramot practiced law in Israel. Mr. Ramot is also the founder of Hayoman Ltd., an Israeli internet company. Mr. Ramot holds LLB and LLM degrees from Tel Aviv University.

*Yair M. Zadik* has served as our director since 2001. He is the Co-Chief Executive Officer of Arrow Ecology & Engineering Overseas (1999) Ltd., a company that provides environmental solutions, and of Eshet Y.E.Z Technologies (2001) Ltd., an investment company. In 2000 Mr. Zadik founded B-Knowledge Investments Ltd., an investment company, and has served as its Chief Executive Officer until 2001. He currently serves as a board member of the Israeli Export Institute, Environmental Branch. Mr. Zadik has a B.Sc. in physics and computer sciences from Bar Ilan University. He is a Colonel (Reserve) in the Israeli Air Force. He is the recipient of the Israeli Presidential National Defense Award for his leadership and management of a major defense project in the Ministry of Defense as well as a recipient of numerous military decorations.

## **B. COMPENSATION**

The aggregate direct compensation we paid to our officers as a group (eight persons) for the year ended December 31, 2008 was approximately \$2 million, which included approximately \$0.7 million that was set aside or accrued to provide for pension, retirement, severance or similar benefits. This amount does not include expenses we incurred for other payments, including dues for professional and business associations, business travel and other expenses, and other benefits commonly reimbursed or paid by companies in Israel. We did not pay our officers who also serve as directors any separate compensation for their directorship during 2008, other than reimbursements for travel expenses.

The aggregate direct compensation we paid to our directors who are not officers for their services as directors as a group (five of the seven directors who served during 2007) for the year ended December 31, 2008 was approximately \$445 thousand. Directors are also reimbursed for expenses incurred in order to attend board or committee meetings.

As of May 31, 2009, there were outstanding options to purchase 691,400 ordinary shares granted to eleven of our directors and officers, at a weighted average exercise price of \$4.1 per share. These options were granted under our 2003 employees share option plan.

The compensation of our directors who are not officers of our Company, including our external directors, was approved by our audit committee, board of directors and shareholders. In accordance with these resolutions, (i) annual gross compensation for independent directors is \$25,000, and \$500 per meeting, while other directors, who are not officers, receive \$18,000, and \$500 per meeting (plus V.A.T, if applicable) to be paid in four equal quarterly installments; (ii) a grant of options to purchase 10,000 of our ordinary shares, with the following terms: (a) each option shall be exercisable for one ordinary share at an exercise equal to the closing price on the date of grant of the options, as reported by the Nasdaq Capital Market; (b) the options shall vest in four equal parts; and (c) any and all other terms and conditions pertaining to the grant of the options shall be in accordance with, and subject to, the "2003 Israeli Share Option Plan" adopted by IncrediMail in 2003 and our standard Option Agreement executed by each director and by IncrediMail promptly after the date of grant.

In accordance with the shareholders approval of December 27, 2007 each of the directors who is not an employee of the Company, receives for each year of service by such person as a director of the Company, an option to purchase 10,000 Ordinary Shares of the Company (in this subsection – the "Annual Grant"), under the following terms: (a) the Annual Grant shall be made immediately following the annual general meeting of the shareholders of the Company in the relevant year, commencing with the shareholders meeting held on December 27, 2007; (b) each option shall be exercisable for one Ordinary Share at an exercise price equal to the closing price of an Ordinary Share on the date of the annual general meeting of the shareholders of the Company upon which such option was granted, as reported by the Nasdaq Global Market; and (c) the options shall vest in four equal portions on each anniversary of the Annual Grant, commencing with the first anniversary. Any and all other terms and conditions pertaining to the grant of the options shall be in accordance with, and subject to, the 2003 Israeli Share Option Plan adopted by IncrediMail in 2003 and our standard Option Agreement. In accordance with this resolution, all directors that are not officers were granted 10,000 options on December 24, 2008 after the 2008 annual general meeting.

On December 27, 2007, and following approval by our audit committee and board of directors, our shareholders approved a grant to each of Mr. Ofer Adler and Mr. Yaron Adler, of options to purchase 50,000 Ordinary Shares of the Company, under the following terms: (a) each option shall be exercisable for one Ordinary Share at an exercise price equal to the closing price of an Ordinary Share on December 27, 2007, as reported by the Nasdaq Global Market; and (b) the options shall vest in four equal portions on each anniversary of the date of approval of the grant, commencing with the first anniversary. Any and all other terms and conditions pertaining to the grant of the options hereunder shall be in accordance with, and subject to, the 2003 Israeli Share Option Plan adopted by the Company in 2003 and the Company's standard Option Agreement<sup>1</sup>. See "Item 6.E Share Ownership – Employee Benefit Plans – The 2003 Plan" below.

On July 17, 2008, and following approval by our audit committee and board of directors, our shareholders approved a grant to Ms. Tamar Gottlieb of options to purchase 10,000 Ordinary Shares of the Company, under the following terms: (a) each option shall be exercisable for one Ordinary Share at an exercise price equal to the closing price of an Ordinary Share on July 17, 2008, as reported by the Nasdaq Global Market; and (b) the options shall vest in three equal portions on each anniversary of the date of approval of the grant, commencing with the first anniversary. Any and all other terms and conditions pertaining to the grant of the options hereunder shall be in accordance with, and subject to, the 2003 Israeli Share Option Plan adopted by the Company in 2003 and the Company's standard Option Agreement. See "Item 6.E Share Ownership – Employee Benefit Plans – The 2003 Plan" below.

Also on July 17, 2008, following approval by our audit committee and board of directors, our shareholders approved a re-pricing of options to purchase Ordinary Shares, previously granted to Mr. Yaron Adler, the Company's President and a member of the board of directors of the Company, such that the exercise price of any previously granted options that exceeded \$3.00 per Ordinary Share were reduced to \$3.00 per share. The Company undertook to re-price Mr. Adler's options as part of the terms of service of Mr. Yaron Adler as the Company's President, which terms were approved at the shareholders meeting of the Company held on April 9, 2008. On June 2, 2009, we provided notice to our shareholders of an extraordinary general meeting to, among other things, vote on amendments to the terms of options granted to the external directors and the directors of the Company. The meeting is scheduled to be held on July 9, 2009 with such terms as provided in the Notice of Meeting filed on Form 6-K with the SEC. If the proposals relating to compensation of our directors are approved, our directors' recurring annual stock option grants will have a vesting period of three years (instead of four years) from the date of their annual stock option grant. Also, upon termination or expiration of the applicable director's service with the Company, provided that the termination or expiration is not "for Cause" and not resulting from the director's resignation, the stock options granted to such director shall retain their original termination dates, and shall not terminate 90 days after the applicable termination date, and the next upcoming tranche of stock options, of each grant, that are scheduled to vest immediately subsequent to the termination date, if any, shall automatically vest and become exercisable immediately prior to the termination date. In addition, to avoid a possible conflict of interest while discussing a Change of Control of the Company (which may result in the termination of the director's term of office), all unvested options held by the director, shall automatically vest and become exercisable upon such "Change of Control" event. "Change of Control" is defined for these purposes as: (i) merger, acquisition or reorganization of the Company with one or more other entities in which the Company is not the surviving entity, (ii) a sale of all or substantially all of the assets of the Company; (iii) a transaction or a series of related transactions as a result of which more than 50% of the outstanding shares or the voting rights of the Company are held by any party (whether directly or indirectly).

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<sup>1</sup> The 50,000 options granted to Yaron Adler shall remain in full force and effect in accordance with the terms of the Option Agreement following the execution of the Amended Agreement. According to the Amended Agreement, despite anything to the contrary contained in the Option Agreement or in the Company's 2003 Share Option Plan, if Yaron Adler's employment with the Company is terminated for any reason prior to the date on which all of the options have become fully vested, the vesting of all of the unvested options shall be immediately accelerated and all of such unvested options shall become fully vested and exercisable in accordance with their terms. In addition, upon the termination of Yaron Adler's employment with the Company for any reason, the expiration date of the options shall be extended to 12 months following the date of such termination. In the event that the Company shall re-price downwards the exercise price of the options granted by it to its executive officers, the Company shall treat the options equally and shall re-price downwards the exercise price of the options to the same new exercise price of the options held by its executive officers. The Amended Agreement was approved by the shareholders at the Extraordinary General Shareholder meeting held on April 9, 2008.

## C. BOARD PRACTICES

### Board of Directors and Executive Officers

We are deemed a “limited liability public company” under the Israeli Companies Law. As a limited liability public company, we are managed by a board of directors and by our executive officers. Under the Israeli Companies Law and our articles of association, the board of directors is responsible, among other things, for:

- establishing our policies and overseeing the performance and activities of our chief executive officer;
- convening shareholders' meetings;
- preparing and approving our financial statements;
- determining our plans of action, principles for funding them and the priorities among them, our organizational structure and wage policy and examining our financial status;
- issuing securities and distributing dividends.

Our board of directors also appoints and may remove our chief executive officer and may appoint or remove other executive officers, subject to any rights that the executive officers may have under employment agreements.

Upon the closing of our initial public offering (meaning, January 30, 2006), all previously existing special rights to appoint or serve as directors had terminated and our articles of association were amended to remove these special rights.

Our board of directors generally consists of seven directors, two of whom qualify as “external directors” for Israeli law purposes and have been determined by our board of directors to qualify as “independent” for Nasdaq Stock Market Purposes as well. Other than external directors, who are subject to special election requirements under Israeli law, our directors are elected in three staggered classes by the vote of a majority of the ordinary shares present and entitled to vote at meetings of our shareholders at which directors are elected. The members of only one staggered class will be elected at each annual meeting for a three-year term, so that the regular term of only one class of directors expires annually. At our annual general meeting held in 2007, the term of the second class, consisting of Ofer Adler and Yair M. Zadik, expired and they were re-elected at that meeting for a three-year term. At our annual general meeting held in 2008, the term of the third class, consisting of Gittit Guberman, expired and she did not stand for reelection. Arik Ramot was elected in her place for a three-year term. At our annual general meeting to be held in 2009, the term of the first class, consisting of Tamar Gottlieb and Yaron Adler, will expire and the directors elected at that meeting will be elected for a three-year term. The external directors will not be assigned a class and will serve in accordance with Israeli law. On March 30, 2009 the term of one of our external directors, Mr. James H. Lee, expired. Since then the board of directors consists of six directors, only one of whom qualifies as an external director. The Company has scheduled an extraordinary shareholder meeting for approving the nomination of another director that qualifies as an external director. See Item 4.A. – “Recent Developments”.

If the number of directors constituting the board is changed, any increase or decrease shall be apportioned among the classes so as to maintain the number of directors in each class as nearly equal as possible, but in no case will a decrease in the number of directors constituting the board shorten the term of any incumbent director.

The board may appoint any other person as a director, whether to fill a vacancy or as an addition to the then current number of directors, provided that the total number of directors shall not at any time exceed seven directors. Any director so appointed shall hold office until the annual general meeting of our shareholders at which the term of his or her class expires, unless otherwise stated in the appointing resolution.

There is no limitation on the number of terms that a director may serve. As described below, external directors may serve two terms of three years each and, subject to certain conditions, an unlimited number of subsequent three-year terms.

Nominations for the election of directors may be made by our board of directors in view of the recommendation of the nominating and governance committee or, subject to the Companies Law, by any of our shareholders. However, any shareholder or shareholders holding at least 5% of the voting rights in our issued share capital may nominate one or more persons for election as directors at a general meeting only if a written notice of such shareholder’s intent to make such nomination or nominations has been given to our secretary and each such notice sets forth all the details and information as required to be provided under our articles of association.

Shareholders may remove a director who is not an external director from office only by a resolution approved by shareholders holding more than two-thirds of the voting power of the issued and outstanding share capital of IncrediMail.

The board of directors appoints its chairperson from among its members in accordance with our articles of association and subject to the provisions of the Companies Law. Pursuant and subject to our articles of association, the chairperson convenes and presides over the meetings of the board. The quorum required for meetings of the board is a majority of the members of the board who are lawfully entitled to participate and vote at the meeting, and resolutions are approved by a vote of the majority of the members present. If the board of directors meeting is adjourned for failure to obtain a quorum and at the adjourned meeting a quorum is not present, then the quorum shall be constituted by the presence of two directors then in office who are lawfully entitled to participate and vote at that meeting. A director may appoint an alternate director to attend a meeting in his or her place, but an alternate director so appointed must be approved by the board prior to the relevant meeting.

Pursuant to the requirements of the Israeli Companies Law, our board has determined that at least one of our directors must have accounting and financial expertise (in addition to the external director that must have accounting and finance expertise). In determining such number of directors, the board considered, among other things, the business of our Company, our size and the scope and complexity of our operations. Such determination also took into account our total number of directors as set forth in the articles of association in accordance with the Israeli Companies Law.

We have agreed to permit a designee of Maxim Group, the lead underwriter of our initial public offering, for a period of no less than three years following the completion of the Company's public offering and subject to certain exceptions, to be an observer on our board of directors. The observer may attend meetings of the board and shall receive all notices and other correspondence and communications sent by us to members of our board of directors. Such observer shall be entitled to reimbursement for costs as provided to the other members of our board of directors. Maxim Group has not yet designated an observer.

Each of our executive officers serves at the discretion of our board of directors and holds office until his or her successor is elected or his or her earlier resignation or removal.

#### **External Directors**

Under the Israeli Companies Law, Israeli companies whose shares have been offered to the public in or outside of Israel are required to appoint at least two external directors to serve on their board of directors for a three year term. Mr. James H. Lee was appointed as an external director on March 30, 2006 and his term expired on March 30, 2009. In addition Mr. David Jutkowitz was appointed as an external director on December 27, 2007, in for three years. The Company has scheduled an extraordinary shareholder meeting for approving the nomination of another director that qualifies as an external director in place of Mr. Lee. See Item 4.A. – "Recent Developments".

Each committee of the board of directors entitled to exercise any powers of the board is required to include at least one external director. The audit committee must include all the external directors.

An amendment to the Israeli Companies Law in January 2006 provides that a person may be appointed as an external director if he or she has professional qualifications or if he or she has accounting and financial expertise. In addition, at least one of the external directors must have accounting and financial expertise. A person may not serve as an external director if at the date of his or her appointment or within the prior two years, that person, or his or her relatives, partners, employers or entities under his or her control, have or had any affiliation with us or any entity or person controlling us at the time of appointment or an entity that is controlled, at the time of appointment or the prior two years, by us or by the person or entity controlling us. Under the Companies Law, "affiliation" is defined in this context to include an employment relationship, a business or professional relationship maintained on a regular basis, control or service as an office holder. However, the service of a director who was appointed for the purpose of being an external director in a company that intends to first offer its shares to the public is not considered a prohibited affiliation. An office holder is defined in the Companies Law as any director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of these positions regardless of that person's title.

A person may not serve as an external director if that person's position or other activities create, or may create, a conflict of interest with the person's service as a director or may otherwise interfere with the person's ability to serve as a director. If at the time any external director is appointed, all members of the board are the same gender, then the external director to be appointed must be of the other gender.

External directors are elected by a majority vote at a shareholders' meeting, as long as either:

- the majority of shares voted for the election includes at least one-third of the shares of non-controlling shareholders voted at the meeting (excluding abstaining votes); or

- the total number of shares of non-controlling shareholders voted against the election of the external director does not exceed one percent of the aggregate voting rights in the company.

The Israeli Companies Law provides for an initial three-year term for an external director, which may be extended for one additional three-year term. Thereafter (with respect to companies whose securities are listed on certain designated stock exchange, including the Nasdaq Global Market), he or she may be reelected by our shareholders for additional periods of up to three years each, in each case provided that the audit committee and the board of directors confirm that, in light of the external director's expertise and special contribution to the work of the board of directors and its committees, the reelection for such additional period(s) is beneficial to the company. External directors may be removed only:

- by a court, and then only if
  - the external directors cease to meet the statutory qualifications for their appointment;
  - they violate their duty of loyalty to the company;
  - the director is unable to perform his or her post on a regular basis; or
  - during his or her tenure, the director was convicted in a court outside of the State of Israel on accounts of bribery, deceit, offenses by managers of a corporate body or offenses involving misuse of inside information; or
- If the board of directors determines that the external director has ceased to meet the statutory qualification for appointment or that the external director has violated his or her duty of loyalty to the company, the board shall call a general meeting of the shareholders and any such external director may be removed for such reason(s) by a resolution of the general meeting approved by the same special majority as required for such external director's election.

In the event of a vacancy created by an external director, our board of directors is required under the Companies Law to call a shareholders' meeting to appoint a new external director as soon as practicable.

External directors may be compensated only in accordance with regulations adopted under the Israeli Companies Law. The regulations provide three alternatives for cash compensation to external directors: a fixed amount determined by the regulations, an amount within a range set in the regulations, or an amount that shall not be lower than the compensation received by another director nor higher than the average compensation to other directors. "Another" or "other" directors are defined in the applicable regulations as directors of the company that are not external directors and who are not (1) controlling shareholders of the company or (2) employees or service providers of the company on a regular basis or (3) serving at, or providing services on a regular basis, to a company that controls the company or to a company that is under common control with the company or (4) directors who do not receive compensation from the company. A company also may issue shares or options to an external director at an amount not lower than that received by another director (as defined in the applicable regulations) nor higher than the average amount granted to other directors (as defined in the applicable regulations). Cash compensation at the fixed amount determined by the regulations does not require shareholder approval. Compensation determined in any other manner requires the approval of the company's audit committee, board of directors and shareholders, in that order. Compensation of external directors must be determined prior to their consent to serve as external directors.

#### **Nasdaq Market Governance Requirements for Foreign Private Issuers**

Assuming that we maintain our status as a foreign private issuer, under the Nasdaq Market Rules, a foreign private issuer may generally follow its home country rules of corporate governance except for certain matters such as composition of the audit committee (as discussed below). Nasdaq Marketplace Rules specify that the board of directors must contain a majority of independent directors and that the independent directors must have regularly scheduled meetings at which only independent directors are present. Our board contains two independent directors in accordance with the provisions contained in Sections 239-249 of the Israeli Companies Law – 1999 and Rule 10A-3 of the general rules and regulations promulgated under the Securities Act of 1933, rather than a majority of independent directors. Israeli law does not require, nor do our independent directors conduct, regularly scheduled meetings at which only they are present. See "Item 10.B Memorandum and Articles of Association – Nasdaq Marketplace Rules and Home Country Practices" and "Item 16G – Corporate Governance" for a summary of the significant ways in which our corporate governance practices follow the requirements of Israeli law rather than Nasdaq governance requirements for domestic companies. Investors are cautioned that there are other Nasdaq governance requirements with which, as a foreign private issuer, we may elect not to comply. If we so elect, we will provide disclosure of any Nasdaq governance requirements we elect not to comply with in accordance with Nasdaq's disclosure requirements, as may be in effect from time to time.

## **Committees of the Board of Directors**

Our board of directors has established an audit committee, a compensation committee and a nominating and governance committee.

### ***Audit Committee***

Our audit committee is comprised of David Jutkowitz and Arik Ramot and operates pursuant to a written charter. The second external director will be a member of the Audit Committee upon being elected by our shareholders at our extraordinary general meeting. See Item 4.A. – “Recent Developments”.

### ***Nasdaq Requirements***

Under the listing requirements of the Nasdaq Stock Market, a foreign private issuer is required to maintain an audit committee that has certain responsibilities and authority (such as being directly responsible for the appointment, compensation, retention and oversight of the work of the issuer’s public accountants). In addition, applicable Nasdaq Marketplace Rules require that a foreign private issuer can maintain an audit committee that meets the requirements of Rule 10A-3(b)(subject to the exemptions provided in Rule 10A-3(c)) under the Exchange Act, instead of an audit committee composed solely of independent directors. We currently maintain a board of audit in accordance with Israeli home country regulations, meeting these requirements of Rule 10A-3, in that our audit committee complies with the requirements under Israeli law. We are currently have scheduled a extraordinary general meeting to elect an external director in place of one whose term has expired. See Item 4.A. – “Recent Developments”.

### ***Israeli Companies Law Requirements***

Under the Israeli Companies Law, the board of directors of a public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the external directors. The audit committee may not include the chairman of the board, any director employed by the company or providing services to the company on an ongoing basis, a controlling shareholder or any of the controlling shareholder’s relatives.

The audit committee provides assistance to the board of directors in fulfilling its legal and fiduciary obligations in matters involving our accounting, auditing, financial reporting, internal control and legal compliance functions by approving the services performed by our independent accountants and reviewing their reports regarding our accounting practices and systems of internal accounting controls. The audit committee also oversees the audit efforts of our independent accountants and takes those actions as it deems necessary to satisfy itself that the accountants are independent of management. Under the Israeli Companies Law, the audit committee is also required to monitor and approve remedial actions with respect to deficiencies in the administration of the company, including by consulting with the internal auditor and recommend remedial actions with respect to such deficiencies, and to review and approve related party transactions.

### ***Compensation Committee***

As a foreign private issuer, we comply with our home country regulations with respect to compensation committee. Under Israeli Companies Law, independent members of our board are not required to determine the compensation of an executive officer, provided that the executive officer does not serve on our board. Therefore our practices differ from those under Nasdaq Marketplace Rules applicable to domestic issuer which require a determination by a majority of the independent directors on the board or a compensation committee comprised solely of independent directors. Our compensation committee is comprised of Tamar Gottlieb and Yair M. Zadik, and operates pursuant to a written charter. The compensation committee will make recommendations to the board of directors regarding the issuance of employee share options under our share option and benefit plans and will determine salaries and bonuses for our chief executive officer and our other executive officers and incentive compensation for our other employees.

### *Nominating and Governance Committee*

Our nominating and governance committee is comprised of Tamar Gottlieb and Yair M. Zadik, and operates pursuant to a written charter. It is responsible for making recommendations to the board of directors regarding candidates for directorships and the size and composition of the board. In addition, the committee is responsible for overseeing our corporate governance guidelines and reporting and making recommendations to the board concerning corporate governance matters. Under Israeli Companies Law, the nominations for director are generally made by our directors but may be made by one or more of our shareholders. However, any shareholder or shareholders holding at least 5% of the voting rights in our issued share capital may nominate one or more persons for election as directors at a general meeting only if a written notice of such shareholder's intent to make such nomination or nominations has been given to our secretary and each such notice sets forth all the details and information as required to be provided under our articles of association.

### **Internal Auditor**

Under the Israeli Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is to examine whether a company's actions comply with the law and proper business procedure. The internal auditor may be an employee of the company employed specifically to perform internal audit functions but may not be an interested party or office holder, or a relative of any interested party or office holder, and may not be a member of the company's independent accounting firm or its representative. The Israeli Companies Law defines an interested party as a holder of 5% or more of the shares or voting rights of a company, any person or entity that has the right to nominate or appoint at least one director or the general manager of the company or any person who serves as a director or as the general manager of a company. The internal auditor shall not be terminated without his or her consent, nor shall he or she be suspended from such position unless the board of directors has so resolved after hearing the opinion of the audit committee and after giving him or her opportunity to present his or her case to the board and to the audit committee. In August 2006 the Board of Directors approved the appointment of the firm of Yardeni-Gelfand as internal auditor of the Company, and they have been acting as such since.

### **Certain Employment Agreements with Directors**

We have entered into employment agreements, effective February 3, 2006, with our co-founder, Chief Executive Officer and Chief Product Officer, Ofer Adler, and our co-founder and President, Yaron Adler, to retain their continuing services. The employment agreements do not provide for a specified term and may be terminated by either party upon ninety days' prior notice. Upon termination by us of the employment of either of these executives other than for "cause" (as set forth in the agreements), we are required to continue to pay the terminated executive his salary, benefits and bonus until the end of the 90 day notice period. However, we will have the option to pay the terminated executive a lump sum equal to all amounts due as of the notice date. As required by Israeli law, we will also remit severance payment to the terminated executive in an amount equal to one month's salary for each year of employment with us following the first year of employment (and a pro rata portion of such monthly salary for each portion of a year of employment following the first year of employment). Such amount of severance payment will be remitted to the executives even if they voluntarily terminate their employment with us. In the event that we terminate the employment of either of Mr. Yaron Adler or Mr. Ofer Adler for "cause," we will not be required to give prior notice and/or to pay the executive severance payment, except for payment required by Israeli law. In the event that the executive resigns without giving the required notice period, we may deduct from the money that we owe the executive an amount equal to the wages to which he would have been entitled had he worked during the notice period.

On February 5, 2008, the board of directors of the Company has resolved to appoint Mr. Yaron Adler as the Company's President, and approved the amendment to Mr. Yaron Adler's Employment Agreement, which was subsequently approved by our Shareholders at an Extraordinary General Meeting held on April 9, 2008 (the "**Amended Agreement**"). According to the Amended Agreement in rendering the services of President, as set forth below, Mr. Yaron Adler shall be subordinate to the Company's Chief Executive Officer. The Company shall have the right to terminate the Amended Agreement at any time by providing Yaron Adler with a 30 days prior notice of termination, provided however, that the Company may not provide Yaron Adler with such prior notice before July 1, 2008. In the event that the Company shall provide Yaron Adler with a notice of termination of the Amended Agreement after July 1, 2008 but prior to May 1, 2009, the Company and Yaron Adler shall enter into an alternative employment agreement pursuant to which Yaron Adler shall provide the Company with consulting services on terms similar to the terms of the Amended Agreement (but in which Yaron Adler shall not be the Company's President), which agreement may be terminated by the Company upon a 30 days prior notice which may be provided on or after (but in no event before) April 1, 2009. Yaron Adler may terminate the Amended Agreement at any time upon providing the Company with a 30 days prior notice. Upon termination of Yaron Adler's employment with the Company, by either party, Yaron Adler shall be entitled to all social benefits, including among others, severance payment in accordance with applicable law, from the date of Yaron Adler's first day of employment with the Company until the date of termination of his employment.

Ofar Adler has agreed not to compete with us during the term of the agreement and for a period of two years thereafter and Yaron Adler agreed to do so during the term of the Amended Agreement and for a period of one year thereafter. The agreements also contain customary confidentiality and intellectual property assignment provisions.

We also have existing employment agreements with our other executive officers. These agreements do not contain any change of control provisions and otherwise contain salary, benefit and non-competition provisions that we believe to be customary in our industry.

#### D. EMPLOYEES

As of December 31, 2008 we had 119 employees, including 118 employees based in Israel and 1 employee based in the US. The breakdown of our employees by department and fiscal period is as follows:

	December 31,		
	2006	2007	2008
Management and administration	9	17	16
Support and creative	25	32	21
Research and development	52	68	64
Selling and marketing	15	31	18
<b>Total</b>	<b>101</b>	<b>148</b>	<b>119</b>

Some provisions of the collective bargaining agreement between the Histadrut, which is the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialist's Association of Israel, apply to our Israeli employees by virtue of extension orders of the Israeli Ministry of Industry, Trade and Labor. These provisions concern the length of the workday and the work-week, recuperation pay and commuting expenses, compensation for working on the day before and after a holiday and payments to pension funds. Furthermore, these provisions provide that the wages of most of our employees are adjusted automatically. The amount and frequency of these adjustments are modified from time to time. Additionally, pursuant to an expansion order, dated as of May 7, 2006, which applies to the software field we are required to insure all of our employees by a comprehensive pension plan or a senior employees' insurance according to the terms and the rates detailed in the order. In addition, Israeli law determines minimum wages for workers, minimum paid leave or vacation, sick leave, working hours and days of rest, insurance for work-related accidents, determination of severance pay, the duty to give notice of dismissal or resignation and other conditions of employment. In addition, certain laws prohibit or limit the employer's ability to dismiss its employees in special circumstances. We have never experienced a work stoppage, and we believe our relations with our employees are good.

Israeli law generally requires the payment of severance by employers upon the retirement or death of an employee or termination of employment. The Company's agreements with employees in Israel, joining the Company since February 2, 2008, are in accordance with section 14 of the Severance Pay Law -1963, whereas, the Company's contributions for severance pay shall be instead of its severance liability. Upon contribution of the full amount of the employee's monthly salary, and release of the policy to the employee, no additional calculations shall be conducted between the parties regarding the matter of severance pay and no additional payments shall be made by the Company to the employee. Further, the related obligation and amounts deposits on behalf of such obligation are not stated on the balance sheet, as they are legally released from obligation to employees once the deposit amounts have been paid.

We currently fund most of our ongoing severance obligations through insurance policies. As of December 31, 2008, our net accrued unfunded severance obligations totaled \$0.4 million.

Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute. These amounts also include payments for national health insurance. The payments to the National Insurance Institute can equal up to approximately 16.0% of wages, of which the employee contributes approximately 10.0% and the employer contributes approximately 6.0%.

## E. SHARE OWNERSHIP

### Security Ownership of Directors and Executive Officers

The following table sets forth information regarding the beneficial ownership of our ordinary shares as of May 31, 2009 by:

- each of our executive officers;
- each of our directors; and
- all of our directors and officers as a group.

Beneficial ownership of shares is determined in accordance with the rules of the SEC and generally includes any shares over which a person exercises sole or shared voting or investment power. Ordinary shares that are subject to warrants or stock options that are presently exercisable or exercisable within 60 days of a specified date are deemed to be outstanding and beneficially owned by the person holding the stock options for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage of any other person.

Except as indicated in the footnotes to this table, each shareholder in the table has sole voting and investment power for the shares shown as beneficially owned by them. Percentage ownership is based on 9,259,949 ordinary shares outstanding on May 31, 2009.

Name	Number of Ordinary Shares Beneficially Owned	Percentage of Ordinary Shares Outstanding
Ofer Adler (1)	2,149,072	23.18%
Yaron Adler (2)	1,410,933	15.16%
Yair M. Zadik (3)	126,800	1.4%
Tamar Gottlieb (4)	126,634	1.4%
Yuval Hamudot (5)	97,500	1.1%
Yacov Kaufman (6)	79,500	*
Dan Blumenfeld (7)	55,500	*
Jeff Holzmann (8)	26,500	*
Keren Elkin (9)	20,916	*
David Jutkowitz (10)	2,500	*
All directors and officers as a group (11 persons) (11)	4,095,855	42.4%

\* Represents less than one percent.

- (1) Includes options to purchase 12,500 ordinary shares at an exercise price of \$5.21 per share, exercisable within 60 days of this Annual Report.
- (2) Includes options to purchase 50,000 ordinary shares at an exercise price of \$3.00 per share, exercisable within 60 days of this Annual Report.
- (3) Includes options to purchase 60,000 ordinary shares at an exercise price of \$7.86 per share and 2,500 ordinary shares at an exercise price of \$5.21 per share, exercisable within 60 days of this Annual Report.
- (4) Includes options to purchase 60,000 ordinary shares at an exercise price of \$7.86 per share, 2,500 ordinary shares at an exercise price of \$5.21 per share and 3,334 at an exercise price of \$2.30 per share, exercisable within 60 days of this Annual Report.
- (5) Includes options to purchase 7,600 ordinary shares at an exercise price of \$1.72 per share, options to purchase 12,500 ordinary shares at an exercise price of \$3.00 per share and 10,000 ordinary shares at an exercise price of \$3.51 per share, exercisable within 60 days of this Annual Report.
- (6) Represents options to purchase 69,500 ordinary shares at an exercise price of \$3.00 per share and 10,000 ordinary shares at an exercise price of \$3.51 per share, exercisable within 60 days of this Annual Report.

- (7) Represents options to purchase 28,000 ordinary shares at an exercise price of \$1.72 per share, options to purchase 17,500 ordinary shares at an exercise price of \$3.00 per share and 10,000 ordinary shares at an exercise price of \$3.51 per share, exercisable within 60 days of this Annual Report.
- (8) Includes options to purchase 15,000 ordinary shares at an exercise price of \$3.00 per share and 10,000 ordinary shares at an exercise price of \$3.51 per share, exercisable within 60 days of this Annual Report.
- (9) Includes options to purchase 3,800 ordinary shares at an exercise price of \$1.72 per share, options to purchase 6,250 ordinary shares at an exercise price of \$3.00 per share and 10,000 ordinary shares at an exercise price of \$3.51 per share, exercisable within 60 days of this Annual Report.
- (10) Represents options to purchase 2,500 ordinary shares at an exercise price of \$5.21 per share within 60 days of this Annual Report.
- (11) Includes options to purchase 403,484 ordinary shares, exercisable within 60 days of this Annual Report.

#### **Employee Benefit Plans**

Our current equity incentive plan was adopted in 2003 under Section 102 of the Israeli Income Tax Ordinance, providing certain tax benefits in connection with share-based compensation. Please also see Note 10 of our financial statements included in this annual report for information on the options issued under our plan.

Under the 2003 Plan, we may grant to our directors, officers, employees, service providers and controlling shareholders options to purchase our ordinary shares. Following an increase in the number of shares available for grant approved by our board of directors and shareholders in December 2007, a total of 2,203,235 ordinary shares are subject to the 2003 Plan. Any expired or cancelled options are available for reissuance under the 2003 Plan. Our employees, officers and directors may only be granted options under Section 102 of the Israeli Income Tax Ordinance (the “**Tax Ordinance**”), which provides for a beneficial tax treatment, and our non-employees (such as service providers) and controlling shareholders may only be granted options under another section of the Tax Ordinance, which does not provide for similar tax benefits. To be eligible for tax benefits under Section 102, options or ordinary shares must be issued through a trustee, and if held by the trustee for the minimum required period, the employees and directors are entitled to defer any taxable event with respect to the options until the earlier of (i) the transfer of the options or underlying shares from the trustee to the employee or director or (ii) the sale of the options or underlying shares to any other third party. Based on elections made by us, our employees and directors will only be subject to capital gains tax of 25% on the sale of the options or the underlying shares, provided the trustee holds their options or, upon their exercise, the underlying shares for the lesser of (i) 30 months, or (ii) 24 months following the repricing of any options and for options without repricing for 24 months following the end of the calendar year in which the options were granted, and if otherwise granted after January 1, 2006, for only 24 months. We may not deduct expenses pertaining to the options for tax purposes.

The tax treatment with respect to options granted to employees and directors under the 2003 Plan is the result of our election of the capital gains tax track under Section 102 of the Tax Ordinance. Section 102 also provides for an income tax track, under which, among other things, the benefit to the employees will be taxed as income, the issuer will be allowed to recognize expenses for tax purposes, and the minimum holding period for the trustee will be 12 months from the date upon which such options are granted. We are able to change our election with respect to future grants under the 2003 Plan as of the close of 2004.

Our board of directors has the authority to administer the 2003 Plan and to grant options under the plan. However, the compensation committee appointed by the board provides recommendations to the board with respect to the administration of the plan and also has full power, among other things, to alter any restrictions and conditions of the options, accelerate the rights of an optionee to exercise options and determine the exercise price of the options.

Options granted to date under the 2003 Plan in past vested over three years from the grant date so that 40% vest after 12 months and an additional 30% vest after each 12 months thereafter. Alternatively, these options may vest in 4 equal parts annually. Options under the 2003 Plan prior our initial public offering were generally granted at an exercise price of \$1.72 per share. Since the Company’s initial public offering all options are granted with an exercise price equal to the closing market price, on the day the grant is approved. However, on February 21, 2008 the board of directors of the Company approved the re-pricing of all the existing options, granted to employees under the 2003 Plan and with an exercise price greater than \$3.00, to \$3.00, which was confirmed by the Israeli Tax Authorities on July 3, 2008. See Note 10 to the Company’s Consolidated Financial Statements. These changes did not apply to the options held by our directors except for Mr. Yaron Adler, the Company’s President and a member of the board of directors of the Company. See “Item 6.B Compensation” for a description of options granted under the 2003 Plan to our directors.

Options granted to date under the 2003 Plan generally expire within five years of the grant date unless extended as provided by the plan. Options may be exercised only if vested and provided that the holder is employed by us or provides us services continuously from the time of granting of the option until the date of exercise. However, if termination of employment is without cause, vested options may be exercised for a period of 90 days from the date of termination of employment; and if termination is the result of death or disability, vested options may be exercised for a period of 12 months after the date of termination. In addition, the board or a compensation committee may extend the exercise period of options held by employees whose employment was terminated for a period not exceeding their expiration date.

The 2003 Plan does not provide for acceleration of the vesting period upon the occurrence of certain corporate transactions. However, the board or compensation committee may provide in individual option agreements that if the options are not substituted or exchanged by a successor company, then the vesting of the options shall accelerate.

Adjustments to the number of options or exercise price shall not be made in the event of rights offering on outstanding shares.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. MAJOR SHAREHOLDERS

The following table sets forth information regarding the beneficial ownership of our ordinary shares as of May 31, 2009 by each person or group of affiliated persons that we know beneficially owns more than 5% of our outstanding ordinary shares. Other than with respect to our directors and officers, we have relied on public filings with the SEC. Unless otherwise stated herein, each shareholder's address is c/o IncrediMail Ltd., 4 HaNechoshet Street, Tel Aviv 69710, Israel.

Beneficial ownership of shares is determined in accordance with the rules of the SEC and generally includes any shares over which a person exercises sole or shared voting or investment power. Ordinary shares that are subject to warrants or stock options that are presently exercisable or exercisable within 60 days of a specified date are deemed to be outstanding and beneficially owned by the person holding the stock options or warrants for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage of any other person.

Except as indicated in the footnotes to this table, each shareholder in the table has sole voting and investment power for the shares shown as beneficially owned by such shareholder. Percentage ownership is based on 9,259,949 ordinary shares outstanding on May 31, 2009. Our major shareholders do not have different voting rights than our other shareholders.

Name	Number of Ordinary Shares Beneficially Owned	Percentage of Ordinary Shares Outstanding
Ofer Adler	2,149,072	23.18%
Yaron Adler	1,410,933	15.16%
Mahoney Associates Inc.	879,192	9.5%
Alpha Capital Anstalt	722,364	7.8%

To our knowledge, as of May 31, 2009, we had 11 stockholders of record of which 3\* were registered with addresses in the United States. These United States holders were, as of such date, the holders of record of approximately 69%\* of our outstanding shares.

\* Includes the Depository Trust Company

## **B. RELATED PARTY TRANSACTIONS**

It is our policy that transactions with office holders or transactions in which an office holder has a personal interest (“Affiliated Transactions”) will be on terms that, on the whole, are no less favorable to us than could be obtained from independent parties.

Generally, Affiliated Transactions which are “extraordinary transactions” (as such term is defined in the Companies Law), must be approved by a majority of our disinterested directors; nevertheless under Israeli law, under certain circumstances, such transactions (i) must be approved by the audit committee and the board of directors and, in certain circumstances, the shareholders; or (ii) may be approved by a simple majority of the board (and by a simple majority of the audit committee if required), and interested directors may participate in the deliberations and the voting with respect to such transactions if the majority of the members of the board (or the audit committee, if such approval is required) have a personal interest in the approval of the transaction; provided that in such circumstances the approval of such Affiliated Transaction shall also require the approval of the shareholders.

See “Item 10.B Memorandum and Articles of Association – Approval of Related Party Transactions” for a discussion of the requirements of Israeli law regarding special approvals for transactions involving directors, officers or controlling shareholders.

On July 17, 2008, and following approval by our audit committee and board of directors, our shareholders approved a grant to Ms. Tamar Gottlieb of options to purchase 10,000 Ordinary Shares of the Company, under the following terms: (a) each option shall be exercisable for one Ordinary Share at an exercise price equal to the closing price of an Ordinary Share on July 17, 2008, as reported by the Nasdaq Global Market; and (b) the options shall vest in four equal portions on each anniversary of the date of approval of the grant, commencing with the first anniversary. Any and all other terms and conditions pertaining to the grant of the options hereunder shall be in accordance with, and subject to, the 2003 Israeli Share Option Plan adopted by the Company in 2003 and the Company’s standard Option Agreement. See “Item 6.E Share Ownership – Employee Benefit Plans – The 2003 Plan” below.

Also on July 17, 2008, following approval by our audit committee and board of directors, our shareholders approved a re-pricing of options to purchase Ordinary Shares, previously granted to Mr. Yaron Adler, the Company’s President and a member of the board of directors of the Company, such that the exercise price of any previously granted options that exceeded \$3.00 per Ordinary Share were reduced to \$3.00 per share. The Company undertook to re-price Mr. Adler’s options as part of the terms of service of Mr. Yaron Adler as the Company’s President, which terms were approved at the shareholders meeting of the Company held on April 9, 2008.

On June 2, 2009, we provided notice to our shareholders of an extraordinary general meeting to approve a proposal to elect an external director of the Company in the place of an external director whose term had expired, and to amend the terms of options granted to the external directors and the directors of the Company. The meeting is scheduled to be held on July 9, 2009 with such terms as provided in the Notice of Meeting filed on Form 6-K with the SEC. See Item 4.A – “Recent Developments” for a description of the terms of these amendments.

## **C. INTERESTS OF EXPERTS AND COUNSEL**

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

### **A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

Our audited consolidated financial statements for the year ended December 31, 2008 are included in this annual report pursuant to Item 18.

#### ***Legal Proceedings***

On November 3, 2008, a complaint was filed against the Company in the United States District Court for the Southern District of New York in a purported class action regarding our Incredimail Premium product. In the suit, Mark Lucas, on behalf of himself and the purported classes, seeks injunctive relief, an unspecified amount of damages, plus costs and attorney fees for alleged claims that components of our Incredimail Premium product were rendered inoperable by a software update or updates. We believe that the allegations against us are without merit and we intend to vigorously defend against the plaintiff’s claims. We further believe that the outcome of these claims should not have a significant impact on the Company’s financial condition.

### ***Policy on Dividend Distribution***

On March 12, 2009 we announced that our board of directors and management determined that the Company's interest for enhancing shareholder value is best served by changing our dividend policy and instituting a revised dividend policy whereby at least 50% of annual net income of the Company will be paid out as a dividend beginning with the net income for 2009. Declaring and issuing the dividend will be subject to the board's review of the Company's financial conditions at the time. See Item 1A – Risk Factors – “Although we have paid dividends in the past, and we expect to pay certain dividends in the future, our ability to pay dividends may be adversely affected by the risk factors described in this report; if we fail to pay dividends the return on investment will be limited to the value of our stock.” On March 25, 2009, we announced that our board of directors had approved a cash dividend of approximately \$4.6 million, or \$0.50 per share, subject to Israeli court approval and a tax pre-ruling from the Israeli Tax Authority as required by Israeli law.

All of the ordinary shares of the Company are entitled to an equal share in any dividends declared and paid. We have decided to reinvest the remaining profits, particularly the tax-exempt income derived from our “Approved Enterprise” status and first distribute other income as dividends.

On January 23, 2008 the Company announced that its Board of Directors had resolved to adopt a share buyback plan, and on March 25, 2009, the Company announced that it had elected to continue with the second phase of this plan that authorizes the purchase of up to an additional \$1 million of its ordinary shares, subject to approval from the Israeli Tax Authority which has not yet been received. As of May 31, 2009, the Company repurchased approximately 346,019 ordinary shares in open market transactions.

The distribution of dividends and the buy-back plan is subject to limitations under Israeli law, including permitting the distribution of dividends (and a purchasing the company's own shares) only out of profits. See “Item 10.B Memorandum and Articles of Association – Dividend and Liquidation Rights.” In addition, the payment of dividends may be subject to Israeli withholding taxes. See “Item 10.E Taxation – Israeli Taxation –Taxation of our Shareholders–Taxation of Non-Israeli Shareholders on Receipt of Dividends.”

### **B. SIGNIFICANT CHANGES**

Since the date of our audited financial statements included elsewhere in this report, there have not been any significant changes other than as set forth in this report under Item 4.A. – “Recent Developments”.

## **ITEM 9. THE OFFER AND LISTING**

### **A. OFFER AND LISTING DETAILS**

Our ordinary shares have been listed on the Nasdaq Capital Market since January 31, 2006 and since June 27, 2007 on the NASDAQ Global Market, under the symbol “MAIL”. Our ordinary shares commenced trading as a dual listed company on the Tel Aviv Stock Exchange on December 4, 2007 under the symbol “EMAIL”.

The following table shows, for the periods indicated, the high and low closing sale prices of our Ordinary Shares as reported on the Nasdaq Capital Market or the Nasdaq Global Market, as applicable, and the Tel Aviv Stock Exchange:

	Nasdaq Capital Market or Nasdaq Global Market		Tel Aviv Stock Exchange	
	High (\$)	Low (\$)	High (NIS)	Low (NIS)
<b>Five most recent full financial years</b>				
2008	5.17	2.00	20.39	8.23
2007	9.99	4.94	25.50**	19.57**
2006	8.65*	4.00*	-	-
<b>Financial quarters during the past two recent full financial years</b>				
First Quarter 2009	3.66	2.30	15.88	9.11
Fourth Quarter 2008	3.60	1.86	11.93	8.22
Third Quarter 2008	3.62	3.03	12.68	10.02
Second Quarter 2008	4.30	2.94	14.25	10.20
First Quarter 2008	5.58	2.50	20.39	10.12
Fourth Quarter 2007	9.15	4.94	25.50**	19.57**
Third Quarter 2007	9.99	6.72	-	-
Second Quarter 2007	8.50	7.22	-	-
<b>Most recent six months</b>				
May 2009	4.96	3.55	21.00	16.03
April 2009	3.99	3.53	16.03	15.35
March 2009	3.66	2.55	15.88	11.00
February 2009	2.99	2.52	11.50	10.00
January 2009	2.70	2.30	10.19	9.11
December 2008	2.69	2.10	9.70	8.66

\* Since our IPO on January 31, 2006.

\*\* Since our listing on the Tel Aviv Stock Exchange on December 4, 2007.

The closing prices of our Ordinary Shares, as reported on the Nasdaq Global Market on June 23, 2009 and on the Tel Aviv Stock Exchange on June 23, 2009, which are the last full trading days before filing of this annual report, were \$4.81 and NIS 20.02, (equal to \$5.04 based on the Bank of Israel representative exchange rate as of such date), respectively.

#### B. PLAN OF DISTRIBUTION

Not applicable.

#### C. MARKETS

Our ordinary shares are quoted on the Nasdaq Global Market under the symbol "MAIL", and on the Tel Aviv Stock Exchange under the symbol "EMAIL".

#### D. SELLING SHAREHOLDERS

Not applicable.

#### E. DILUTION

Not applicable.

#### F. EXPENSES OF THE ISSUE

Not applicable.

## ITEM 10. ADDITIONAL INFORMATION

### A. SHARE CAPITAL

Not applicable.

### B. MEMORANDUM AND ARTICLES OF ASSOCIATION

#### Registration Number and Purposes

Our registration number with the Israeli Companies Registrar is 51-284949-8. Pursuant to Section 3 of our articles of association, our objectives are the development, manufacture and marketing of software and any other objective as determined by our board of directors.

#### Dividend and Liquidation Rights

The holders of the ordinary shares are entitled to their proportionate share of any cash dividend, share dividend or dividend in kind declared with respect to our ordinary shares on or after the date of this annual report. We may declare dividends out of profits legally available for distribution. Under the Israeli Companies Law, a company may distribute a dividend only if the distribution does not create a reasonable risk that the company will be unable to meet its existing and anticipated obligations as they become due. A company may only distribute a dividend out of the company's profits, as defined under the Israeli Companies Law. If the company does not meet the profit requirement, a court may allow it to distribute a dividend, as long as the court is convinced that there is no reasonable risk that such distribution might prevent the company from being able to meet its existing and anticipated obligations as they become due.

Under the Israeli Companies Law, the declaration of a dividend does not require the approval of the shareholders of a company unless the company's articles of association provide otherwise. Our articles of association provide that the board of directors may declare and distribute dividends without the approval of the shareholders. In the event of our liquidation, holders of our ordinary shares have the right to share ratably in any assets remaining after payment of liabilities, in proportion to the paid-up par value of their respective holdings.

These rights may be affected by the grant of preferential liquidation or dividend rights to the holders of a class of shares that may be authorized in the future.

#### Voting, Shareholder Meetings and Resolutions

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. This right may be changed if shares with special voting rights are authorized in the future.

Our articles of association and the laws of the State of Israel do not restrict the ownership or voting of ordinary shares by non-residents of Israel, except with respect to citizens of countries that are in a state of war with Israel.

Under the Israeli Companies Law, an annual general meeting of our shareholders should be held once every calendar year, but no later than 15 months from the date of the previous annual general meeting. The quorum required for a general meeting of shareholders consists of at least two shareholders present in person or by proxy holding in the aggregate at least 33 1/3% of the voting power. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the chairperson of the board of directors designates in a notice to the shareholders with the consent of the holders of the majority voting power represented at the meeting voting on the question of adjournment. In the event of a lack of quorum in a meeting convened upon the request of shareholders, the meeting shall be dissolved. At the reconvened meeting, the required quorum consists of any number of shareholders present in person or by proxy.

Our board of directors may, in its discretion, convene additional meetings as "special general meetings." In addition, the board must convene a special general meeting upon the demand of two of the directors, one fourth of the nominated directors, one or more shareholders having at least 5% of outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company. The chairperson of the board of directors presides at each of our general meetings. The chairperson of the board of directors is not entitled to a vote at a general meeting in his capacity as chairperson.

Most shareholders' resolutions, including resolutions to:

- amend our articles of association (except as set forth below);

- make changes in our capital structure such as a reduction of capital, increase of capital or share split, merger or consolidation;
- authorize a new class of shares;
- elect directors, other than external directors;
- appoint auditors; or
- approve most transactions with office holders;

will be deemed adopted if approved by the holders of a majority of the voting power represented at a shareholders' meeting, in person or by proxy, and voting on that resolution. Except as set forth in the following sentence none of these actions require the approval of a special majority. Amendments to our articles of association relating to the election and vacation of office of directors, the composition and size of the board of directors and the insurance, indemnification and release in advance of the company's office holders with respect to certain liabilities incurred by them require the approval at a general meeting of shareholders holding more than two-thirds of the voting power of the issued and outstanding share capital of the company.

#### **Notices**

Under the Israeli Companies Law, shareholders' meetings generally require prior notice of at least 21 days, or 35 days if the meeting is adjourned for the purpose of voting on any of the following matters:

- (1) appointment and removal of directors;
- (2) approval of certain matters relating to the fiduciary duties of office holders) and of certain transactions with interested parties;
- (3) approval of certain mergers; and
- (4) any other matter in respect of which the articles of association provide that resolutions of the general meeting may be approved by means of a voting document.

#### **Modification of Class Rights**

The Israeli Companies Law provides that, unless otherwise provided by the articles of association, the rights of a particular class of shares may not be adversely modified without the vote of a majority of the affected class at a separate class meeting.

#### **Election of Directors**

Our ordinary shares do not have cumulative voting rights in the election of directors. Therefore, the holders of ordinary shares representing more than 50% of the voting power at the general meeting of the shareholders, in person or by proxy, have the power to elect all of the directors whose positions are being filled at that meeting, to the exclusion of the remaining shareholders. External directors are elected by a majority vote at a shareholders' meeting, provided that either:

- the majority of shares voted for the election includes at least one-third of the shares of non-controlling shareholders voted at the meeting (excluding abstaining votes); or
- the total number of shares of non-controlling shareholders voting against the election of the external director does not exceed one percent of the aggregate voting rights in the company.

See "Item 6.C Board Practices" regarding our staggered board.

#### **Transfer Agent and Registrar**

American Stock Transfer and Trust Company is the transfer agent and registrar for our ordinary shares.

#### **Approval of Related Party Transactions**

#### *Office Holders*

The Israeli Companies Law codifies the fiduciary duties that office holders owe to a company. An office holder is defined in the Israeli Companies Law as any director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of these positions regardless of that person's title. Each person listed in the table under "Management – Executive Officers and Directors" is an office holder under the Israeli Companies Law.

*Fiduciary duties.* An office holder's fiduciary duties consist of a duty of loyalty and a duty of care. The duty of loyalty requires the office holder to act in good faith and to the benefit of the company, to avoid any conflict of interest between the office holder's position in the company and any other of his or her positions or personal affairs, and to avoid any competition with the company or the exploitation of any business opportunity of the company in order to receive personal advantage for himself or others. This duty also requires him or her to reveal to the company any information or documents relating to the company's affairs that the office holder has received due to his or her position as an office holder. The duty of care requires an office holder to act with a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to use reasonable means to obtain information regarding the advisability of a given action submitted for his or her approval or performed by virtue of his or her position and all other relevant information pertaining to these actions.

*Compensation.* Under the Israeli Companies Law, all compensation arrangements for office holders who are not directors require approval of the board of directors, unless the articles of association provide otherwise. Our compensation committee will be required to approve the compensation of all office holders. Arrangements regarding the compensation of directors (including officers who are also directors) require audit committee, board and shareholder approval, in such order.

*Disclosure of personal interest.* The Israeli Companies Law requires that an office holder promptly disclose to the company any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. "Personal interest", as defined by the Israeli Companies Law, includes a personal interest of any person in an act or transaction of the company, including a personal interest of his relative or of a corporate body in which that person or a relative of that person is a 5% or greater shareholder, a holder of 5% or more of a company's outstanding shares or voting rights, a director or general manager, or in which he or she has the right to appoint at least one director or the general manager. "Personal interest" does not apply to a personal interest stemming merely from the fact that the office holder is also a shareholder in the company.

The office holder must make the disclosure of his personal interest without delay and no later than the first meeting of the company's board of directors that discusses the particular transaction. This duty does not apply to the personal interest of a relative of the office holder in a transaction unless it is an "extraordinary transaction". The Israeli Companies Law defines an extraordinary transaction as a transaction not in the ordinary course of business, not on market terms or that is likely to have a material impact on the company's profitability, assets or liabilities, and defines a relative as a spouse, sibling, parent, grandparent, descendant, spouse's descendant and the spouse of any of the foregoing.

*Approvals.* The Israeli Companies Law provides that a transaction with an office holder or a transaction in which an office holder has a personal interest may not be approved if it is adverse to the company's interest. In addition, such a transaction generally requires board approval, unless the transaction is an extraordinary transaction or the articles of association provide otherwise. If the transaction is an extraordinary transaction, or if it concerns exculpation, indemnification or insurance of an office holder, then in addition to any approval stipulated by the articles of association, approval of the company's audit committee and the board of directors is required. Exculpation, indemnification, insurance or compensation of a director also would require shareholder approval. A director who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not attend that meeting or vote on that matter, unless a majority of the board of directors or the audit committee also has a personal interest in the matter. If a majority of the board of directors or the audit committee has a personal interest in the transaction, shareholder approval is also required.

#### **Shareholders**

The Israeli Companies Law imposes the same disclosure requirements, as described above, on a controlling shareholder of a public company that it imposes on an office holder. For these purposes, a controlling shareholder is any shareholder that has the ability to direct the company's actions, including any shareholder holding 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. Two or more shareholders with a personal interest in the approval of the same transaction are deemed to be one shareholder.

Approval of the audit committee, the board of directors and our shareholders is required for:

- extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest; and
- employment of a controlling shareholder or a relative of a controlling shareholder.

The shareholder approval must include the majority of shares voted at the meeting. In addition, either:

- the majority must include at least one-third of the shares of the voting shareholders who have no personal interest in the transaction voted at the meeting (excluding abstaining votes); or
- the total shareholdings of those who have no personal interest in the transaction and who vote against the transaction must not represent more than 1% of the aggregate voting rights in the company.

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

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

A shareholder has a general duty to refrain from depriving any other shareholder of their rights as a shareholder. In addition, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder or class vote and any shareholder who, pursuant to the company's articles of association has the power to appoint or prevent the appointment of an office holder in the company is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty of fairness.

#### **Anti-Takeover Provisions; Mergers and Acquisitions**

*Merger.* The Israeli Companies Law permits merger transactions with the approval of each party's board of directors and shareholders, except that when the merger involves one of the following companies, the approval of the shareholders of these companies is not required:

- an absorbed company which is under the full control and ownership of the surviving company; or
- a surviving company, if all of the following conditions are met: (i) the merger does not entail an amendment of the articles of association or memorandum of association of the surviving company, (ii) the surviving company does not issue in the course of the merger more than twenty percent of the voting rights in the company, and as a result of the share issuance no person shall become a controlling shareholder in the surviving company, and (iii) circumstances that would otherwise mandate an approval by a special majority of the shareholders (as described in the following paragraph) do not exist.

At the general meeting of a merging company which shares are held by the other party to the merger or by any person holding at least 25% of any control measures of the other party to the merger, a merger shall not be deemed approved if the shareholders holding the majority of the voting power present at the meeting object to the merger. In calculating this majority, (i) the abstaining shareholders and (ii) shareholders that are part of the other party to the merger or hold 25% or more of any control measures of the other party to the merger are excluded. Shares held by relatives or companies controlled by a person are deemed held by that person. The term "control measures" of a company includes, among other things, voting power or means of appointing the board of directors.

Under the Israeli Companies Law, a merging company must inform its creditors of the proposed merger. Any creditor of a party to the merger may seek a court order to delay or block the merger, if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of the parties to the merger. Moreover, a merger may not be completed until all of the required approvals have been filed by both merging companies with the Israeli Registrar of Companies and (i) 30 days have passed from the time both companies' shareholders resolved to approve the merger, and (ii) at least 50 days have passed from the time that the merger proposal was filed with the Israeli Registrar of Companies.

*Tender Offer.* The Israeli Companies Law requires a purchaser to conduct a tender offer in order to purchase shares in publicly held companies, if as a result of the purchase the purchaser would hold more than 25% of the voting rights of a company in which no other shareholder holds more than 25% of the voting rights, or the purchaser would hold more than 45% of the voting rights of a company in which no other shareholder holds more than 45% of the voting rights. The requirement to conduct a tender offer shall not apply to (i) the purchase of shares in a private placement, provided that such purchase was approved by the company's shareholders as a private placement that is intended to provide the purchaser with more than 25% of the voting rights of a company in which no other shareholder holds more than 25% of the voting rights, or with more than 45% of the voting rights of a company in which no other shareholder holds more than 45% of the voting rights; (ii) a purchase from a holder of more than 25% of the voting rights of a company that results in a person becoming a holder of more than 25% of the voting rights of a company, and (iii) a purchase from the holder of more than 45% of the voting rights of a company that results in a person becoming a holder of more than 45% of the voting rights of a company.

Under the tender Companies Law, a person may not purchase shares of a public company if, following the purchase of shares, the purchaser would hold more than 90% of the company's shares or of any class of shares unless the purchaser makes a tender offer to purchase all of the target company's shares or all the shares of the particular class, as applicable. If, as a result of the tender offer, the purchaser would hold more than 95% of the company's shares or a particular class of shares, the ownership of the remaining shares will be transferred to the purchaser. However, if the purchaser is unable to purchase 95% or more of the company's shares or class of shares, the purchaser may not own more than 90% of the shares or class of shares of the target company.

*Tax Law.* Israeli tax law treats some acquisitions, such as a stock-for-stock swap between an Israeli company and a foreign company, less favorably than U.S. tax law. For example, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in a foreign corporation to immediate taxation. Please see "Item 10.E Taxation – Israeli Taxation."

#### **Exculpation, Indemnification and Insurance of Directors and Officers**

Our articles of association allow us to indemnify, exculpate and insure our office holders, which includes our directors, to the fullest extent permitted by the Israeli Companies Law, provided that procuring this insurance or providing this indemnification or exculpation is approved by the audit committee and the board of directors, as well as by the shareholders if the office holder is a director. Our articles of association also allow us to insure or indemnify any person who is not an office holder, including any employee, agent, consultant or contractor who is not an office holder.

Under the Israeli Companies Law, a company may indemnify an office holder in respect of some liabilities, either in advance of an event or following an event. If a company undertakes to indemnify an office holder in advance against monetary liability incurred in his or her capacity as an office holder whether imposed in favor of another person pursuant to a judgment, a settlement or an arbitrator's award approved by a court, the indemnification must be limited to foreseeable events in light of the company's actual activities at the time of the indemnification undertaking and to a specific sum or a reasonable criterion under such circumstances, as determined by the board of directors. However, as described below, an undertaking to indemnify an office holder in advance of an event need not be limited with respect to reasonable litigation expenses, including attorneys' fees.

Under the Israeli Companies Law, only if and to the extent provided by its articles of association, a company may indemnify an office holder against the following liabilities or expenses incurred in his or her capacity as an office holder:

- any monetary liability whether imposed on him or her in favor of another person pursuant to a judgment, a settlement or an arbitrator's award approved by a court;
- reasonable litigation expenses, including attorneys' fees, incurred by him or her as a result of an investigation or proceedings instituted against him or her by an authority empowered to conduct an investigation or proceedings, which are concluded either (i) without the filing of an indictment against the office holder and without the levying of a monetary obligation in lieu of criminal proceedings upon the office holder, or (ii) without the filing of an indictment against the office holder but with levying a monetary obligation in substitute of such criminal proceedings upon the office holder for a crime that does not require proof of criminal intent; and
- reasonable litigation expenses, including attorneys' fees, in proceedings instituted against him or her by the company, on the company's behalf or by a third-party, or in connection with criminal proceedings in which the office holder was acquitted, or as a result of a conviction for a crime that does not require proof of criminal intent.

Under the Israeli Companies Law, a company may obtain insurance for an office holder against liabilities incurred in his or her capacity as an office holder, if and to the extent provided for in its articles of association. These liabilities include a breach of duty of care to the company or a third-party, a breach of duty of loyalty and any monetary liability imposed on the office holder in favor of a third-party.

A company may, in advance only, exculpate an office holder for a breach of the duty of care. However, a company may not so exculpate an office holder for a breach of the duty of care in connection with a distribution of dividends or a repurchase of the company's securities. A company may not exculpate an office holder from a breach of the duty of loyalty towards the company.

Under the Israeli Companies Law, however, an Israeli company may only indemnify or insure an office holder against a breach of duty of loyalty to the extent that the office holder acted in good faith and had reasonable grounds to assume that the action would not prejudice the company. In addition, an Israeli company may not indemnify, insure or exculpate an office holder against a breach of duty of care if committed intentionally or recklessly, or an action committed with the intent to derive an unlawful personal gain, or for a fine or forfeit levied against the office holder in connection with a criminal offense.

Our board of directors and shareholders have resolved to indemnify our directors and our Chief Financial Officer to the extent permitted by law and by our articles of association for liabilities not covered by insurance and that are of certain enumerated events, subject to an aggregate sum equal to 50.0% of the shareholders equity as set forth in the financial report of the preceding year to which a claim for indemnification is made.

#### **Nasdaq Marketplace Rules and Home Country Practices**

In accordance with Israeli law and practice and subject to the exemption set forth in Rule 4350(a)(1) of the NASDAQ Marketplace Rules, we follow the provisions of the Israeli Companies Law – 1999, rather than the requirements of Marketplace Rule 4350 with respect to the following requirements:

- Distribution of annual and quarterly reports to shareholders – Under Israeli law we are not required to distribute annual and quarterly reports directly to shareholders and the generally accepted business practice in Israel is not to distribute such reports to shareholders. We do however make our audited financial statements available to our shareholders at the Company's offices and to mail such reports to shareholders upon request. Incredimail also files its annual reports with the SEC. As a foreign private issuer, we are generally exempt from the SEC's proxy solicitation rules.
- Quorum – Under Israeli law a company is entitled to determine in its articles of association the number of shareholders and percentage of holdings required for a quorum at a shareholders meeting. Our Articles of Association provide that a quorum of two or more shareholders holding at least 33.3% of the voting rights in person or by proxy is required for commencement of business at a general meeting. However, the quorum set forth in our Articles of Association with respect to an adjourned meeting, consists of two or more shareholders in person or by proxy.
- Independence of Directors – Our board contains two independent directors in accordance with the provisions contained in Sections 239-249 of the Israeli Companies Law – 1999 and Rule 10A-3 of the general rules and regulations promulgated under the Securities Act of 1933, rather than a majority of independent directors. Israeli law does not require, nor do our independent directors conduct, regularly scheduled meetings at which only they are present.
- Audit Committee – Our audit committee complies with all of the requirements under Israeli law, and is composed of two independent directors, which are all of our independent directors, and one other director. Consistent with Israeli law, the independent auditors are elected at a meeting of shareholders instead of being appointed by the audit committee.

- Nomination of our Directors – With the exception of our independent directors, our directors are elected for terms of one year or until the following annual meeting, by a general meeting of our shareholders. The nominations for director which are presented to our shareholders are generally made by our directors but may be made by one or more of our shareholders. However, any shareholder or shareholders holding at least 5% of the voting rights in our issued share capital may nominate one or more persons for election as directors at a general meeting only if a written notice of such shareholder's intent to make such nomination or nominations has been given to our secretary and each such notice sets forth all the details and information as required to be provided under our articles of association.
- Compensation of Officers – Provided that the executive officer does not serve on our board, Israeli law does not require and we do not require that independent members of our board determine the compensation of an executive officer.
- Approval of Related Party Transactions – All related party transactions are approved in accordance with the requirements and procedures for approval of interested party acts and transactions, set forth in sections 268 to 275 of the Israeli Companies Law-1999, and the regulations promulgated thereunder, which require audit committee approval and shareholder approval, as well as board approval, for specified transactions, rather than approval by the audit committee or other independent body of our board are required under Nasdaq Marketplace Rules. See also "Item 10.B Memorandum and Articles of Association – Approval of Related Party Transactions" for the definition and procedures for the approval of related party transactions.
- Shareholder Approval – We seek shareholder approval for all corporate action requiring such approval, in accordance with the requirements of the Israeli Companies Law – 1999, which are different or in addition to the requirements for seeking shareholder approval under Nasdaq Marketplace Rule 4350(i).

#### **C. MATERIAL CONTRACTS**

Since the third quarter of 2006, search revenues powered by Google's AdSense program made a significant contribution to the Company's results. On July 1, 2008, we entered into an agreement with Google regarding our participation in Google's AdSense program, which allows us to receive a portion of the amount paid to Google by advertisers for the activity performed through the Company's applications. See Exhibits 4.1 and 4.4.

Our OEM Agreement with Commtouch Ltd., effective December 7, 2004 and most recently renewed effective July 15, 2008, is described under "Item 4.B Business Overview – Intellectual Property" and a copy of this agreement is included in Exhibit 4.2. The purchase option granted to the lead underwriter of our initial public offering, are described under "Item 7.B Related Party Transactions – Registration Rights." The employment agreements with our principal officers are described under "Item 6.C Board Practices – Employment Agreements".

#### **D. EXCHANGE CONTROLS**

Non-residents of Israel who hold our ordinary shares are able to receive any dividends, and any amounts payable upon the dissolution, liquidation and winding up of our affairs, freely repatriable in non-Israeli currency at the rate of exchange prevailing at the time of conversion. However, Israeli income tax is required to have been paid or withheld on these amounts. In addition, the statutory framework for the potential imposition of exchange controls has not been eliminated, and may be restored at any time by administrative action.

#### **E. TAXATION**

The following is a general summary only and should not be considered as income tax advice or relied upon for tax planning purposes.

#### **ISRAELI TAXATION**

THE FOLLOWING DESCRIPTION IS NOT INTENDED TO CONSTITUTE A COMPLETE ANALYSIS OF ALL TAX CONSEQUENCES RELATING TO THE OWNERSHIP OR DISPOSITION OF OUR ORDINARY SHARES. YOU SHOULD CONSULT YOUR OWN TAX ADVISOR CONCERNING THE TAX CONSEQUENCES OF YOUR PARTICULAR SITUATION, AS WELL AS ANY TAX CONSEQUENCES THAT MAY ARISE UNDER THE LAWS OF ANY STATE, LOCAL, FOREIGN OR OTHER TAXING JURISDICTION.

The following is a summary of the material Israeli tax laws applicable to us, and some Israeli Government programs benefiting us. This section also contains a discussion of some Israeli tax consequences to persons acquiring our ordinary shares. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of Israel or traders in securities who are subject to special tax regimes not covered in this discussion. Since some parts of this discussion are based on new tax legislation that has not yet been subject to judicial or administrative interpretation, we cannot assure you that the appropriate tax authorities or the courts will accept the views expressed in this discussion.

*The discussion below should not be construed as legal or professional tax advice and does not cover all possible tax considerations. Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including, in particular, the effect of any foreign, state or local taxes.*

## **General Corporate Tax Structure in Israel**

**Israeli companies are generally subject to corporate tax at the rate of 26% in 2009. The rate was 27% for 2008, and is scheduled to decline to 25% in 2010 and thereafter. However, the effective tax rate payable by a company that derives income from an approved enterprise (as discussed below) may be considerably less. In March 2006, a new program was approved, to begin in 2008. Special Provisions Relating to Taxation under Inflationary Conditions**

The Income Tax Law (Inflationary Adjustments), 1985, or the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Until December 31, 2005 we measured our Israeli taxable income in accordance with this law, but from January 1, 2006 we have elected to measure our Israeli taxable income in relation to changes in the U.S. dollar/NIS exchange rate rather than the Israeli inflation index. We were permitted to make such a change pursuant to regulations published by the Israeli Minister of Finance, which provide the conditions for so doing. A company that elects to measure its results for tax purposes based on the U.S. dollar/NIS exchange rate cannot change that election for a period of three years following the election. We believe that we meet the necessary conditions and as such, continue to measure our results for tax purposes based on the U.S. dollar/NIS exchange rate.

## **Law for the Encouragement of Capital Investments, 1959**

The Law for Encouragement of Capital Investments, 1959 (the "Investment Law") provides that capital investments in a production facility (or other eligible assets) may, upon approval by the Investment Center of the Israel Ministry of Industry and Trade (the "Investment Center"), be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program, delineated both by the financial scope of the investment and by the physical characteristics of the facility or the asset. The tax benefits from any certificate of approval relate only to taxable profits attributable to the specific Approved Enterprise.

On April 1, 2005, a comprehensive amendment to the Investment Law came into effect. The amendment revised the criteria for investments qualified to receive tax benefits. An eligible investments program under the amendment will qualify for benefits as a Privileged Enterprise (rather than the previous terminology of Approved Enterprise). As the amended Investment Law does not retroactively apply for investments programs having an approved enterprise approval certificate issued by the Israeli Investment Center prior to December 31, 2005. The Company intends to have the benefits of the "Privileged Enterprise" in 2008.

Currently we have two Approved Enterprise Programs under the Investment Law, which entitle us to certain tax benefits, and a ruling for one Privileged Enterprise Program, to begin in 2008. The Approved Enterprise Programs granted to us are defined in the Investment Law as Alternative Benefits Programs, which allow for a two years exemption for undistributed income and reduced company tax rate of between 10% and 25% for the following five to eight years, depending on the extent of foreign (non-Israeli) investment in us during the relevant year. The tax rate will be 20% if the foreign investment level is more than 49% but less than 74%, 15% if the foreign investment level is more than 74% but less than 90%, and 10% if the foreign investment level is 90% or more. The lowest level of foreign investment during a particular year will be used to determine the relevant tax rate for that year. The period in which we receive these tax benefits may not extend beyond 14 years from the year in which approval was granted and 12 years from the year in which operations or production by the enterprise began.

A company that has elected to participate in the alternative benefits program and that subsequently pays a dividend out of the income derived from the Approved Enterprise during the tax exemption period will be subject to corporate tax in respect of the amount distributed at the rate that would have been applicable had the company not elected the alternative benefits program (generally 10% to 25%, depending on the foreign (non-Israeli) investment in it). In addition, such company is required to withhold tax at source from the dividend amount at the rate of 15%.

The Investment Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program.

The benefits available to an Approved Enterprise are conditioned upon terms stipulated in the Investment Law and the regulations thereunder and the criteria set forth in the applicable certificate of approval. If we do not fulfill these conditions in whole or in part, the benefits can be canceled and we may be required to refund the amount of the benefits, with the addition of the Israeli consumer price index linkage differences and interest. We believe that our Approved Enterprises currently operate in compliance with all applicable conditions and criteria, but there can be no assurance that they will continue to do so.

Income derived from sources other than "Approved Enterprise" programs during the benefit period will be subject to tax at the regular corporate tax rate.

Pursuant to the amendment to the Investments Law, only approved enterprises receiving cash grants require the approval of the Investment Center. Approved enterprises which do not receive benefits in the form of governmental cash grants, such as benefits in the form of tax benefits, are no longer required to obtain this approval (such enterprises are referred to as privileged enterprises). However, a privileged enterprise is required to comply with certain requirements and make certain investments as specified in the amended Investment Law. The amendment to the Investment Law addresses benefits that are being granted to privileged enterprises and the length of the benefits period.

#### **Tax benefits under the 2005 Amendment**

A recent Amendment to the Investment Law, effective as of April 1, 2005 has significantly changed the provisions of the Investment Law. The amendment includes revisions to the criteria for investments qualified to receive tax benefits as an Approved Enterprise.

However, a company that was granted benefits according to section 51 of the Investment Law (prior the amendment) would not be allowed to choose new tax year as a Year of Election (as describe below) under the new amendment, for a period of 2 years from the company's previous Year of Commencement under the old investment law.

This amendment simplifies the approval process for the approved enterprise. According to the amendment, only approved enterprises receiving cash grants require the approval of the Investment Center. The Investment Center will be entitled to approve such programs only until August 1, 2009.

As a result of the Amendment, it is no longer necessary for a company to acquire Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Route, and therefore such companies need not apply to the Investment Center for this purpose. Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns or by notifying the Israeli Tax Authority within 12 months of the end of that year, provided that its facilities meet the criteria for tax benefits set out by the Amendment (the "**Privileged Enterprise**"). Companies are also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment. The Amendment includes provisions attempting to ensure that a company will not enjoy both Government grants and tax benefits for the same investment program.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, the Amendment states that the company must make an investment in the Privileged Enterprise exceeding a certain percentage or a minimum amount specified in the Law. Such investment may be made over a period of no more than 3 years ending at the end of the year in which the company requested to have the tax benefits apply to the Privileged Enterprise (the "**Year of Election**"). Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Privileged Enterprise and the company's effective tax rate will be the result of a weighted average of the applicable rates. In this case, the minimum investment required in order to qualify as a Privileged Enterprise is required to exceed a certain percentage or a minimum amount of the company's production assets at the end of the year before the expansion.

The amended Investment Law specifies certain conditions that a privileged enterprise has to comply with in order to be entitled to benefits. These conditions include among others:

- that the privileged enterprise's revenues during the applicable tax year from any single market (i.e. country or a separate customs territory) do not exceed 75% of the privileged enterprise's aggregate revenues during such year; or
- that 25% or more of the privileged enterprise's revenues during the applicable tax year are generated from sales into a single market (i.e. country or a separate customs territory) with a population of at least 12 million residents.

The duration of tax benefits is subject to a limitation of the earlier of 7 to 10 years from the Commencement Year (Commencement Year defined as the later of: (i) the first tax year in which the Company had derived income for tax purposes from the Privileged Enterprise or (ii) the year in which the Company requested to have the tax benefits apply to the Beneficiary Enterprise – Year of Election), or 12 years from the first day of the Year of Election. The tax benefits granted to a Privileged Enterprise are determined, as applicable to its geographic location within Israel.

Similar to the previously available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Privileged Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Privileged Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) in respect of the **gross amount** of the dividend that we may be distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise.

There can be no assurance that we will comply with the above conditions in the future or that we will be entitled to any additional benefits under the amended Investment Law.

The Amendment changes the definition of "foreign investment" in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company's outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition will take effect retroactively from 2003.

As a result of the amendment, tax-exempt income generated under the provisions of the Investments Law, as amended, will subject us to taxes upon distribution or liquidation.

A substantial portion of our taxable operating income is derived from our approved enterprise program and we expect that a substantial portion of any taxable operating income that we may realize in the future will be also derived from such program.

#### **Law for the Encouragement of Industry (Taxes), 1969**

We believe that we currently qualify as an "Industrial Company" within the meaning of the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law. The Industry Encouragement Law defines "Industrial Company" as a company resident in Israel, of which 90% or more of its income in any tax year, other than of income from defense loans, capital gains, interest and dividends, is derived from an "Industrial Enterprise" owned by it. An "Industrial Enterprise" is defined as an enterprise whose major activity in a given tax year is industrial production.

The following corporate tax benefits, among others, are available to Industrial Companies:

- amortization of the cost of purchased know-how and patents, which are used for the development or advancement of the company, over an eight-year period;
- accelerated depreciation rates on equipment and buildings;
- under specified conditions, an election to file consolidated tax returns with additional related Israeli Industrial Companies; and
- expenses related to a public offering are deductible in equal amounts over three years.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. We cannot assure that we qualify or will continue to qualify as an "Industrial Company" or that the benefits described above will be available in the future.

### **Taxation of our Shareholders**

*Taxation of Non-Israeli Shareholders on Receipt of Dividends.* Non-residents of Israel are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 20%, which tax will be withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. With respect to a substantial shareholder (which is someone who alone, or together with another person, holds, directly or indirectly, at least 10% in one or all of any of the means of control in the corporation), the applicable tax rate will remain at 25%. Under the U.S.-Israel Tax Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) is 25%. However, generally, the maximum rate of withholding tax on dividends, not generated by our Approved Enterprise, that are paid to a U.S. corporation holding 10% or more of our outstanding voting capital throughout the tax year in which the dividend is distributed as well as the previous tax year, is 12.5%. Furthermore, dividends paid from income derived from our Approved Enterprise are subject, under certain conditions, to withholding at the rate of 15%. We cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders' tax liability.

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

*Capital Gains Taxes Applicable to Non-Israeli Resident Shareholders.* Shareholders that are not Israeli residents are generally exempt from Israeli capital gains tax on any gains derived from the sale, exchange or disposition of our ordinary shares, provided that (1) such shareholders did not acquire their shares prior to our initial public offering, (2) the shares are listed for trading on the Tel Aviv Stock Exchange and/or a foreign exchange, (3) the provisions of the Income Tax Law (inflationary adjustments), 1985 do not apply to such gain, and (4) such gains did not derive from a permanent establishment of such shareholders in Israel. However, non-Israeli corporations will not be entitled to the foregoing exemptions if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary of or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly. In certain instances, where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Under the U.S.-Israel Tax Treaty, the sale, exchange or disposition of our ordinary shares by a shareholder who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) holding the ordinary shares as a capital asset is exempt from Israeli capital gains tax unless either (i) the shareholder holds, directly or indirectly, shares representing 10% or more of our voting capital during any part of the 12-month period preceding such sale, exchange or disposition, or (ii) the capital gains arising from such sale are attributable to a permanent establishment of the shareholder located in Israel.

### **Transfer Pricing**

In accordance with Section 85A of the Israeli Tax Ordinance, if in an international transaction (whereby at least one party is a foreigner or all or part of the income from such transaction is to be taxed abroad as well as in Israel) there is a special relationship between the parties (including but not limited to family relationship or a relationships of control between companies), and due to this relationship the price set for an asset, right, service or credit was determined or other conditions for the transaction were set such that a smaller profit was realized than what would have been expected to be realized from a transaction of this nature, then such transaction shall be reported in accordance with customary market conditions and tax shall be charged accordingly. This section shall apply solely to transactions that transpire after November 29, 2006, at which time regulations with respect to this section were legislated. The assessment of whether a transaction falls under the aforementioned definition shall be implemented in accordance with one of the procedures mentioned in the regulations and is based, among others, on comparisons of characteristics which portray similar transactions in ordinary market conditions, such as profit, the area of activity, nature of the asset, the contractual conditions of the transaction and according to additional terms and conditions specified in the regulations.

## U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a description of the material U.S. federal income tax considerations applicable to an investment in the ordinary shares by U.S. Holders who acquire our ordinary shares and hold them as capital assets for U.S. federal income tax purposes. As used in this section, the term “U.S. Holder” means a beneficial owner of an ordinary share who is:

- an individual citizen or resident of the United States;
- a corporation created or organized in or under the laws of the United States or of any state of the United States or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if the trust has elected validly to be treated as a United States person for U.S. federal income tax purposes or if a U.S. court is able to exercise primary supervision over the trust’s administration and one or more United States persons have the authority to control all of the trust’s substantial decisions.

The term “Non-U.S. Holder” means a beneficial owner of an ordinary share who is not a U.S. Holder. The tax consequences to a Non-U.S. Holder may differ substantially from the tax consequences to a U.S. Holder. Certain aspects of U.S. federal income tax relevant to a Non-U.S. Holder also are discussed below.

This description is based on provisions of the U.S. Internal Revenue Code of 1986, as amended, referred to in this discussion as the Code, existing and proposed U.S. Treasury regulations and administrative and judicial interpretations, each as available and in effect as of the date of this annual report. These sources may change, possibly with retroactive effect, and are open to differing interpretations. This description does not discuss all aspects of U.S. federal income taxation that may be applicable to investors in light of their particular circumstances or to investors who are subject to special treatment under U.S. federal income tax law, including:

- insurance companies;
- dealers in stocks, securities or currencies;
- financial institutions and financial services entities;
- real estate investment trusts;
- regulated investment companies;
- persons that receive ordinary shares as compensation for the performance of services;
- tax-exempt organizations;
- persons that hold ordinary shares as a position in a straddle or as part of a hedging, conversion or other integrated instrument;
- individual retirement and other tax-deferred accounts;
- expatriates of the United States;
- persons (other than Non-U.S. Holders) having a functional currency other than the U.S. dollar; and
- direct, indirect or constructive owners of 10% or more, by voting power or value, of us.

This discussion also does not consider the tax treatment of persons or partnerships that hold ordinary shares through a partnership or other pass-through entity or the possible application of United States federal gift or estate tax or alternative minimum tax.

We urge you to consult with your own tax advisor regarding the tax consequences of investing in the ordinary shares, including the effects of federal, state, local, foreign and other tax laws.

## Distributions Paid on the Ordinary Shares

We currently do not intend to pay cash dividends in the foreseeable future. However, subject to the discussion below under “Passive Foreign Investment Company Considerations,” a U.S. Holder generally will be required to include in gross income as ordinary dividend income the amount of any distributions paid on the ordinary shares, including the amount of any Israeli taxes withheld, to the extent that those distributions are paid out of our current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Subject to the discussion below under “Passive Foreign Investment Company Considerations,” distributions in excess of our earnings and profits will be applied against and will reduce the U.S. Holder’s tax basis in its ordinary shares and, to the extent they exceed that tax basis, will be treated as gain from a sale or exchange of those ordinary shares. Our dividends will not qualify for the dividends-received deduction applicable in some cases to U.S. corporations. Dividends paid in NIS, including the amount of any Israeli taxes withheld, will be includible in the income of a U.S. Holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date they are included in income by the U.S. Holder, regardless of whether the payment in fact is converted into U.S. dollars. Any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend is includible in the income of the U.S. Holder to the date that payment is converted into U.S. dollars generally will be treated as ordinary income or loss.

A non-corporate U.S. holder’s “qualified dividend income” currently is subject to tax at reduced rates not exceeding 15%. For this purpose, “qualified dividend income” generally includes dividends paid by a foreign corporation if either:

- (a) the stock of that corporation with respect to which the dividends are paid is readily tradable on an established securities market in the U.S., or
- (b) that corporation is eligible for benefits of a comprehensive income tax treaty with the U.S. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The Internal Revenue Service has determined that the U.S.-Israel Tax Treaty is satisfactory for this purpose.

In addition, under current law a U.S. Holder must generally hold his ordinary shares for more than 60 days during the 121 day period beginning 60 days prior to the ex-dividend date and meet other holding period requirements for qualified dividend income.

Dividends paid by a foreign corporation will not qualify for the reduced rates, if the dividend is paid in a tax year of the recipient beginning after December 31, 2002, however, if such corporation is treated, for the tax year in which the dividend is paid or the preceding tax year, as a “passive foreign investment company” for U.S. federal income tax purposes. We do not believe that we will be classified as a “passive foreign investment company” for U.S. federal income tax purposes for our current taxable year. However, see the discussion under “– Passive Foreign Investment Company Considerations” below.

Subject to the discussion below under “Information Reporting and Back-up Withholding,” a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax on dividends received on ordinary shares unless that income is effectively connected with the conduct by that Non-U.S. Holder of a trade or business in the United States.

## Controlled Foreign Corporation Considerations

If more than 50% of either the voting power of all classes of voting stock or the total value of stock is owned, directly or indirectly, by citizens or residents of the U.S., U.S. domestic partnerships and corporations or estates or trusts other than foreign estates or trusts, each of which owns 10% or more of the total combined voting power of all classes of stock entitled to vote (“10-Percent Shareholders”), we could be treated as a controlled foreign corporation (“CFC”), for U.S. federal income tax purposes. This classification would, among other consequences, require 10-Percent Shareholders to include in their gross income their pro rata shares of “Subpart F income” (as defined by the Code) and earnings invested in U.S. property (as defined by the Code).

In addition, gain from the sale or exchange of preferred shares by a U.S. person who is or was a 10-Percent Shareholder at any time during the five-year period ending with the sale or exchange is treated as dividend income to the extent of earnings and profits of the company attributable to the stock sold or exchanged. Under certain circumstances, a corporate shareholder that directly owns 10% or more of voting shares may be entitled to an indirect foreign tax credit for income taxes paid by us in connection with amounts so characterized as dividends under the Code.

If we are classified as both a passive foreign investment company, as described below, and a CFC, we would generally not be treated as a passive foreign investment company with respect to 10-Percent Shareholders. We believe that we are not and will not become a CFC.

### **Foreign Tax Credit**

Any dividend income resulting from distributions we pay to a U.S. Holder with respect to the ordinary shares generally will be treated as foreign source income for U.S. foreign tax credit purposes, which may be relevant in calculating such holder's foreign tax credit limitation. Subject to certain conditions and limitations, Israeli tax withheld on dividends may be deducted from taxable income or credited against a U.S. Holder's U.S. federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules relating to the determination of foreign source income and the foreign tax credit are complex, and the availability of a foreign tax credit depends on numerous factors. Each prospective purchaser who would be a U.S. Holder should consult with its own tax advisor to determine whether its income with respect to the ordinary shares would be foreign source income and whether and to what extent that purchaser would be entitled to the credit.

### **Disposition of Ordinary Shares**

Upon the sale or other disposition of ordinary shares, subject to the discussion below under "Passive Foreign Investment Company Considerations," a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized on the disposition and the holder's adjusted tax basis in the ordinary shares. U.S. Holders should consult their own advisors with respect to the tax consequences of the receipt of a currency other than U.S. dollars upon such sale or other disposition.

In the event there is an Israeli income tax on gain from the disposition of ordinary shares, such tax should generally be the type of tax that is creditable for U.S. tax purposes; however, because it is likely that the source of any such gain would be a U.S. source, a U.S. foreign tax credit may not be available. U.S. shareholders should consult their own tax advisors regarding the ability to claim such credit.

Gain or loss upon the disposition of the ordinary shares will be treated as long-term if, at the time of the sale or disposition, the ordinary shares were held for more than one year. Long-term capital gains realized by non-corporate U.S. Holders are generally subject to a lower marginal U.S. federal income tax rate than ordinary income, other than qualified dividend income, as defined above. The deductibility of capital losses by a U.S. Holder is subject to limitations. In general, any gain or loss recognized by a U.S. Holder on the sale or other disposition of ordinary shares will be U.S. source income or loss for U.S. foreign tax credit purposes. U.S. Holders should consult their own tax advisors concerning the source of income for U.S. foreign tax credit purposes and the effect of the U.S.-Israel Tax Treaty on the source of income.

Subject to the discussion below under "Information Reporting and Back-up Withholding", a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax on any gain realized on the sale or exchange of ordinary shares unless:

- that gain is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States, or
- in the case of any gain realized by an individual Non-U.S. Holder, that holder is present in the United States for 183 days or more in the taxable year of the sale or exchange, and other conditions are met.

### **Passive Foreign Investment Company Considerations**

Special U.S. federal income tax rules apply to U.S. Holders owning shares of a passive foreign investment company. A non-U.S. corporation will be considered a passive foreign investment company for any taxable year in which, after applying certain look-through rules, 75% or more of its gross income consists of specified types of passive income, or 50% or more of the average value of its assets consists of passive assets, which generally means assets that generate, or are held for the production of, passive income. Passive income may include amounts derived by reason of the temporary investment of funds. If we were classified as a passive foreign investment company, a U.S. Holder could be subject to increased tax liability upon the sale or other disposition of ordinary shares or upon the receipt of amounts treated as "excess distributions." Under these rules, the excess distribution and any gain would be allocated ratably over the U.S. Holder's holding period for the ordinary shares, and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a passive foreign investment company would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. The tax liability with respect to the amount allocated to years prior to the year of the disposition, or "excess distribution," cannot be offset by any net operating losses. In addition, holders of stock in a passive foreign investment company may not receive a "step-up" in basis on shares acquired from a decedent. U.S. Holders who hold ordinary shares during a period when we are a passive foreign investment company will be subject to the foregoing rules even if we cease to be a passive foreign investment company.

We believe that we are not a passive foreign investment company for U.S. federal income tax purposes, but we cannot be certain whether we will be treated as a passive foreign investment company for the current year or any future taxable year. Our belief that we will not be a passive foreign investment company for the current year is based on our estimate of the fair market value of our intangible assets, including goodwill, not reflected in our financial statements under U.S. GAAP, and our projection of our income for the current year. If the IRS successfully challenged our valuation of our intangible assets, it could result in our classification as a passive foreign investment company. Moreover, because passive foreign investment company status is based on our income and assets for the entire taxable year, it is not possible to determine whether we will be a passive foreign investment company for the current taxable year until after the close of the year. In the future, in calculating the value of our intangible assets, we will value our total assets, in part, based on our total market value determined using the average of the selling price of our ordinary shares on the last trading day of each calendar quarter. We believe this valuation approach is reasonable. While we intend to manage our business so as to avoid passive foreign investment company status, to the extent consistent with our other business goals, we cannot predict whether our business plans will allow us to avoid passive foreign investment company status or whether our business plans will change in a manner that affects our passive foreign investment company status determination. In addition, because the market price of our ordinary shares is likely to fluctuate and the market price of the shares of technology companies has been especially volatile, and because that market price may affect the determination of whether we will be considered a passive foreign investment company, we cannot assure that we will not be considered a passive foreign investment company for any taxable year.

The passive foreign investment company rules described above will not apply to a U.S. Holder if the U.S. Holder makes an election to treat us as a qualified electing fund. However, a U.S. Holder may make a qualified electing fund election only if we furnish the U.S. Holder with certain tax information. We currently do not provide this information, and we currently do not intend to take actions necessary to permit you to make a qualified electing fund election in the event we are determined to be a passive foreign investment company. As an alternative to making this election, a U.S. Holder of passive foreign investment company stock which is publicly-traded may in certain circumstances avoid certain of the tax consequences generally applicable to holders of a passive foreign investment company by electing to mark the stock to market annually and recognizing as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of the passive foreign investment company stock and the U.S. Holder's adjusted tax basis in the passive foreign investment company stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years. This election is available for so long as our ordinary shares constitute "marketable stock," which includes stock of a passive foreign investment company that is "regularly traded" on a "qualified exchange or other market." Generally, a "qualified exchange or other market" includes a national market system established pursuant to Section 11A of the Exchange Act. A class of stock that is traded on one or more qualified exchanges or other markets is "regularly traded" on an exchange or market for any calendar year during which that class of stock is traded, other than in de minimis quantities, on at least 15 days during each calendar quarter. We believe that the Nasdaq Global Market will constitute a qualified exchange or other market for this purpose. However, no assurances can be provided that our ordinary shares will continue to trade on the Nasdaq Global Market or that the shares will be regularly traded for this purpose.

The rules applicable to owning shares of a passive foreign investment company are complex, and each prospective purchaser who would be a U.S. Holder should consult with its own tax advisor regarding the consequences of investing in a passive foreign investment company.

## Information Reporting and Back-up Withholding

Holders generally will be subject to information reporting requirements with respect to dividends paid in the United States on ordinary shares. In addition, Holders will be subject to back-up withholding tax on dividends paid in the United States on ordinary shares unless the holder provides an IRS certification or otherwise establishes an exemption. Holders will be subject to information reporting and back-up withholding tax on proceeds paid within the United States from the disposition of ordinary shares unless the holder provides an IRS certification or otherwise establishes an exemption. Information reporting and back-up withholding may also apply to dividends and proceeds paid outside the United States that are paid by certain "U.S. payors" or "U.S. middlemen," as defined in the applicable Treasury regulations, including:

- (1) U.S. person;
- (2) the government of the U.S. or the government of any state or political subdivision of any state (or any agency or instrumentality of any of these governmental units);
- (3) a controlled foreign corporation;
- (4) a foreign partnership that is either engaged in a U.S. trade or business or whose United States partners in the aggregate hold more than 50% of the income or capital interests in the partnership;
- (5) a foreign person that derives 50% or more of its gross income for certain periods from the conduct of a trade or business in the U.S.; or
- (6) a U.S. branch of a foreign bank or insurance company.

The back-up withholding tax rate is 28%. Back-up withholding and information reporting will not apply to payments made to Non-U. S. Holders if they have provided the required certification that they are not United States persons.

In the case of payments by a payor or middleman to a foreign simple trust, foreign grantor trust or foreign partnership, other than payments to a holder that qualifies as a withholding foreign trust or a withholding foreign partnership within the meaning of the Treasury regulations and payments that are effectively connected with the conduct of a trade or business in the United States, the beneficiaries of the foreign simple trust, the person treated as the owner of the foreign grantor trust or the partners of the foreign partnership will be required to provide the certification discussed above in order to establish an exemption from backup withholding tax and information reporting requirements.

The amount of any back-up withholding may be allowed as a credit against a U.S. Holder's U.S. federal income tax liability and may entitle the holder to a refund, provided that required information is furnished to the IRS

### F. DIVIDENDS AND PAYING AGENTS

Not applicable.

### G. STATEMENT BY EXPERTS

Not applicable.

### H. DOCUMENTS ON DISPLAY

You may request a copy of our U.S. SEC filings, at no cost, by writing or calling us at IncrediMail Ltd., 4 HaNechoshet Street, Tel-Aviv 69710, Israel, Attention: Yacov Kaufman, Telephone: +972-3-7696100. A copy of each report submitted in accordance with applicable United States law is available for public review at our principal executive offices. In addition, our filings with the SEC may be inspected without charge at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public from the SEC's website at [www.sec.gov](http://www.sec.gov).

A copy of each document (or a translation thereof to the extent not in English) concerning IncrediMail that is referred to in this annual report on Form 20-F, is available for public view (subject to confidential treatment of agreements pursuant to applicable law) at our principal executive offices at IncrediMail Ltd., 4 HaNechoshet Street, Tel-Aviv 69710, Israel.

### I. SUBSIDIARY INFORMATION

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Exchange Rate Risk.* A significant portion of our revenues and expenses are in foreign currencies. As a result numerous balances are denominated or linked to these currencies. In 2007 the related foreign currency fluctuation resulted in \$198,000 financial income and in 2008 resulted in financial income of \$3,000. Both sums are components of the exchange rate differences set forth in Note 11(a) of our financial statements. As of December 31, 2008, our net liability in foreign currencies amounted to approximately \$2.9 million.

In addition, in territories where our prices are based on local currencies, fluctuations in the dollar exchange rate could affect our gross profit margin. We may compensate for such fluctuations by changing product prices accordingly. We also hold a small part of our financial investments in other currencies, mainly New Israeli Shekels and Euro. The dollar value of those investments may decline. A revaluation of 1% of the foreign currencies (i.e. other than U.S. dollar) could reduce our income before taxes by approximately \$0.05 million.

A majority of our costs, including salaries, expenses and office expenses are incurred in New Israeli Shekels. Inflation in Israel may have the effect of increasing the U.S. dollar cost of our operations in Israel. If the U.S. dollar declines in value in relation to the New Israeli Shekel, it will become more expensive for us to fund our operations in Israel. A revaluation of 1% of the NIS will affect our income before tax by less than one percent. The exchange rate of the U.S. dollar to the New Israeli Shekel, based on exchange rates published by the Bank of Israel, was as follows:

	Year Ended December 31,		
	2006	2007	2008
Average rate for period	4.457	4.108	3.588
Rate at year-end	4.225	3.846	3.802

Towards the end of 2006, we engaged a firm to analyze our exposure to the fluctuation in foreign currency exchange rates and are implementing their recommendations since then. However, due to the market conditions, volatility and other factors, its proposals and their implementation occasionally prove to be ineffective or can cause additional finance expenses.

*Interest Rate Risk.* The primary objective of our investment activities is to preserve principal while maximizing the interest income we receive from our investments, without increasing risk. Our current investment policy is to invest in dollar denominated or linked debentures, of limited sums, rated A or higher and with an average maturity of no more than 3 years. We are exposed to market risks resulting from changes in interest rates relating primarily to our financial investments in cash, deposits and marketable securities. We do not use derivative financial instruments to limit exposure to interest rate risk. Our interest gains may decline in the future as a result of changes in the financial markets. However, we believe any such potential loss would be immaterial to us.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

## PART II

### ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

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

A. None.

#### B. USE OF PROCEEDS

The effective date of our first registration statement, filed on Form F-1 under the Securities Act (File No. 333-129246), relating to the initial public offering of our ordinary shares, was January 30, 2006.

### ITEM 15T. CONTROLS AND PROCEDURES

(a) **Disclosure Controls and Procedures.** Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2008. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2008, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act and the rules thereunder, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to the our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) **Management's Annual Report on Internal Control Over Financial Reporting:** Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management recognizes that there are inherent limitations in the effectiveness of any system of internal control over financial reporting, including the possibility of human error and the circumvention or override of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation, and may not prevent or detect all misstatements. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control – Integrated Framework." Our management has concluded, based on its assessment, that our internal control over financial reporting was effective as of December 31, 2008.

Our financial statements have been audited by Kost, Forer, Gabbay & Kasierer (A Member of Ernst & Young Global), an independent registered public accounting firm.

(c) Attestation Report of Registered Public Accounting Firm:

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report in this annual report.

(d) Changes in Internal Control Over Financial Reporting: During the period covered by this report, no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) have occurred that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 16. [Reserved]**

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our board of directors has determined that Mr. David Jutkowitz, who is an independent director (as defined under Rule 4200(a)(15) of the NASD market rules) and serves on our audit committee, qualifies as an "audit committee financial expert" as defined in Item 16A of Form 20-F.

**ITEM 16B. CODE OF ETHICS**

Our board of directors has adopted a code of conduct applicable to all of our directors, officers and employees as required by the Nasdaq Marketplace Rules, which also complies with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act of 2002. A copy of the code of ethics is included herein as Exhibit 11.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

We paid the following fees for the professional services rendered by Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, which have served as our registered public accounting firm for the last three years in thousands:

	<u>2007</u>	<u>2008</u>
Audit Fees	\$ 152	\$ 128
Audit Related Fees	22	-
Tax Fees	50	83
Total	<u>\$ 224</u>	<u>\$ 211</u>

Audit Fees include audit services, quarterly reviews. Audit related fees includes consultation regarding financial reporting. Tax fees include: corporate tax returns, international tax, tax implication regarding our status as a PFIC, VAT advice and tax advice related to acquisitions.

Our audit committee is responsible for the establishment of policies and procedures for review and pre-approval by the committee of all audit services and permissible non-audit services to be performed by our independent auditor, in order to ensure that such services do not impair our auditor's independence. Pursuant to the pre-approval policy adopted by our audit committee, certain enumerated audit, audit-related and tax services have been granted general pre-approval by our audit committee and need not be specifically pre-approved. Pre-approval fee levels or budgeted amounts for all services to be provided by the independent auditor will be established annually by the audit committee and the committee may also determine the appropriate ratio between the total amount of fees for audit, audit-related, tax services and other services. All requests for services to be provided by the independent auditor will be submitted to our Chief Financial Officer, who will determine whether such services are included within the enumerated pre-approved services. The audit committee will be informed on a timely basis of any pre-approved services that were performed by the auditor. Requests for services that require specific pre-approval will be submitted to the audit committee with a statement as to whether, in the view of the Chief Financial Officer and the independent auditor, the request is consistent with the SEC's rules on auditor independence. The Chief Financial Officer will monitor the performance of all services and determine whether such services are in compliance with the policy.

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

None.

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

## Issuer Purchases of Equity Securities (1)

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans	(d) Approximate Dollar Value in thousands of Shares that May Yet Be Purchased Under the Plans or Programs
May 2009	0	0	0	\$ 0
April 2009	0	0	0	\$ 0
March 2009	2,403	2.69	2,403	\$ 0
February 2009	18,891	2.74	18,891	\$ 4
January 2009	24,161	2.58	24,161	\$ 56
December 2008	76,910	2.37	76,910	\$ 118
November 2008	44,896	2.71	44,896	\$ 301
October 2008	93,788	3.14	93,788	\$ 422
September 2008	26,204	3.42	26,204	\$ 717
August 2008	39,093	3.32	39,093	\$ 806
July 2008	19,673	3.25	19,673	\$ 936
June 2008	0	0	0	\$ 0

(1) On January 23, 2008 we announced that our board had approved the use of \$1 million of our available cash to repurchase our ordinary shares. On March 25, 2009 we announced that our board had elected to continue with the second phase of this plan that authorizes the purchase of up to an additional \$1 million of our ordinary shares, subject to approval from the Israeli Tax Authority which has not yet been received. Under the repurchase program, share purchases may be made from time to time at the discretion of management in the open market or in privately negotiated transactions depending on market conditions, share price, trading volume and other factors. Such purchases will be made in accordance with the requirements of the SEC. For a portion of the authorized repurchase amount, we may enter into a plan that is compliant with Rule 10b5-1 of the Securities Exchange Act of 1934 that is designed to facilitate such purchases. The repurchase program has no time limit, does not require us to acquire a specific number of shares, and may be suspended from time to time or discontinued.

**ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT**

Not applicable.

**ITEM 16G. CORPORATE GOVERNANCE**

As a foreign private issuer whose shares are listed on the Nasdaq Global Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the Nasdaq Marketplace Rules.

As described in Item 10.B "Additional Information – Nasdaq Marketplace Rules and Home Country Practices," we do not comply with the Nasdaq requirement that an issuer listed on the Nasdaq Global Market have a quorum requirement that in no case be less than 33 1/3% of the outstanding shares of the company's common voting stock. However, our articles of association, consistent with the Israeli Companies Law, provide that the quorum requirements for an adjourned meeting are the presence of a minimum of two shareholders present in person. Our quorum requirements for an adjourned meeting do not comply with the Nasdaq requirements and we instead follow our home country practice.

As a foreign private issuer listed on the Nasdaq Global Market, we may also follow home country practice with regard to, among other things, distribution of annual and quarterly reports to shareholders, approval of related party transactions, composition of the board of directors, approval of compensation of executive officers, director nomination process and regularly scheduled meetings at which only independent directors are present. In addition, we may follow our home country practice, instead of the Nasdaq Marketplace Rules, which require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company. Under Nasdaq Marketplace Rules, U.S. domestic issuers are required to solicit proxies, provide proxy statements for all shareholder meetings and provide copies of such proxy materials to Nasdaq; however, as a foreign private issuer, we are generally exempt from the SEC's rules governing the solicitation of shareholder proxies.

See Item 6 "Directors, Senior Management and Employees – Board Practices" and Item 10.B "Additional Information – Nasdaq Marketplace Rules and Home Country Practices" for a detailed description of the significant ways in which the registrant's corporate governance practices differ from those followed by U.S. companies under the listing standards of the Nasdaq Global Market.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

The following financial statements and related auditors' report are filed as part of this annual report:

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Statements of Cash Flows for the Years Ended December 31, 2006, 2007 and 2008	F-7
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**ITEM 19. EXHIBITS:**

<u>No.</u>	<u>Description</u>
1.1	Memorandum of Association of Registrant (1)
1.2	Certificate of Change of Name of Registrant (translated from Hebrew) (1)
1.3	Amended and Restated Articles of Association of Registrant, dated February 3, 2006 (2)
4.1	Google AdSense™ Online Standard Terms and Conditions (4)
4.2	OEM Agreement, effective December 7, 2004, between Commtouch Ltd. and the Registrant (1)
4.3	The Registrant's 2003 Israeli Share Option Plan and the form of Option Agreement (1)
4.4	Google Services Agreement, dated July 1, 2008, by and between the Registrant and Google Ireland Ltd., a company organized under the laws of Ireland.*
8	List of all subsidiaries.
11	Code of Ethics (4)
12.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Executive officer of the Company
12.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Financial officer of the Company
13.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code
13.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code
14	Consent of Kost Forer Gabbay & Kasierer, an affiliate of Ernst & Young Global, Independent Auditors

(1) Previously filed with the SEC on October 25, 2005 as an exhibit to our registration statement on Form F-1/A (File No. 333-129246).

(2) Previously filed with the SEC on January 5, 2006 as an exhibit to our registration statement on Form F-1/A (File No. 333-129246).

(3) Previously filed with the SEC on January 26, 2006 as an exhibit to our registration statement on Form F-1/A (File No. 333-129246).

(4) Previously filed with the SEC on May 12, 2008 as an exhibit to our annual report on Form 20-F.

\* Confidential treatment has been requested with respect to certain portions of this exhibit pursuant to 17.C.F.R. §200.80(b)(4) . Omitted portions were filed separately with the SEC.

INCREDIMAIL LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2008

IN U.S. DOLLARS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Shareholders and Board of Directors of**

**INCREDIMAIL LTD.**

We have audited the accompanying consolidated balance sheets of Incredimail Ltd. ("the Company") and its subsidiaries as of December 31, 2007 and 2008, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2007 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
June 24, 2009

/s/ KOST FORER GABBAY & KASIERER  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2007	2008
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 4,611	\$ 7,835
Short term bank deposit	1,000	-
Marketable securities	17,811	18,790
Trade receivables	1,993	2,194
Deferred taxes, net	368	362
Other receivables and prepaid expenses	2,017	4,941
<b>Total current assets</b>	<b>27,800</b>	<b>34,122</b>
<b>LONG-TERM ASSETS:</b>		
Severance pay fund	1,037	955
Deferred taxes, net	92	328
Other long-term assets	740	619
Property and equipment, net	1,808	1,478
Other intangible assets, net	164	149
Goodwill	125	-
<b>Total long-term assets</b>	<b>3,966</b>	<b>3,529</b>
<b>Total assets</b>	<b>\$ 31,766</b>	<b>\$ 37,651</b>

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

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	December 31,	
	2007	2008
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 1,546	\$ 1,948
Deferred revenues	3,254	2,605
Accrued expenses and other liabilities	3,244	4,426
<b>Total current liabilities</b>	<b>8,044</b>	<b>8,979</b>
<b>LONG-TERM LIABILITIES:</b>		
Deferred revenues	1,559	1,743
Accrued severance pay	1,392	1,385
<b>Total long-term liabilities</b>	<b>2,951</b>	<b>3,128</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital -		
Ordinary shares of NIS 0.01 par value - Authorized: 15,000,000 shares as of December 31, 2007 and 2008; Issued and outstanding: 9,475,943 and 9,271,159 shares at December 31, 2007 and 2008, respectively	20	21
Additional paid-in capital	22,029	23,358
Accumulated other comprehensive income	112	12
Treasury shares - 0 and 300,564 Ordinary shares as of December 31, 2007 and 2008, respectively	-	(882)
Retained earnings (accumulated deficit)	(1,390)	3,035
<b>Total shareholders' equity</b>	<b>20,771</b>	<b>25,544</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 31,766</b>	<b>\$ 37,651</b>

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

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2006	2007	2008
<b>Revenues:</b>			
Advertising and other services	\$ 3,066	\$ 9,597	\$ 12,748
Products	7,785	9,078	9,158
	10,851	18,675	21,906
<b>Cost of Products</b>	<b>858</b>	<b>1,740</b>	<b>1,795</b>
<b>Gross profit</b>	<b>9,993</b>	<b>16,935</b>	<b>20,111</b>
<b>Operating expenses:</b>			
Research and development	3,251	6,125	7,589
Selling and marketing	1,767	4,682	7,343
General and administrative	2,717	3,693	3,806
Goodwill impairment and other charges	-	163	1,153
<b>Total operating expenses</b>	<b>7,735</b>	<b>14,663</b>	<b>19,891</b>
<b>Operating income</b>	<b>2,258</b>	<b>2,272</b>	<b>220</b>
Financial income (expenses), net	984	(3,641)	4,494
<b>Income (loss) before taxes on income</b>	<b>3,242</b>	<b>(1,369)</b>	<b>4,714</b>
Taxes on income	765	1,393	289
<b>Net income (loss)</b>	<b>\$ 2,477</b>	<b>\$ (2,762)</b>	<b>\$ 4,425</b>
<b>Net earnings (loss) per Ordinary share:</b>			
Basic	\$ 0.27	\$ (0.29)	\$ 0.47
Diluted	\$ 0.27	\$ (0.29)	\$ 0.46

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands (except per share data)

	Share capital	Additional paid-in capital	Deferred stock compensation	Accumulated other comprehensive income	Retained earnings (accumulated deficit)	Treasury shares	Total comprehensive income (loss)	Total shareholders' equity
Balance as of January 1, 2006	\$ 12	\$ 1,154	\$ (257)	\$ 78	\$ (1,022)	\$ -		\$ (35)
Issuance of share capital upon initial public offering, net	5	16,374	-	-	-	-		16,379
Conversion of preferred shares	3	3,027	-	-	-	-		3,030
Issuance of shares upon the acquisition of Bizchord	*)	100	-	-	-	-		100
Issuance of shares to non-employees	*)	60	-	-	-	-		60
Reclassification of deferred stock compensation to additional paid-in capital upon adoption of SFAS 123R	-	(257)	257	-	-	-		-
Stock based compensation	-	525	-	-	-	-		525
Exercise of share options	*)	10	-	-	-	-		10
Comprehensive income:								
Changes in unrealized holding gains on marketable securities, net	-	-	-	31	-	-	\$ 31	31
Net income	-	-	-	-	2,477	-	2,477	2,477
Total comprehensive income							\$ 2,508	
Balance as of December 31, 2006	20	20,993	-	109	1,455	-		22,577
Tax benefit in respect of offering expenses		143	-	-	-	-		143
Issuance of shares to non-employees	*)	63	-	-	-	-		63
Stock based compensation		706	-	-	-	-		706
Exercise of share options	*)	124	-	-	-	-		124
FIN 48 opening balance adjustment	-	-	-	-	(83)	-		(83)
Comprehensive income:								
Changes in unrealized holding gains on marketable securities, net	-	-	-	3	-	-	\$ 3	3
Net loss	-	-	-	-	(2,762)	-	(2,762)	(2,762)
Total comprehensive loss							\$ (2,759)	
Balance as of December 31, 2007	20	22,029	-	112	(1,390)	-		20,771
Stock based compensation	-	1,165	-	-	-	-		1,165
Exercise of share options	1	164	-	-	-	-		165
Repurchase of Ordinary shares	-	-	-	-	-	(882)		(882)
Comprehensive income:								
Changes in unrealized holding gains on marketable securities, net	-	-	-	(100)	-	-	(100)	(100)
Net income	-	-	-	-	4,425	-	4,425	4,425
Total comprehensive income							\$ 4,325	
Balance as of December 31, 2008	\$ 21	\$ 23,358	\$ -	\$ 12	\$ 3,035	\$ (882)		\$ 25,544

\*) Represents an amount less than \$1.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2006	2007	2008
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ 2,477	\$ (2,762)	\$ 4,425
Adjustments required to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	245	510	1,050
Stock based compensation	585	769	1,165
Impairment of goodwill and other intangible assets	-	316	169
Other-than-temporary impairment on long-term investment and marketable securities	-	5,147	956
Amortization of premium (accretion of discount) and accrued interest on marketable securities	7	92	55
Gain from sale of marketable securities, net	(226)	(386)	(4,774)
Deferred taxes, net	(290)	211	(217)
Accrued severance pay, net	185	91	75
Decrease (increase) in trade receivables	243	(165)	(201)
Increase in other receivables and prepaid expenses	(799)	(1,406)	(2,924)
Decrease (increase) in long-term deposits	(258)	(70)	26
Increase in trade payables	350	1,082	402
Increase (decrease) in deferred revenues	1,360	159	(465)
Increase in accrued expenses and other liabilities	1,309	226	1,182
Other	-	7	-
<b>Net cash provided by operating activities</b>	<b>5,188</b>	<b>3,821</b>	<b>924</b>
<b>Cash flows from investing activities:</b>			
Purchase of property and equipment	(831)	(1,355)	(640)
Proceeds from sale of property and equipment	-	15	-
Proceeds from short-term bank deposits	-	-	1,000
Investment in short-term bank deposits	-	(1,000)	-
Restricted cash	(62)	(66)	(5)
Capitalization of software development costs, content costs and domain	(76)	(84)	(109)
Payment for the acquisition of Bizchord (a)	(456)	-	-
Proceeds from sales of marketable securities	5,833	54,369	25,209
Investment in marketable securities	(20,462)	(59,749)	(22,438)
<b>Net cash used in investing activities</b>	<b>(16,054)</b>	<b>(7,870)</b>	<b>3,017</b>
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of shares upon initial public offering, net	16,798	-	-
Tax benefit in respect of issuance expenses	-	111	-
Exercise of share options	10	124	165
Reimbursement of issuance costs	-	59	-
Short-term bank credit, net	(4)	-	-
Repurchase of Ordinary shares	-	-	(882)
<b>Net cash provided by (used in) financing activities</b>	<b>16,804</b>	<b>294</b>	<b>(717)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>5,938</b>	<b>(3,755)</b>	<b>3,224</b>
Cash and cash equivalents at beginning of year	2,428	8,366	4,611
<b>Cash and cash equivalents at end of year</b>	<b>\$ 8,366</b>	<b>\$ 4,611</b>	<b>\$ 7,835</b>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2006	2007	2008
<u>Supplemental information and disclosures of non-cash investing and financing activities:</u>			
Decrease in deferred issuance costs	\$ 478	\$ -	\$ -
Conversion of Preferred shares into Ordinary shares	\$ 3,030	\$ -	\$ -
<u>Cash paid during the year for:</u>			
Income taxes	\$ 275	\$ 2,019	\$ 2,832
<u>(a) Payment for the acquisition of Bizchord:</u>			
Estimated fair value of assets acquired at the acquisition date:			
Other intangible assets	\$ 268		
Goodwill	288		
		556	
Less - issuance of Ordinary shares		(100)	
		456	

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: – GENERAL

a. General:

Incredimail Ltd. and its wholly-owned subsidiary in the U.S, Incredimail Inc., design develop and market content and media products, particularly email products, creating an entertaining experience by offering users the ability to design a customized and personal presentation, targeting the consumer and home market. Bizchord Ltd., a wholly-owned subsidiary in Israel, is engaged in transaction processing. Incredimail Ltd (“Incredimail”) and its wholly-owned subsidiaries are collectively referred to as “the Company”. The Company was incorporated under the laws of Israel in 1999 and commenced operations in 2000.

As for major customer data, see Note 12.

b. Initial Public Offering (“IPO”):

On February 3, 2006, the Company effected an Initial Public Offering (“IPO”) of its Ordinary shares on the Nasdaq Capital Market. The Company issued 2,500,000 shares at a price of \$7.50 per share before underwriting and issuance expenses. Total net proceeds from the issuance amounted to approximately \$16.4 million. Upon closing of the IPO, each Preferred share was converted into 38 Ordinary shares. On the closing date of the IPO, the Company granted to its underwriters an option to purchase 175,000 Ordinary shares at a price per share of \$9.375. The option shall expire five years following the grant date.

c. Acquisition of certain assets of Bizchord Consulting Corporation (“Bizchord”):

On December 18, 2006, the Company consummated an agreement to acquire certain assets of Bizchord Consulting Corporation in consideration of \$556,000 including 12,210 Ordinary shares of the Company valued at \$100,000 based on the market price two days before and after the acquisition date. Bizchord was a provider of online transaction process solutions, and as such was a significant supplier of the Company. The primary reason for the acquisition was to ensure the continued availability of these solutions, as well as the ability to maintain and further improve them in the future.

Under the terms of the acquisition agreement, additional contingent payment of up to \$250,000 in cash and in shares of Incredimail, equally, was to be paid to the selling shareholders of Bizchord based on services rendered to the Company by the selling shareholders over two years. In 2007, one of the selling shareholders ceased rendering services to the Company and accordingly, \$125,000 out of the total amount has been forfeited. The remaining \$125,000 was recognized as an operating expense over the service period in accordance with Emerging Issue Task Force (“EITF”) 95-8 “Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination”.

The acquisition was accounted for by the purchase method of accounting in accordance with SFAS No. 141 and accordingly, the purchase price has been allocated according to the estimated fair value of the assets acquired. The results of Bizchord operations have been included in the consolidated financial statements since December 18, 2006.

The following table summarizes the estimated fair values of the assets acquired at the acquisition date:

	U.S. dollars in thousands
Core technology	\$ 268
Goodwill	288
Net assets acquired	\$ 556

In 2007 and 2008, the Company recorded an impairment loss with respect to core technology and goodwill acquired on the acquisition of Bizchord, see Notes 2(i) and 2(j).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 1: – GENERAL (Cont.)**

In December 2008, the Company decided to discontinue BizChord's independent activities and restrict its activity to processing the Company's own transactions. In light of this the Company recorded an impairment loss for the remaining value of its goodwill and core technology.

**NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements have been prepared according to United States Generally Accepted Accounting Principles ("U.S. GAAP").

**a. 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.

**b. Financial statements in U.S. dollars:**

The Company has operations in Israel and most of the Israeli expenses are currently paid in New Israeli Shekels ("NIS"); however, the markets for the Company's products are located outside of Israel and the Company generates most of its revenues in U.S. dollars ("dollars"). The Company's management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation". All transaction gains and losses of the remeasured monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

**c. Principles of consolidation:**

Intercompany balances and transactions have been eliminated upon consolidation.

**d. Cash equivalents:**

The Company considers short-term unrestricted highly liquid investments that are readily convertible into cash, purchased with original maturities of three months or less to be cash equivalents.

**e. Restricted cash:**

Restricted cash is invested in bank deposits, which are pledged in favor of the bank which provides to the Company guarantees with respect to office lease agreements and business credit.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Marketable securities and long-term investment:

The Company accounts for investments in debt securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date.

At December 31, 2007 and 2008, all marketable securities are designated as available-for-sale. Marketable securities classified as "available-for-sale" are carried at fair value. Unrealized gains and losses, net of tax, are reported in a separate component of shareholders' equity in accumulated other comprehensive income. Gains and losses are recognized when realized, on a specific identification basis, in the Company's consolidated statements of operations.

In accordance with the Company's policy and FASB Staff Position ("FSP") Nos. SFAS 115-1 (FSP 115-1) and SFAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments", the Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. The Company considers various factors in determining whether to recognize an impairment charge, including the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value, the length of time and extent to which the fair value has been less than the cost basis, the credit ratings of the securities and the financial condition and near-term prospects of the issuers. As for other-than temporary impairment recognized in these financial statements, see note 3a.

g. Property and equipment:

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

	%
Computers and peripheral equipment	33
Office furniture and equipment	7 - 15
Automobiles	15

Leasehold improvements are depreciated by the straight-line method over the term of the lease or the estimated useful life of the improvements, whichever is shorter.

h. Intangible assets:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets".

Amortization is calculated using the straight-line method over the estimated useful lives at the following annual rates:

	Weighted average %
Capitalized software development costs (see 2l)	33
Capitalized content costs (see 2o)	33
Core technology	25
Domain	33

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## i. Impairment of long-lived assets:

The Company's long-lived assets, tangible and intangible, other than goodwill, are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. In 2006, no impairment loss has been identified. In 2007 and 2008, the Company recorded an impairment loss to cost of revenues in the amounts of \$153,000 and \$44,000, respectively, in respect of core technology acquired in the acquisition of Bizchord.

## j. Goodwill:

Goodwill represents the excess of the cost over the fair value of the net assets of businesses acquired. Under SFAS No. 142, goodwill is not amortized, but instead is tested for impairment at least annually (or more frequently if impairment indicators arise).

Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. The Company operates in two operating segments, Incredimail and BizChord, and these segments comprise its reporting units. Goodwill is allocated to the reporting unit of BizChord. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair value is determined using discounted cash flows. Significant estimates used in the fair value methodologies include estimates of future cash flows, future growth rates and the weighted average cost of capital of the reporting unit. In 2007 and 2008, the Company recorded an impairment loss in the amounts of \$163,000 and \$125,000 in respect of Bizchord reporting unit, respectively.

## k. Revenue recognition:

The company derives revenues from: (i) advertising and other services and (ii) from product sales. Revenues from advertising and other services include search related advertising, other advertising and collaboration arrangements. Revenues from products include licensing the right to use its email software, content database and email anti spam.

The Company generates revenues from search related advertising, receiving a share of the advertising revenues from companies providing search capabilities. In addition, the Company offers advertisers the ability to place text-based ads on its website and banners in its email clients. Advertisers are charged monthly based on the number of times a user clicks on the ads. The Company recognizes revenues from direct and third party advertisement at that time.

In accordance with EITF No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Product," the Company accounts for cash consideration given to customers, for which it does not receive a separately identifiable benefit or cannot reasonably estimate fair value, as a reduction of revenue rather than as an expense.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Collaboration arrangements have been established with companies that use the Company's brand name "Incredi" for their website and to which the Company refers users. In consideration of the brand and promotional activity that the Company provides, it is entitled to a share of the gross revenues generated from the website or to a share of the net license fees received by the Company's collaborator through its website. Revenues from these collaboration arrangements are recognized when earned.

Revenues from email software license sales are recognized when all criteria outlined in Statement of Position ("SOP") 97-2, "Software Revenue Recognition" (as amended), are met. Revenues from software license are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectability is probable. The Company's e-mail users may also purchase a license to its content database. This content database provides additional Incredimail content files in the form of email background, animation sounds, graphics and e-mail notifiers. Licensing fees are recognized over the license period. Lifetime licensing revenues are recognized over the estimated usage period of the content database. In accordance with its policy, the Company reviews the estimated usage period of the lifetime licensing on an ongoing basis.

Deferred revenues include upfront payments received from customers, for which revenues have not yet been recognized.

Revenues from email anti-spam license fees are recognized ratably over the term of the license.

With regard to arrangements involving multiple elements, the Company revenues should be allocated to the different elements in the arrangement under the "relative fair value method" when Vendor Specific Objective Evidence ("VSOE") of fair value exists for all elements in accordance with SOP No. 97-2. Under the relative fair value method, the Company allocates revenue proportionally based on the fair value of its delivered and undelivered elements. Any discount in the arrangement is allocated pro rata to the different elements in the arrangements.

I. Research and development costs:

Research and development costs incurred in the process of software production before establishment of technological feasibility, are charged to expenses as incurred. Costs of the production of a product master incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed". Based on the Company's product development process, technological feasibility is established upon completion of a working model.

Costs incurred by the Company between completion of the working model and the point at which the product is ready for general release, have been capitalized.

Capitalized software development costs are amortized commencing with general product release, by the greater of the amount computed using the: (i) ratio that current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product. The Company assesses the recoverability of this intangible assets on an annually basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its analyses, management believes that no impairment of capitalized software development cost exist as of December 31, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## m. Income taxes:

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement.

The Company classifies interest as tax expenses. The Company's policy for interest related to income tax exposures was not impacted as a result of the adoption of the recognition and measurement provisions of FIN No. 48.

As a result of the implementation of FIN No. 48, the Company recognized a \$83 increase in liability for unrecognized tax benefits, which was accounted for as an decrease to the January 1, 2007 balance of retained earnings.

## n. Advertising costs:

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2006, 2007 and 2008 amounted to \$218,000, \$1,411,000 and \$3,466,000, respectively.

## o. Content costs:

The Company assembles content for the use of its customers through purchases of a variety of creative and diverse graphics, sound and multimedia from third party manufacturers and through internal creation of such content. In 2006, the Company expensed content costs as incurred. Effective January 1, 2007, the Company changed its accounting policy for recognizing costs of database contents acquired from third parties. Under the new policy, these costs are capitalized and amortized over their estimated useful life of three years. The Company determined that this change in accounting principle is preferable in the circumstances from the following reasons: (1) content database is acquired and added to the Company's library, (2) being developed and subsequently billed by independent third parties, the market value of this content is easily determined. This content is being used by the Company's customers over several years and does not get depleted. The customers cease using the content after several years when it becomes no longer attractive or innovative. Prior periods have not been restated due to immateriality.

Content costs for the year 2006 amounted to \$198,000. Content costs in 2007 and 2008 amounted to \$568,000 and \$779,000, respectively, of which \$84,000 and \$74,000 was capitalized and the remaining expensed as incurred. Amortization of capitalized content costs in 2007 and 2008 amounted to \$17,000 and \$33,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## p. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short term bank deposits, marketable securities and trade receivables.

The majority of the Company's cash and cash equivalents and short term bank deposits are invested mainly in dollar instruments with major banks in Israel and the U.S.. Deposits in the U.S. may be in excess of insured limits and are not insured in other jurisdictions. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk.

The Company's marketable securities consist of investment-grade corporate debentures and government debentures. The Company's investment policy, approved by the Investment Committee, limits the amount the Company may invest in any one type of investment or issuer, thereby reducing credit risk concentrations.

The Company is subject to a low amount of credit risk with respect to sales of the Company's software products and content database, as these sales are primarily obtained through credit card sales. The Company's major customer is financially sound, and the Company believes low credit risk is associated with this customer. To date, the Company has not experienced any material bad debt losses.

## q. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israeli Severance Pay Law based on its employees' most recent monthly salaries, multiplied by the number of years of their employment, or a portion thereof, as of the balance sheet date. This liability is fully provided for by monthly deposits in insurance policies and by an accrual.

The deposited funds include profits (losses) accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli Severance Pay Law or labor agreements.

The Company's agreements with employees in Israel, joining the Company since February 2, 2008, are in accordance with section 14 of the Severance Pay Law -1963, whereas, the Company's contributions for severance pay shall be instead of its severance liability. Upon contribution of the full amount of the employee's monthly salary, and release of the policy to the employee, no additional calculations shall be conducted between the parties regarding the matter of severance pay and no additional payments shall be made by the Company to the employee. Further, the related obligation and amounts deposits on behalf of such obligation are not stated on the balance sheet, as they are legally released from obligation to employees once the deposit amounts have been paid.

Severance expenses for the years ended December 31, 2006, 2007 and 2008 amounted to \$405,000, \$499,000 and \$715,000, respectively.

## r. Net earnings (loss) per Ordinary share:

In 2006, the Company applied the two-class method as required by Emerging Issues Task Force ("EITF") No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, "Earnings per Share" (SFAS 128). EITF No. 03-6 requires the income per share for each class of shares (Ordinary shares and Preferred shares) to be calculated assuming 100% of the Company's earnings are distributed as dividends to each class of shares based on their contractual rights. In 2007 and 2008, the Company had only one class of shares.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Basic net earnings (loss) per Ordinary shares are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per Ordinary share are computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with SFAS No. 128, "Earnings per Share".

The total weighted average number of Ordinary shares related to the outstanding options excluded from the calculations of diluted net earnings per Ordinary share because these securities are anti-dilutive was 539,609 and 1,205,834 for the years ended December 31, 2006 and 2008. Because of the loss in 2007, all options were excluded from the calculation of diluted net loss per share.

s. Accounting for stock-based compensation:

The Company accounts for stock-based compensation under SFAS No. 123(R), "Share-Based Payment" ("SFAS 123(R)") which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors.

SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statements of operations.

The Company recognizes compensation expenses for the value of its awards, which have graded vesting based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company estimates the fair value of stock options granted using the Binomial method option-pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon an average between historical volatilities of the Company, similar entities and industry sector index similar to the Company's characteristics, since it does not have sufficient company specific data.

The expected option term was calculated based on the Company's assumptions of early exercise multiples which were calculated based on comparable companies and termination exit rate which was calculated based on actual historical data. The expected option term represents the period that the Company's stock options are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The fair value of the Company's stock options granted to employees and directors was estimated using the following weighted average assumptions:

	Year ended December 31,		
	2006	2007	2008
Risk free interest rate	4.8%	4.1%	2.87%
Dividend yield	0%	0%	0%
Expected volatility	41%-71.9%	46.9%-59.8%	43.72%-74.43%
Weighted average volatility	56.3%	53.4%	59.07%
Expected term (years)	3.95	4.175	4.051

t. Derivatives instruments:

The Company uses derivatives instruments to protect against foreign currency fluctuations. These instruments were not designated as cash flow hedge as defined by SFAS No. 133 and therefore the Company recognized the changes in fair value of these instruments to the statements of operations as financial income or expense, as incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

u. Fair value of financial instruments:

The carrying amounts of financial instruments carried at cost, including cash and cash equivalents, short term bank deposits, trade receivables and trade payables approximate their fair value due to the short-term maturities of such instruments.

The Company adopted the provisions of SFAS No. 157, “Fair Value Measurements”(“SFAS No. 157”) and FSP No. SFAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active”, except as it applies to the nonfinancial assets and nonfinancial liabilities subject to FSP 157-2 effective January 1, 2008. Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. SFAS No. 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

- Level 1 – Valuations based on quoted prices in active markets for identical assets that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2 – Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of observable inputs can vary from investment to investment and is affected by a wide variety of factors, including, for example, the type of investment, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment, and categorizes as Level 3.

The Company’s marketable securities trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency, therefore are categorized as Level 2.

The following table presents assets measured at fair value on a recurring basis at December 31, 2008:

	Fair value measurements using input type			
	Level 1	Level 2	Level 3	Total
<b>Cash equivalent:</b>				
Treasury notes	\$ -	\$ 2,100	\$ -	\$ 2,100
<b>Marketable securities:</b>				
Corporate debentures	-	8,419	-	8,419
Government debentures	-	10,371	-	10,371
Total Financials Assets	\$ -	\$ 20,890	\$ -	\$ 20,890

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2: – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The following table presents the changes in Level 3 instruments measured on a recurring basis for the year ended December 31, 2008. The Company’s Level 3 instrument consists of an Auction Rate Security (see note 3(b)).

	ARS issued by Credit Suisse
Balance, beginning of period	\$ 100
Sale of ARS, net	(100)
Balance, end of period	\$ -

v. Treasury shares:

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

w. Recently issued accounting pronouncements:

In February 2008, the FASB issued FASB Staff Position (“FSP”) FAS No. 157-2, “Effective Date of FASB Statement No. 157” (“FSP 157-2”), to delay the effective date of FASB Statement 157 for one year for certain nonfinancial assets and nonfinancial liabilities, excluding those that are recognized or disclosed in financial statements at fair value on a recurring basis (that is, at least annually). For purposes of applying the FSP 157-2, nonfinancial assets and nonfinancial liabilities include all assets and liabilities other than those meeting the definition of a financial asset or a financial liability in FASB Statement 159. FSP 157-2 defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP 157-2. The adoption of FAS 157 to nonfinancial assets and nonfinancial liabilities under the scope of FSP 157-2 did not have a material impact on the Company’s financial position, results of operations or cash flows.

In March 2008, the FASB issued Statement 161 “Disclosures about Derivative Instruments and Hedging Activities” (“SFAS 161”) an amendment to FASB No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why and entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. The adoption of SFAS 161 did not have a material impact on the Company’s financial position, results of operations or cash flows.

In April 2008, the FASB issued FSP 142-3, “Determination of the Useful Life of Intangible Assets” (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets”. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP 142-3 did not have a material impact on the Company’s financial position, results of operations or cash flows.

In April 2009, the FASB issued FSP, No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, or the FSP. The FSP is intended to provide greater clarity to investors about the credit and noncredit component of an other-than-temporary impairment event and to more effectively communicate when an other-than-temporary impairment event has occurred. The FSP applies to fixed maturity securities only and requires separate display of losses related to credit deterioration and losses related to other market factors. When an entity does not intend to sell the security and it is more likely than not that an entity will not have to sell the security before recovery of its cost basis, it must recognize the credit component of an other-than-temporary impairment in earnings and the remaining portion in other comprehensive income. Upon adoption of the FSP, an entity will be required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to accumulated other comprehensive income. The FSP will be effective for us for the quarter ending June 30, 2009. The Company is currently evaluating the impact of adopting the FSP.

In April 2009, the FASB issued FSP No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, or FSP 157-4. FSP 157-4 provides additional authoritative guidance to assist both issuers and users of financial statements in determining whether a market is active or inactive, and whether a transaction is distressed. The FSP will be effective for us for the quarter ending June 30, 2009. The Company does not expect the adoption of FSP 157-4 to have a material impact on our consolidated financial position and results of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3: - MARKETABLE SECURITIES AND LONG-TERM INVESTMENT

a. Marketable securities:

The Company's marketable securities are classified as available-for-sale securities and are carried at fair value. The following table summarizes amortized costs, gross unrealized holding gains and losses and market value of marketable securities as of December 31, 2007 and 2008:

	Amortized cost		Gross unrealized gains		Gross unrealized losses		Market value	
	December 31,		December 31,		December 31,		December 31,	
	2007	2008	2007	2008	2007	2008	2007	2008
U.S. dollars in thousands								
Corporate debentures	\$ 17,631	\$ 8,370	\$ 135	\$ 131	\$ 5	\$ 82	\$ 17,761	\$ 8,419
Government debentures	50	10,404	-	8	-	41	50	10,371
	<u>\$ 17,681</u>	<u>\$ 18,774</u>	<u>\$ 135</u>	<u>\$ 139</u>	<u>\$ 5</u>	<u>\$ 123</u>	<u>\$ 17,811</u>	<u>\$ 18,790</u>

The Company reviews various factors in determining whether it should recognize an impairment charge for its marketable securities, including its intent and ability to hold the investment for a period of time sufficient for any anticipated recovery in market value, the length of time and extent to which the fair value has been less than its cost basis, the credit ratings of the securities, the nature of underlying collateral, as applicable and the financial condition and near-term prospects of the issuer. Based on the Company's consideration of these factors, the amortized cost of marketable securities as of December 31, 2007 and 2008 was reduced by \$247,000 and \$956,000, respectively, to reflect other-than-temporary impairment that was recorded in 2007 and 2008 with respect to these securities.

As of December 31, 2008, all marketable securities with unrealized losses, are in a loss position for less than 12 months.

The following table summarizes the carrying amount of available-for-sale debt marketable securities at December 31, 2008, segregated based on their scheduled maturities:

	U.S. dollars in thousands
Due within one year	\$ 10,206
Due after one year through five years	8,058
Due after ten years	526
	<u>\$ 18,790</u>

b. Long-term investment:

At December 31, 2007, the Company had \$5,000,000 of principal invested in Auction Rate Security ("ARS"). The ARS held by the Company is a private placement security with long-term nominal maturities for which the interest rates are reset through an auction each month. The monthly auctions historically have provided a liquid market for these securities. Some of the underlying collateral for the ARS held by the Company consists of sub-prime mortgages.

With the liquidity issues experienced in global credit and capital markets, the ARS held by the Company at December 31, 2007 had experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders. Based on valuation models and an analysis of other-than-temporary impairment factors, the Company has recorded a pre-tax impairment charge of \$4,900,000 in the fourth quarter of 2007 in the financial expenses. The estimated market value of the Company's ARS holdings at December 31, 2007 was \$100,000, which is presented in other long-term assets as of that date.

On October 23, 2008 as a result of a general settlement arrangement with the issuer of the ARS, the Company sold the ARS for its par value and recorded financial income in the amount of approximately \$4.8 million (net off legal expenses in the amount of \$0.1 million).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4: - PROPERTY AND EQUIPMENT, NET

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Cost:		
Computers and peripheral equipment	\$ 2,125	\$ 2,544
Office furniture and equipment	278	365
Leasehold improvements	631	516
Automobiles	41	38
	<u>3,075</u>	<u>3,463</u>
Accumulated depreciation	1,267	1,985
	<u>1,808</u>	<u>1,478</u>
Depreciated cost	\$ 1,808	\$ 1,478

Depreciation expenses totaled \$242,000, \$402,000 and \$970,000 for the years ended December 31, 2006, 2007 and 2008, respectively.

NOTE 5: - OTHER INTANGIBLE ASSETS, NET

Other intangible assets:

	December 31,	
	2007	2008
	U.S. dollars in thousands	
Original amounts:		
Capitalized software development costs	\$ 76	\$ 76
Capitalized content costs	84	158
Core technology	115	71
Domain	-	35
	<u>275</u>	<u>340</u>
Accumulated amortization	111	191
Other intangible assets, net	\$ 164	\$ 149

b. Amortization expense amounted to \$3,000, \$108,000 and \$80,000 for the years ended December 31, 2006, 2007 and 2008, respectively.

c. Estimated amortization expense for the years ended December 31:

	U.S. dollars in thousands
2009	\$ 81
2010	51
2011	17
	<u>149</u>

d. For impairment losses, see Note 2(i).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6: - GOODWILL

The changes in the carrying amount of goodwill for the years ended December 31, 2007 and 2008 were as follows:

	December 31,	
	2007	2008
U.S. dollars in thousands		
Goodwill, beginning of the year	\$ 288	\$ 125
Goodwill impairment	(163)	(125)
Goodwill, end of year	\$ 125	\$ -

NOTE 7: - ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2007	2008
U.S. dollars in thousands		
Employees and payroll accruals	\$ 1,443	\$ 1,467
Government authorities	1,296	2,023
Accrued expenses	505	936
	\$ 3,244	\$ 4,426

NOTE 8: - COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

The Company rents its facilities under an operating lease agreement with an initial term expiring in 2011, with an option for additional two years.

Future minimum lease commitments under non-cancelable operating leases for the years ended December 31, are as follows:

	U.S. dollars in thousands
2009	\$ 456
2010	624
2011	624
	\$ 1,704

Total rent expenses for the years ended December 31, 2006, 2007 and 2008 amounted to \$118,000, \$337,000 and \$678,000 respectively.

The Company leases its motor vehicles under cancelable operating lease agreements. The minimum payment under these operating leases, upon cancellation of these lease agreements amounted to \$34,000 as of December 31, 2008. Total lease expenses for the years ended December 31, 2006, 2007 and 2008 amounted to, \$206,000, \$373,000 and \$556,000, respectively.

b. Legal Proceedings

On November 3, 2008, a complaint was filed against the Company in the United States District Court for the Southern District of New York in a purported class action regarding one of the Company's products. The plaintiff, on behalf of himself and the purported classes, seeks injunctive relief, an unspecified amount for damages, plus costs and attorney fees for alleged claims that components of the Company's product were rendered inoperable by a software update or updates. The Company believes that the allegations have no merit and therefore no provision was recorded as of December 31, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 9: - INCOME TAXES**

- a. Tax benefits under the Israel Law for the Encouragement of Capital Investments, 1959 (the "Law"):

Two programs of the Company have been granted "Approved Enterprise" status under the Law. For these programs, the Company has elected alternative benefits, waiving grants in return for tax exemptions. These benefits include a tax-exemption for a period of two years and taxation at the reduced corporate tax rate of 25% for an additional period of five to eight years thereafter. The benefit period commenced in 2003 and in 2005 for the first and second programs, respectively.

The period of tax benefits detailed above is subject to limits of the earlier of 12 years from the commencement of production or 14 years from receiving the approval. The entitlement to the above benefits is subject to fulfilling the conditions stipulated by the Law, regulations published thereunder and instruments of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2008, management believes that the Company meets all conditions of the approvals.

On April 1, 2005, an amendment to the Law came into effect ("the Amendment") and has significantly changed the provisions of the Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a "Privileged Enterprise" (rather than the previous terminology of Approved Enterprise), such as a provision requiring that at least 25% of the "Privileged Enterprise" income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Law so that companies are no longer required for Investment Center approval in order to qualify for tax benefits. The period of tax benefits for a new "Privileged Enterprise" commences in the "Year of Commencement". This year is the later of: (1) the year in which taxable income is first generated by the Company, or (2) a year selected by the Company for commencement, on the condition that the Company meets certain provisions provided by the Law ("Year of Election").

In addition, the Law provides that terms and benefits included in any letter of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore, the two existing Approved Enterprises will not be subject to the provisions of the Amendment.

The Company has one "Privileged Enterprise" plan. The period of benefits under the Privileged Enterprise first program has commenced in 2008.

As a result of the amendment, tax-exempt income generated under the provisions of the amended law, will subject the Company to taxes upon dividend distribution or complete liquidation.

As of December 31, 2008, approximately \$7,954,000 is tax-exempt attributable to its various Approved Enterprise and Privileged Enterprise programs. If such tax exempt income is distributed (other than in respect of the first two programs upon the complete liquidation of the Company), it would be taxed at the reduced corporate tax rate applicable to such profits (currently 25%) and an income tax liability of up to approximately \$1,989,000 would be incurred as of December 31, 2008. The Company does not intend to distribute dividend out off tax exempt income incurred up to December 31, 2008, accordingly no deferred tax liability have been provided on income attributable to the Company's Approved Enterprise and Privileged Enterprise programs. In March 2009, the Company board of directors approved a cash dividend in the amount of \$4.6 million (see note 14). The amount of tax exempt income will not change as a result of this dividend, since the distribution is from sources other than tax exempt income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 9: - INCOME TAXES (Cont.)**

Income of the Company from sources other than the Approved Enterprise and Privileged Enterprise during the period of benefits is taxable at the regular corporate tax rate.

b. Corporate tax rates in Israel:

Taxable income of Israeli companies is subject to tax at the rate of 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

c. Deferred tax assets, net:

Deferred taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Components of the Company's deferred tax assets are as follows:

	December 31,	
	2007	2008
U.S. dollars in thousands		
Employee benefits	\$ 138	\$ 304
Research and development expenses	181	157
Issuance costs	123	-
Other-than-temporary impairment on marketable securities and ARS	1,287	301
Impairment of intangible assets and goodwill	36	83
Other	-	150
Deferred tax assets, before valuation allowance	1,765	995
Valuation allowance *)	(1,287)	(301)
Deferred tax assets	478	694
Deferred tax liability	(18)	(4)
	\$ 460	\$ 690

\*) The Company recorded a valuation allowance with respect to deferred tax assets related to other-than-temporary impairment on marketable securities and ARS, due to current uncertainty of whether the Company will produce sufficient gains from marketable securities in the future, which are considered a source of income required to offset losses from marketable securities under the Israeli Tax Law.

All deferred tax assets and liabilities are domestic.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9: - INCOME TAXES (Cont.)

d. A reconciliation of the Company's effective tax rate to the statutory tax rate in Israel is as follows:

	Year ended December 31,		
	2006	2007	2008
	U.S. dollars in thousands		
Income (loss) before taxes on income	\$ 3,242	\$ (1,369)	\$ 4,714
Statutory tax rate in Israel	31%	29%	27%
Theoretical income tax expense	\$ 1,005	\$ (397)	\$ 1,273
Increase (decrease) in tax expenses resulting from:			
"Approved Enterprise" benefits	(409)	(77)	(536)
Non-deductible expenses	234	358	374
Previous years taxes	(68)	-	(234)
Other-than-temporary impairment on marketable securities and ARS	-	1,493	258
Gain on sale of ARS, previously impaired	-	-	(1,323)
Other	3	16	477
Taxes on income	\$ 765	\$ 1,393	\$ 289
Net earnings (loss) per Ordinary share - benefit resulting from "Approved Enterprise" status:			
Basic	\$ 0.05	\$ (0.01)	\$ (0.06)
Diluted	\$ 0.04	\$ (0.01)	\$ (0.06)

e. Income taxes are comprised as follows:

Deferred tax benefit (expense)	\$ (70)	\$ 106	\$ (216)
Current taxes	903	1,191	739
Previous years taxes	(68)	88	(234)
	\$ 765	\$ 1,393	\$ 289

f. Uncertain tax position:

A reconciliation of the beginning and ending balances of the total amounts of unrecognized tax benefits is as follows:

	U.S. dollars in thousands
Balance at January 1, 2008	\$ 842
Increases in tax positions for current year*)	801
Reductions for prior year tax positions due to settlement	(286)
Balance at December 31, 2008	\$ 1,357

\*) Includes additions generated from changes in the Dollar/NIS exchange rate, adjustment to the CPI and accrued interest in the total amount of \$77,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 9: - INCOME TAXES (Cont.)**

As of December 31, 2008, the Company is subject to Israeli income tax examinations for the tax years 2006 through 2008 and to U.S. Federal income tax examinations for the tax years of 2006 through 2008.

g. Income (loss) before taxes on income is comprised as follows:

	Year ended December 31,		
	2006	2007	2008
Domestic	\$ 3,222	\$ (1,415)	\$ 4,676
Foreign - U.S.A	20	46	38
	<u>\$ 3,242</u>	<u>\$ (1,369)</u>	<u>\$ 4,714</u>

**NOTE 10: - SHAREHOLDERS' EQUITY**

a. Ordinary share rights:

The Ordinary shares entitle their holders to voting rights, the right to receive cash dividend and the right to a share in excess assets upon liquidation of the Company.

b. Shares granted to non-employees:

In August 2006, the Company granted 7,500 restricted Ordinary shares to non-employee in respect of services granted to the Company. The shares vested on December 1, 2006.

In February 2007, the Company granted 7,500 restricted Ordinary shares to non-employee in respect of services granted to the Company. The shares vested on June 1, 2007.

The Company accounted for the grant in accordance with SFAS No. 123 and Emerging Issues Task Force ("EITF") No. 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services". Stock based compensation amounted to \$60,000, \$63,000 and \$0 in the years ended December 31, 2006, 2007 and 2008, respectively.

c. Treasury shares:

In July 2008, the Company's Board of Directors authorized the repurchase of up to \$3,750,000 in the open market, subject to normal trading restrictions. During 2008, the Company repurchased 300,564 of its Ordinary shares for a total consideration of \$882,000 which were recorded as treasury shares, at cost as part of shareholders' equity.

d. Share option plans:

In 2003, the Company adopted a share option plan ("the 2003 Option Plan"). Under the 2003 Option Plan, employees, officers and non-employees may be granted options to acquire Ordinary shares. Pursuant to the 2003 Option Plan, the Company has reserved for issuance a total of 2,368,000 Ordinary shares. As of December 31, 2008, 911,195 options were still available for future grant under the 2003 Option Plan.

Options granted under the 2003 Plan vested over three to four years from the grant date. The options expire no later than five years from the date of grant.

The Company recognizes compensation costs using the straight line attribution method, but not less than the grant date fair value of the options vested at the balance-sheet date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10: - SHAREHOLDERS' EQUITY (Cont.)

A summary of the activity in the share options granted to employees and directors as of December 31, 2008 and related information is as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term  (Years)	Aggregate intrinsic value  U.S. dollars in thousands
Outstanding at January 1, 2008	1,109,320	\$ 4.93*)	3.58	\$ 2,128
Granted	412,500	\$ 3.35		
Exercised	(95,780)	\$ 1.72		
Expired	(122,000)	\$ 4.92		
Forfeited	(12,000)	\$ 4.50		
Outstanding at December 31, 2008	1,292,040	\$ 4.08	3.28	\$ 62
Exercisable at December 31, 2008	529,340	\$ 4.41	2.40	\$ 61

\*) After adjustment with respect to re-pricing, for further information see below.

The weighted-average grant-date fair value of options granted during the years 2006, 2007 and 2008 was \$2.57, \$2.46 and \$1.32, respectively.

As of December 31, 2008, the total compensation cost related to options granted to employees, not yet recognized amounted to \$1,157,000. The cost is expected to be recognized over a weighted average period of 2.43 years.

Aggregate intrinsic value of options exercised in 2006, 2007 and 2008 amounted to \$39,000, \$444,673 and \$76,000, respectively.

In February 2008, the Company's Board of Directors resolved to re-price 516,100 options which were previously granted to the Company's employees to the fair market value as of that date. The Company accounted for the re-pricing as a modification in accordance with SFAS 123R and recorded an additional compensation expense, in the amount of \$309,000 which will be recognized over the remaining vesting period or immediately for vested options.

NOTE 11: - SUPPLEMENTARY DATA ON SELECTED CONSOLIDATED STATEMENTS OF OPERATIONS

a. Goodwill impairment and other charges:

In 2008, the Company terminated certain activities and decided to restrict the business of its Bizchord subsidiary to exclusively processing the Company's transactions and to cease investing in the subsidiary's pursuit of other business. As a result of these actions, the Company reduced its work force and terminated certain contracts.

	Year ended December 31,		
	2006	2007	2008
	U.S. dollars in thousands		
Goodwill impairment	\$ -	\$ 163	\$ 125
Severance and other employee related termination benefit	-	-	528
Contract termination costs	-	-	500
	\$ -	\$ 163	\$ 1,153

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11: - SUPPLEMENTARY DATA ON SELECTED CONSOLIDATED STATEMENTS OF OPERATIONS (Cont.)

b. Financial income (expenses), net:

	Year ended December 31,		
	2006	2007	2008
	U.S. dollars in thousands		
Financial income:			
Interest from bank deposits and marketable securities	\$ 998	\$ 1,033	\$ 883
Gains from marketable securities, net	151	-	3,587
Exchange rate differences, net	-	39	3
Other	-	198	87
	<u>1,149</u>	<u>1,270</u>	<u>4,560</u>
Financial expenses:			
Losses from marketable securities and ARS, net	-	4,887	-
Exchange rate differences, net	68	-	-
Other	97	24	66
	<u>165</u>	<u>4,911</u>	<u>66</u>
	<u>\$ 984</u>	<u>\$ (3,641)</u>	<u>\$ 4,494</u>

c. Net earnings (loss) per Ordinary share:

Computation of basic and diluted net earnings (loss) per share is as follows:

1. Numerator:

	Year ended December 31,		
	2006	2007	2008
	U.S. dollars in thousands (except share data)		
Numerator for basic and diluted net earnings (loss) per share -			
Net income - (loss) as reported	\$ 2,477	\$ (2,762)	\$ 4,425
Net income attributable to Preferred shareholders	(45)	-	-
Net income (loss) available to Ordinary shareholders	<u>\$ 2,432</u>	<u>\$ (2,762)</u>	<u>\$ 4,425</u>

2. Denominator:

Denominator for basic net earnings per share -			
Weighted average number of Ordinary shares, net of treasury stock	8,982,201	9,442,658	9,427,424
Effect of dilutive securities:			
Add - stock options	164,192	-	89,053
Denominator for diluted net earnings per share - adjusted weighted average shares	<u>9,146,393</u>	<u>9,442,658</u>	<u>9,516,477</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12: - MAJOR CUSTOMER DATA

Major customer data as a percentage of total revenues:

	Year ended December 31,		
	2006	2007	2008
Customer A	14%	42%	49%

The Company relies upon a major customer, a loss of whom could cause a material adverse effect on the Company's results of operations and financial position. The major customer has limited termination rights.

NOTE 13: - SEGMENT INFORMATION

a. Reportable segments information:

In 2007, following the acquisition of Bizchord, the Company determined that Bizchord is considered a reportable segment and provided summarized financial information as set forth below.

	Year ended December 31, 2007			
	Incredimail	Bizchord	Intercompany charges	Total
	U.S. dollars in thousands			
Revenues	\$ 18,647	\$ 316	\$ (288)	\$ 18,675
Gross profit (loss)	\$ 17,307	\$ (84)	\$ (288)	\$ 16,935
Operating expenses	\$ 14,020	\$ 931	\$ (288)	\$ 14,663
Operating income (loss)	\$ 3,287	\$ (1,015)	\$ -	\$ 2,272

  

	Year ended December 31, 2008			
	Incredimail	Bizchord	Intercompany charges	Total
	U.S. dollars in thousands			
Revenues	\$ 21,827	\$ 415	\$ (336)	\$ 21,906
Gross profit	\$ 20,230	\$ 217	\$ (336)	\$ 20,111
Operating expenses	\$ 18,530	\$ 1,697	\$ (336)	\$ 19,891
Operating income (loss)	\$ 1,700	\$ (1,480)	\$ -	\$ 220

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13: - SEGMENT INFORMATION (Cont.)

b. Product lines:

Total revenues from external customers divided on the basis of the Company's product lines are as follows:

	Year ended December 31,		
	2006	2007	2008
U.S. dollars in thousands			
Search related advertising	\$ 1,464	\$ 7,855	\$ 11,745
Advertising and Collaborations	1,602	1,714	924
Software license	3,494	3,128	3,609
Content database	2,463	2,526	1,745
Anti-Spam	1,828	3,424	3,804
Bizchord - clearing house services	-	28	79
	<u>\$ 10,851</u>	<u>\$ 18,675</u>	<u>\$ 21,906</u>

c. Long-lived assets:

The following presents long-lived assets of December 31, 2007 and December 31, 2008:

	December 31,	
	2007	2008
U.S. dollars in thousands		
Incredimail	\$ 1,798	\$ 1,519
Bizchord	299	108
	<u>\$ 2,097</u>	<u>\$ 1,627</u>

NOTE 14: - SUBSEQUENT EVENT

In March 2009, the Company instituted a dividend policy whereby at least 50% of the Company's annual net income beginning with the net income for 2009 will be paid out as a dividend. Declaring and issuing the dividend will be subject to the board's review of the Company's financial conditions at the time.

In March 2009 the Company's board of Directors approved a cash dividend of approximately \$4.6 million, or \$0.50 per share, subject to Israeli court approval and a tax pre-ruling from the Israeli Tax Authority as required by Israeli law.

**SIGNATURES**

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

IncrediMail Ltd.

By: /s/ Ofer Adler

\_\_\_\_\_  
Ofer Adler  
Chief Executive Officer

Date: June 24, 2009

## EXHIBIT INDEX

<u>No.</u>	<u>Description</u>
1.1	Memorandum of Association of Registrant (1)
1.2	Certificate of Change of Name of Registrant (translated from Hebrew) (1)
1.3	Amended and Restated Articles of Association of Registrant, dated February 3, 2006 (2)
4.1	Google AdSense™ Online Standard Terms and Conditions (4)
4.2	OEM Agreement, effective December 7, 2004, between Commtouch Ltd. and the Registrant (1)
4.3	The Registrant's 2003 Israeli Share Option Plan and the form of Option Agreement (1)
4.4	Google Services Agreement, dated July 1, 2008, by and between the Registrant and Google Ireland Ltd., a company organized under the laws of Ireland.*
8	List of all subsidiaries.
11	Code of Ethics (4)
12.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Executive officer of the Company
12.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Financial officer of the Company
13.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code
13.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code
14	Consent of Kost Forer Gabbay & Kasierer, an affiliate of Ernst & Young Global, Independent Auditors

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(1) Previously filed with the SEC on October 25, 2005 as an exhibit to our registration statement on Form F-1/A (File No. 333-129246).

(2) Previously filed with the SEC on January 5, 2006 as an exhibit to our registration statement on Form F-1/A (File No. 333-129246).

(3) Previously filed with the SEC on January 26, 2006 as an exhibit to our registration statement on Form F-1/A (File No. 333-129246).

(4) Previously filed with the SEC on May 12, 2008 as an exhibit to our annual report on Form 20-F.

\* Confidential treatment has been requested with respect to certain portions of this exhibit pursuant to 17.C.F.R. § 200.80(b)(4). Omitted portions were filed separately with the SEC.

PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934; [\*\*\*] DENOTES OMISSIONS.

**GOOGLE SERVICES AGREEMENT**

This Google Services Agreement (“GSA”) is entered into by and between Google Ireland Limited, a company incorporated under the laws of Ireland whose principal place of business is at Gordon House, Barrow Street, Dublin 4 (“Google”) and Incredimail, Ltd whose registered office is at 4 Hanechoshet st. Tel Aviv, Israel (“Customer”).

This GSA shall be effective from the GSA Effective Date. Each Order Form shall be governed by this GSA and shall become effective on the Order Form Effective Date.

**INTRODUCTION**

- (A) Google supplies a range of search and advertising related services.
- (B) Google and Customer have agreed that Google will provide certain of these services to Customer.
- (C) The Services ordered by Customer are identified on one or more separately stated Order Forms.
- (D) This GSA together with the terms and conditions of any applicable Order Form(s) state the terms and conditions under which Google will supply and Customer may use the Services.

**AGREED TERMS**

**1. Definitions**

1.1 In this GSA and any Order Form(s) the following words and phrases shall have the following meanings:

“Above-the-fold” means visible to any End User at a minimum resolution of 800 by 600 pixels without scrolling within a Site page as viewed through an Internet browser application considered among the top two (2) most widely used from time to time;

“Ad” means: (a) in the context of the AdSense for Content Services, a content targeted and/or site targeted hyperlinked text and/or image based advertisement and (b) in the context of the AdSense for Search Services, a keyword targeted hyperlinked text and/or image based advertisement and, for the avoidance of doubt, in the case of both (a) and (b) image based advertisements may include moving image based and/or video based and/or interactive advertisements, and text based advertisements may include interactive advertisements;

“AdSense for Content Set” means a set of one or more Ads provided by Google as part of the AdSense for Content Services in accordance with the applicable Agreement;

“AdSense for Content Services” means the provision of content targeted and/or site targeted hyperlinked advertisements in accordance with the applicable Agreement;

**“AdSense for Content Site”** means the web site(s) located at the URL(s) stated in the applicable Order Form or as otherwise agreed between the parties in writing from time to time;

**“AdSense for Search Set”** means a set of one or more Ads provided by Google as part of the AdSense for Search Services in accordance with the applicable Agreement;

**“AdSense for Search Services”** means the provision of keyword targeted hyperlinked advertisements in accordance with the applicable Agreement;

**“AdSense for Search Site”** means the web site(s) located at the URL(s) stated in the applicable Order Form or as otherwise agreed between the parties in writing from time to time;

**“Advertising Results Set”** means an AdSense for Content Set and/or an AdSense for Search Set (as applicable);

**“AFC Ads”** means Qualifying Ads provided by Google to Customer under an Agreement through the AdSense for Content Services.

**“AFS Ads”** means Qualifying Ads provided by Google to Customer under an Agreement through the AdSense for Search Services.

**“AFC Revenues”** for any period during the Services Term means ad revenues that are recognised by Google in such period and attributed to AFC Ads displayed on the AdSense for Content Site in such period in accordance with the requirements of this Agreement;

**“AFS Revenues”** for any period during the Services Term means ad revenues that are recognised by Google in such period and attributed to AFS Ads displayed on the AdSense for Search Site in such period in accordance with the requirements of this Agreement;

**“Agreement”** has the meaning stated in clause 2.4 of this GSA;

**“Beta Features”** means any features which are identified by Google as “Beta” or unsupported in Google’s technical documentation from time to time;

**“Brand Features”** means the trade names, trademarks, service marks, logos, domain names and other distinctive brand features of each party as owned by such party from time to time;

**“Client Application”** means any application, plug-in, helper, component or other executable code that runs on user’s computer (examples of Client Applications include those that provide instant messaging, chat, email, data, file viewing, media playing, file sharing, games, internet navigation, search and/or other services);

**“Client ID(s)”** means a unique alphanumeric code or codes provided by Google to Customer (and which may be modified by Google from time to time) to be used by Customer in accordance with the applicable Google Data Protocol in order to identify each Query or Request;

**“Customer Client Application”** means the Client Application(s) (if any) approved for the purpose of accessing one or more of the Services as stated in the applicable Order Form;

**“Customer Content”** means any editorial, text, graphic, audiovisual and other content that is served to End Users of the Site [\*\*\*] and that is not provided by Google;

“**Destination Page**” means a web page which may be accessed by clicking on any portion of an Advertising Results Set or on any Websearch Results;

“**End Users**” means individual human end users of the Site [\*\*\*] accessing the Site [\*\*\*] by non-automated means;

“**Google Data Protocol(s)**” means the Google data protocol(s) applicable to the Services being supplied by Google to Customer in accordance with the applicable Agreement as notified to Customer by Google prior to the Launch Date for those Services and any revised versions of such protocol(s) that may be notified to Customer by Google from time to time following such Launch Date;

“**GSA Effective Date**” means 1 July 2008;

“**Intellectual Property Rights**” means all copyright; moral rights; patent rights; trade or service marks; design right; semiconductor topography rights; rights in or relating to databases; rights in or relating to confidential information; rights in relation to domain names; privacy or publicity rights and any other intellectual property rights (registered or unregistered) throughout the world; including all rights of reversion and rights to any applications and pending registrations and the right to sue for and recover damages for past infringements;

“**Invalidating Act**” means any of the actions in clauses 5.1(h) and 5.1(i) of this GSA;

“**Launch Date**” means the date on which Google notifies Customer in accordance with clause 3.5(b) that Customer may put its implementation of the applicable Services (as approved by Google) into live use;

“**NDA**” means the non disclosure agreement entered into by the parties the effective date of which is stated on the Order Form(s);

“**Net AdSense for Content Revenues**” means for any period during the Services Term AFC Revenues for such period minus: [\*\*\*]

“**Net AdSense for Search Revenues**” means for any period during the Services Term AFS Revenues for such period minus: [\*\*\*]

“**Net AdSense Revenues**” means Net AdSense for Content Revenues and Net AdSense for Search Revenues;

“**Non-Qualifying Advertising Results**” means:

[\*\*\*]

“**Order Form**” means a fully executed Google order form which incorporates this GSA;

“**Order Form Effective Date**” means the effective date of the applicable Order Form as stated on that Order Form or, if no date is stated, the later of the two signature dates at the foot of that Order Form;

“**Qualifying Ads**” means Ads (excluding Non-Qualifying Advertising Results) displayed on the AdSense for Content Site or AdSense for Search Site (as applicable) in accordance with the applicable Agreement(s);

“**Query**” means a search query entered on the Site or through [\*\*\*] approved by Google for such purpose (if any) by an End User by way of a search box or other similar means implemented in accordance with the Agreement which is transmitted by Customer to Google in order to obtain Websearch Results;

“**Request**” means a request for an AdSense for Content Set generated by an End User accessing a web page on the AdSense for Content Site on which the Customer has implemented the AdSense for Content Services in accordance with the applicable Google Data Protocol;

“**Services**” means the AdSense for Search Services, AdSense for Content Services and/or WebSearch Services (as applicable);

“**Services Term**” means the term stated in clause 2.5;

“**Site**” means the AdSense for Search Site, AdSense for Content Site and/or WebSearch Site (as applicable);

“**Valid Query**” means [\*\*\*]

“**Valid Request**” means: [\*\*\*]

“**Websearch Results Page**” means any Site page which contains any WebSearch Result(s);

“**WebSearch Result**” means a web search result provided by Google to Customer as part of the WebSearch Services in accordance with the applicable Agreement;

“**WebSearch Result Set**” means a set of one or more (but no more than ten) web search results provided by Google to Customer as part of the WebSearch Services in accordance with the applicable Agreement;

“**WebSearch Services**” means the provision of Web search results in accordance with the applicable Agreement; and

“**WebSearch Site**” means the web site(s) located at the URL(s) stated in the applicable Order Form or as otherwise agreed between the parties in writing from time to time.

- 1.2 The headings to the clauses of this GSA and any Order Forms are for ease of reference only and shall not affect the interpretation or construction of this GSA and/or any Agreement.

- 1.3 Reference to any statute or statutory provision includes a reference to that statute or statutory provision as from time to time amended, extended or re-enacted.
2. **Order Forms and Services Terms**
- 2.1 This GSA contains general terms relating to the provision by Google from time to time of Services. Google shall provide such Services in accordance with this GSA as the parties shall agree from time to time.
- 2.2 Before Google provides any such Services, Google and Customer will in each case first agree in relation to such Services:
- (a) exactly what Services are to be supplied;
  - (b) any other relevant details;
- in each case all of this information will be included in an Order Form.
- 2.3 If any Order Form conflicts with the provisions of this GSA then the provisions of that Order Form will take precedence in relation to the Services to be supplied in accordance with that Order Form. In the event of conflicting Order Forms, any subsequent Order Form shall take precedence over any prior conflicting Order Form.
- 2.4 Each agreed Order Form will form a separate agreement (an “**Agreement**”) between Customer and Google on the terms contained in the Order Form and in this GSA. Each Agreement will be separately terminable by either party in accordance with clause 14.
- 2.5 For each Agreement entered into between Google and Customer, the term of such Agreement shall commence on the Order Form Effective Date and shall continue for the period of the applicable Initial Services Term and, if renewed in accordance with this clause, for the applicable renewal period, unless earlier terminated as provided in this GSA or the applicable Order Form. An Agreement may be renewed at the end of the applicable Initial Services Term only upon mutual written agreement of the parties. If an Agreement is not renewed, then it will automatically expire at the end of the applicable Initial Services Term.
3. **Services**
- 3.1 **General**
- (a) Implementation of the Services on the Site is conditional upon the Site being wholly owned and operated exclusively by Customer. Customer may modify or add additional URLs to those comprising the Site with Google’s prior written consent.
  - (b) Certain Services may include Beta Features. Customer acknowledges and agrees that Beta Features are provided “as is” and any use of them shall be solely at Customer’s own risk. Google reserves the right, in its sole discretion, to include or cease providing Beta Features as part of any Services at any time.
- 3.2 **Websearch Services (if ordered)**
- (a) Google shall, from the Launch Date:

- (i) for each Valid Query received by it, where available transmit to Customer a set of up to [\*\*\*] Websearch Results;
  - (ii) if 'Language Restrict' is enabled by Customer in accordance with the instructions provided by Google in the applicable Google Data Protocol, assist Customer in limiting Websearch Results to web pages in the language(s) specified on the Order Form;
  - (iii) if 'Country Restrict' is enabled by Customer in accordance with the instructions provided by Google in the applicable Google Data Protocol, assist Customer in limiting Websearch Results to web pages served from the country(ies) specified on the Order Form; and
  - (iv) if 'Safe Search' is enabled by Customer [\*\*\*]
  - (v) within [\*\*\*] of the end of each month during the Services Term, provide Customer with WebSearch Services usage reports in the form generally made available at that time or as otherwise may be provided online.
- (b) Customer acknowledges and agrees that:
- (i) it is Customer's responsibility to enable the 'Language Restrict', 'Country Restrict' [\*\*\*] features in accordance with the instructions provided by Google in the applicable Google Data Protocol; and
  - (ii) Google does not commit that all Websearch Results will be limited to the languages and/or countries specified [\*\*\*].
- (c) Customer shall, from the Launch Date:
- (i) send all Queries received by Customer from End Users (without editing, modifying, appending additional search terms to or filtering such Queries individually or in the aggregate) to Google in accordance with the applicable Google Data Protocol and otherwise in compliance with the requirements stated in the Agreement for processing by Google;
  - (ii) implement on the Site a search box which, provided this has been agreed in advance by Google, together with each Websearch Results Page shall conspicuously display a text and/or graphic module, in a form provided by Google from time to time, that unambiguously indicates that the Websearch Results are provided by Google;
  - (iii) display the Websearch Results on the applicable Site; and
  - (iv) ensure that each Websearch Results Page is [\*\*\*] in the form set out in the applicable Exhibit(s) to the applicable Order Form, unless otherwise agreed in writing between the parties.
- (d) In the event that Customer uses any Websearch Results in a manner inconsistent with this clause 3.2, Google shall have the right to suspend Customer's right to use the relevant Websearch Services (or any part of them) with immediate effect until such time as, in Google's reasonable opinion, Customer has taken all necessary steps to rectify such inconsistent use.

3.3 *AdSense for Search (if ordered)*

- (a) Google shall, from the Launch Date:
- (i) for each Valid Query received by it, where available, provide to Customer an AdSense for Search Set comprising at least the minimum number of Ads stated in the applicable Order Form for display on the AdSense for Search Site;
  - (ii) [\*\*\*]
  - (iii) within [\*\*\*] of the end of each calendar month during the Services Term, provide Customer with AdSense for Search revenue reports in the form generally made available at that time or as otherwise may be provided online.
- (b) Customer shall, from the Launch Date:
- (i) for any and all Queries received by Customer from End Users, (without editing, modifying, appending additional search terms to or filtering such Queries individually or in the aggregate) send such Queries to Google in accordance with the applicable Google Data Protocol;
  - (ii) [\*\*\*]
  - (iii) [\*\*\*]
  - (iv) ensure that no AdSense for Search Sets requests sent by Customer to Google contain information that is or may be personally identifiable;
  - (v) display each AdSense for Search Set to End Users on the relevant Site page and ensure that each Site page containing any AdSense for Search Set(s) shall conform to the specifications stated in the applicable Order Form;
  - (vi) ensure that its implementation of the AdSense for Search Services is in all material respects in the form set out in the applicable Exhibit(s) to the applicable Order Form, unless otherwise agreed in writing between the parties;
  - (vii) unambiguously mark each AdSense for Search Set as “Sponsored Links” or other equivalent designation indicating that the Ad(s) contained in the AdSense for Search Set are linked advertisements, and distinct from search results;
  - (viii) place on each Site page on which an AdSense for Search Set is displayed a link in the form provided by Google from time to time that contains the Google logo, text [\*\*\*] such link to be placed Above-the-Fold and in accordance with the specifications stated in the applicable Order Form;
  - (ix) not hinder, truncate or obstruct in any way the display of the full text of any Ad as provided by Google (including without limitation through the use of pop-ups, pop-unders or similar graphical units).

(c) Customer shall:

- (i) not set up, configure or implement the Site(s) or any successor Sites in such a way that they include [\*\*\*]
- (ii) implement the AdSense for Search Services in such a way that all search queries submitted by End Users via the Site(s) are sent to Google by the applicable Google Data Protocol so as to generate a request for AdSense for Search Set in accordance with the Agreement.

3.4 *AdSense for Content (if ordered)*

(a) Google shall, from the Launch Date:

- (i) for each Valid Request received by it in accordance with the applicable Google Data Protocol, where available provide an AdSense for Content Set to Customer for display on the AdSense for Content Site;
- (ii) [\*\*\*]
- (iii) within [\*\*\*] of the end of each month after the Launch Date during the Services Term, provide Customer with AdSense for Content revenue reports in the form generally made available at that time or as otherwise may be provided online.

(b) Customer shall, from the Launch Date:

- (i) ensure that the AdSense for Content Services are implemented on the AdSense for Content Site in accordance with the applicable Google Data Protocol and Google's technical requirements and specifications as notified to Customer from time to time so that each time an End User accesses a web page on the AdSense for Content Site this will generate a Valid Request to Google;
- (ii) ensure that each AdSense for Content Set conforms to the specifications stated in the applicable Order Form and that its implementation of the AdSense for Content Services is in all material respects in the form set out in the applicable Exhibit(s) to the applicable Order Form, unless otherwise agreed in writing between the parties;
- (iii) in the event that the AdSense for Content Site requires user authentication [\*\*\*];
- (iv) ensure that no AdSense for Content Sets are displayed on any Site pages which contain web search results, private email, newsletters or community content (including, but not limited to, message boards), consist of slide show pages or gallery pages or chat pages, consist primarily of other advertising, are personal web pages, registration pages, "thank you" or error pages, exist behind password protected areas, contain pornographic, obscene or excessively profane content or content intended to advocate or advance computer hacking or cracking, gambling, illegal activity, drug paraphernalia, hate, violence or racial or ethnic intolerance or which Google has otherwise notified Customer are pages of a type on which the display of AdSense for Content Sets is not allowed.

- (c) Customer shall not:
- (i) Implement the AdSense for Content Services on the AdSense for Content Site in such a way that more than [\*\*\*] is generated per page view, unless agreed in writing in advance by Google;
  - (ii) display more than [\*\*\*] AdSense for Content Set per web page on the AdSense for Content Site, unless agreed in writing in advance by Google;
  - (iii) edit, modify or disable its AdSense for Content Services implementation (or any portion thereof) at any time;
  - (iv) minimise, edit or remove any AdSense for Content Set(s) or any Ad(s) contained in such AdSense for Content Set(s) from display unless approved in writing in advance by Google; or
  - (v) hinder, truncate or obstruct in any way the display of the full text of any Ad as provided by Google (including without limitation through the use of pop-ups, pop-uppers or similar graphical units);
- (d) Customer shall keep Google informed of all planned material changes to the design and content of the AdSense for Content Site and as early in the process as is feasible identify to Google any additional advertising inventory in any newly created area of the AdSense for Content Site. Customer and Google shall cooperate in identifying those portions, if any, of the additional inventory on which Customer would seek to implement AdSense for Content Services.

### 3.5 ***Implementation of Services***

- (a) For each Agreement, the parties will each use their reasonable endeavours to assist each other in implementation of the Services on the Site and to ensure that the Launch Date is reached in an estimated time frame of [\*\*\*] from the Order Form Effective Date or such other longer time frame as agreed between the parties in writing. Customer acknowledges that in order for such estimated time frame to be met Customer will have to ensure that it complies with all Google's technical requirements in relation to such implementation.
- (b) For each Agreement, once Google's technical and account management personnel are satisfied that Customer has properly implemented the Services on the Site in accordance with Google's technical and branding requirements and otherwise in accordance with the Agreement and have approved the implementation (such approval not to be unreasonably withheld or delayed), then Google will notify Customer that it may put its implementation of the Services (as approved by Google) into live use. This notification will be by way of e-mail or such other means as Google shall reasonably decide. Customer will not put its implementation of the Services into live use until it has received this notification from Google.
- (c) Google grants to Customer a non-exclusive and non-sublicensable licence during the applicable Services Term to use the applicable Google Data Protocol(s) as supplied to Customer by Google solely for the purpose of implementing the applicable Services and transmitting Queries and other required information to Google in accordance with Google's technical requirements as notified to Customer from time to time.
- (d) Unless otherwise agreed between the parties in writing, Customer's implementation of the applicable Services shall be in all material respects in the form set out in the applicable Exhibit(s) to the applicable Order Form(s). Customer will not make any material changes to the implementation of the Services without Google's prior written agreement. Material changes to the implementation will include (but not be limited to) [\*\*\*]

- (e) Customer shall ensure that all Services are implemented in accordance with the applicable Google Data Protocol(s) and in accordance with Google's technical requirements for such Services as notified to Customer from time to time. Once the Services have been implemented, Customer will not make any changes which might affect the implementation of the Services on the Site [\*\*\*] prior written notice to Google.
- (f) Customer will use Client IDs as instructed by Google and will provide such information to Google as Google may reasonably request with respect to the use and application of any Client IDs.
- (g) Google shall have the right to modify any Google Data Protocol(s) and/or technical specifications at any time in its sole reasonable discretion. Where applicable, Customer shall implement such modifications no later than [\*\*\*] after receipt thereof.
- (h) For each Agreement, during the applicable Services Term, the parties shall meet (or, if agreed, hold a conference call) at such times and dates as agreed from time to time to discuss service performance [\*\*\*]

#### 4. **Support Services**

For each Agreement, Google shall provide technical support services to Customer during the applicable Services Term in accordance with Google's support guidelines in effect from time to time. Prior to making any support request to Google, Customer shall first use its best endeavours to fix any error, bug, malfunction, or network connectivity defect on its own without any escalation to Google. Thereafter, the "Technical Contact" indicated on the applicable Order Form may submit a request for support via email to, or such other email address that Google may provide with advance notice from time to time.

Customer shall provide support services to End Users at its own expense. Google shall not be responsible for providing any End User support services.

#### 5. **Customer's Obligations**

5.1 Customer shall not, and shall not allow any third party to:

- (a) edit, modify, truncate, add content to, change the order of the information contained in or filter any Websearch Results and/or Advertising Results Set without Google's prior written consent, [\*\*\*]
- (b) frame:
  - (i) any Site page containing any Advertising Results Set and/or any Websearch Results;
  - (ii) any Destination Page; and/or
  - (iii) any Websearch Results;
- (c) [\*\*\*]
- (d) display any Websearch Results and/or Advertising Results Sets to any third parties other than End Users;

- (e) enter into any arrangement or agreement under which any third party pays Customer fees or shares in any revenue payments and/or royalties for any Websearch Results and/or Advertising Results Sets displayed on the Site;
  - (f) display any Websearch Results and/or Advertising Results Sets in pop-up, pop-under, exit windows, expanding buttons, or animation or other similar methods;
  - (g) minimise, remove or otherwise inhibit the full and complete display of any Site page which includes any Websearch Results and/or Advertising Results Sets and/or Ads, and the corresponding Destination Pages accessed by clicking on any portions thereof;
  - (h) directly or indirectly generate impressions of or clicks on Advertising Results Sets through any automated, deceptive, fraudulent or other invalid means (including, but not limited to, click spam, query spam, robots, macro programs, and internet agents);
  - (i) encourage or require End Users or other persons, either with or without their knowledge, to generate impressions of or to click on Advertising Results Sets through offering incentives or any other methods that are manipulative, deceptive, malicious or fraudulent;
  - (j) provide End Users with access to any Websearch Results and/or Advertising Results Sets through any Client Application (except to the extent that such access is provided through a Customer Client Application in accordance with the terms of the applicable Agreement) or otherwise provide End Users with access to any Websearch Results and/or Advertising Results Sets other than by displaying such Websearch Results and/or Advertising Results Sets on a page on the Site in accordance with the applicable Agreement(s); or
  - (k) implement any click tracking or other monitoring of clicks on Advertising Results Sets or Advertising Results.
- 5.2 Customer shall ensure that neither the Site nor the Customer Client Application (if any) contains any pornographic, hate-related, violent or otherwise offensive content or contains any other material, products or services that violate or encourage conduct that would violate any criminal laws, any other applicable laws, or any third party rights.
- 5.3 Customer shall not, and shall not allow any third party to:
- (a) modify, adapt, translate, prepare derivative works from or decompile, reverse engineer, disassemble or otherwise attempt to derive source code from (except to the extent allowed by law) any Services, the Google Data Protocol(s), or any other Google technology, content, data, routines, algorithms, methods, ideas design, user interface techniques, software, materials and/or documentation;
  - (b) remove, deface, obscure, or alter Google's copyright notice, trademarks or other proprietary rights notices affixed to or provided or displayed as part of any Services, the Google Data Protocol(s), or any other Google technology, software, materials and/or documentation;
  - (c) "crawl", "spider", index or in any non-transitory manner store or cache information obtained from the Services (including, but not limited to, Websearch Results and/or Advertising Results Sets, or any part, copy or derivative thereof);

- (d) transfer, sell, lease, syndicate, sub-syndicate, lend, or use for co-branding, timesharing, service bureau or other unauthorised purposes any Services or access thereto (including, but not limited to Websearch Results and/or Advertising Results Sets, or any part, copy or derivative thereof);
  - (e) directly or indirectly access, launch and/or activate the Services through or from any software application or means other than the Site or the Customer Client Application (if any);
  - (f) engage in any action or practice that in Google's reasonable opinion reflects poorly on Google or otherwise disparages or devalues Google's reputation or goodwill; or
  - (g) create or attempt to create a substitute service or product through use of any of the Services or proprietary information related to them.
- 5.4 Customer shall not place anything on the Site that in any way implies that Google is responsible for the contents of any Websearch Results or Advertising Results Sets provided by it or for any web sites accessed via such Websearch Results or Advertising Results Sets.
- 5.5 Customer shall ensure that there is no use of or access to the Services through the Site or the Customer Client Application (if any) which is not in compliance with the terms of the Agreement or not otherwise approved by Google, [\*\*\*]
- 5.6 Google may send uncompensated test Queries to the Site or the Customer Client Application (if any) or make uncompensated clicks on any Advertising Results Sets displayed on the Site at any time to verify Customer's compliance with any requirements contained in the applicable Agreement(s).
6. [\*\*\*]
- 6.1 [\*\*\*]
7. **Intellectual Property Rights**
- 7.1 Google shall own all right, title and interest, including without limitation all Intellectual Property Rights, relating to the Services (and any derivative works or enhancements thereof), including but not limited to, all software, technology, information, content, materials, guidelines, documentation, and the Google Data Protocol(s). Customer shall not acquire any right, title, or interest therein, except for the limited use rights expressly set forth in the Agreement. Any rights not expressly granted herein are deemed withheld.
- 7.2 Customer, its licensors, or other applicable third party providers shall own all Intellectual Property Rights in and to Customer Content. Google shall not acquire any right, title or interest in or to Customer Content, except as provided in this GSA and/or any applicable Order Form.
8. **Trade mark licence**
- 8.1 Each party shall own all right, title and interest, including without limitation all Intellectual Property Rights, relating to its Brand Features.

- 8.2 For each Agreement Google hereby grants to Customer a non-exclusive and non-sublicensable licence during the applicable Services Term to display the Google name and logo and such other of the Google Brand Features as expressly authorised by Google in the applicable Agreement on the applicable Site solely for the purposes of fulfilling Customer's obligations to Google as stated in the applicable Agreement and provided that all such use by Customer is in accordance with the agreed implementation of the Site as set out in the applicable Order Form (or as varied by agreement in writing between the parties from time to time) and Google's reasonable instructions from time to time.
- 8.3 Customer shall ensure that: a) all use by Customer of the Google Brand Features; and b) Customer's implementation of the Services, including but not limited to each Websearch Results Page and each page on which AdSense for Search Sets or AdSense for Content Sets are displayed, complies with Google's then current Google Branding Guidelines and any content contained or referenced therein, which may be found at the following URL: (or such other URL Google may provide from time to time).
- 8.4 Customer hereby grants to Google a non-exclusive and non-sublicensable licence during the term of this GSA to include Customer's name and logo in presentations, marketing materials and customer lists (including, but not limited to, in customer lists posted on Google's web sites and in screen shots of Customer's implementation of the Services).
- 8.5 Except as stated in this GSA and/or any applicable Order Forms, neither party acquires any right, title or interest in or to the other party's Brand Features. All use by Google of Customer Brand Features (including any goodwill associated therewith) shall inure to the benefit of Customer and all use by Customer of Google Brand Features (including any goodwill associated therewith) shall inure to the benefit of Google. No party shall challenge or assist others to challenge the Brand Features of the other party (except to protect such party's rights with respect to its own Brand Features) or the registration thereof by the other party, nor shall either party attempt to register any Brand Features or domain names that are confusingly similar to those of the other party.
- 8.5 Either party may revoke the licence granted by it to the other under clause 8.2 or 8.3 above (as applicable) at any time [\*\*\*]
- 8.6 Subject to clause 13, neither party will issue any press release regarding the existence or content of this GSA or any Agreement without the other party's prior written approval.

9. **Payment**

The fees and payment terms for all Services shall be as set out in this clause 9 unless expressly stated otherwise in the applicable Order Form.

9.1 *Search Services (if ordered)*

[\*\*\*]

9.2 *AdSense for Search Services (if ordered) and/or AdSense for Content Services (if ordered)*

Google shall pay to Customer [\*\*\*]

9.3 *All AdSense Services (if ordered)*

[\*\*\*]

9.4 *All Services*

- (a) All payments under the Agreement are exclusive of taxes imposed by any governmental entity. [\*\*\*]
- (b) Google's obligation to pay Customer shall commence on the Launch Date.
- (c) All payments due to Google or to Customer shall be in the currency specified in the applicable Order Form.
- (d) Payments to Google shall be made by telegraphic transfer to the account notified to Customer by Google for that purpose.
- (e) Payments to Customer (if by telegraphic transfer) shall be made to the account notified to Google by Customer for that purpose. Customer acknowledges that Google may, at its option, set off any payment obligations to Customer it may incur under any Agreement against any fees owed and not yet paid by Customer under that Agreement and/or any other Agreement(s) and/or any other agreements between Google and Customer, in addition to any other rights and remedies Google may have. [\*\*\*] In addition, Google reserves the right to withhold and offset against its payment obligations under any Agreement, or to require Customer to repay to Google within [\*\*\*] of request for such repayment, any amounts which Google may have previously overpaid to Customer in relation to any Agreement.

10. **Warranties**

- 10.1 Each party warrants to the other that it has full power and authority to enter into this GSA and any applicable Agreement(s).
- 10.2 Google warrants to Customer that it will provide the Services with reasonable care and skill.
- 10.3 Customer warrants to Google that:
  - (a) it shall only use information provided by Google (including Websearch Results and/or Advertising Results Sets) in a manner that complies with applicable laws; and
  - (b) it will use reasonable care and skill in complying with its obligations under this GSA and any Agreement(s).
- 10.4 Google does not warrant that the Services (or any of them) will meet all of Customer's requirements or that performance of the Services (or any of them) will be uninterrupted, virus-free, secure or error-free.

- 10.5 No conditions, warranties or other terms apply to any Services or to any other goods or services supplied by Google under this GSA and/or any Agreement(s) except to the extent that they are expressly set out in this GSA and/or the applicable Agreement(s). Subject to clause 12.1, no implied conditions, warranties or other terms apply (including any implied terms as to satisfactory quality, fitness for purpose or conformance with description).
- 10.6 Google will not be liable for any breach of warranty under this GSA or any Agreement(s) to the extent that the breach of warranty concerned results from a failure by Customer to fulfil its obligations under this GSA or any Agreement(s).
11. **Indemnities**
- 11.1 Google shall defend, or at its option settle, any court proceedings brought by a third party against Customer based upon or otherwise arising out of a claim that [\*\*\*]
- 11.2 In no event shall Google have any obligations or liability under this clause 11 arising from:
- (a) use of any Beta Features;
  - (b) use of the Services or Google Brand Features in a modified form or in combination with materials not furnished by Google, or
- [\*\*\*]
- 11.3 Google, in its sole and reasonable discretion, reserves the right to terminate Customer's continued use of any Services or Google Brand Features which are alleged or believed by Google to infringe any third party's Intellectual Property Rights.
- 11.4 Customer shall defend, or at its option settle, any court proceedings brought against Google by a third party based upon or otherwise arising out of:
- (a) the Customer Content, Site, [\*\*\*] (if any) and/or Customer Brand Features infringe any copyright, trade secret or trademark of such third party;
  - (b) Google's use of any Customer Content in compliance with this GSA and/or the applicable Agreement(s); and/or
  - (c) Customer's use of the Services in any manner inconsistent with or in breach of this GSA and/or any applicable Agreement(s).
- 11.5 Indemnification under this clause 11 shall be limited to payment by the indemnifying party of all damages and costs finally awarded for such claim, or settlement costs approved in writing by the indemnifying party.
- 11.6 The indemnification obligations under this clause 11 shall exist only if the party seeking indemnification:
- (a) promptly notifies the indemnifying party of such claim;

- (b) provides the indemnifying party with reasonable information, assistance and cooperation in defending the lawsuit or proceeding; and
- (c) gives the indemnifying party full control and sole authority over the defence and settlement of such claim. The indemnified party may appoint its own supervising counsel of its choice at its own expense.

11.7 The indemnifying party shall only reimburse the indemnified party for expenses incurred by the indemnified party with the indemnifying party's prior written approval.

11.8 This clause 11 states the parties' entire liability and exclusive remedy with respect to infringement of a third party's intellectual Property Rights.

## 12. **Limitation of Liability**

12.1 Nothing in this GSA or any Agreement shall exclude or limit either party's liability for:

- (a) death or personal injury resulting from the negligence of either party or their servants, agents or employees;
- (b) fraud or fraudulent misrepresentation;
- (c) breach of any implied condition as to title or quiet enjoyment;
- (d) misuse of confidential information,

12.2 Save to the extent that this GSA or any Agreement expressly states otherwise, nothing in this GSA or any Agreement shall exclude or limit either party's liability for breach of [\*\*\*]

12.3 Subject to clauses 12.1 and 12.2 but notwithstanding clause 12.4 and 12.5, neither party shall be liable in contract, tort (including, without limitation, negligence, pre-contract or other representations (other than fraudulent misrepresentation) or otherwise arising out of or in connection with this GSA and/or any Agreement for:

- (a) any economic losses (including, without limitation: loss of revenues, profits, contracts, data, business, anticipated savings or cost of substitute services);
- (b) any loss of goodwill or reputation; or
- (c) any special, indirect or consequential losses;

in any case, whether or not such losses were within the contemplation of the parties at the date of this GSA and/or the applicable Agreement, suffered or incurred by that party arising out of or in connection with the provisions of, or any matter under, this GSA and/or the applicable Agreement.

- 12.4 Subject to clauses 12.1, 12.2 and 12.3, each party's total liability in relation to all events or series of connected events occurring in any given calendar year arising from or in connection with any particular Agreement and in relation to anything which the party concerned may have done or not done in connection with such Agreement (whether the liability arises because of breach of contract, negligence or for any other reason and including any liability that arises or exists by reason of the unenforceability or invalidity of any term of any Agreement) shall be limited to:
- [\*\*\*]
- 12.5 Subject to clauses 12.1, 12.2 and 12.3, each party's total aggregate liability arising from or in connection with any particular Agreement and in relation to anything which the party concerned may have done or not done in connection with such Agreement (whether the liability arises because of breach of contract, negligence or for any other reason and including any liability that arises or exists by reason of the unenforceability or invalidity of any term of any Agreement) shall be limited to:
- [\*\*\*]
13. **Confidentiality**
- 13.1 Subject to clause 13.2 below, disclosure of confidential and/or proprietary information pursuant to this GSA and/or any Agreement (including the existence and content of this GSA and/or any Agreement) shall be governed by the NDA which is hereby incorporated into this GSA and each Agreement by reference. In the event of any conflict between the NDA and this GSA or any applicable Order Form, the provisions of this GSA or the applicable Order Form will take precedence.
- 13.2 Customer understands and agrees that, notwithstanding anything to the contrary in the NDA, [\*\*\*] Such disclosure of information shall be subject to the terms of the Google Privacy Policy located at, or such other URL as Google may provide from time to time, and shall not include "personally identifying information," as described in such Google Privacy Policy.
14. **Term and Termination**
- 14.1 This GSA shall commence on the GSA Effective Date and remain in force until it terminates or expires in accordance with its terms.
- 14.2 Either party may suspend performance and/or terminate any Agreement, in whole or in part, with immediate effect, if the other party:
- (a) is in material breach of the Agreement where the breach is incapable of remedy; or
  - (b) is in material breach of the Agreement where the breach is capable of remedy and fails to remedy that breach within [\*\*\*] after receiving written notice of such breach.
- 14.3 Either party may suspend performance and/or terminate this GSA (and all Agreements entered into in accordance with it) with immediate effect, if:

- (a) a meeting of creditors of the other party is held or an arrangement or composition with or for the benefit of its creditors (including a voluntary arrangement as defined in the Insolvency Act 1986) is proposed by or in relation to the other party;
  - (b) a chargeholder, receiver, administrative receiver or other similar person takes possession of or is appointed over or any distress, execution or other process is levied or enforced (and is not discharged within [\*\*\*] ) on the whole or a material part of the assets of the other party;
  - (c) the other party ceases to carry on business or is deemed to be unable to pay its debts within the meaning of section 123 Insolvency Act 1986;
  - (d) the other party or its directors or the holder of a qualifying floating charge gives notice of their intention to appoint, or makes an application to the court for the appointment of, an administrator;
  - (e) a petition is presented (and is not discharged within [\*\*\*] ) or a resolution is passed or an order is made for the administration or the winding-up, bankruptcy or dissolution of the other party; or
  - (f) an event analogous to any of the above happens to the other party in any jurisdiction in which it is incorporated or resident or in which it carries on business or has assets.
- 14.4 Google may terminate this GSA (and all Agreements entered into in accordance with it) immediately upon written notice, if:
- (a) [\*\*\*] Google may terminate this GSA (and all Agreements entered into in accordance with it) immediately upon notice if such breach is incapable of remedy or where such breach is capable of remedy, where Customer fails to remedy such breach within [\*\*\*] after receiving written notice of such breach; or
  - (b) [\*\*\*]
- 14.5 Upon the expiration or termination of this GSA for any reason:
- (a) all rights and licences granted by each party shall cease immediately; and
  - (b) each party shall (at the other party's option) promptly return to the other party, or destroy and certify the destruction of, all Confidential Information of the other party.
- 14.6 The termination or expiration of an individual Agreement shall not have the effect of terminating any other Agreement or this GSA unless expressly agreed to by the parties in writing. If an Agreement (but not this GSA) terminates or expires, all rights and licences granted by Google to Customer relating to the applicable Services and all other rights and licences granted by Google to Customer in relation to the applicable Services as stated in such Agreement, if any, shall cease immediately. Termination or expiration of all Agreements shall result in the expiration of this GSA on the same date on which the last Agreement terminates or expires.

14.7 Termination or expiration of this GSA or any Agreement, in part or in whole, shall not: a) limit either party from pursuing other remedies available to it, or b) affect the accrued rights and obligations of either party as at the date of such termination or expiry (including without limitation any obligation to pay fees that have accrued under any Agreement prior to the date of termination or expiry).

15. **General**

15.1 Any notices required to be given under this GSA and/or any Agreement shall be in English and in writing and:

- (a) if to Customer, sent to the address/fax number identified for legal notices on the applicable Order Form;
- (b) if to Google, marked for the attention of the Google Legal Department and sent to the following address/fax number:  
[\*\*\*]
- (c) in either case, sent to such other address/fax number as either party may designate from time to time in accordance with this clause.

Notices shall be deemed to have been duly served if hand delivered; sent by facsimile (with the original forwarded by first class post or special delivery); by special delivery within the United Kingdom and outside the United Kingdom by recorded airmail post; in each case correctly addressed in accordance with this clause. Any notice pursuant to this clause shall be deemed to have been served:

- (a) if hand delivered at the time of delivery by posting through the letter box of the correct addressee in accordance with this clause;
- (b) if sent by facsimile one hour after transmission during business hours at its destination or 24 hours after transmission if not within business hours but in each case subject to proof by the sender that it holds an acknowledgement confirming receipt of the transmitted notice in readable form; and
- (c) if sent by post 48 hours after posting (excluding Sundays or any applicable bank or public holidays in the country of posting) if posted to an address within the country of posting and seven days after posting (excluding Sundays or any applicable bank or public holidays in the country of posting) if posted to an address outside the country of posting.

15.2 Customer shall not assign or otherwise transfer its rights or delegate its obligations under this GSA and/or any Agreement(s), in whole or in part, without the prior written consent of Google.

15.3 [\*\*\*]

- 15.4 Nothing in this GSA or any Order Form(s) shall create or confer any rights or other benefits whether pursuant to the Contracts (Rights of Third Parties) Act 1999 or otherwise in favour of any person other than the parties to this GSA and the Order Form(s), except that this clause shall not operate so as to restrict or limit the rights of any lawful assignee under this GSA or any Agreement to exercise the rights and benefits conferred on him by his assignor.
- 15.5 Nothing in this GSA or any Order Form shall be construed as creating a partnership or joint venture of any kind between the parties or as constituting either party as the agent of the other party for any purpose whatsoever and neither party shall have the authority or power to bind the other party or to contract in the name of or create a liability against the other party in any way or for any purpose.
- 15.6 Neither party shall be liable for failure to perform or delay in performing any obligation under this GSA and/or any Agreement(s) if the failure or delay is caused by any circumstances beyond its reasonable control, including but not limited to acts of god, war, terrorism, civil commotion, acts of government, court order, changes to any applicable laws, internet or telecommunications disturbances, industrial dispute or any failure or delay by the other party to fulfil its obligations under this GSA and/or any Agreement(s). If such delay or failure continues for at least 30 days, the party not subject to the force majeure shall be entitled to terminate the applicable Agreement(s) or, at that party's discretion, this GSA and all Agreements by notice in writing to the other with immediate effect.
- 15.7 Google reserves the right to suspend or terminate the provision of any Services or parts of any Services or to vary any Services or parts of Services and/or the manner in which these are provided at any time in order to comply with any applicable law.
- 15.8 The failure to exercise or delay in exercising a right or remedy under this GSA and/or any Agreement shall not constitute a waiver of the right or remedy or a waiver of any other rights or remedies and no single or partial exercise of any right or remedy under this GSA and/or any Agreement shall prevent any further exercise of the right or remedy or the exercise of any other right or remedy. The rights and remedies contained in this GSA and any Agreement(s) are cumulative and not exclusive of any rights or remedies provided by law.
- 15.9 The invalidity, illegality or unenforceability of any provision (or part of a provision) of this GSA and/or any Order Form shall not affect or impact the continuation in force of the remainder of the provision (where applicable) and this GSA or the applicable Order Form.
- 15.10 Subject to clause 12.1(b), this GSA and any Order Form(s) represent the entire terms agreed between the parties in relation to their subject matter and supersedes all previous contracts or arrangements or any kind between the parties relating to their subject matter. Each party acknowledges and agrees that, in entering into this GSA and any Order Form(s) it has not relied on any statement, representation, assurance or warranty of any person (whether a party to this GSA or not) other than as expressly set out in this GSA or any Order Form. This GSA and any Order Form(s) may be executed in counterparts, including facsimile counterparts.
- 15.11 Where this GSA and/or any Order Form(s) refer to agreements or approvals to be in writing, at Google's sole discretion, this may (where appropriate) include e-mail.

PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934; [\*\*\*] DENOTES OMISSIONS.

15.12 This GSA and any Order Form(s) shall be governed by and construed in accordance with English law and the parties hereby submit to the exclusive jurisdiction of the English courts in respect of any dispute or matter arising out of or connected with this GSA and/or any Order Form(s). If this GSA or any Order Form is translated into any other language and if there is a discrepancy in interpretation between the English text and the text of such other language, the English text will govern.

**Signed by the parties on the dates shown below.**

**Google Ireland Limited:**

**By:** /s/ John Herlihy

\_\_\_\_\_

**Print Name:** John Herlihy

\_\_\_\_\_

**Title:** Director

\_\_\_\_\_

**Date:** 30 June 2008

\_\_\_\_\_

**Customer: Incredimail Limited**

**By:** /s/ Ofer Adler /s/ Yacov Kaufman

\_\_\_\_\_

**Print Name:** Ofer Adler Yacov Kaufman

\_\_\_\_\_

**Title:** CEO, CFO

\_\_\_\_\_

**Date:** June 29, 2008

\_\_\_\_\_



Google Services  
Agreement  
ORDER FORM

Google SPD rep: [\*\*\*]  
Google SPD director: [\*\*\*]  
Google sales engineer: [\*\*\*]  
Google legal contact: [\*\*\*]

Google Ireland Limited  
Gordon House  
Barrow Street  
Dublin 4  
Ireland  
Tel: 353 1 436 1000  
Fax: 353 1 436 1001

<b>CUSTOMER (FULL LEGAL NAME): IncrediMail</b>				<b>GSA Effective Date: 1 July 2008</b>	<b>NDA Effective Date: 26 March 2008</b>
	<b>corporate contact information:</b>	<b>technical contact information:</b>	<b>legal notices to:</b>		
<b>attention:</b>	Ofer Adler	Yuval Hamudut	Yacov Kaufman		
<b>title:</b>	CEO	CTO	CFO		
<b>address, city, area, postal code, country:</b>	Or Towers B second floor 4 Hanechoshet St Ramat Hachayal Tel Aviv 69710, Israel	Or Towers B second floor 4 Hanechoshet St Ramat Hachayal Tel Aviv 69710, Israel	Or Towers B second floor 4 Hanechoshet St Ramat Hachayal Tel Aviv 69710, Israel		
<b>phone:</b>	+972 3 7696103	+972 3 7696106	+972 3 7696157		
<b>fax:</b>	+972 3 6474601	+972 3 6474601	+972 3 6445502		
<b>email:</b>	ofer@incredimail.com	yuval@incredimail.com	yacov@incredimail.com		
<b>Order Form Effective Date: 1 July 2008</b>			<b>Initial Services Term: 12 months from the Effective Date</b>		

**SEARCH SERVICES**

SEARCH SERVICES	non-refundable annual service and support fee	monthly search fee minimum payment	search fees (for all Queries)
[***]	[***]	[***]	[***]

PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934; [\*\*\*] DENOTES OMISSIONS.

**ADSENSE SERVICES**

<b>ADSENSE FOR SEARCH</b>	<b>Net AdSense for Search Revenues percentage (%) to Customer</b>	<b>specifications</b>
AdSense for Search Site: Mystart.incredimail.com		Ads/Results Page min[***] Above-the-fold: [***] AdWords Link location: [***] AdWords Link size: as shown in Exhibit [B]

<b>optional AdSense for Search features:</b> (check the applicable boxes)	<b>AdSafe</b> level: [***]	<b>Placement Targeting</b> [***] (as shown in exhibits)
------------------------------------------------------------------------------	-------------------------------	------------------------------------------------------------

**Payment Information Details**

**currency:** Dollars





**GSA Order Form Terms and Conditions**

“GSA” means the ‘Google Services Agreement’ entered into between Google and Customer with the ‘GSA Effective Date’ stated on this Order Form above.

- 1 This Order Form (including any special terms and conditions stated in it) shall be governed by and incorporates by reference the GSA and all defined terms used in this Order Form have the same meaning as in the GSA unless this Order Form expressly states otherwise.
- 2 In the event of any conflict between any special terms and conditions set out in this Order Form and the GSA, the special terms and conditions set out in this Order Form will take precedence.
- 3 Unless otherwise agreed between the parties in writing, Customer’s implementation of the applicable Services shall be in all material respects in the form set out in Exhibits A, B and C to this Order Form and shall comply in all material respects with the specifications set out in Exhibits A, B, C and D to this Order Form.
- 4 **Linking to Google Sites:** Customer may implement the links shown as "Images", "Video" and "News" in Exhibit A provided always that:
  - a. such links shall link directly to such services (of the same name) as are provided from time to time by Google in the territory of the End User making the request (“**Links**”);
  - b. Customer shall not edit, modify, append or filter, add to or alter End User queries sent via the Links; and  
[\*\*\*] [\*\*\*]
- 5 **Client Applications:**  
[\*\*\*] [\*\*\*] [\*\*\*]

This Order Form may be executed in counterparts, including facsimile counterparts.

**Google Ireland Limited:**

By: /s/ John Herlihy

Print name: John Herlihy  
Title: Director  
Date: June 30, 2008

**Incredimail Ltd:**

By: /s/ Ofer Adler /s/ Yacov Kaufman

Print name: Ofer Adler, Yacov Kaufman  
Title: CEO, CFO  
Date: June 29, 2008

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PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934; [\*\*\*] DENOTES OMISSIONS.

**EXHIBIT A**

[\*\*\*]

(4 pages)

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PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934; [\*\*\*] DENOTES OMISSIONS.

**EXHIBIT B**

[\*\*\*]

**(1 page)**

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PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT OF 1934; [\*\*\*] DENOTES OMISSIONS.

**EXHIBIT C**

[\*\*\*]

(2 pages)

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**List of all subsidiaries**

1. IncrediMail Inc., a Delaware corporation.
  2. BizChord Ltd., a company incorporated in Israel.
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CERTIFICATIONS

I, Ofer Adler, Chief Executive Officer of IncrediMail Ltd., certify that:

1. I have reviewed this annual report on Form 20-F of IncrediMail Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: June 24, 2009

/s/ Ofer Adler

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Ofer Adler,  
Chief Executive Officer

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**CERTIFICATIONS**

I, Yacov Kaufman, Chief Financial Officer of IncrediMail Ltd., certify that:

1. I have reviewed this annual report on Form 20-F of IncrediMail Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: June 24, 2009

/s/ Yacov Kaufman

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Yacov Kaufman,  
Chief Financial Officer

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CERTIFICATION OF PERIODIC FINANCIAL REPORTS  
UNDER 18 U.S.C 1350

In connection with the Annual Report on Form 20-F of IncrediMail Ltd. For the year ended December 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies that:

1. The Report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. Information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

/s/ Ofer Adler

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Ofer Adler  
Chief Executive Officer

Date: June 24, 2009

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CERTIFICATION OF PERIODIC FINANCIAL REPORTS  
UNDER 18 U.S.C 1350

In connection with the Annual Report on Form 20-F of IncrediMail Ltd. For the year ended December 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies that:

1. The Report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. Information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

/s/ Yacov Kaufman

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Yacov Kaufman  
Chief Financial Officer

Date: June 24, 2009

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CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement on Form S-8 (File Nos. 333-152010 and 333-133968), pertaining to the 2003 Israeli Share Option Plan of Incredimail Ltd., of our report dated June 24, 2009, with respect to the consolidated financial statements of Incredimail Ltd. and its subsidiaries included in this Annual Report on Form 20-F for the year ended December 31, 2008.

Tel Aviv, Israel  
June 24, 2009

/s/ KOST FORER GABBAY & KASIERER  
KOST FORER GABBAY & KASIERER  
A member of Ernst & Young Global

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