

COMMTOUCH SOFTWARE LTD
Form 20-F
March 31, 2008

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2007

OR

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 number 000-26495

COMMTOUCH SOFTWARE LTD.

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

Israel

(Jurisdiction of incorporation or organization)

**4A Hazoran Street
Poleg Industrial Park,
P.O. Box 8511
Netanya 42504, Israel
011-972-9-863-6888**

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, par value NIS 0.15 per share*	NASDAQ Capital Market

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

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

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report (December 31, 2007).

Ordinary Shares, par value NIS 0.15*	25,346,042*
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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No x

Note: Checking the above box will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Large accelerated filer o

Accelerated filer x

Non-accelerated filer o

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 o Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

*The Company effected a reverse split at a ratio of one for three Ordinary Shares on January 2, 2008. At December 31, 2007, on a pre-split basis, the outstanding share capital of the Company totaled 76,038,207 Ordinary Shares, par value NIS 0.05 per share. Unless otherwise indicated, all shareholding related information contained in this report reflects post-reverse split data.

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.

Unless otherwise indicated, all references in this document to “Commtouch,” “the Company,” “we,” “us” or “our” are Commtouch Software Ltd. or its wholly-owned subsidiary, Commtouch Inc., as relating to consolidated financial information contained herein, and former majority-owned subsidiary, Commtouch K.K. (Japan) (during 2002 Commtouch divested itself of its majority holdings and retained an equity interest in this company, which is now known as Imatrix Corporation).

The selected consolidated statements of operations data for the years ended December 31, 2005, 2006 and 2007 and the selected consolidated balance sheet data as of December 31, 2006 and 2007 have been derived from the Consolidated Financial Statements of Commtouch included elsewhere in this report. The selected consolidated statements of operations data for the years ended December 31, 2003 and 2004 and the selected consolidated balance sheet data as of December 31, 2003, 2004 and 2005 have been derived from the Consolidated Financial Statements of Commtouch not included elsewhere in this report. Our historical results are not necessarily indicative of results to be expected for any future period. The data set forth below should be read in conjunction with “Item 5. Operating and Financial Review and Prospects” and the Consolidated Financial Statements and the Notes thereto included elsewhere herein:

	Year Ended December 31,				
	2003	2004	2005	2006	2007
	(USD in thousands, except per share data)				
Selected Data:					
Revenues	\$ 329	\$ 1,523	\$ 3,925	\$ 7,234	\$ 11,250
Net income (loss) attributable to ordinary and equivalently participating shareholders	\$ (6,834)	\$ (7,193)	\$ (2,690)	\$ (190)	\$ 2,109
Basic and diluted net earnings (loss) per share	\$ (0.84)	\$ (0.54)	\$ (0.28)	\$ (0.01)	\$ 0.08
Weighted average number of shares used in computing basic net earnings (loss) per share	8,191	13,323	15,802	22,113	24,847
Weighted average number of shares used in computing diluted net earnings (loss) per share	8,191	13,323	15,802	22,113	27,591
Total Assets	\$ 6,855	\$ 5,479	\$ 7,995	\$ 11,999	\$ 18,210

FORWARD LOOKING STATEMENTS

Except for the historical information contained in this Annual Report, the statements contained in this Annual Report are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of

1995, as amended, and other federal securities laws with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results.

We urge you to consider that statements which use the terms “anticipate,” “believe,” “expect,” “plan,” “intend,” “estimate” and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements, or industry results, expressed or implied by such forward looking statements. Such forward-looking statements appear in Item 4 - “Information on the Company” and Item 5 - “Operating and Financial Review and Prospects,” as well as elsewhere in this Annual Report. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to update or revise any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears below.

RISK FACTORS

You should carefully consider the following risk factors before you decide to buy our Ordinary Shares. You should also consider the other information in this report. If any of the following risks actually occur, our business, financial condition, operating results or cash flows could be materially adversely affected. This could cause the trading price of our Ordinary Shares to decline, and you could lose part or all of your investment. The risks described below are not the only ones facing us. Additional risks not presently known to us, or that we currently deem immaterial, may also impair our business operations.

Business Risks

If the market does not continue to respond favorably to our current advanced email defense solutions, including our anti-spam and anti-virus solutions, or our future solutions do not gain acceptance, we will fail to generate sufficient revenues.

Our success depends on the continued acceptance and use of our advanced email defense solutions by current and new enterprise, Original Equipment Manufacturer or “OEM”, and Internet Service Provider or “ISP” customers and technology licensees. We have been selling our anti-spam products for over four years, our Zero-Hour™ virus outbreak detection product for approximately three years and our IP reputation service (our latest version being known as GlobalView™ Mail Reputation) for less than two years.

As the market for email defense products continues to mature, we are seeing increasing competitive pressures and demands for even higher quality products at lower prices. This increasing demand comes at a time when email threats are more varied and intensive, challenging even the top end of email defense solutions to keep their threat detection at an industry acceptable high level of accuracy. If our solutions do not continue to evolve to meet market demand, or newer products on the market prove more effective, our business could fail. Also, if the growth in the market for email defense solutions unexpectedly begins to slow, our business will suffer dramatically.

Governmental regulation could decrease the distribution of unsolicited bulk (spam) email and malicious software and decrease demand for our solutions or increase our cost of doing business.

On December 16, 2003, President Bush signed into law the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act), which establishes a framework of administrative, civil, and criminal tools to combat spam. The law establishes both civil and criminal prohibitions to assist in deterring the most offensive forms of spam, including unmarked sexually-oriented messages and emails containing fraudulent headers. Under the law, senders of email are required to honor a request by a consumer not to receive any further unsolicited messages. While past high profile prosecutions of direct marketers seemingly have not had much of a deterrent effect on marketers of unsolicited email, it is not known whether or not future legislative endeavors will prove effective.

In addition, various state legislatures have enacted laws aimed at regulating the distribution of unsolicited email.

These and similar legal measures may have the effect of reducing the amount of unsolicited email and malicious software that is distributed and hence diminish the need for our solutions. Any such developments would have an adverse impact on our revenues.

We depend upon OEM partners and resellers and we have a limited concentration of products.

We expect to continue to be dependent upon resellers and OEM partners for a significant portion of our revenues, which will be derived from sales of our email defense solutions. Our operating results and financial condition may be materially adversely affected if:

- Our limited product suite fails to remain attractive in the email defense market;
- Anticipated orders or royalty payments from these resellers and OEM partners fail to materialize;

• We are unable to locate and or sign additional OEM partners (given the limited pool of available candidates for our technology); or

• Some of the key resellers or OEM partners cease the promotion of our business or begin to promote additional solutions in a layered approach to email defense management.

Our quarterly operating results may fluctuate, which could adversely affect the value of your investment.

A number of factors, many of which are enumerated in this “Risk Factors” section, are likely to cause fluctuations in our operating results or cause our share price to decline. These factors include:

• Our ability to successfully develop and market our email defense solutions to new markets, both domestic and international;

- Our ability to successfully develop and market new, modified or upgraded solutions, as may be needed;
 - The continued market acceptance of our new email defense solutions;
- Our ability to expand our workforce with qualified personnel, as may be needed;
- Unanticipated bugs or other problems affecting the delivery of our email defense solutions to customers;
 - The success of our resellers’ and OEM partners’ sales efforts to potential customers;

• The solvency of our resellers and OEM partners and their ability to allocate sufficient resources towards the marketing of our email defense solutions to their potential customers;

- Our OEM partners’ ability to effectively integrate our solutions into their product offerings;
 - The rate of adoption of email defense solutions by customers;
 - The substantial decrease in information technology spending;
 - The pricing of our solutions;
- Our ability to timely collect fees owed by resellers and OEM partners;

• Our ability to add space and equipment to our current detection centers in a timely and effective manner to match the rate of growth in our business, plus our ability to build new detection centers as worldwide demand for our products may require; and

•The effectiveness of our customer support, whether provided by our resellers and OEM partners, or directly by Commtouch.

We commenced operations in 1991. Up until 1998, we focused on selling, maintaining and servicing stand-alone email client software products for mainframe and personal computers. From 1998 through 2001, we were a provider of outsourced Web-based email services and, during the first half of 2002, we concentrated on marketing our software messaging solution. In mid-2002, we began focusing on the email defense market, and with the subsequent completion of development of our anti-spam solutions, we began to sell those products during the latter half of 2003. In late 2004, we added to our repertoire of email defense products our Zero-Hour™ anti-virus solution and, in late 2006, we also announced the availability of our IP reputation service, now known as GlobalView Mail Reputation. The above described changes in business models required that we adjust our business processes and workforce, which caused fluctuations in our results from operations. While during the past four years our business has been more stable and we have had success in particular in signing agreements with OEM partners, we remain subject to future fluctuations in our results of operations if any of the enumerated risks occurs. As an example, our current and future expense levels are, to a large extent, fixed, so we may be unable to adjust spending quickly to compensate for any revenue shortfall caused by any of the enumerated risks described herein. Thus, any significant revenue shortfall would have an immediate negative effect on our results of operations and share price.

We have many established competitors who are offering a multitude of solutions to the problems of spam and virus distribution.

The market for email defense products in general and anti-spam solutions in particular is intensely competitive and we expect it to be increasingly competitive. During 2006 and 2007, we began to see more OEM security vendors adopting a “layered approach” to protecting email systems - adding more than one email defense solution to their products in an effort to achieve maximum results. During 2008, it is likely that this approach will remain popular, if not continue to grow. Increased competition and the adoption of a layered approach to fighting spam and viruses could result in pricing pressures, low operating margins and smaller market share, any of which could cause our business to suffer.

In the market for email defense solutions, there are less providers offering somewhat ineffectual “content filtering” solutions (solutions focusing solely on the content of potential spam email) than in the past, and more sophisticated offerings that compete with our solutions. Email defense providers offering forms of software (gateway), multi-functional appliances and managed service solutions and which may be viewed as both competitors and potential customers to Commtouch include Symantec (Brightmail), TrendMicro, McAfee, Secure Computing (CipherTrust) and Cisco (IronPort). Email defense providers offering solutions on an OEM basis similar to Commtouch’s business model, and which may be viewed as direct competitors, include Cloudmark, Mailshell and Mail-Filters. As this market continues to develop, it is likely that companies with greater resources than ours will attempt to either enter or increase their presence in this market by acquiring or forming strategic alliances with our competitors or business partners. Some examples of this are the acquisitions of IronPort by Cisco, CipherTrust by Secure Computing, Brightmail by Symantec Corp. and Microsoft of both Frontbridge Technologies and Sybari Software (which, up until the acquisition, was one of our largest distributors).

Also, there are companies that develop and maintain in-house anti-spam solutions, such as Google and Yahoo. These and other companies could potentially leverage their existing capabilities and relationships to enter the email defense industry.

Competitors could introduce products with superior features, scalability and functionality at lower prices than our products and could also bundle existing or new products with other more established products that discourage users from purchasing our products. As noted above, our market’s level of competition has increased as current competitors have improved the sophistication and effectiveness of their offerings and as new participants have entered the market. In the future, as we expand our offerings, we may encounter increased competition in the development and distribution of these solutions. Some of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and greater financial, technical, sales, marketing and other resources than we do and may enter into strategic or commercial relationships on more favorable terms. New technologies and the expansion of existing technologies may increase competitive pressures on us, and we may not be able to compete successfully against current and future competitors.

Our ability to continue to increase our revenues will depend on our ability to successfully execute our sales and business development plan.

The complexity of the underlying technological base of email defense solutions and the current landscape of the market require highly trained sales and business development personnel to educate prospective resellers, OEM partners and customers regarding the use and benefits of our solutions. It may take time for our current and future employees, OEM partners and resellers to learn how to most effectively market our solutions. As a result, our sales and business development personnel may not be able to compete successfully against larger, more heavily financed and more experienced sales and business development departments of our competitors.

The loss of our key employees would adversely affect our ability to manage our business, therefore causing our operating results to suffer and the value of your investment to decline.

Our success depends on the skills, experience and performance of our senior management and other key personnel. The loss of the services of any of our senior management or other key personnel, including Gideon Mantel, our Chief Executive Officer, and Amir Lev, our President and Chief Technical Officer, could materially and adversely affect our business. The loss of our software developers may also adversely affect the continued development and support of our email defense solutions, therefore causing our operating results to suffer and the value of your investment to decline. We do not have employment agreements inclusive of set periods of employment with any of our key personnel. We cannot prevent them from leaving at any time. We do not maintain key-person life insurance policies, listing us as a beneficiary, on any of our employees.

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Our business and operating results could suffer if we do not successfully address potential risks inherent in doing business overseas.

As of December 31, 2007, we had sales offices in Israel and the United States. We also are marketing our email defense solutions in international markets by utilizing appropriate distribution channels. However, we may not be able to compete effectively in international markets due to various risks inherent in conducting business internationally, such as:

- Differing technology standards;
- Inability of distribution channels to successfully market our solutions;
 - Export restrictions;
- Difficulties in collecting accounts receivable and longer collection periods;
 - Unexpected changes in regulatory requirements;
 - Political and economic instability;
 - Potentially adverse tax consequences;

• The adoption of new legislation-backed penalties which may discourage the distribution of unsolicited email messages; and

- Limited enforcement mechanisms for protecting intellectual property rights.

Any of these factors could adversely affect the Company's prospective international sales and, consequently, business and operating results.

Technology Risks

We may not have the resources or skills required to adapt to the changing technological requirements and shifting preferences of our customers and their users.

The email defense industry is characterized by difficult technological challenges, sophisticated "spammers", multiple-variant viruses, unique phishing scams and constantly evolving malevolent software distribution practices and targets that could render our solutions and proprietary technology ineffective. Our success depends, in part, on our ability to continually enhance our existing email defense solutions and to develop new solutions, functions and technology that address the potential needs of prospective customers, OEM partners and their users. The development of proprietary technology and necessary enhancements entails significant technical and business risks and requires substantial expenditures and lead-time. We may not be able to keep pace with the latest technological developments. We may not be able to use new technologies effectively or adapt to customer, OEM or end user requirements or emerging industry standards. Also, we must be able to act more quickly than our competition, and may not be able to do so.

Our solutions may be adversely affected by defects or denial of service attacks, which could cause our customers, OEM partners or end users to stop using our solutions.

Our email defense solutions are based in part upon new and complex software and highly advanced computer systems. Complex software and computer systems can contain defects, particularly when first introduced or when new versions are released, and are possible targets for denial of service attacks instigated by “hackers”. Although we conduct extensive testing and implement Internet security processes, we may not discover defects to or vulnerabilities in our software or systems that affect our new or current solutions or enhancements until after they are delivered. Although we have not experienced any material defects or vulnerabilities to date in our email defense solution offerings, it is possible that, despite testing by us, defects or vulnerabilities may exist in the solutions we license. These defects or vulnerabilities could cause or lead to interruptions for customers of our email defense solutions, resulting in damage to our reputation, legal risks, loss of revenue, delays in market acceptance and diversion of our development resources, any of which could cause our business to suffer.

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Our solutions may be adversely affected if we are not able to receive a sufficient sampling of internet traffic.

Our email defense solutions are dependent, in part, on the ability of our Detection Centers to analyze, in an automated fashion, live feeds of internet traffic received through our services to customers and other contractual arrangements. If we were to suffer an unanticipated, substantial decrease in such traffic, the effectiveness of our technology would drop, and our product offerings would become less attractive.

Investment Risks

If we will be in need of additional capital, we may not be able to secure additional funds on acceptable terms and the Company could fail.

We have invested heavily in technology development. We expect to continue to spend financial and other resources on developing and introducing new offerings and maintaining our corporate organizations and strategic relationships. We also expect to invest resources in research and development projects to develop a URL categorization and blocking service and enhanced anti-spam and anti-virus solutions for enterprises and, possibly, other target markets.

The Company has exhibited incremental improvement in its financial condition over the past few years, eventually leading to the Company becoming profitable in 2007. Nevertheless, we might become dependent upon raising additional funds to finance our business or strategic initiatives. Our cash balance (including marketable securities) was approximately \$14.4 million at December 31, 2007. Based on the cash balance at December 31, 2007, current projections of revenues, related expenses and the ability to further curtail certain discretionary expenses, the Company believes it has sufficient cash to continue operations through at least March 2009.

In the past we have received funds for the development of our business from the State of Israel through the Office of the Chief Scientist, or the OCS. If additional funding becomes necessary and we are unable to raise those funds, the Company could fail. There can be no assurance that we will be able to raise necessary funds or that we will be able to do so on terms acceptable to us. Even if available on acceptable terms, any such additional funding may result in significant dilution to existing shareholders.

If we cannot continue to satisfy NASDAQ's maintenance requirements, it may delist our Ordinary Shares and we may not have an active public market for our Ordinary Shares. The absence of an active trading market would likely make our Ordinary Shares an illiquid investment.

Our Ordinary Shares are quoted on The NASDAQ Capital Market. To continue to be listed, among other requirements, we are required a) to maintain shareholders' equity of at least \$2,500,000, or market value of our outstanding shares (excluding shares held by Company insiders and principal shareholders) of at least \$35,000,000, or we must have realized at least \$500,000 in net income from continuing operations in our last fiscal year or in two of our last three fiscal years and b) we must maintain a minimum bid price per Ordinary Share of \$1.00. Up through 2006, the Company did not meet the applicable listing requirements on several occasions. The Company believes it has solidified its position on The NASDAQ Capital Market and, with the effectuation of a reverse split on January 2, 2008, the Company intended to achieve the requirements necessary to move its listing to The NASDAQ Global Market. A subsequent downturn in the financial markets in general at the beginning of 2008 and in the Company's stock price in particular has delayed the Company's ability to apply for listing on The NASDAQ Global Market. There can be no assurance that the Company will be able to list its Ordinary Shares on The NASDAQ Global Market.

If the Company's business or stock price deteriorates significantly, we may be at risk for a delisting by NASDAQ from the Capital Market.

Our directors, executive officers and principal shareholders will be able to exert significant influence over matters requiring shareholder approval and could delay or prevent a change of control.

Our directors and affiliates of our directors, our executive officers and our shareholders who currently individually beneficially own over five percent of the voting power in the Company (together known as “affiliated entities”), beneficially own, in the aggregate, approximately 30% of our outstanding Ordinary Shares as of December 31, 2007. Included in the calculation of voting power are warrants and options exercisable by the affiliated entities within 60 days thereof. If they vote together (especially if they were to convert all beneficial holdings into shares entitled to voting rights in the Company), these shareholders will be able to exercise significant influence over all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership could also delay or prevent a change in control of Commtouch. In addition, conflicts of interest may arise as a consequence of the significant shareholders control relationship with us, including:

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Conflicts between significant shareholders, and our other shareholders whose interests may differ with respect to, among other things, our strategic direction or significant corporate transactions;

Conflicts related to corporate opportunities that could be pursued by us, on the one hand, or by these shareholders, on the other hand; or

Conflicts related to existing or new contractual relationships between us, on the one hand, and these shareholders, on the other hand.

Substantial sales of our Ordinary Shares could adversely affect our share price and dilute the interests of our existing shareholders.

The sale, or availability for sale, of large quantities of our Ordinary Shares may have the effect of further depressing its market price. We continue to maintain various registration statements declared effective in prior years by the Securities and Exchange Commission, or SEC, which cover the resale of shares issued and shares to be issued on the exercise of warrants issued under certain private placements closed prior to 2006. In particular, the additional Ordinary Shares to be issued if and when outstanding warrants to purchase 1,035,502 Ordinary Shares (as of January 2, 2008) are exercised will dilute existing shareholders of Ordinary Shares.

If we fail to honor registration rights for past private placements, we will be subject to payment of liquidated damages.

According to registration rights agreements with the selling security holders listed under registration statements on Form F-3 filed by us with the SEC between 2004 and 2006, should we fail to maintain the effectiveness of those registration statements for the periods stated in the respective agreements, we risk having imposed on us liquidated damages as defined in those agreements. For example, one of the agreements provides for liquidated damages of up to one million additional unregistered Series A Preferred Shares (which, given the prior conversion of all outstanding Series A Preferred Shares, and taking into account the reverse split effective January 2, 2008 now equals 666,667 unregistered Ordinary Shares). These liquidated damages would dilute the value of Ordinary Shares held by other shareholders.

Intellectual Property Risks

If we fail to adequately protect our intellectual property rights or face a claim of intellectual property infringement by a third party, we could lose our intellectual property rights or be liable for significant damages.

We regard our patented and patent pending technology, copyrights, service marks, trademarks, trade secrets and similar intellectual property as critical to our success, and rely on patent, trademark and copyright law, trade secret protection and confidentiality or license agreements with our employees and customers to protect our proprietary rights.

During 2004, we purchased a United States patent, U.S. Patent No. 6,330,590. During 2005, we filed in the United States two anti-spam related patent applications, claiming priority for prior periods based on filings of U.S. Provisional Patent Applications, and one virus outbreak detection related patent application. During 2006, we filed in the United States a patent application relating to the prevention of spam in streaming systems or, in other words, unwanted conversational media sessions (i.e. voice and video related). We may seek to patent certain additional software or other technology in the future. Any such patent applications might not result in patents issued within the scope of the claims we seek, or at all.

Despite our precautions, unauthorized third parties may copy certain portions of our technology, reverse engineer or obtain and use information that we regard as proprietary or otherwise infringe or misappropriate our patent or our patent pending technology, trade secrets, copyrights, trademarks and similar proprietary rights. We may not have the proper resources in order to adequately protect our intellectual property. In addition, the laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the United States. Our means of protecting our proprietary rights in the United States or abroad may not be adequate and competitors may independently develop similar technology.

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We cannot be certain that our software does not infringe issued patents that may relate to our anti-spam or anti-virus solutions. In addition, because patent applications in the United States are not publicly disclosed until the patent is issued, applications previously may have been filed which relate to our anti-spam and virus outbreak detection solutions. Therefore, other parties, whether in the United States or elsewhere, may assert infringement claims against us. We may also be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of the patents, trademarks and other intellectual property rights of third parties by ourselves and our licensees. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. We may not have the proper resources in order to adequately defend against such claims.

Risks Relating to Operations in Israel

We have important facilities and resources located in Israel, which has historically experienced severe economic instability and military and political unrest.

We are incorporated under the laws of the State of Israel. Our principal research and development facilities are located in Israel. Although the substantial majority of our past sales were made to customers outside Israel, we are nonetheless directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel, or the interruption or curtailment of trade between Israel and its present trading partners, could significantly harm our business, operating results and financial condition.

Since the State of Israel was established in 1948, a number of armed conflicts have occurred between Israel and its Arab neighbors. Since October 2000, terrorist violence in Israel has increased significantly. Recently, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups, as well as extensive hostilities along Israel's northern border with Lebanon in the summer of 2006, and extensive hostilities along Israel's border with the Gaza Strip since June 2007 when the Hamas effectively took control of the Gaza Strip. Ongoing and revived hostilities or other Israeli political or economic factors could harm our operations and cause our revenues to decrease.

In addition, Israel and some companies doing business with Israel have been the subject of an economic boycott by Arab countries since Israel's establishment. These restrictive laws and policies may have an adverse impact on our operating results, financial condition or expansion of our business.

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

Certain of our officers and employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called for active military duty at any time in the event of a national emergency. Although Commtouch has operated effectively under these requirements since its inception, we cannot predict the effect of these obligations on Commtouch in the future. Our operations could be disrupted by the absence for a significant period of one or more of our officers or key employees due to military service. Any disruption in our operations would harm our business.

Because a substantial portion of our revenues historically have been generated in U.S. dollars and a portion of our expenses have been incurred in New Israeli Shekels, our results of operations may be adversely affected by currency fluctuations.

We have generated a substantial portion of our revenues in U.S. dollars and incurred a portion of our expenses, principally salaries and related personnel expenses in Israel, in New Israeli Shekels, or NIS. We anticipate that a significant portion of our expenses will continue to be denominated in Israeli shekels. As a result, we are exposed to risk to the extent that the value of the U.S. dollar decreases against the NIS. In that event, the U.S. dollar cost of our operations will increase and our U.S. dollar-measured results of operations will be adversely affected, as occurred in

2006 and 2007, when the NIS appreciated against the U.S. dollar, which resulted in a significant increase in the U.S. dollar cost of our operations. We cannot predict the trend for future years. Our operations also could be adversely affected if we are unable to guard against currency fluctuations in the future. To date, we have not engaged in hedging transactions. In the future, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of the dollar against the NIS. These measures, however, may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

The government programs and benefits which we previously received require us to meet several conditions and may be terminated or reduced in the future.

Prior to 1998, we received grants from the Government of Israel, through the OCS, for the financing of a significant portion of our research and development expenditures in Israel. These grants totaled \$0.6 million. In 2001, we received \$0.6 million and in 2002 we received \$0.2 million. We did not submit an application for funding during the period 2004 - 2007. We have not received OCS funding in recent years, but we may apply for additional grants in the future. The OCS budget has been subject to reductions which may affect the availability of funds for possible future grants. Therefore, we cannot be certain that we will be able to receive future grants in similar amounts, or at all. In addition, the terms of any future OCS grants may be less favorable than our past grants.

In order to meet specified conditions in connection with the grants and programs of the OCS, we have made representations to the Israel government about our Israeli operations. From time to time the conduct of our Israeli operations has deviated from our forecasts. If we fail to meet the conditions of the grants, including the maintenance of a material presence in Israel, or if there is any material deviation from the representations made by us to the Israeli government, we could be required to refund the grants previously received (together with an adjustment based on the Israeli consumer price index and an interest factor) and would likely be ineligible to receive OCS grants in the future.

Under the Law for the Encouragement of Industrial Research and Development, 5744-1984 and the related regulations, the discretionary approval of an OCS committee is required for any transfer of technology developed with OCS funding or for the transfer of manufacturing rights outside of Israel. OCS approval is not required for the export of any products resulting from the research and development. There is no assurance that we will receive the required approvals for any proposed future transfer. Such approvals, if granted, may be subject to the following additional restrictions:

- a requirement to pay the OCS a portion of the consideration we receive upon any sale of such technology to an entity that is not Israeli. The scope of the support received, the royalties that were paid by us, the amount of time that elapsed between the date on which the know-how was transferred and the date on which the grants were received, as well as the sale price, will be taken into account in order to calculate the amount of the payment; and
- the transfer of manufacturing rights could be conditioned upon an increase in the royalty rate and payment of increased aggregate royalties (up to 300% of the amount of the grant plus interest, depending on the percentage of the manufacturing that is foreign).

These restrictions may impair our ability to sell certain of our older technology assets outside of Israel. The restrictions will continue to apply even after we repay the full amount of royalties payable for the grants.

The tax benefits from our approved enterprise programs require us to satisfy specified conditions. If we fail to satisfy these conditions, we may be required to pay additional taxes and would likely be denied these benefits in the future.

The Investment Center of the Israeli Ministry of Industry, Trade and Labor has granted approved enterprise status to several investment programs at our facility. The portion of our income derived from these approved enterprise programs, commencing when we begin to generate net income from these programs, will be exempt from tax for a period of two years and will be subject to a reduced tax rate for an additional five to eight years, depending on the percentage of our share capital held by non-Israelis. The benefits available to an approved enterprise program are dependent upon the fulfillment of conditions stipulated in applicable law and in the certificate of approval. If we fail to comply with these conditions, in whole or in part, we may be required to pay additional taxes during the period in which we would have benefited from the tax exemption or reduced tax rates and would likely be denied these benefits in the future.

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

We are organized under the laws of Israel, and we maintain significant operations in Israel. In addition, several of our directors and executive officers are not residents of the United States and most of their assets and our assets are located outside the United States. Service of process upon our non-U.S. resident directors or executive officers and enforcement of judgments obtained in the United States against us and our directors and executive officers may be difficult to obtain within the United States. It may be difficult to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum in which to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the substance of the applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. Furthermore, there is little binding case law in Israel addressing these matters.

Israeli courts might not enforce judgments rendered outside Israel which may make it difficult to collect on judgments rendered against us. Subject to certain time limitations, an Israeli court may declare a foreign civil judgment enforceable only if it finds that (a) the judgment was rendered by a court which was, according to the laws of the state of the court, competent to render the judgment; (b) the judgment may no longer be appealed; (c) the obligation imposed by the judgment is enforceable according to the rules relating to the enforceability of judgments in Israel and the substance of the judgment is not contrary to public policy; and (d) the judgment is executory in the state in which it was given.

Even if these conditions are satisfied, an Israeli court will not enforce a foreign judgment if it was given in a state whose laws do not provide for the enforcement of judgments of Israeli courts (subject to exceptional cases) or if its enforcement is likely to prejudice the sovereignty or security of the State of Israel. An Israeli court also will not declare a foreign judgment enforceable if (i) the judgment was obtained by fraud; (ii) there is a finding of lack of due process; (iii) the judgment was rendered by a court not competent to render it according to the laws of private international law in Israel; (iv) the judgment is at variance with another judgment that was given in the same matter between the same parties and that is still valid; or (v) at the time the action was brought in the foreign court, a suit in the same matter and between the same parties was pending before a court or tribunal in Israel.

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

Israeli corporate law regulates mergers and acquisitions of shares through tender offers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax law treats stock-for-stock acquisitions between an Israeli company and a foreign company less favorably than does 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 or to taxation before his investment in the foreign corporation becomes liquid. These provisions may adversely affect the price of our shares.

Item 4. Information on the Company.

Overview

The legal name of the Company is Commtouch Software Ltd., and its principal executive offices are located at 4A Hazoran Street, Poleg Industrial Park, P.O.Box 8511, Netanya 42504, Israel, where our telephone number is 011-972-9-863-6888. The Company was incorporated under the laws of the State of Israel on February 5, 1991 and its legal form is a company limited by shares. Its Articles of Association are on file in Israel with the office of the Israeli Registrar of Companies and available for public inspection from the Israel Companies Registrar. The Company's wholly owned subsidiary, Commtouch Inc., is located at 292 Gibraltar Drive, Suite 107, Sunnyvale, California 94089, where our telephone number is (650) 864-2000.

We are a provider of email defense products to enterprise customers and OEM distribution partners, including real-time anti-spam, virus outbreak detection and IP reputation solutions. The Company offers its email defense solutions to small, medium and large enterprises through a variety of third party distribution channels. The solutions are also available for integration with security, content filtering, anti-virus and other filtering solutions through alliances and strategic technology partnerships. A combination of proprietary patented and patent-pending technologies makes it possible for Commtouch to detect, alert and block spam and virus attacks as they are distributed over the Internet. At the core of Commtouch email defense offerings is Commtouch's proprietary Recurrent Pattern Detection (RPD)TM technology which, in general terms, analyzes messages associated with mass email outbreaks and directs the blocking of such emails, without the need to analyze individual messages.

Commtouch Offerings

We offer a Software Development Kit or "SDK" comprised of multiple components; each different component enables third-party vendors to integrate one of the Company's licensing offerings. Two components, known as ctasd and ctengine, are two different methods of enabling third-party vendors to integrate the Commtouch anti-spam solution into their existing offerings. Both ctengine and ctasd provide these manufacturers or service providers with full spam identification and spam classification services from the Commtouch Detection Centers (described below). The SDK communicates fully with a remote Detection Center, receiving results to queries about suspicious messages and acting according to set policies on the customer side. These same two components also enable integration of the Company's Zero-Hour™ virus outbreak protection, which is built on our proprietary Recurrent Pattern Detection™ technology. This solution provides customers with the ability to block malevolent software (or as known in the industry "malware"), including email borne viruses, in real time, at the moment the initial attack occurs. During the initial attack phase, traditional anti-virus vendors are typically analyzing messages to determine whether they are indeed infected with a virus. It is this critical lag in response time by traditional anti-virus vendors that the Zero-Hour solution has been developed to remedy.

A third component of the SDK, known as ctipd, enables integration of the Company's Mail Reputation Service. The Reputation Service is typically integrated into a device that sits at the perimeter of the organization, deciding which email traffic to allow to enter the organization, and which to block. It accomplishes this by receiving classification data from a Commtouch Detection Center about the sender of each email message. During 2007, the Company launched an advanced version of this Reputation Service known as "GlobalView".

Products that may benefit from integration of the SDK solution include:

- Anti-virus applications;
- Content filtering solutions;
- Firewall systems;
- Security servers; and
- Other network appliances

We also offer an enterprise anti-spam solution, consisting of both a software element, or the "Enterprise Gateway", and a service component, or a Commtouch "Detection Center". At the Enterprise Gateway, messages are filtered at the customer organization's entry point, before being distributed to recipients, with added user-level controls and a top level of secure spam detection services from the Detection Center, all allowing for real-time reaction to worldwide spam attacks. At the heart of the solution, however, is the Detection Center, which detects new spam attacks as soon as they are launched and distributed over the Internet. The Detection Center provides real-time spam detection services to enterprise customers by maintaining constant communication with Enterprise Gateways that are locally installed at customer premises in different locations worldwide. The Detection Center collects information from multiple sources about new spam attacks, analyzes the input using Commtouch patented technology, identifies and detects spam, classifies the data, matches its stored information against outstanding queries for spam detection from Enterprise Gateways and replies in real-time back to the Enterprise Gateways with a prioritized resolution.

In particular, the Commtouch anti-spam solution operates to help eliminate spam as follows:

- Inbound email enters the Enterprise Gateway, a software add-on to the enterprise SMTP server;

- The Enterprise Gateway matches key characteristics of the message with predefined spam policies created by IT managers or end-users;
- If the solution does not match the message to a known source, either spam or non-spam, it compares characteristics of the incoming message against the Enterprise Gateway cache of recently identified spam;
- If the message remains suspicious, but cannot be confirmed as spam, the Enterprise Gateway queries the Detection Center for remote spam detection and classification services;
 - The outgoing query consists of digital signatures taken from email header information. The signatures may be hashed (one-way encrypted) to ensure enterprise security and confidentiality. The query does not contain the full email body or its attachments and it is therefore very small in size (500 Bytes);
- The Detection Center weighs the values of the outstanding query against its vast database of real-time information about known spam patterns and sources of spam, and replies to the Enterprise Gateway with a unique and up-to-date classification; and

·The Enterprise Gateway applies a locally predefined action to the message and may store the information internally to match against new incoming messages bearing similar characteristics.

Latly, the Company expects to release a URL categorization and blocking service during 2008 that will analyze and categorize for customers of our OEM partners (i.e. enterprises, ISPs and consumers) the source of URLs being accessed by such customers, in order to prevent the possibility of malware attacks being propogated by malicious URLs.

Competitive Landscape

The markets in which Commtouch competes are intensely competitive and rapidly changing. We believe there is no single competitor that offers the complete package of anti-spam, anti-virus and IP reputation protections that Commtouch provides. We are aware of competitors that provide anti-spam, anti-virus and reputation services either alone or as part of a complete messaging system or email security system. However, in the past few years, we began to see more OEM security vendors adopting a “layered approach” to protecting email systems - adding more than one email defense solution to their products in an effort to achieve maximum results. During 2008 it is likely that this approach will remain popular, thereby creating pricing pressure, reduced gross margins and possibly loss of market share for us.

Commtouch’s GlobalView Mail Reputation Service competes in a relatively young and continuously evolving market. While this provides opportunity to attempt to shape the market to suit our strengths, there is also risk that this space will not fully evolve, or that a strong competitor will define the market to suit its needs. While the space is immature, there are some established vendors, including TrendMicro, that are offering reputation-based solutions. In some cases, while the product positioning may be new, the underlying solutions may be mature - for example, Spamhaus repositioning its RBL, or “Real-time Block List”, service as a commercial reputation service. In addition, there are several startups competing in this space, perhaps the most notable being Karmasphere.

In the market for email defense solutions, there are fewer providers offering somewhat ineffectual “content filtering” solutions (solutions focusing solely on the content of potential spam email) than in the past, and more sophisticated offerings that compete with our solutions. Email defense providers offering forms of software (gateway), multi-functional appliances and managed service solutions and which may be viewed as both competitors and potential customers to Commtouch include Symantec (Brightmail), TrendMicro, McAfee, Secure Computing (CipherTrust) and Cisco (IronPort). Email defense providers offering solutions on an OEM basis similar to Commtouch’s business model, and which may be viewed as direct competitors, include Cloudmark, Mailshell and Mail-Filters.

The principal competitive factors in our industry include price, product functionality, product integration, platform coverage and ability to scale, worldwide sales infrastructure and global technical support. Some of our competitors have greater financial, technical, sales, marketing and other resources than we do, as well as greater name recognition and a larger installed customer base. Additionally, some of these competitors have research and development capabilities that may allow them to develop new or improved products that may compete with product lines we market and distribute.

We expect that the market for email defense solutions will continue to become more consolidated, with companies having greater resources than ours increasing their presence in this market by acquiring or forming strategic alliances with our competitors or business partners. Some examples of this are the acquisitions of IronPort by Cisco, CipherTrust by Secure Computing, Brightmail by Symantec Corp. and Microsoft of Sybari Software (which, up until the acquisition, was one of our largest distributors).

Our success will depend on our ability to adapt to these competing forces, to develop more advanced products more rapidly and less expensively than our competitors, and to educate potential customers as to the benefits of licensing our products rather than developing their own products. Competitors could introduce products with superior features, scalability and functionality at lower prices than our products and could also bundle existing or new products with other more established products that discourage users from purchasing our products.

The market for real-time virus protection products is constantly evolving, as those promoting the proliferation of viruses continually seek new distribution techniques. Commtouch's offering differs from traditional anti-virus solutions in that we are offering an additional, complementary solution to signature and heuristic-based anti-virus engines. For this reason, our Zero-Hour virus outbreak protection engine has been licensed by several anti-virus companies, including F-Secure and VirusBuster. If virus distribution methods continue to migrate from email to other formats, there may be less of a demand for our Zero-Hour solution and more of a demand for a web security solution of the type in which we have begun to invest R&D resources.

See also disclosure under “Item 3. Key Information- RISK FACTORS—Business Risks—We have many established competitors who are offering a multitude of solutions to the problems of spam and virus distribution.”

Sales and Marketing

We utilize third party distribution channels to sell our products. Generally, our SDK is licensed to OEM customers, who in turn integrate the SDK into their product offerings for sale to their customers. We are paid license fees or royalties under a variety of fee structures, including fixed fee and fee sharing arrangements.

Our enterprise anti-spam solution is sold through resellers, who pay us pre-negotiated fees from each sale closed with a reseller’s customer.

All Company sales are managed by the Company’s and its U.S. subsidiary’s business development departments, each of which consists of a department head and a relatively small number of business development professionals. The Company’s marketing efforts are aimed mainly at potential OEM customers. The marketing department is concentrated in the Company’s Israel office, though our personnel travel internationally in furtherance of the Company’s marketing goals.

Intellectual Property

We regard our patented and patent pending anti-spam and anti-virus technology, copyrights, service marks, trademarks, trade secrets and similar intellectual property as critical to our success, and rely on patent, trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. During 2004, we purchased a United States patent, Patent No. 6,330,590, which we believe to be an integral part of our patent strategy aimed at protecting our proprietary anti-spam technology. During 2005, we filed in the United States two anti-spam related patent applications, claiming priority for prior periods based on filings of U.S. Provisional Patent Applications, and one virus outbreak detection related patent application. During 2006, we filed in the United States a patent application relating to the prevention of spam in streaming systems (i.e. voice and video related email). We are only actively maintaining our registered trademark for “COMMTOUCH”, which is registered in the U.S., Canada, India, Israel, European Union, China, Mexico, Norway, Taiwan, Russian Federation, South Korea and Australia. While previous registrations of PRONTO (Canada and South Korea) may still be in force, we are not currently actively maintaining these trademarks and they will lapse. Since at least September 2003, we are also claiming trademark rights in “RPD” and “Recurrent Pattern Detection”, as applicable to our email defense solutions. We have also been claiming trademark rights in Zero-Hour in relation to our virus outbreak detection product and GlobalView in relation to our IP reputation product.

It may be possible for unauthorized third parties to copy or reverse engineer certain portions of our products or obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the United States. There can be no assurance that our means of protecting our proprietary rights in the United States or abroad will be adequate or that competing companies will not independently develop similar technology.

Other parties may assert infringement claims against us. We may also be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement by us and/or our licensees of the trademarks and other intellectual property rights of third parties. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Government Regulation

Laws aimed at curtailing the spread of spam have been adopted by the United States federal government, i.e. CAN-SPAM Act, and some individual U.S. states, with the CAN-SPAM Act superseding some state laws or certain elements thereof. See also disclosure under “Item 3. Key Information- RISK FACTORS—Business Risks— “Governmental regulation could decrease the distribution of unsolicited bulk (spam) email and malicious software and decrease demand for our solutions or increase our cost of doing business.” Despite this legislation, we have not seen abatement in the amount of spam traffic on the Internet; rather, a continuing increase in large numbers that is being distributed in more sophisticated ways. The continuing growth and development of the spam market may prompt calls for even more stringent Internet user protection laws that would limit the ability of companies and individuals promoting or delivering spam online, and thus potentially negatively affect our business.

The propagation of email viruses aimed at destroying or stealing third party data is illegal under standard state and federal law outlawing theft, misappropriation, conversion, etc., without the need for special legislation prohibiting such activities on the Internet. Despite the existence of these laws, sources for Internet viruses continue to spread multi-variant viruses seemingly without much fear of recrimination. New laws providing for more stringent penalties could be adopted in various jurisdictions, but it is unclear what, if any, affect these would have on the anti-virus industry in general and our Zero-Hour Virus Outbreak Detection solution in particular.

Employees

As of December 31, 2007, 2006 and 2005, we had 60, 46 and 35 employees, respectively. None of our U.S. employees are covered by a collective bargaining agreement. As of December 31, 2007, our employees were categorized as follows:

LOCATION	General & Administrative	Sales & Marketing	Research & Development	Hosting (Operations)	TOTAL:
ISRAEL OFFICE	9	12	27	-	48
U.S. OFFICE	3	6	-	3	12

We believe that our relations with our employees are good.

Israeli law and certain provisions of the nationwide collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordinating Bureau of Economic Organizations (the Israeli federation of employers' organizations) apply to Commtouch's Israeli employees. These provisions principally concern the maximum length of the workday and workweek, minimum wages, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. Furthermore, pursuant to such provisions, the wages of most of Commtouch's Israeli employees are subject to cost of living adjustments, based on changes in the Israeli Consumer Price Index. The amounts and frequency of such adjustments are modified from time to time. Pursuant to an order issued in December 2007 by the Israeli Minister of Industry, Trade and Labor, new provisions relating to pension arrangements in the collective bargaining agreements will apply to all employees in Israel, including our employees. According to these provisions, all employees employed for at least nine months (or six months commencing in 2009) will be entitled to pension benefits to be funded by preset monthly contributions of the employee and the employer. Israeli law generally requires the payment of severance pay upon the retirement or death of an employee or upon termination of employment by the employer or, in certain circumstances, by the employee. We currently fund our ongoing severance obligations by making monthly payments for insurance policies and by an accrual. A general practice in Israel followed by Commtouch, although not legally required, is the contribution of funds on behalf of certain employees to an individual insurance policy known as "Managers' Insurance." This policy provides a combination of savings plan, insurance and severance pay benefits to the insured employee. It provides for payments to the employee upon retirement or death and secures a substantial portion of the severance pay, if any, to which the employee is legally entitled upon termination of employment. Each participating employee contributes an amount equal to 5% of such employee's base salary, and the employer contributes between 13.3% and 15.8% of the employee's base salary. Full-time employees who are not insured in this way are entitled to a savings account, to which each of the employee and the employer makes a monthly contribution of 5% of the employee's base salary. We also provide certain Israeli employees with an Education Fund, to which each participating employee contributes an amount equal to 2.5% of such employee's base salary, and the employer contributes an amount equal to 7.5% of the employee's base salary, up to a certain maximum base salary set by law.

Description of Property

All of our facilities are leased. Our headquarters, in Netanya, Israel, is approximately 1,007.4 square meters, and it houses senior management, research and development, sales, marketing and administrative personnel. Our subsidiary's Sunnyvale, California office, which is approximately 3,600 square feet in size, houses administrative, sales and hosting (operations) personnel.

Geographic Information

The Company conducts its business on the basis of one reportable segment (see also Note 1 of Notes to the Financial Statements for a brief description of the Company's business). The Company has adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information".

Revenues for Last Three Financial Years

See Item 5. Operating and Financial Review and Prospects - "Revenue Sources" and the F pages to this Form 20-F below. Below is a breakdown of our revenues by location (in thousands):

	Year December 31,		
	2005	2006	2007
Israel	\$ 365	\$ 344	\$ 742
North America	2,737	4,525	6,424
Europe	687	1,715	2,735
Asia	136	493	1,038
Other	-	157	34
	\$ 3,925	\$ 7,234	\$ 11,250

We have had only negligible capital expenditures and divestitures in the last three financial years.

Item 4A. Unresolved Staff Comments.

[None.]

Item 5. Operating and Financial Review and Prospects.

The following discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included elsewhere in this report. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, the words "expects," "anticipates," "believes," "intends," "plans," "seeks" and "estimates" and similar expressions are intended to identify forward-looking statements. Commtouch's actual results and the timing of certain events may differ significantly from those projected in the forward-looking statements. Factors that might cause future results to differ materially from those projected in the forward-looking statements include, but are not limited to, those set forth under "Item 3. Key Information-Risk Factors" and in the Company's other filings with the SEC.

Overview

From 2003 through 2007, the focus of our business has been the development and selling, through reseller and OEM distribution channels, anti-spam, Zero-Hour virus outbreak detection and IP reputation solutions to enterprise class customers. While no uniform definition of spam exists, the Company generally defines "spam" as the sending of unsolicited bulk email for commercial and non-commercial purposes.

Subsequent to balance sheet date, in January 2008, the Board of Directors and shareholders approved a 3:1 reverse stock split of the Company's share capital. As a result of this action, every three shares (including all authorized, issued and outstanding shares and all outstanding warrants and options to purchase shares) will be combined into one

share of the same respective class of shares bearing a par value of NIS 0.15 each. All of the Company's authorized, issued and outstanding shares (including all outstanding warrants and options to purchase shares) as of December 31, 2007 and 2006, have been restated to reflect the effect of the reverse stock split.

Critical Accounting Policies and Estimates

Operating and Financial Review and Prospects are based upon the Company's consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Management believes the critical accounting policies and areas that require the most significant judgments and estimates to be used in the preparation of the consolidated financial statements are accounting for stock-based compensation, revenue recognition, investment in affiliate and commitments and contingencies.

Accounting for Stock-Based Compensation:

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 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 No. 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), for periods beginning in fiscal year 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS No. 123(R). We have applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). SFAS No. 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 our consolidated operations statements.

At December 31, 2007, we has three stock-based employee compensation plans, which are described more fully in Note 5 of the financial statements. Prior to January 1, 2006, we accounted for those plans under the recognition and measurement provisions of APB No. 25, "Accounting for Stock Issued to Employees" ("Opinion 25"), and related interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation". During the years ended December 31, 2005 and 2004, the Company recognized stock-based compensation expenses in the amount of zero and \$ 30 thousands, respectively.

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment", using the modified-prospective-transition method. Under that transition method, compensation cost recognized during 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS No. 123(R) on January 1, 2006, our net loss for the year ended December 31, 2006, is \$ 790 thousand higher than if we had continued to account for share- based compensation under Opinion 25. Basic and diluted loss per share for the year ended December 31, 2006, is \$ 0.03 higher than if we had continued to account for share-based compensation under Opinion 25.

We estimate the fair value of stock options granted using the Black-Scholes option pricing model. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements. The expected term of options granted is based upon historical experience and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. We have historically not paid dividends and has no foreseeable plans to pay dividends. We recognize the related expenses over the vesting period using the straight line method.

Revenue recognition

Revenue is recognized when the earnings process is complete, as evidenced by an agreement between the customer and the Company, when delivery has occurred or services have been rendered, when the fee is fixed or determinable and when collection is probable. The service component of the Company's solutions is considered essential to the functionality of the software components. Furthermore, the software components cannot be used on a standalone basis, or with another party's service. The customer has no ability to run the software or the SDK on its own hardware. As the software portion of the product can not stand on its own, the Company considers each sale as a service arrangement. Therefore, revenues deriving from anti-spam services are recognized ratably over the service term, which generally includes a term period of one year to three years. The Company's revenue recognition policy is discussed in Note 2 of Notes to Consolidated Financial Statements.

Commitments and Contingencies

Commtouch periodically records the estimated impacts of various conditions, situations or circumstances involving uncertain outcomes. These events are called "contingencies", and Commtouch's accounting for such events is prescribed by Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" ("SFAS No. 5"). SFAS No. 5 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur."

SFAS No. 5 does not permit the accrual of gain contingencies under any circumstances. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that the loss has been incurred, given the likelihood of the uncertain future events; and (2) that the amount of the loss can be reasonably estimated.

The accrual of a contingency involves considerable judgment on the part of management. Commtouch uses its internal expertise, and outside experts (such as lawyers, tax specialists and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss. The Company has recorded contingencies in situations where management determined it was probable a loss had been incurred and the amount could be reasonably estimated.

Valuation of investments

Fair values of marketable securities are estimated using quoted market prices where available. Our marketable securities consist of highly-rated federal backed student loan securities. As of December 31, 2007, the marketable securities are stated at market value which is equivalent to par value. We classify our investments as available for sale. Changes in fair value of investments classified as available for sale are not recognized to income during the period, but rather are recognized as a separate component of equity until realized.

Subsequent to balance sheet date, commencing in February 2008, the auction rate securities suffered from failed auctions.

Accounting for income taxes

On January 1, 2007, we adopted FIN 48, "Accounting for Uncertainty in Income Taxes," which contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with Statement 109, "Accounting for Income Taxes." 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, "Accounting for Income Taxes" (SFAS No. 109) and SFAS No. 5 "Accounting for Contingencies" ("SFAS No. 5"). No provision was recommended as a result of the adoption of FIN 48 or for the year ended December 31, 2007.

The Company and its subsidiary have provided a valuation allowance in respect to the deferred tax assets resulting from operating loss carryforwards and other temporary differences. Management currently believes that since the Company and its subsidiary have a history of losses it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized in the foreseeable future.

Revenue Sources

Service Fees.

We recognize revenues from anti-spam, Zero-Hour virus outbreak detection and GlobalView Mail Reputation Service. Revenues from anti-spam, Zero-Hour virus outbreak detection services and GlobalView Mail Reputation Service are recognized when persuasive evidence of an arrangement exists, services are provided, the fee is fixed or determinable and collectibility is probable. Revenues deriving from anti-spam and Zero-Hour virus outbreak detection services are recognized ratably over the life of the service period.

Patent License Fees.

We also recognize revenues from our patent licensing program. Revenues from patent licenses are recognized when persuasive evidence of an arrangement exists, delivery has occurred and the Company has no further obligations, the fee is fixed or determinable and collectibility is probable.

Results of Operations

The following table sets forth financial data for the years ended December 31, 2005, 2006 and 2007 (in thousands):

	2005	2006	2007
Revenues	\$ 3,925	\$ 7,234	\$ 11,250
Cost of revenues	700	901	1,411
Gross profit	3,225	6,333	9,839
Operating expenses:			
Research and development	1,524	1,763	2,187
Sales and marketing	2,476	2,686	3,453
General and administrative	1,881	2,299	2,589
Total operating expenses	5,881	6,748	8,229
Operating income (loss)	(2,656)	(415)	1,610
Interest and other income (expenses), net	141	274	527
Equity in losses of affiliate	(175)	(49)	-
Net income (loss) before taxes	(2,690)	(190)	2,137
Taxes on income	-	-	28
Amortization of beneficial conversion feature relating to convertible Series A Preferred Shares	(1,751)	—	-
Net income (loss) attributable to ordinary and equivalently participating shareholders	\$ (4,441)	\$ (190)	\$ 2,109

Comparison of Years Ended December 31, 2007 and 2006

Revenues. Revenues increased by \$4.1 million from \$7.2 million in 2006 to \$11.3 million in 2007. The increase is due to an increase in market share, especially in the international market. The number of OEM's increased by 35 in 2007

and amounted to 88 as of December 31, 2007.

Cost of Revenues. Cost of revenues increased by \$0.5 million from \$0.9 million in 2006 to \$1.4 million in 2007. The increase in 2007 is mainly due to higher facility costs and hosting expenses aiming to serve the increasing number of customers. Cost of revenues did not increase in the same proportion as sales in 2007 due to economies of scale. Most costs of revenues are fixed and are not affected by increases or decreases in revenues.

Research and Development. Research and development expenses increased by 24% and amounted to \$2.2 million in 2007 compared to \$1.8 million in 2006. The increase is due to recruitment of more employees as part of the Company's decision to develop new products. Research and development expenses include \$246,000 of expenses in connection with SFAS No. 123(R).

Sales and Marketing. Sales and marketing expenses increased by 29% and amounted to \$3.5 million compared to \$2.7 million in 2006. The increase is mainly due to recruitment of employees and increased selling and marketing activity. In 2007, sales and marketing expenses included \$194,000 expenses in connection with SFAS No. 123(R)

General and Administrative. General and administrative expenses increased by 13% from \$2.3 million in 2006 to \$2.6 million in 2007. The increase is mainly due to the recruitment of two new employees. In 2007, general and administrative expenses included \$544,000 expenses in connection with SFAS No. 123(R).

Interest and Other Income (Expenses), Net. Interest and other income (expenses), net, increased by 92% from net income of \$274,000 in 2006 to net income of \$527,000 in 2007. The increase is primarily due to interest income derived from the proceeds of an equity financing round in 2007

Equity in Earnings (Losses) of Affiliate. In 2006, the Company recorded losses that occurred in Imatrix affiliate up to the carrying amount of its investment as of December 31, 2006. In 2007, since Imatrix did not incur income in excess of its cumulative losses, no equity loss was recorded with respect to such affiliate. Due to our dilution in the equity ownership and lack of significant influence in Imatrix, the investment will be accounted for under the cost method as of December 31, 2007.

Comparison of Years Ended December 31, 2006 and 2005

Revenues. Revenues increased by \$3.3 million from \$3.9 million in 2005 to \$7.2 million in 2006. Revenues increased in 2006 as the Company's new Virus outbreak detection service was available for the full year of 2006 but only a portion of 2005, and also due to increase in market share.

Cost of Revenues. Cost of revenues increased by \$0.2 million from \$0.7 million in 2005 to \$0.9 million in 2006. The increase in cost of revenues is due to an increase in sales. Cost of revenues did not increase in the same proportion as sales in 2006 due to economies of scale. Most costs of revenues are fixed and are not affected by increases or decreases in revenues.

Research and Development. Research and development expenses increase by 16% and amounted to \$1.8 million in 2006 compared to \$1.5 million in 2005. The increase is mainly due to the implementation of SFAS No. 123(R), starting January 1, 2006. The adoption of SFAS No.123(R) increased research and development expenses by \$196,000 (see also note 21 of the consolidated financial statements).

Sales and Marketing. Sales and marketing expenses increased by 8% from \$2.5 million in 2005 to \$2.7 million in 2006. The increase is mainly due to the implementation of SFAS No.123(R) starting January 1, 2006. The adoption of SFAS No.123(R) increased Sales and marketing expenses by \$96,000 (see also note 21 of the consolidated financial statements). The increase is also due to payroll of new recruitments in the sales and marketing department and due to increased marketing activity as part of our decision to meet the increasing demand of our products and to gain more market share.

General and Administrative. General and administrative expenses increased by 22% from \$1.9 million in 2005 to \$2.3 million in 2006. The increase is due to the implementation of SFAS No.123(R) starting January 1, 2006. The adoption of FAS123R increased General and administrative expenses by \$483,000 (see also note 21 of the consolidated financial statements).

Interest and Other Income (Expenses), Net. Interest and other income (expenses), net, increased by 94% from net income of \$141,000 for 2005 to net income of \$274,000 in 2006, primarily due to interest income derived from the proceeds of an equity financing round in 2006.

Equity in Earnings (Losses) of Affiliate. Equity in losses of an affiliate decreased by 72% from \$175,000 for 2005 to \$49,000 in 2006. During 2006 we recorded losses that occurred in the affiliate up to the carrying amount of its investment as of December 31, 2005.

Quarterly Results of Operations (Unaudited)

The following table sets forth certain unaudited quarterly statements of operations data for the eight quarters ended December 31, 2007. This information has been derived from the Company's consolidated unaudited financial statements, which, in management's opinion, have been prepared on the same basis as the audited consolidated financial statements, and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information for the quarters presented. This information should be read in conjunction with our audited consolidated financial statements and the notes thereto included elsewhere in this report. The operating results for any quarter are not necessarily indicative of the operating results for any future period.

	Mar. 31, 2006	Jun. 30, 2006	Sept. 30, 2006	Three Months Ended				
				Dec. 31, 2006	Mar. 31, 2007	Jun 30, 2007	Sept. 30, 2007	Dec. 31, 2007
	(in thousands) (unaudited)							
Revenues	\$ 1,473	\$ 1,698	\$ 1,866	\$ 2,197	\$ 2,405	\$ 2,617	\$ 2,930	\$ 3,298
Cost of revenues	218*	208*	220*	255	286	346	357	422
Gross profit	1,255	1,490	1,646	1,942	2,119	2,271	2,573	2,876
Operating expenses:								
Research and development	396*	433*	422*	512	456	539	559	633
Sales and marketing	688*	635*	636*	727	826	810	874	943
General and administrative	579*	570*	518*	632	661	627	620	681
Total operating expenses	1,663	1,638	1,576	1,871	1,943	1,976	2,053	2,257
Operating income (loss)	(408)	(148)	70	71	176	295	520	619
Interest and other income (expenses), net	64	49	79	82	91	188	119	129
Equity in losses of affiliate	(34)	(15)	—	—	—	—	—	—
Net income (loss)	(378)	(114)	149	153	267	483	639	748
Taxes on income	—	—	—	—	—	—	—	28
Net income (loss) attributable to ordinary and equivalently participating shareholders	\$ (378)	\$ (114)	\$ 149	\$ 153	\$ 267	\$ 483	\$ 639	\$ 720
Basic								
Net income (loss) per share	\$ (0.03)	\$ (0.00)	\$ 0.00	\$ 0.00	\$ 0.01	\$ 0.02	\$ 0.03	\$ 0.03
Diluted net income (loss) per share	\$ (0.03)	\$ (0.00)	\$ 0.00	\$ 0.00	\$ 0.01	\$ 0.02	\$ 0.02	\$ 0.03

* Certain amounts from prior quarters have been reclassified to conform to the current presentation.

Up through early 2006, we had a history of incurring operating losses, and we cannot be certain that we will continue to achieve profitability on a quarterly or annual basis in the future. A relatively large expense in a quarter could have a negative effect on our financial performance in that quarter. Additionally, as a strategic response to a changing competitive environment, we may elect from time to time to make certain pricing, service, marketing or acquisition decisions that could have a negative effect on our quarterly financial performance. Other factors that may cause our future operating results to fluctuate include, but are not limited to:

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Our ability to successfully develop and market our email defense solutions to new markets, both domestic and international;

- Our ability to successfully develop and market new, modified or upgraded solutions, as may be needed;
 - The continued market acceptance of our new email defense solutions;

- Our ability to expand our workforce with qualified personnel, as may be needed;
 - Unanticipated bugs or other problems affecting the providing of our email defense solutions to customers;
 - The success of our resellers' and OEM partners' sales efforts to potential customers;
- The solvency of our resellers and OEM partners and their ability to allocate sufficient resources towards the marketing of our email defense solutions to their potential customers;
- Our OEM partners' ability to effectively integrate our solutions into their product offerings;
 - The rate of adoption of email defense solutions by customers;
 - The substantial decrease in information technology spending;
 - The pricing of our solutions;
 - Our ability to timely collect fees owed by resellers and OEM partners;
 - Our ability to add space and equipment to our current Detection Centers in a timely and effective manner to match the rate of growth in our business, plus our ability to build new Detection Centers as worldwide demand for our products may require; and
- The effectiveness of our customer support, whether provided by our resellers and OEM partners, or directly by Commtouch.

In addition to the factors set forth above, our operating results will be impacted by the extent to which we incur non-cash charges associated with stock-based arrangements with employees and non-employees.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for financial statement issued for fiscal years beginning on January 1, 2008. The FASB issues a FASB Staff Position (FSP) to defer the effective date of SFAS No. 157 for one year for all non-financial assets and non-financial liabilities, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We are not expecting the adoption will have material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. The provisions of SFAS No. 159 are effective for financial statement issued for fiscal years beginning on January 1, 2008. We are not expecting the adoption will have material impact on our consolidated financial statements

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the

goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008. Earlier adoption is prohibited. We are not expecting the adoption of SFAS 141R will have material impact on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements, an amendment of ARB No. 51". SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the non-controlling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are not expecting that the adoption of SFAS No. 160 will have significant impact on our consolidated financial statement.

On December 21, 2007 the SEC staff issued Staff Accounting Bulletin No. 110 (SAB 110), which, effective January 1, 2008, amends and replaces SAB 107, Share-Based Payment. SAB 110 expresses the views of the SEC staff regarding the use of a “simplified” method in developing an estimate of expected term of “plain vanilla” share options in accordance with FASB Statement No. 123(R), Share-Based Payment. Under the “simplified” method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option.

The use of the “simplified” method, which was first described in Staff Accounting Bulletin No. 107, was scheduled to expire on December 31, 2007. SAB 110 extends the use of the “simplified” method for “plain vanilla” awards in certain situations. The SEC staff does not expect the “simplified” method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. We are currently assessing the potential impact that the adoption of SAB 110 could have on our financial statements.

Liquidity and Capital Resources

We have financed our operations from the issuance of equity securities and, to a lesser extent, from private loans and research and development grants from the Israeli government.

On May 8, 2006, the Company entered into a small financing transaction with one private investor, whereby the Company received \$100,000 against the issuance of 31,153 Ordinary Shares and warrants to purchase an additional 23,364 Ordinary Shares.

As of December 31, 2006 and December 31, 2007, we had approximately \$10.0 million and \$14.4 million of cash and cash equivalents and marketable securities, respectively. The increase was due to positive operating cash flow and receipt of proceeds from the exercise of warrants and options in the amount of \$1.7 million.

In 2007, net cash provided by operating activities was approximately \$4.1 million. The increase in operating cash flow was mainly due to our net income in 2007 compared to a loss in 2006. Net cash provided by financing activities in 2007 was approximately \$2.5 million, due to option and warrant exercises. Net cash used by investing activities in 2007 was \$3.0 million and consisted primarily of an increase in short term cash deposits of \$1.6 million, an investment of \$0.8 million in an affiliate and purchase of property and equipment in the amount of \$0.6 million. As of December 31, 2006 and December 31, 2007, we had working capital of \$7.5 million and \$11.8 million, respectively.

Based on the cash balance at December 31, 2007, current projections of revenues and related expenses, the Company believes it has sufficient cash to continue operations at least through March 2009.

Contractual obligations

The following table summarizes our outstanding contractual obligations as of December 31, 2007 (in thousands):

Contractual Obligation	Total	Payments due by period (USD in thousands)			More than 5 years
		Less than 1 year	1-3 years	3-5 years	
Operating lease obligation	\$ 438	\$ 285	\$ 153	\$ -	\$ -
Other Long-term liabilities reflected on the Company's Balance Sheet -					
Accrued severance pay	931	-	-	-	931
Other Long-term asset reflected on the Company's Balance Sheet -	(821)	-	-	-	(821)

severance pay fund							
Net - severance pay liability	110	-	-	-	110		
Total	\$ 548	\$ 285	\$ 153	\$ -	\$ 110		

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Effective Corporate Tax Rates

Our tax rate will reflect a mix of the U.S. statutory tax rate on our U.S. income and the Israeli tax rate discussed below. Israeli companies are generally subject to corporate tax on their taxable income. The applicable corporate tax rate was 29% in 2007 and will be progressively reduced to the followin