

# CYREN LTD.

## **FORM 6-K** (Report of Foreign Issuer)

Filed 08/27/99 for the Period Ending 06/30/99

Telephone	7037603320
CIK	0001084577
Symbol	CYRN
SIC Code	7372 - Services-Prepackaged Software
Industry	Software
Sector	Technology
Fiscal Year	12/31

# COMMTOUCH SOFTWARE LTD

## FORM 6-K (Report of Foreign Issuer)

Filed 8/27/1999 For Period Ending 6/30/1999

Address	C/O COMMTOUCH SOFTWARE INC 3945 FREEDOM CIRCLE SUITE 730 SANTA CLARA, California 95054
Telephone	408-653-4330
CIK	0001084577
Industry	Communications Services
Sector	Services
Fiscal Year	12/31

# FORM 6-K

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

REPORT OF FOREIGN ISSUER

PURSUANT TO RULE 13a-16 OF 15d-16 OF  
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE MONTH OF AUGUST 1999  
(CONTAINING QUARTERLY INFORMATION FOR THE QUARTER ENDED JUNE 30, 1999)

### COMMTOUCH SOFTWARE LTD.

(TRANSLATION OF REGISTRANT'S NAME INTO ENGLISH)

10 TECHNOLOGY AVENUE EIN VERED 40696, ISRAEL  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

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

Form 20-F  Form 40-F

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

Yes No  X

**COMMTOUCH SOFTWARE LTD.**  
**FORM 6-K**

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Signatures

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**COMMTOUCH SOFTWARE LTD.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(IN THOUSANDS)

	JUNE 30, 1999	DECEMBER 31, 1998
	----- (UNAUDITED)	----- (1)
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 11,663	\$ 834
Trade receivables	465	133
Prepaid expenses	1,263	96
Government authorities	31	45
Other accounts receivable	244	103
	-----	-----
Total current assets	13,666	1,211
Severance Pay Fund	273	223
Property and Equipment, net	2,155	932
	-----	-----
	\$ 16,094	\$ 2,366
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>		
Current Liabilities:		
Short-term bank line of credit	\$ --	\$ 1,328
Current portion of bank loans and capital leases	124	112
Trade payables	797	446
Employees and payroll accruals	476	313
Government authorities	275	246
Deferred revenue	84	74
Other liabilities	308	132
	-----	-----
Total current liabilities	2,064	2,651
	-----	-----
Long-term Portion of Bank Loans and Capital Leases	99	164
Accrued Severance Pay	465	366
	-----	-----
	564	530
	-----	-----
Commitments and Contingent Liabilities	--	--
	-----	-----
Shareholder's Equity (Deficit):		
Convertible Preferred Shares		
	107	74
Ordinary Shares		
	36	27
Additional Paid-in Capital	39,421	11,256
Stock-Based Employee Deferred Compensation	(7,528)	(418)
Notes Receivable from Shareholders	(964)	(77)
Accumulated Deficit	(17,606)	(11,677)
	-----	-----
Total Shareholders' Equity (Deficit)	13,466	(815)
	-----	-----
	\$ 16,094	\$ 2,366
	=====	=====

The accompanying note is an integral part of these condensed consolidated financial statements.

(1) The balance sheet at December 31, 1998 has been derived from audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

**COMMTOUCH SOFTWARE LTD.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	1999	1998	1999	1998
Email Services - revenue .....	\$ 553	\$ 59	\$ 899	\$ 91
Cost of Email services - revenue .....	747	85	1,202	144
Gross loss .....	(194)	(26)	(303)	(53)
Operating expenses:				
Research and development, net .....	407	305	714	571
Sales and marketing .....	1,180	506	1,661	965
General and administrative .....	828	137	1,587	275
Amortization of stock-based employee deferred compensation .....	1,013	8	1,399	10
Total operating expenses .....	3,428	956	5,361	1,821
Operating loss .....	(3,622)	(982)	(5,664)	(1,874)
Interest income (expense) and other, net .	6	(59)	(265)	(86)
Net loss .....	\$(3,616)	\$(1,041)	\$(5,929)	\$(1,960)
Basic and diluted net loss per share .....	\$ (1.66)	\$ (0.72)	\$ (3.17)	\$ (1.35)
Weighted average number of shares used in computing basic and diluted net loss per share .....	2,178	1,450	1,869	1,450

The accompanying note is an integral part of these condensed consolidated financial statements.

COMMTOUCH SOFTWARE LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

	SIX MONTHS ENDED JUNE 30,	
	1999	1998
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss .....	\$ (5,929)	\$ (1,960)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization .....	498	87
Amortization of stock-based employee deferred compensation and warrants issued for service received and bank line of credit .....	1,752	10
Decrease (increase) in trade receivables .....	(332)	32
Increase in other accounts receivable and prepaid expenses .....	(1,294)	(200)
Increase (decrease) in trade payables .....	351	(35)
Increase (decrease) in other liabilities .....	303	(75)
Increase in deferred revenue .....	10	--
Increase in accrued severance pay, net .....	49	19
Net cash used in operating activities .....	(4,592)	(2,122)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment .....	(1,659)	(248)
Net cash used in investing activities .....	(1,659)	(248)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Short-term bank line of credit, net .....	(1,328)	496
Payment of capital lease .....	(50)	--
Proceeds from issuance of shares .....	18,458	1,890
Net cash provided by financing activities .....	17,080	2,386
Increase in cash and cash equivalents .....	10,829	16
Cash and cash equivalents at the beginning of the period .....	834	324
Cash and cash equivalents at the end of the period .....	\$ 11,663	\$ 340
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS ACTIVITY:		
Cash paid during the year:		
Interest .....	\$ 42	\$ 25
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITY:		
Ordinary shares issued for notes receivable from shareholders .....	\$ 887	\$ --

The accompanying note is an integral part of these condensed consolidated financial statements.

**COMMTOUCH SOFTWARE LTD.**

**NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

1. Basis of Presentation:

The condensed consolidated financial statements have been prepared by Commtouch Software Ltd., without audit, and include the accounts of Commtouch Software Ltd. and its wholly-owned subsidiary (collectively the "Company"). Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company, the financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial position at June 30, 1999 and the operating results and cash flows for the reported periods. These financial statements and notes should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended December 31, 1998, which were filed with the Securities and Exchange Commission on Form F-1.

The results of operations for the three and six months ended June 30, 1999 are not necessarily indicative of the results that may be expected for the future quarters or the year ending December 31, 1999.



## PART I. FINANCIAL INFORMATION

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations 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 "believes," "anticipates," "plans," "expects," "intends" 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 discussed in "Risk Factors" in the Company's prospectus dated July 13, 1999.

#### OVERVIEW

We are a leading global provider of outsourced email and other messaging services. Our flexible and highly customizable solutions enable us to satisfy the different email and messaging needs of a wide range of business partners, including websites of all sizes and businesses worldwide. As of June 30, 1999, we had approximately 109 business partners offering our Web-based email from their sites. Our business partners include Excite, LookSmart, FortuneCity, Talk City and Nippon Telephone and Telegraph. Through our business partners' sites we serve approximately 4.9 million emailboxes. In November 1998, we launched our ZapZone Network service, which enables sites to provide email to their end users at no cost. As of June 30, 1999, we had registered approximately 103,000 sites through the ZapZone Network service, and were serving over 658,000 ZapZone Network emailboxes. Business partners may provide us with a large number of users but pay a relatively small minimum annual service fee. Consumers have historically been reluctant to pay for services on the Internet, and therefore end users may not be willing to pay for premium services. Since untargeted advertising on the Internet has not shown a significant success rate, advertisers may not be willing to pay us to provide banner advertising or direct e-marketing.

#### STRATEGIC TRANSACTION

Concurrently with our initial public offering, we entered into an agreement with Go2Net, a network of branded, technology- and community-driven websites focused on personal finance, commerce, and games. Go2Net also develops Web-related software. Pursuant to the agreement we will offer Go2Net's end users with a private label email service, including our email, calendaring and other services. The services will be customized to the look and feel of Go2Net's websites. The terms of this agreement are substantially the same as our commercial agreements with other business partners except that we have agreed to share a materially greater portion of our advertising revenues with Go2Net than we are sharing under other similar agreements. In addition, in connection with the agreement, we will issue to Go2Net a warrant to purchase 1,136,000 ordinary shares at a per share exercise price of \$12.80, subject to adjustment as set forth in the warrant. The warrant is fully vested and non-forfeitable. The warrant will expire on the fifth anniversary of the public offering. The fair value of the warrant, estimated at \$5.8 million, will be amortized to operating expenses ratably over the minimum term of the agreement, or one-year. Simultaneously with the sale of the shares in the public offering, we sold 1,344,086 ordinary shares to Go2Net and Vulcan Ventures Incorporated at \$14.88 per share in a private placement which was not registered with the Securities and Exchange Commission at the time of the public offering, but will be registered within the six months following the offering. In the future, we may have to issue in-the-money warrants to acquire our ordinary shares to business partners who provide us with a large base of potential end users. We may also have to provide these business partners with more favorable commercial terms than we have previously provided to our business partners. The issuance of in-the-money warrants and the grant of more favorable terms to business partners may further dilute our shareholders, increase our operating loss in the future and cause our stock price to fall.

#### RESULTS OF OPERATIONS

The following table sets forth financial data for the three month and six month periods ended June 30, 1999 and 1998 (in thousands):

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	1999	1998	1999	1998
Email service - revenue .....	\$ 553	\$ 59	\$ 899	\$ 91
Cost of Email service - revenue .....	747	85	1,202	144
Gross loss .....	(194)	(26)	(303)	(53)
Operating expenses:				
Research and development, net .....	407	305	714	571
Sales and marketing .....	1,180	506	1,661	965
General and administrative .....	828	137	1,587	275
Amortization of stock-based employee deferred compensation .....	1,013	8	1,399	10
Total operating expenses .....	3,428	956	5,361	1,821
Operating loss .....	(3,622)	(982)	(5,664)	(1,874)
Interest income/(expense) and other .	6	(59)	(265)	(86)
Net loss .....	\$(3,616)	\$(1,041)	\$(5,929)	\$(1,960)

### COMPARISON OF THE THREE AND SIX MONTHS ENDED JUNE 30, 1999 AND 1998

**Revenues.** Email service revenues increased from \$59,000 for the three months ended June 30, 1998 to \$553,000 for the three months ended June 30, 1999. Email service revenue increased from \$91,000 for the six months ended June 30, 1998 to \$899,000 for the six months ended June 30, 1999. The key factor contributing to the growth of our revenues for the three and six month periods ended June 30, 1999 is the increase in the number of Business partners that have contracts that are generating revenue for the Company. As of June 30, 1999, the Company had backlog from minimum service fee contracts amounting to approximately \$4,000,000, which will be recognized as revenue on a ratable basis through the second quarter of 2001. Revenues from one customer, Excite, amounted to \$55,000 and \$110,000, or 9.9% and 12.2% of total revenues for the three and six months ended June 30, 1999, respectively. In the future, we expect revenues from Excite to decrease substantially as a percentage of email services revenue.

**Cost of Revenues.** Our cost of revenues increased from \$85,000 for the three months ended June 30, 1998 to \$747,000 for the three months ended June 30, 1999 and increased from \$144,000 for the six months ended June 30, 1998 to \$1,202,000 for the six months ended June 30, 1999 because of the increase in the number of business partners. Costs of revenues consisted primarily of costs related to Internet data center services from a third-party provider, depreciation of equipment, Internet access, personnel and related costs. We expect cost of revenues to increase on an absolute basis, primarily as a result of an increase in our email service revenues, but to decrease as a percentage of email service revenues due to economies of scale.

**Research and Development Costs, Net.** Research and development costs consist primarily of personnel and related costs, depreciation of equipment, supply costs and royalties paid to the Israeli Government for grants received in prior years for research and development activities. These royalties are paid at rates ranging from 3% to 5% of total revenues. We do not expect to receive further grants from the Israeli Government. Our research and development costs increased from \$305,000 for the three months ended June 30, 1998 to \$407,000 for the three months ended June 30, 1999 and from \$571,000 from the six months ended June 30, 1998 to \$714,000 for the six months ended June 30, 1999, due primarily to higher personnel and related costs. We expect that research and development costs, net, will increase in absolute dollar amounts due to increases in personnel costs related directly to new employees being hired to develop new service offerings, however such costs will decrease as a percentage of revenues.

**Sales and Marketing.** Sales and marketing expenses consist primarily of personnel and related costs, public relations, direct sales efforts, including travel expenses and royalties paid to the Israeli Government for grants received in prior years for marketing activities. Our sales and marketing expenses increased from \$506,000 for the three months ended June 30, 1998 to \$1,180,000 for the three months ended June 30, 1999 and increased from \$965,000 for the six months ended June 30, 1998 to \$1,661,000 for the six months ended June 30, 1999 due primarily to marketing and other costs to support the growth of our email service revenues. We expect sales and marketing expenses to significantly increase in the future in absolute dollar amounts due to increases in personnel costs related directly to new employees being hired to conduct sales to business partners and the related market support to further develop our brand. We expect that for the next several quarters, the increase in sales and marketing will be somewhat proportionate to the increase in revenues. Once we achieve significant revenue growth, we expect that sales and marketing expenses will start to decline as a percentage of total revenues as we hire additional personnel and continue to support and develop the email service business.

General and Administrative. General and administrative costs consist primarily of personnel and related costs, professional services and facility costs. Our general and administrative expenses increased from \$137,000 for the three months ended June 30, 1998 to \$828,000 for the three months ended June 30, 1999, and increased from \$275,000 for the six months ended June 30, 1998 to \$1,587,000 for the six months ended June 30, 1999, due primarily to substantially higher personnel and related costs, facility costs, higher fees for outside professional services and other costs to support the growth of our email service revenues. We expect general and administrative costs to increase on an absolute basis due to increased personnel and related costs, higher facility costs associated with additional personnel and other costs necessary to support and develop the email service business. We expect that general and administrative expenses as a percentage of total revenues will start to decline in the next several quarters.

Amortization of Stock-based Employee Deferred Compensation. Our stock-based employee compensation expenses increased from \$8,000 for the three months ended June 30, 1998 to \$1,013,000 for the three months ended June 30, 1999 and from \$10,000 for the six months ended June 30, 1998 to \$1,399,000 for the six months ended June 30, 1999. The deferred compensation is being amortized using the sum-of-digits method over the vesting schedule, generally four years and will be slightly higher in the third quarter of 1999 then decreasing in each successive quarter.

Interest Income/(Expense) and Other Expense, Net. Our interest income/(expense) and other expense, net, decreased from a net expense of \$59,000 for the three months ended June 30, 1998 to a net income of \$6,000 for the three months ended June 30, 1999, due primarily to increased recognized costs of warrants granted to the Bank Lepituach Ha Taasia B'Israel Ltd. (Bank Lepituach Ha Taasia) net of interest income earned from cash and cash equivalents. In April 1999, we fully repaid the short-term bank line of credit to Bank Lepituach Ha Taasia.

## **LIQUIDITY AND CAPITAL RESOURCES**

We have financed our operations principally from the sale of equity securities and to a lesser extent from bank loans and research and development and royalty-bearing marketing grants from the Israeli government. As of June 30, 1999, we had \$11,663,000 in cash and cash equivalents.

Net cash provided by financing activities was \$17,080,000 for the six months ended June 30, 1999. Net cash used in operating activities was \$4,592,000 for the six months ended June 30, 1999. Net cash used for operating activities is comprised of net loss for the six months, partially offset by depreciation, amortization expenses, increases in other accounts receivable and prepaid expenses, which primarily relate to costs incurred in connection with Company's initial public offering, which was closed in July 1999. Net cash used in investing activities was \$1,659,000 for the six months ended June 30, 1999. These investing activities consisted of purchases of property and equipment.

As of June 30, 1999, we had net working capital of \$11,602,000. The short-term bank line of credit was repaid in April 1999. Through March 31, 1999, we issued to Bank Lepituach Ha Taasia warrants to purchase 96,340 ordinary shares. The bank exercised the warrant in the second quarter of 1999.

In the first quarter of 1999, we issued Series C Convertible Preferred Shares to investors resulting in net proceeds of \$5.3 million. In the second quarter of 1999, we issued to investors Convertible Promissory Notes which have since converted into 42,081 Series D Convertible Preferred Shares, resulting in net proceeds of approximately \$13.2 million. All of our convertible preferred shares automatically converted into ordinary shares upon the closing of our initial public offering.

On July 13, 1999, the Company raised \$67,500,000, net of underwriters commission, from the public offering and the private placement from the Strategic partnership with Go2Net and Vulcan Ventures.

## **YEAR 2000 ISSUE**

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any computer programs or hardware that have date-sensitive software or embedded chips may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations, causing disruptions of operations for any company using such computer programs or hardware, including, among other things, a temporary inability to process transactions, send invoices or engage in normal business activities. As a result, many companies' computer systems may need to be upgraded or replaced in order to avoid Year 2000 issues.

We are a comparatively new enterprise, and, accordingly, the majority of the software and hardware we use to manage our business has been purchased or developed by us within the last 24 months. While this fact does not uniformly protect us against Year 2000 exposure, we believe we gain some mitigation from the fact that the information technology (IT) we use to manage our business is not based upon "legacy system" hardware and software. "Legacy system" is a term often used to describe hardware and software systems which were developed in previous decades when there was less awareness of Year 2000 issues. Generally, hardware and software design in this decade and the past several years in particular has given greater consideration to Year 2000 issues. All of the software code we have internally developed to manage our network traffic, for example, uses four digits to define the applicable year.

We are in the process of testing our internal IT and non-IT systems. To date, we have only completed preliminary testing of our internally developed IT and non-IT systems. All of the testing we have completed has been performed by our own personnel; to date, we have not retained any outside service or consultants to test or review our systems for Year 2000 compliance. Based on the testing we have performed, we believe that such software is Year 2000 compliant; however, we intend to complete more extensive testing in the third quarter of 1999.

In addition to our internally developed software, we utilize software and hardware developed by third parties for both our network and internal information systems. To date, we have not done any testing of such third-party software or hardware to determine Year 2000 compliance. We have, however, obtained certifications from our key suppliers of hardware and networking equipment for our data centers that such hardware and networking equipment is Year 2000 compliant. Additionally, we have received assurances from the providers of key software applications for our internal operations that their software is Year 2000 compliant. Based upon an initial evaluation of our broader list of software and hardware providers, we believe that all of these providers are reviewing and implementing their own Year 2000 compliance programs, and we will work with these providers to address the Year 2000 issue and continue to seek assurances from them that their products are Year 2000 compliant.

In addition, we rely on third party network infrastructure providers to gain access to the Internet. If such providers experience business interruptions as a result of their failure to achieve Year 2000 compliance, our ability to provide Internet connectivity could be impaired, which could have a material adverse effect on our business, results of operations and financial condition.

Our customers' success in maintaining Year 2000 compliance is also significant to our ability to generate revenues and execute our business plan. We currently derive revenue by charging a fixed fee per month for each mailbox we host, by charging a service fee plus advertising sharing or by sharing advertising revenues with our customers. In either case, interruptions in our customers' services and online activities caused by Year 2000 problems could have a material, adverse effect on our revenues to the extent that such interruptions limit or delay our customers' ability to expand their base of email users.

We have not incurred any significant expenses to date, and we do not anticipate that the total costs associated with our Year 2000 remediation efforts, including both expenses already incurred and any to be incurred in the future, will exceed \$100,000. However, if we, our customers, our providers of hardware and software, or our third party network providers fail to remedy any Year 2000 issues, our service could be interrupted and we could experience a material loss of revenues that could have a material adverse effect on our business, results of operations, and financial condition. We would consider such an interruption to be the most reasonably likely unfavorable result of any failure by us, or the third parties upon whom we rely, to achieve Year 2000 compliance. Presently, we believe we are unable to reasonably estimate the duration and extent of any such interruption, or quantify the effect it may have on our future revenues. We have yet to develop a comprehensive contingency plan to address the issues which could result from such an event. We are prepared to develop such a plan if our ongoing assessment leads us to conclude we have significant exposure based upon the likelihood of such an event.

## **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. We expect that most of our taxable income will be generated in Israel. Israeli companies are generally subject to corporate tax at the rate of 36% of taxable income. The majority of our income, however, is derived from our company's capital investment program with Approved Enterprise status under the Law for the Encouragement of Capital Investments in two separate plans, and is therefore eligible for certain tax benefits. Pursuant to these benefits, we will enjoy a tax exemption on income derived during the first two years in which such investment plans produce taxable income (provided that we do not distribute such income as a dividend) and a reduced tax rate of 10% to 25% for an additional period of eight years depending on the level of foreign investment in CommTouch. All of these tax benefits are subject to various conditions and restrictions. There can be no assurance that we will obtain approval for additional Approved Enterprise programs, or that the provisions of the law will not change. Moreover, notwithstanding these tax benefits, to the extent we receive income from countries other than Israel, such income may be subject to withholding tax.

Since we have incurred tax losses through December 31, 1998, we have not yet used the tax benefits for which we are eligible.

## **IMPACT OF INFLATION AND CURRENCY FLUCTUATIONS**

Most of our sales are in dollars. However, a large portion of our costs relates to our operations in Israel. A substantial portion of our operating expenses, primarily our research and development expenses, is denominated in NIS. For the purposes of our financial statements, costs not effectively denominated in dollars are translated to dollars when recorded, at prevailing exchange rates and will increase if the rate of inflation in Israel exceeds the devaluation of the NIS as compared to the dollar or if the timing of such devaluations lags considerably behind inflation. Consequently, we are and will be affected by changes in the prevailing NIS/dollar exchange rate. We might also be affected by the dollar exchange rate to the major European and Asian currencies, due to the fact that we derive revenues from business partners in Europe and Asia.

In recent years (until 1997), inflation in Israel exceeded the devaluation of the NIS against the dollar and the Company experienced increases in the dollar cost of its operations in Israel. Because exchange rates between the NIS and the dollar fluctuate continuously (albeit with a historically declining trend in the value of the NIS), exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency remeasurements are reported in the Consolidated Financial Statements in current operations. In the fourth quarter of 1998 the rate of exchange between the NIS and the dollar fluctuated more significantly than in prior periods.

The representative exchange rate, as reported by the Bank of Israel, was NIS 4.076 for one dollar on June 30, 1999.

## **QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK**

We develop our technology in Israel and provide our services in North America, India, Europe and the Far East. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As most of our sales are currently made in U.S. dollars, a strengthening of the dollar could make our services less competitive in foreign markets. Our interest expense on our capital lease obligations with a U.S. leasing company is sensitive to changes in the general level of U.S. interest rates. Due to the nature and level of our debts, we have concluded that there is currently no material market risk exposure. Therefore, no quantitative tabular disclosures are required.

## **SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### **COMMTOUCH SOFTWARE, LTD.**

(Registrant)

*Date August 27, 1999*  
-----

*By /s/ JAMES E. COLLINS*  
-----

*James E. Collins*  
*Chief Financial Officer*

## EXHIBIT 1

### FOR IMMEDIATE RELEASE

### COMMTOUCH REVENUES INCREASE 837 PERCENT

Santa Clara, CA (August 10, 1999)--CommTouch Software Ltd. (Nasdaq: CTCH), a leading provider of web-based email, today reported results for the second quarter and six months ended June 30, 1999. Revenues for the quarter ended June 30, 1999 increased 837% to \$553,000 from \$59,000 in the comparable quarter a year ago. Revenues for the six months ended June 30, 1999 increased 887% to \$899,000 from \$91,000 for the six months ended June 30, 1998. Revenues for the 1999 second quarter rose 59% over first quarter revenues of \$346,000. As of June 30, 1999, the Company had a backlog from email service fee contracts amounting to approximately \$4,000,000 which will be recognized as revenue on a ratable basis through the second quarter of 2001.

"The increase in our revenues are a testament to the rapidly growing number of business partners who recognize CommTouch's unique ability to provide them with state of the art email services," explained Gideon Mantel, CEO of CommTouch. "During the past quarter, CommTouch has attracted nearly two million new subscribers to its services, and we see this trend continuing as we provide more email solutions," Mantel added.

Net loss for the quarter ended June 30, 1999 was \$3.60 million compared to \$1.04 million for the second quarter of 1998. Net loss for the six month period ended June 30, 1999 were \$5.93 million compared to \$1.96 million for the six months ended June 30, 1998. Net loss per share for the quarter ended June 30, 1999 was \$1.66 compared to net loss per share of \$0.72 in the comparable quarter a year ago.

### ABOUT COMMTOUCH

Serving now 6.4 million active mailboxes around the world, CommTouch is a leading provider of private-label email services, offered exclusively through the web sites of major Internet portals, community sites and web based businesses. CommTouch email is designed for superior performance and rapid scalability, offering end user interfaces in fifteen of the world's major languages.

With more than eight years of delivering intuitive, award-winning email software, CommTouch provides its partners a truly comprehensive turn-key email service, together with options for premium communications services and direct marketing opportunities.

The Company partners with internationally recognized consumer-driven organizations, including Excite (NASDAQ: ATHM), Go2Net (Nasdaq: GNET), McGraw Hill's BusinessWeek Magazine (NYSE: MHP), Discovery Channel Online, Nippon Telephone & Telegraph (NYSE: NTT), ZDNet (NYSE: ZDZ), Talk City, LookSmart, Netopia (NASDAQ: NTPA), Hachette Multimedia, the McClatchy Group's Nando.net (NYSE: MNI), The Headbone Zone, News Corp's (NYSE:NWS) People's Daily joint venture ChinaByte and the Hollinger Group's Jerusalem Post.

Founded in 1991, CommTouch has offices in Silicon Valley, California, New York City and Ein Vered, Israel. Additional information may be obtained by visiting: [www.commtouch.com](http://www.commtouch.com).

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**COMMTOUCH SOFTWARE LTD.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	JUNE 30, 1999 ----- (UNAUDITED)	DECEMBER 31, 1998 -----
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 11,663	\$ 834
Trade receivables	465	133
Prepaid expenses	1,263	96
Government authorities	31	45
Other accounts receivable	244	103
	-----	-----
Total current assets	13,666	1,211
Severance Pay Fund	273	223
Property and Equipment, net	2,155	932
	-----	-----
	\$ 16,094	\$ 2,366
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>		
Current Liabilities:		
Short-term bank line of credit	\$ --	\$ 1,328
Current portion of bank loans and capital leases	124	112
Trade payables	797	446
Employees and payroll accruals	476	313
Government authorities	275	246
Deferred revenue	84	74
Other liabilities	308	132
	-----	-----
Total current liabilities	2,064	2,651
	-----	-----
Long-term Portion of Bank Loans and Capital Leases	99	164
Accrued Severance Pay	465	366
	-----	-----
	564	530
	-----	-----
Commitments and Contingent Liabilities:	--	--
Shareholder's Equity (Deficit)		
Convertible Preferred Shares	107	74
Ordinary Shares	36	27
Additional Paid-in Capital	39,421	11,256
Stock-Based Employee Deferred Compensation	(7,528)	(418)
Notes Receivable from Shareholders	(964)	(77)
Accumulated Deficit	(17,606)	(11,677)
	-----	-----
Total Shareholders' Equity (Deficit)	13,466	(815)
	-----	-----
	\$ 16,094	\$ 2,366
	=====	=====



COMMTOUCH SOFTWARE LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	1999	1998	1999	1998
Email Services - revenue .....	\$ 553	\$ 59	\$ 899	\$ 91
Cost of Email services - revenue .....	747	85	1,202	144
Gross loss .....	(194)	(26)	(303)	(53)
Operating expenses:				
Research and development, net .....	407	305	714	571
Sales and marketing .....	1,180	506	1,661	965
General and administrative .....	828	137	1,587	275
Amortization of stock-based employee deferred compensation .....	1,013	8	1,399	10
Total operating expenses .....	3,428	956	5,361	1,821
Operating loss .....	(3,622)	(982)	(5,664)	(1,874)
Interest income (expense) and other, net .	6	(59)	(265)	(86)
Net loss .....	\$(3,616)	\$(1,041)	\$(5,929)	\$(1,960)
Basic and diluted net loss per share .....	\$(1.66)	\$(0.72)	\$(3.17)	\$(1.35)
Weighted average number of shares used in computing basic and diluted net loss per share .....	2,178	1,450	1,869	1,450