March 2, 2010

Bezeq The Israel Telecommunication Corporation Ltd.

Periodic Report for the Year 2009*

Chapter A - Description of Company Operations

Chapter B - Directors' Report on the State of the Company's Affairs

Chapter C - Financial Statements

Chapter D - Additional Information about the Company

* The periodic report was drawn up in accordance with the Securities Regulations (Periodic and Immediate Reports), 5730 – 1970

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Chapter A – Description of Corporation's Operations

In this report, which contains a description of the Corporation's business operations as at December 31, 2009, the Company has included forward-looking information, as defined in the Securities Law 5728-1968 (the Securities Law). Such information includes forecasts, targets, appraisals and assessments which apply to future events or matters the realization of which is not certain and is not under the Corporation's control and are affected by factors that cannot be assessed in advance, and which are not within the control of the Company, including the risk factors that are characteristic of its operations as set out in this report, and developments in the general environment, and external factors and the regulation that affects the Company's operations, as set out in this report.

Forward-looking information is not a proven fact and is based only on the Company's subjective assessment, based, inter alia, on a general analysis of the information available at the time of drafting of this report, including public announcements, studies and surveys, and they contain no undertakings as to the correctness or completeness of the information contained therein, and the Corporation does not independently check the correctness thereof. The Company's assessments vary from time to time, depending on circumstances.

Forward-looking information in this report will usually be identified specifically, or by employing statements such as "the Company expects", "the Company assesses", "it is the Company's intention", and similar statements.

Bezeq The Israel Telecommunication Corporation Limited (the Company or Bezeq) along with the subsidiaries that it owns in whole or in part, whose financial statements are consolidated with the Company's, as well as DBS Satellite Services (1998) Ltd, which is an investee company, shall be jointly referred to in this periodic report as the Group or the Bezeq Group[1].

1. Description of General Development of Group Operations

1.1 Group Activity and Description of its Business Development

1.1.1 General

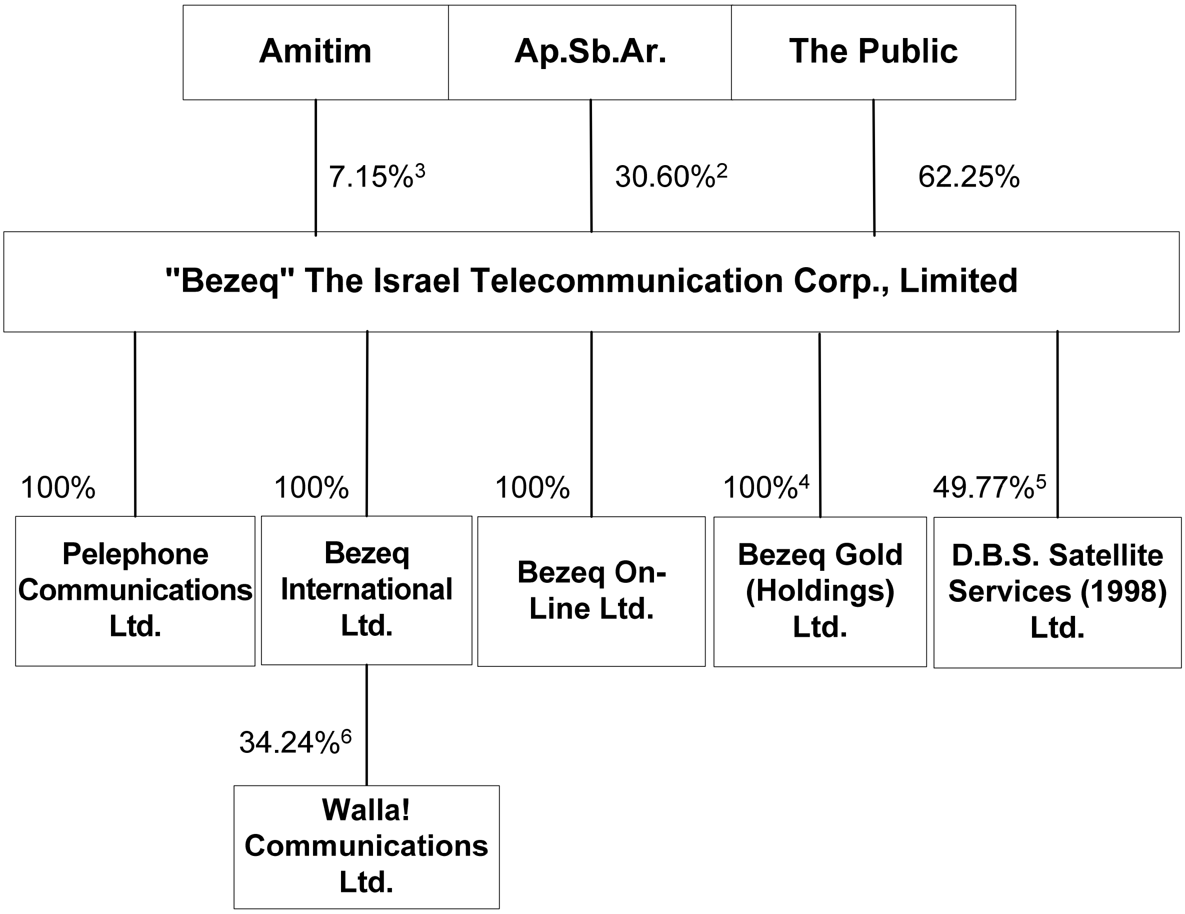
As at the date of this periodic report, the Bezeq Group is the principal provider of communications services in Israel. The Bezeq Group implements and provides a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services, multi-channel television, satellite broadcasts, internet services, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers, television and radio broadcasts, and supply and maintenance of equipment on customer premises (network end point – NEP – services).

The Company was founded as a government company in 1980 and has been privatized over a period of years. The Company became a public company in 1990 and its shares are traded on the Tel Aviv Stock Exchange.

Since October 11, 2005, the controlling shareholder of the Company is Ap. Sb. Ar. Holdings Ltd. (Ap. Sb. Ar.) which holds 30.60% of the shares in the Company (29.69% in full dilution) as at March 1, 2010 (see section 1.3.1 below). For details with regard to the agreement for the sale of the Ap. Sb. Ar. Shares, see Section 1.3.1 hereunder.

[1] Attention is drawn to the fact that the definition of "The Group" in the Company's financial statements for the period ended December 31, 2009 (in Note 2) does not include DBC Satellite Services (1998) Ltd

The following chart describes the structure of shareholdings of the Company, and the Company's shareholdings in its principal subsidiaries and affiliates, as at March 1, 2010.



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2 The shareholders in Ap. Sb. Ar. are: 1. SCG Israel Ventures LLC (capital 45% voting 40.5%), which is controlled by private companies controlled by Haim Saban. 2. Sagol Yarok Project and Investment Ltd, together with Tzahov Yarok Financing and Investment Ltd (jointly: capital 45% and voting 40.5%), which is indirectly wholly (100%) owned by corporations of the APAX EUROPE VI Fund, which is managed by APAX EUROPE MANAGERS LTD. 3. Arkin Communications Ltd (capital 10%, voting 19%), which is controlled by Moshe Arkin.

3 Amitim – the veteran arrangement pension funds – under special management (see Section 1.3.1 hereunder). As the Company was informed, Amitim is the name of the common organizational structure of all the veteran arrangement pension funds, which are under special management as this term is defined in Section 78 of the Supervision of Financial Services (Insurance) Law, 5741-1981 ("the Funds"), which does not constitute a separate legal personality, and the framework whereof common consolidated operation of the Funds is performed, by virtue of an operation agreement. Despite the operational consolidation, the Funds maintain their separate legal identity and clear separation between the assets and liabilities of each fund,. following is a breakdown of the Funds: Mivtachim Social Insurance Institution of the Employees Ltd, Keren Makefet Pension and Benefits Center, Cooperative Society Ltd, the Central Pension Fund of the Employees of the Histadrut Ltd, the Pension Fund of the Members of Egged Ltd, the Pension Fund for Employees of Hadassah Ltd, the Insurance and Pension Fund of Agricultural and Unskilled Laborers Ltd, and the Insurance and Pension Fund of Construction and Public Work Laborers, Cooperative Society Ltd.

4 A company whose entire operation consists of holding the Company's Series 5 bonds (see Section 2.17.1 hereunder).

5 The Company has option warrants which, as at the date of publication of the report, confer a right to 8.6% of the shares of DBS (in the matter of the failure to approve a merger between the Company and DBS, see Section 1.1.2 hereunder).

6 34.24% as at December 31, 2009 (32.41% fully diluted) .

The following are details of the rates of holdings of the Company under full dilution, assuming exercise of all of the options allocated to the Group's employees and managers (see Section 1.3.2 hereunder) as at December 31, 2009 and March 1, 2010.

Shareholders	Percentage of holdings		
	As at December 31, 2009	March 1, 2010	Fully diluted[7]
Ap. Sb. Ar.	30.61%	30.60%	29.69%
Amitim	7.35%	7.15%	6.94%
The Public	62.04%	62.25%	63.37%

For details of the sale of the Company's shares by Ap. Sb. Ar. and by the Zeevi Group, see Section 1.3.1 hereunder.

1.1.2 Mergers and acquisitions

D.B.S. Satellite Services (1998) Ltd. (DBS)

On August 20, 2009, the Supreme Court handed down a verdict in the appeals filed by the Antitrust Authority and Eurocom DBS Ltd against the verdict of the Antitrust Tribunal dated February 3, 2009, approving the merger of the Company with DBS Satellite Services (1998) Ltd (DBS) subject to conditions. The Supreme Court accepted the Antitrust Commissioner's objection to the merger and decided not to approve the merger. In view of the Supreme Court's ruling, the Company no longer controls DBS. Accordingly, as of August 21, 2009, the Company ceased to consolidate DBS's financial statements in its financial statements, and the investment in DBS shares is presented as of that date according to the book value method. As at the date of termination of consolidation, the Company estimated its investment in DBS shares and options and the loans that were extended thereby to DBS according to fair value, based on a valuation performed by an independent assessor, whereby the value of the Company's investment in DBS is estimated at approximately NIS 1,145 – 1,234 million. The Company estimated the investment at the sum of NIS 1,175 million and recognized a profit of approximately NIS 1,538 million. In this regard see also Note 5 to the Company's financial statements for the year ended December 31, 2009.

It should be noted that on January 10, 2010, Polar Communication Ltd (Polar), a shareholder in DBS, announced the completion of a deal whereby it sold Mr. Yaakov Charlap and a company wholly owned thereby approximately 32% of its holdings in DBS (758 ordinary shares par value NIS 1 each, constituting approximately 2.54% of DBS's paid up capital and 32% of the loans extended by Polar to DBS), all in return for the sum total of NIS 40 million, after the conditions for the completion of the deal have been met and after the other shareholders in DBS failed to exercise their right of first refusal for the purchase of the sold shares on a pro rata basis according to their relative stake in DBS.

1.2 Areas of Operation

The Group has four principal areas of operation. These four areas of operation are reported as business segments in the Company's consolidated financial statements (see also Note 29 to the Company's financial statements for the year ended December 31, 2009, included in this periodic report):

1.2.1 The Company – domestic fixed-line communications

This segment primarily includes the Company's operation as a domestic operator, including telephony services, internet services, transmission services and data communications.

[7] Full dilution was calculated on the assumption that the allocated options will be exercised to shares. In view of the net exercise mechanism in the options plan for managers and senior employees in the Group (see section 1.3.2 and section 2.9.6 below), this assumption is theoretic only and in practice, based on the terms of the plan and the description, the offerees who will exercise the options will not be allocated the full shares deriving from them, only the number of shares that reflect the amount of the financial benefit of the options.

1.2.2 Pelephone Communications Ltd (Pelephone) – Cellular Radio Telephone (MRT)

Cellular mobile radio-telephone services (cellular communications), marketing of end-user equipment, installation, operation and maintenance of cellular communications equipment and systems.

1.2.3 Bezeq International Ltd (Bezeq International) – international communications, internet services and NEP

International communications services, internet access (ISP) services, and NEP services. Bezeq International also holds 34.24% (32.41% fully diluted)[8] of Walla! Communications Ltd., an Israeli company whose shares are listed on the Tel Aviv Stock Exchange and which provides internet and portal services (see Section 4.14 below).

1.2.4 DBS Satellite Service (1998) Ltd (DBS) – multi-channel television

Multi-channel digital television broadcasts to subscribers over satellite (DBS) and provision of value-added services to subscribers.

Note that there is another sector of operations headed "Other" in the Company's consolidated financial statements, which, from the consolidated financial statements of 2007, mainly include customer call center services (through the subsidiary Bezeq Online Ltd.) and investment in a venture capital fund. This sector is not substantial on the Group level.

1.3 Investments in Equity and Share Transactions

1.3.1 Deals in Bezeq Shares

A. The sale of the control core

On October 25, 2009, Ap. Sb. Ar., the controlling shareholder in the Company, informed the Company that it had contracted with 012 Smile Communications Ltd (012 Smile) in an agreement for an ex-stock exchange sale of 814,211,545 ordinary shares of the Company, par value NIS 1 each, constituting approximately 30.6% of the Company's issued and paid up share capital registered in the name of Poalim (Romema) Trustees Ltd, in return for the sum of NIS 6,513,692,360. In accordance with the said notice, the share price that was set in the framework of the deal is NIS 8. The consummation of the deal is contingent on the regulatory approval required by law being obtained no later than April 25, 2010, including the following approvals: the Ministry of Communications' approval of the deal (including the granting of control permits); the Antitrust Commissioner's approval of the deal; the approval of the prime minister and the minister of communications in accordance with the provisions of the Communications Law (Bezeq and Broadcasts), 5742-1982, and the provisions of the Communications Order (Bezeq Broadcasts) (determination of an essential service provided by Bezeq the Israel Telecommunications Corp. Ltd), 5767-1997; any other approval or consent required by law. After consummation of the deal, Ap. Sb. Ar. is not expected to hold any Company shares.

For caution's sake, and in view of the possibility of Ap. Sb. Ar. having a personal interest in the contractual arrangements of the companies of the Group as a supplier and/or as a customer, with companies in the 012 Smile Group, on November 4, 2009, the Company's board of directors approved contractual arrangements between the parties as stated for a period of six months. The overall annual scope of the deals is approximately NIS 745 million, and they consist mainly of the purchase and sale of equipment and services, service agreements and marketing cooperation agreements that were carried out on a regular basis between the parties before the date of signing the agreement between Ap. Sb. Ar. and 012 Smile and are continuing and/or being renewed after that date as well. A large number of agreements are involved, none of which could materially affect the Company's profitability, assets or liabilities. Additionally, all the deals are in the normal course of the business of the parties and are carried out under market conditions. It should be noted that according to a report by 012 Smile dated February 1, 2010, it has completed the sale of its communications operations to a third party.

[8] See footnote 6 above.

In light of the activity of the 012 Smile Group in the Israeli market and in view of the fact that 012 Smile is traded on NASDAQ, the change in control at the Company might have additional implications stemming from the identity of the new controlling shareholder.

In this matter see also Note 1 to the Company's financial statements for year ended December 31, 2009.

B. Other deals in Bezeq shares

1. On August 10, 2009, October 19, 2009 and November 9, 2009, deals for the sale of the Company's shares that were held by Zeevi Communications Ltd (in receivership) by means of UBS Investment House Ltd were completed, in such a manner that after the completion of the last deal, the entire balance of Company shares that were held by Zeevi Communications Ltd (in receivership) were sold and, with the sale thereof, it ceased to be an interested party in the Company. Following is a breakdown of the deals:

Date	Number of shares sold (par value NIS 1 each)	Total price in NIS
August 10, 2009	155,000,000	1,151,650,000
October 19, 2009	120,000,000	976,800,000
November 9, 2009	184,331,617	1,533,270,390

2. On August 11, 2009, a deal was completed for the distribution of 149,376,642 Bezeq shares, par value NIS 1 each, that were held by Ap. Sb. Ar. by means of the Citigroup Group (Citigroup Global Markets Ltd) in return for the sum of NIS 1,120,324,815, such that upon completion of the purchase, no purchaser held more than 5% of the Company's share capital.

3. On September 17, 2009, a deal was completed for the distribution of 95,623,358 Bezeq shares, par value NIS 1 each, that were held by Ap. Sb. Ar. by means of the Citigroup Group (Citigroup Global Markets Ltd) in return for the sum of NIS 748,730,893, such that upon completion of the purchase, no purchaser held more than 5% of the Company's share capital. Upon completion of the purchase, as detailed in this Section and in Section B(2) above, Ap. Sb. Ar.'s holdings in the Company were reduced to approximately 30.68% (approximately 29.69% fully diluted).

4. On December 10, 2009, Amitim (the veteran arrangement pension funds – under special management) (Amitim) informed the Company that it had become an interested party in the Company in the wake of an ex-stock exchange purchase of 63,928,590 Bezeq shares, par value NIS 1 each, at a rate of NIS 8.534 per share, such that after this purchase Amitim held 195,605,625 Company shares, which constituted at that time approximately 7.36% of the Company's issued share capital.

1.3.2 <u>Employee option plans</u>

A. As at the date of publication of this periodic report, there are two option plans for shares of the Company: An employee option plan of 2007, in which the Company allotted 78,151,368 options for shares of the Company to its employees. As at March 1, 2010, 55,260,249 options out of this plan had been exercised.

B. An options plan for managers and senior employees of the Group, of November 2007, for the allotment of up to 65,000,000 options for shares of the Company to senior managers and employees of the Company and its affiliates (the general meeting approved the issue of the options under this plan on January 31, 2008). Of this sum, as at the date of this periodic report, 59,383,333 options were allotted (net, less options that vested).

An employee option plan from 2005, in which Company employees were offered up to 122,697,648 options for shares of the Company held by the State of Israel expired on December 10, 2009, in accordance with the outline terms.

For further details regarding the above compensation plans, see section 2.9.6 below.

1.4 Payment of Dividends

1.4.1 <u>Dividend policy</u>

On August 4, 2009, the Company's board of directors decided to adopt a dividend distribution policy whereby the Company would distribute to its shareholders, semiannually, a dividend at a rate of 100% of its semiannual profit (after tax) (profit for the period attributed to the Company's owners) in accordance with the Company's consolidated financial statements. The implementation of the dividend policy is subject to the provisions of any law, including the distribution tests set forth in the Companies Law, 5759-1999, and in the estimate of the Company's board of directors with regard to the Company's ability to meet its existing and anticipated liabilities from time to time, all noting the anticipated cash flow, the Company's operation and liabilities, the Company's cash reserves, its plans and its condition from time to time and subject to approval by the general meeting of the Company's shareholders with regard to each specific distribution, as stipulated in the Company's articles.

1.4.2 <u>Distribution of a dividend</u>

Below are details of distributions made by the Company in 2008-2009 and up to the date of publication of this periodic report

Date of distribution	Type of distribution	Total distributed amount (NIS millions)	Distributed amount per share (NIS)
April 28, 2008	Cash dividend	679	0.260648
October 29, 2008	Cash dividend	835	0.3205318
May 24, 2009	Cash dividend	792	0.3013025
October 5, 2009	Cash dividend	1,149	0.4329743

The distributable profit balance as at the date of the report – NIS 2,453 million (surplus accumulated over the past two years).

On March 2, 2010 the Company's board of directors resolved to recommend to the Company's general meeting of shareholders to distribute a dividend to the shareholders in the total sum of NIS 2,453 million.

1.5 Financial Information Regarding Areas of Group Operations

All the figures in this Section 1.5 are in NIS millions.

1.5.1 2009

	Domestic fixed-line communications	Cellular	International communications, internet services and NEP	Multi-channel television	Other	Adjustments to consolidated *	Consolidated
Total revenue:							
From externals	5,039	5,130	1,273	1,529	54	(1,529)	11,496
From other areas of operations in the group	264	246	45	1	20	(553)	23
Total	5,303	5,376	1,318	1,530	74	(2,082)	11,519
Total attributed costs							
Variable costs attributed to the area of operation	1,774	2,153	635	498	47		
Fixed costs attributed to the area of operation*	2,006	2,033	422	784	23		
Total costs	3,780	4,186	1,057	1,282	70	(1,828)	8,547
Costs not constituting revenue from another area of operation	3,543	4,003	934	1,259	66	(1,259)	8,546
Costs constituting revenue from other areas of operation	237	183	123	23	4	(569)	1
Total costs	3,780	4,186	1,057	1,282	70	(1,828)	8,547
Profit from regular operation attributed to the Company's owners	1,523	1,190	261	123	5	(130)	2,972
Profit from regular operation attributed to non-controlling rights	-	-	-	125	(1)	(125)	(1)
Total assets attributed to the area of operations as at December 31, 2009	6,368	4,990	1,106	1,206	85	186	13,941
Total liabilities attributed to the area of operation as at December 31, 2009	6,390	2,440	404	4,315	22	(6,168)	7,403

* The companies in the Group that are service providing companies, (as distinct from manufacturing companies) do not manage a dedicating costing system distinguishing between fixed and variable costs. The above distribution was made for the purposes of this report only. Variable costs are costs which the company's management and control over them are flexible in the short term and their effect on the output is direct, unlike fixed costs that are not flexible in the short term and do not directly affect output.

1.5.2 2008***

	Domestic fixed-line communications	Cellular	International communications, internet services and NEP	Multi-channel television	Other	Adjustments to consolidated *	Consolidated
Total revenue:							
From externals	5,179	4,448	1,243	1,506	31	(1,506)	10,901
From other areas of operations in the group	319	265	63	7	44	(584)	114
Total	5,498	4,713	1,306	1,513	75	(2,090)	11,015
Total attributed costs							
Variable costs attributed to the area of operation	1,785	1,849	622	555	53		
Fixed costs attributed to the area of operation*	2,238	1,931	442	781	22		
Total costs	4,023	3,780	1,064	1,336	75	(1,903)	8,355
Costs not constituting revenue from another area of operation	3,743	3,614	928	1,222	73	(1,212)	8,368
Costs constituting revenue from other areas of operation	280	166	136	114	2	(691)	7
Total	4,023	3,780	1,064	1,336	75	(1,903)	8,375
Profit from regular operation attributed to the Company's owners	1,475	933	242	88	(1)	(97)	2,640
Profit from regular operation attributed to non-controlling rights	-	-	-	89	1	(89)	1
Total assets attributed to the area of operation as at December 31, 2008	6,281	4,644	994	1,132	100	1,163	14,314
Total liabilities attributed to the area of operation as at December 31, 2008	6,037	2,552	284	4,024	29	(2,856)	10,070

* The companies in the Group that are service providing companies, (as distinct from manufacturing companies) do not manage a dedicating costing system distinguishing between fixed and variable costs. The above distribution was made for the purposes of this report only. Variable costs are costs which the company's management and control over them are flexible in the short term and their effect on the output is direct, unlike fixed costs that are not flexible in the short term and do not directly affect output.

** Details of the nature of the adjustments to the consolidated – transactions between areas of activity

*** Reclassified

1.5.3 2007***

	Domestic fixed-line communications	Cellular	International communications, internet services and NEP	Multi-channel television	Other	Adjustments to consolidated *	Consolidated
Total revenue:							
From externals	5,373	4,380	1,226	1,403	18	(1,403)	10,997
From other areas of operations in the group	340	304	78	12	46	(641)	139
Total	5,713	4,684	1,304	1,415	64	(2,044)	11,136
Total attributed costs							
Variable costs attributed to the area of operation	2,352	2,038	679	530	47		
Fixed costs attributed to the area of operation*	2,042	1,841	421	829	17		
Total costs	4,394	3,879	1,100	1,359	64	(1,981)	8,815
Costs not constituting revenue from another area of operation	4,062	3,711	960	1,220	63	(1,220)	8,796
Costs constituting revenue from other areas of operation	332	168	140	139	1	(761)	19
Total	4,394	3,879	1,100	1,359	64	(1,981)	8,815
Profit from regular operation attributed to the Company's owners	1,319	805	204	27	1	(35)	2,321
Profit from regular operation attributed to non-controlling rights	-	-	-	29	(1)	(29)	(1)

* The companies in the Group that are service providing companies, (as distinct from manufacturing companies) do not manage a dedicating costing system distinguishing between fixed and variable costs. The above distribution was made for the purposes of this report only. Variable costs are costs which the company's management and control over them are flexible in the short term and their effect on the output is direct, unlike fixed costs that are not flexible in the short term and do not directly affect output.

** Details of the nature of the adjustments to the consolidated – transactions between areas of activity

*** Reclassified

1.5.4 Principal results and operational data

A. Bezeq Fixed-Line (the Company's activity as domestic operator) (NIS millions except where stated otherwise)

	2009	2008	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Revenue	5,303	5,498	1,316	1,343	1,318	1,326	1,348	1,388	1,354	1,408
Operating profit	1,523	1,475	161	491	434	437	232**	428**	442**	373**
Depreciation and amortization	794	852	194	184	205	211	209	214	211	218
EBITDA	2,317	2,327	355	675	639	648	441**	642**	653**	591**
Investment in property, plant & equipment and intangible assets	853	616	220	204	191	238	170	156	132	158
Proceeds from sale of property, plant & equipment	86	144	9	19	8	50	47	12	25	60
Number of active subscriber lines at end of period (in thousands)	2,489	2,615	2,489	2,518	2,547	2,579	2,615	2,645	2,681	2,711
Average monthly revenue per line (NIS)*	82	83	82	83	81	81	82	85	82	84
No. of outgoing minutes (in millions)	12,196	13,439	2,964	3,096	3,014	3,123	3,154	3,428	3,346	3,511
No. of incoming minutes (in millions)	6,718	6,691	1,674	1,737	1,664	1,654	1,648	1,719	1,651	1,673
No. of ADSL subscribers at end of period (in thousands)	1,035	1,005	1,035	1,026	1,016	1,011	1,005	994	982	970
Average monthly revenue per ADSL user (NIS)	70	67	72	72	69	68	67	68	66	68

* Not including revenue from data transmission and communication services, internet services, services to communication operators, contract work and other revenue.

** Reclassification of the sum of approximately NIS 26 million, spread over the four quarters of 2008, for financing costs for provisions for termination of labor relations under early retirement, presented in the past under the item of operating expenses (income) net.

B. Pelephone

(NIS millions except where stated otherwise)

	2009	2008	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Revenue	5,376	4,713	1,393	1,372	1,346	1,265	1,138	1,214	1,188	1,173
Operating profit	1,190	933	251	316	321	302	159	293	266	215
Depreciation and amortization	603	523	158	155	151	139	135	129	130	129
EBITDA	1,794	1,456	410	471	472	441	294	422	396	344
Net profit	875	682	181	231	233	230	128	211	180	163
Cash flow from current operations	1,115	1,277	55	395	290	375	298	379	344	256
Investment in property, plant & equipment and intangible assets	559	798	101	146	163	149	163	350	182	103
Proceeds from sale of property, plant & equipment	4	3	-	-	4	-	1	-	1	1
No. of subscribers at end of period (in thousands)	2,766	2,649	2,766	2,721	2,694	2,669	2,649	2,698	2,636	2,595
Average monthly minutes of use (MOU) per subscriber*	333	352	339	339	329	323	335	359	358	355
Average monthly revenue per ADSL subscriber (NIS)*	132	126	132	136	131	128	122	129	128	126
No. of subscribers at end of period (in thousands)	1,531	1,151	1,531	1,407	1,307	1,217	1,151	1,068	977	867
Revenue from value added services and content, of revenues from cellular services (%)	19.6%	16.3%	20.8%	20.0%	19.1%	18.5%	18.4%	16.2%	15.5%	15.0%

* On December 31, 2008, Pelephone Ltd adopted a more stringent subscriber counting policy whereby customers who only receive SMS messages would not be counted as subscribers. The policy change led to the deletion of approximately 92,000 subscribers. The drop in MOU in 2009 stems from the transition to billing by segments of one second, as of January 1, 2009, which led to a drop in the number of minutes billed.

C. Bezeq International

(NIS millions except where stated otherwise)

	2009	2008	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Revenue	1,318	1,306	334	332	327	324	337	329	326	314
Operating profit	261	242	67	66	68	60	65	59	63	55
Depreciation and amortization	84	80	23	21	21	20	20	20	20	20
EBITDA	345	322	89	88	88	80	85	79	83	75
Net profit	200	178	49	51	56	44	46	44	47	42
Cash flow from operating activities	320	163	72	82	83	84	73	32	51	8
Investment in property, plant & equipment and intangible assets*	120	119	39	33	26	21	27	33	31	28
Proceeds from sale of property, plant & equipment	-	1	-	-	-	-	1	-	-	-

* The item also includes long-term investments in assets

D. DBS

(NIS millions except where stated otherwise)

	2009	2008	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Revenue	1,530	1,513	390	380	376	384	376	375	380	381
Operating profit	248	177	63	61	59	66	55	52	43	27
Depreciation and amortization	234	250	63	59	56	57	66	59	61	65
EBITDA	482	427	126	120	115	122	121	111	103	92
Net profit (loss)	(222)	(265)	(38)	(88)	(95)	(1)	(17)	(82)	(99)	(66)
Cash flow from operating activities	410	347	91	135	93	91	134	97	32	84
Investment in property, plant & equipment and intangible assets *	262	238	53	87	60	61	63	56	40	79
Proceeds from sale of property, plant & equipment	1	-	1	-	-	-	-	-	-	-
No. of ADSL subscribers at end of period (in thousands)	571	560	571	567	562	560	560	556	551	549
Average monthly revenue per subscriber (NIS)	226	228	229	224	224	228	225	226	230	231

* This item also includes investments in the cost of acquiring subscribers.

1.6 2010 Outlook

The Bezeq Group projects full-year 2010 revenues, net profit from continuing operations and EBITDA to be in line or slightly higher than 2009 levels. This forecast is underpinned by the strength of the Bezeq Group's comprehensive consumer and business communications offerings and a strict focus on improving operating efficiencies.

The Bezeq Group expects gross capital expenditure in 2010 to be close to the 2009 level and will mainly reflect continuing investment in Bezeq's Next Generation Network (NGN), expanding its coverage to reach approximately 50% of Israeli households by the end of 2010, and slightly lower capital expenditures at Pelephone, which successfully completed and launched its High Speed GSM (HSPA) network in early 2009.

The aforementioned guidance for the full-year 2010 is based on the anticipated Bezeq Group consolidated financial performance, which following the deconsolidation of D.B.S. Satellite Services (1998) Ltd. ("DBS") financials as of August 21st, 2009, excludes the financial contribution of DBS from both the 2009 and 2010 full-year period.

The information in this section includes forward looking information based on internal estimates of the Company. The actual outcome may differ significantly from the foregoing estimates, taking into account changes that may apply to the business conditions and the impact of regulatory decisions.

1.7 General Environment and Effect of External Factors on the Group's Activities

The communications industry around the world and in the Israeli economy is developing rapidly. The communications industry is subject to changes in terms of technology and in terms of the corporate structure of the industry and the regulations affecting it.

The Group's business is affected by the level of the financial activity in the domestic market and therefore, positive or negative developments at this level are expected to have a corresponding impact on the business of the Group.

A number of communications groups operate in the Israeli communications market on the basis of marketing cooperation between a number of companies and/or common holdings for the supply of comprehensive communications services, thereby utilizing the marketing and operational advantages inherent in such a structure. In view of the regulatory restrictions that are imposed, at present, on the Group in connection with the creation of cooperative ventures between the companies in the Group, the Group is meeting the challenge of providing a suitable solution for the threats stemming from increasing competition on the part of the other communications groups.

1.8 The Group's Strategy

- **Leadership** – reinforcing and establishing the Bezeq Group as Israel's leading telecommunications group.
- **Presence in the central arenas in the communications market for the end customer** – the cellular market, the customer's home, the business sector, internet, TV and content
- **One-stop solution for the customer –** providing the private and business customer with a comprehensive communication solution, based on diverse services and products
- **Material presence in every component of the value chain –** intensifying and strengthening the link with the customer by maintaining dominance throughout the infrastructure, service and content value chain
- **Customer customization and service** – focusing on the provision of customized services for the customer, providing high level service and a comprehensive response to the needs of the private and business customer
- **Innovativeness and technology –** basing the Group's relative edge, inter alia, on the leading and most up to date technology available in the market; those that have reached maturity enabling deployment and provision of services on an extensive scale and with the required reliability

- **Business focus –** focusing on the core areas of the communications market and on related areas and focusing on the local market in Israel
- **Maintaining and reinforcing the perception of quality, reputation and asset value of the Group's brands**

In the nature of things, a review of the Group's strategy involves estimates with regard to future developments related to customer needs and behavior, the rate at which new services are adopted, technological changes, regulatory polity and the marketing strategy of the competition. Nevertheless, there is no certainty that the strategy will be realized in reality or in the manner described above. The circumstances that are liable to lead to the non-realization of the strategy or even to the failure thereof are rooted, inter alia, in frequent technological changes and regulatory constraints.

2. Bezeq The Israel Telecommunication Corporation Limited (the Company) – Domestic Fixed-line Communications

2.1 General Information on the Area of Operations

2.1.1 Structure of area of operations and changes therein

The Company has a general license for the provision of domestic fixed-line communication services. The Company provides diverse communications services as described in Section 2.2 below. The telecommunications sector is developing rapidly in global markets and in Israel. The sector is affected by changes in technology, in relation to both the business structure of the industry and the regulations that apply to it.

2.1.2 Statutory restrictions and special constraints

The Company's operations are subject to comprehensive regulation and control that relate, *inter alia*, to matters such as determining and approving the fields of the Company's permitted activity and services, holding and transferring means of control, licensing, determining tariffs, quality and terms of service to subscribers and obligation to pay royalties. These regulations and controls are attributable to the status of the Company as a licensee under the Communications (Telecommunications and Broadcasts) Law, 5742-1982 (the Communications Law), and are subject to the provisions of the Communications Law as well as the regulations and rules that have been promulgated there under, and the terms of its general license. The Company's status as an essential telecommunications service provider is subject to the provisions of the Communications Order based on section 4D of the Communications Law and other laws.

The tariffs for the Company's main activities are subject to strict control under various provisions of the law. The tariffs are updated and change from time to time in regulations.

The Company was declared a monopoly in its main fields of activity, and is also subject to control and restrictions under the Antitrust Law, 5748-1988.

Furthermore, some of the Company's activities involve the use of wireless frequencies and the operation of devices emitting electromagnetic radiation, which are subject, respectively, to the Wireless Telegraph Ordinance (New Version), 5732-1972 (see Section 2.16.8 below), the Non-Ionizing Radiation Law, 5766-2005 (see Section 2.15 below) and National Outline Plan 36 and National Outline Plan 56 (see \section 2.16.11 below).

2.1.3 Changes in the volume of operation and profitability in the sector

See section 1.5.4 above.

2.1.4 Developments in the market and in customer attributes

While the number of cellular subscribers has grown to reach approximately 9.6 million (according to data published by the cellular companies), there has been a decline in the number of households and businesses holding a fixed line, and to the Company's best knowledge, the number of calls from fixed-line networks is also declining (the Company estimates that about two thirds of all calls are now made in cellular networks). In internet, recent years have seen growth in the number of customers – growth which is moderating over time. Nevertheless, this area is characterized by a rise in surfing speeds and in the adoption of advanced services and added value applications. Computer communications and transmission for business customers and communications providers are also seeing rapid growth in the bandwidth needs of their customers, but overall, prices for a given volume of traffic are falling.

For a description of the development of competition in domestic fixed-line communications, see section 2.6 below.

2.1.5 Technological changes that can materially impact the area of operation

A. Penetration of broadband internet and the availability of new IP-based technologies offer the customer a wide variety of applications and services over IP-based infrastructures, such as telephony, video streaming and network with web-based organizational applications (such as ERP and CRM).

For a description of competition in the provision of telephony over the Company's broadband network (VOB[9] – Video Over Broadband), see section 2.6.1 below. Given the trend of increasing bandwidth in recent years, the Company is adapting its infrastructures to allow it to provide its customers with significant bandwidths (on this, see Sections 2.6.6 and 2.7.2 on the NGN).

B. The increase in the number and capacity of cellular networks, along with technological enhancements, enable cellular service providers to compete with the Company's internet services more effectively, and the number of cellular internet surfers has increased over the past year.

C. In addition, wireless technology (such as WiMAX) allows the provision of services that compete with the Company's services, both in telephony and in data communications and broadband internet, without the need to invest heavily in land-based access infrastructure.

D. Technological developments may enable other operators to build networks that provide services similar to those offered by the Company, at lower cost.

2.1.6 Critical success factors in the area of operation and changes therein

A. Regulatory decisions.

B. The ability to offer reliable communication systems at a competitive price based on a cost structure that is adjusted to the frequent changes in the Company's business environment.

C. The ability to maintain innovation and technological leadership, and to translate those into advanced, reliable applications of value to customers, within short response times.

D. Technological and marketing innovation.

E. Efficacy of internal and external sales systems and distribution channels.

F. The ability to provide high quality commercial and technical service to customers of the Company.

G. Management of an intelligent price policy, subject to regulatory limitations, in view of growing competition and technological changes that are reflected in generally lower prices in the industry.

H. Intelligent migration of customers from traditional networks to next-generation networks.

I. Preserving brand values and adapting them to the changing competitive environment.

2.1.7 Main entry and exit barriers for the area of operations and changes therein

Traditionally, the main entry barrier in the domestic fixed-line communications market is attributable to the need for substantial investments in technological infrastructure and complementary systems until economies of scale are achieved, and from the high costs involved in establishing marketing, sales and customer support systems and the construction of brands. In recent years, the traditional entry barriers to the Company's areas of activity have been to a great extent removed, as a result of technological improvements, reduction of infrastructure and equipment prices, the regulatory relief given to new competitors, and the ability to exploit existing systems, including the Company's network (inter alia due to regulatory decisions) by competing communications operators or operators intending to compete with the Company.

Regulation of VOB-based competition (and in the future, to the extent possible, competition based on regulations for sub-loop unbundling and wholesale services) significantly reduces investments by the Company's competitors and thus reduces the entry barriers to competition in telephony.

The main exit barriers are attributable to the following: the obligation of the Company, as stipulated in its license, to provide services at a defined quality of service on a universal basis; its being subject to the emergency regulations and the provisions of the

[9] Voice Over Broadband

Communications Order based on section 4D of the Communications Law; the obligation to some of its employees as part of collective agreements; long-term agreements with infrastructure providers; large investments requiring a long time to return on investment; and an obligation to repay long-term loans taken to finance the investments.

2.1.8 Alternatives and changes in products in the sector

Cellular communication services have become an alternative to services offered by the Company, in telephony as well as in broadband access.

IP Technologies such as VOB (see Section 2.6.1 below) and the internet are also an alternative to the Company's services. In transmission and data communications, technological developments enable new services to be provided at high speeds and low prices.

2.1.9 Structure of competition in the area of operation and changes therein

Communications are regulated and controlled by the Ministry of Communications, including by means of the issue of licenses for operators. The Ministry of Communications has issued additional licenses in data transmission and communication, broadband internet access and telephony (including licenses for providing domestic fixed-line communication services with no obligation to provide universal nationwide) service, and in these areas the competition is lively.

The data transmission and communications sector, particularly at high speeds, was opened to competition at the end of 2000.

In the broadband internet sector, cable company partnerships began to compete against the Company in March 2002.

In telephony, HOT Telecom, a partnership of the cable companies (HOT or HOT Telecom) started to provide services on a commercial basis on November 25, 2004.

Competition in the sector is dependent on a variety of factors, such as possible changes to the terms of the licenses of the Company and the subsidiaries and the terms of the licenses of their competitors; mergers and joint ventures between companies in competition with companies in the Group; financing universal service; the new services that the Company will be permitted to offer; tariff policy and the level of flexibility that will be granted to the Company in offering service packages, including with subsidiaries.,

For a description of developments in competition, see section 2.6 below.

2.2 Products and Services

2.2.1 General

The Company provides a wide range of communications services to business and private customers, as described below.

2.2.2 Telephony

The Company's telephony services include, mainly, basic telephone services via household telephone lines, installations and relocation of telephone lines, and other auxiliary services such as voice mail, caller ID, 144 information service, call waiting, follow-me, speed dialing and conference calls.

Furthermore, the Company provides national number services for businesses, in which the business pays for all or part of the incoming calls.

The Company currently operates approximately 12,500 public telephones around the country that are operated by various kinds of cards.

Since February 8, 2007, the Company has operated a unified telephone number information center by a network code set by the Ministry of Communications (1344), including for the cellular operators and for HOT, as well as a free internet site, in addition to the Company's 144 service.[10]

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[10] This activity was granted an exemption from the need to obtain approval for a cartel, valid through August 11, 2011.

On December 20, 2009, the Ministry of Communications published a request for the positions of the public concerning the need and the format for opening the telephone number information service to competition. Among the topics on which the public's position is requested, are cancellation of the 144 access code allocated to the Company, obligating all the cellular and domestic operators to provide the information service using a four-digit access code, allowing entities that are not telephony operators to provide information services, and requiring telephony operators to allow access to their data bases, whether free of charge or for payment. The Company submitted its position in a detailed document that it filed on February 7, 2010.The Company believes that its 144 service cannot and should not be cancelled, and that telephony operators cannot be and should not be required to allow others access to their data bases.

The Company's telephony services are among the main services provided by the Company, and in recent years they have been on a downward trend, in terms of both use and revenues. This is mainly due to the telephony services provided by competing domestic communications operators and alternative services provided by the cellular companies.

As part of the Company's marketing strategy, it is acting to develop and introduce new services in both the private and business sectors. The Company intends to continue launching additional products, in accordance with market trends and customer needs.

2.2.3 Internet access services

At the end of 2009, the Company had approximately 1,035,000 ADSL subscribers (compared to approximately 1,005,000 subscribers at the end of 2008), accounting for approximately 59% of the broadband internet market in Israel[11] (based on items in the Israeli media regarding the number of subscribers who are not subscribers of the Company). For changes in the number of the Company's ADSL subscribers and average monthly revenue per ADSL subscriber, see section 1.5.4 above.

The high speed internet market was one of the fastest-growing markets (the growth rate has been slowing recently) and that growth is reflected in the Company's business, becoming one of the main occupations of the Company and a major channel for its investments in technologies, in marketing, in advertising and in customer acquisition and upgrading.

The high speed internet market is also marked by lively competition with HOT, and more recently with the cellular companies, which offer cellular surfing services, including from home, combined with internet access services. (Concerning a hearing on this matter, see Section 2.6.2 below.)

Following a decision of the Ministry of Communications, on May 15, 2008 the Company started providing, in addition to its ADSL + telephone line combined service, its "ADSL only" service (i.e. without a telephone line).

2.2.4 Data transmission and communication services

Data communications services are network services for point-to-point transfer of data, transfer of data between computers and various communications networks, services to connect communications networks to the internet, and remote access services.

Data communication services are provided over established traditional infrastructures such as Sifranet and frame relay, on ATM infrastructure and on innovative and advanced infrastructures such as IPVPN (Virtual Private Network) and Metro Ethernet. The IPVPN infrastructure enables managed communications solutions for businesses by connecting the various branches of the organization. Metro Ethernet infrastructure enables the supply of a communications infrastructure in Ethernet technology for services in the business and private sector. In recent years, customers have been switching from data communication solutions provided over older and traditional infrastructures, to IP- and Ethernet-based infrastructures.

In a letter dated January 5, 2010, the Ministry of Communications requested data from the Company, in the wake of enquiries which raise concern that the Company is contravening legislated provisions in the matter of IPVPN and Metro Ethernet services. The Company

[11] 59% of the internet market is based on fixed line infrastructure. Approximately 57% (including Pelephone) of the internet market is based on cellular infrastructure.

believes that it operates according to the law in these matters, and that the pricing of these services is reasonable and appropriate, and will submit its detailed remarks accordingly to the Ministry.

The Company offers transmission services, including high speed services, to its business customers and communication operators over a variety of protocols (see section 2.6.3 below). On January 24, 2010, the Company received a letter for its comments from the Ministry of Communications, contending that its refusal to provide transmission services for Cellcom domestic operator constitutes a violation of the provisions of its license and that it must provide such services. The Company believes that it acted lawfully, and that the Ministry failed to conduct the necessary thorough investigation. Accordingly, on February 14, 2010, the Company submitted its position to the Ministry. See also Section 2.16.7 below.

2.2.5 Other services

A. Services to communications operators

The Company provides services to other communications operators, including the cellular and international operators, cable broadcasting license-holders, NEP operators, ISPs, domestic operators, and Palestinian communications providers.

The Company's services include infrastructure, connection to the Company's network, transmission, billing and collection, rental of space and provision of services in the rented properties, and rights of use for seabed cables.

B. Broadcasting services

The Company operates and maintains radio transmitters operated, inter alia, by the Israel Broadcasting Authority, television transmitters of Channel 1, Educational Television and Channel 2, and the transmitters of regional radio stations. The Company also operates the DTT transmitters. The Company is responsible only for operation and maintenance of the transmitters for distribution of radio and television programs, and not for the content of the broadcasts. See also section 2.15.1 below.

C. Contract work

The Company performs setup and operation work on networks and sub-networks for various customers (such as the Ministry of Defense, HOT, radio and television broadcasting companies, cellular and international communication operators, local authorities, municipalities and government agencies).

The Company and HOT have agreements for the provision of installation and maintenance services of cable networks, on the Company's infrastructure, from the starting point of those licensees' operating center, up to the point of delivery at the entrance to subscribers' homes (the connection and maintenance from these points to the subscribers' homes is not the Company's responsibility).

D. IP Centrex

The IP Centrex service is a virtual private exchange service.

E. Data Center

Data Center service enables provision of a solution for customers from the aspects of backup and survivability

F. 144 internet site (B144)

A search engine for finding business and private telephone numbers.

2.3 Breakdown of Revenue and Profitability of Products and Services

For data on the distribution of Company revenues by principal product and service in its areas of operation, see Note 22 to the Company's financial statements and Note 6 to the financial data from the consolidated financial statements attributed to the Company as parent, for the year ended December 31, 2009, which are attached to this Periodic Report.

2.4 Customers

The Company is not dependent on a single customer or small number of customers, which if lost would significantly affect the area of operation.

The Company does not have any single customer generating revenues of 10% or more of its total revenues.

Company sales are divided into two main sectors: the private sector (approximately 60%), and the business sector (approximately 40%). This division is based on revenue.

2.5 Marketing, Distribution and Service

The Company has marketing, sales and service systems for the private and business sectors, which include customer managers for the business sector, combined sales and service centers (including the 199 center) located throughout the country, technical support centers for private and business customers, and 15 points of sale and service (the Bezeq Store network) around the country.

The Company markets its services mainly through advertising in the mass media and telesales centers, customer managers, and a system of independent dealers including primarily ISPs and points of sale operating by an outsourcing method.

2.6 Competition

Following is a description of the development of competition in the domestic fixed-line communications market:

2.6.1 <u>Telephony</u>

A. Intensifying competition with HOT, which was granted a general license for the provision of domestic fixed-line services, including telephony, is reflected, among other way, in offers by HOT that bundles broadband internet, telephony and cable television into one package for households. HOT also marks telephony services to business customers

On December 23, 2009, the Ministry of Communications announced that it intends to amend the licenses of HOT Telecom and HOT Broadcasts and to grant a special license to NOT Net, a limited partnership wholly owned by HOT Broadcasts, for the provision of internet access services after it reviews the responses submitted to it and after consulting with the Cable Broadcasting Council. The amendments would establish various mechanisms allowing them to market a joint basket of services, albeit with some restrictions.

B. Since 2004, the Minister has been authorized to grant special general licenses for the provision of domestic fixed-line communication services, including telephony without an obligation to provide universal service or an obligation for minimal geographic deployment. Such licenses were granted to a number of operators, among them Cellcom Fixed-Line Communication Services, 012 Telecom Ltd. and Partner Fixed-Line Communications Solutions(on this, see also Sections 3.7 and 4.1.2.2 below).

C. According to a policy document published by the Ministry of Communications on January 31, 2007, the Company and its subsidiaries may provide VOB services only after the Company's market share of the domestic fixed-line telephony market in a particular customer sector (business or private) falls below 85%. According to a notice of the Ministry of Communications, the Company's market share in the private sector fell below 85% in June 2008, and in the business sector in September 2009. On February 8, 2009, a corporation wholly-owned by Bezeq International received a special general license to provide VOB services in the private sector. For information about broadening the license for the business sector, see Section 4.1.2.2 below.

According to a notice issued by the Ministry of Communications on February 23, 2010, in December 2009 the Company's market share in the private sector was 75.7% and in the business sector 83.9% in terms of normative revenue. Another measurement method employed by the Ministry, for determining the discount that the Company is permitted to offer for in the approval of alternative tariff baskets as described in the

Gronau Report, the Company's market share on standard (single) lines based on normative revenue, was 74.2% and 78.5% in access lines.

Call completion tariffs in the network of a VOB operator are the same as payment for call completion in a public telecommunications network of the Company or of another domestic operator. Call completion tariffs in domestic operator networks are expected to be reviewed by a public committee that will be appointed to draft recommendations for the fixed-line area of operation.

D. Competition in telephony from the cellular companies

The cellular penetration rate in Israel is among the highest in the western world. In the opinion of the Company – an opinion not accepted by the Ministry of Communications or the Antitrust Commissioner, the penetration rate combined with low airtime rates compared with international levels, have to a large extent made the cellular telephone an alternative to the telephone line. The Company estimates that deepening the substitution of the fixed line and the mobile line is one of the reasons for the pace of removal of telephone lines, in such a way that about 16% of households in Israel not longer have a fixed line in their homes (compared with 5% in 1996).

Partner Fixed-Line Communication Solutions also received a license to provide domestic fixed-line services, and it provides line-telephone services in VOB technology, as well as ISP services. To the best of the Company's knowledge, Partner sells packages that bundle line telephone services that include cellular minutes and ISP services.

2.6.2 Broadband internet access

In broadband internet access, competition is keen.

HOT has deployed a broadband infrastructure nationwide over which it can provide a range of communications and advanced interactive applications. This network is today the main alternative for competition with the Company in the private sector.

On May 10, 2009, HOT announced the setup of an Ultra Fast Internet (UFI) network which operates in Docsis3 technology, which will offer internet surfing speeds of up to 100 mega. According to HOT's notice, the network was launched in October 2009.

Upgrading the internet infrastructure and grant of an ISP license to HOT as noted in Section 2.6.1 above, is expected to intensify the competition in internet and could also increase the number of HOT customer who subscribe to its Triple Play service.

During 2008, the cellular companies deepened their broadband operations on the cellular infrastructure in both the private and the business sector, and they also provide ISP services. The surfing services are provided from the cellular handset and though a cellular modem that is connected to laptop and desktop computers.

On August 31, 2009, the Ministry of Communications published a request for the public's positions on regulation of the structure of the market for broadband services on the cellular network. See also Sections 3.7 and 4.1.2 below.

2.6.3 Data transmission and communications

The companies that operate in this area are Cellcom, Partner, HOT, and the internet companies that also use leased infrastructure.

To the best of the Company's knowledge, Cellcom has deployed and set up a transmission network, including optical fibers, which it uses for both its own purposes (instead of transmission formerly provided by the Company) and for competition with the Company in the data transmission and communications market. Entry to the domestic fixed-line telephony market enables Cellcom to offer its customers a complete basket of solutions that includes domestic telephony, data communications and cellular, using its own infrastructure and its own sales array.

On August 15, 2006, Partner was granted a special license for providing data transmission and communication services, after purchasing the operation of Med-1.

2.6.4 Additional factors that could affect competition

A. Numbering and number portability

On December 2, 2007, the number portability plan began to be implemented, enabling customers to transfer between the various communication operators without changing their telephone numbers. Number portability increases competition and the strength of that competition.

Following a hearing in May 2007 on the imposition of financial sanctions permitted under the Communications Law in respect of violation – so the Ministry contended – of the duty to provide number portability commencing September 1, 2006, the Ministry requested of the Company and the other relevant licensees, on November 20, 2008, for information about the dates of actual implementation of number portability. According to the Ministry, the request was made to enable it to formulate its position on the question of the Company's compliance with the provisions of the Law and the numbering plan for number portability. On January 5, 2009, the Company submitted its position and the information to the Ministry.

B. Other potential competing infrastructures

In addition to HOT's cable and fiber-optic network and Cellcom's and Partner's fiber-optic infrastructures, there are a number of fiber-optic networks in Israel today, most of which are owned by State-owned companies or government agencies. These include Israel Electric Corporation (IEC), Israel Railways, Mekorot, an oil infrastructure company and the Cross-Israel Highway Company. On January 6, 2010, the Ministry of Communications announced that it had agreed with IEC on a trial connection of 100 – 150 households to 100 mega symmetrical surfing speed and broadband applications, and on February 7, 2010 IEC was granted a technology trial license. Some municipalities are also attempting to create an alternative to the laying of pipelines by communications licensees, via the infrastructure of such municipalities.

On March 1, 2009, the Ministry published a policy for allocating frequencies for broadband wireless access networks. The Ministry decided that the Company and HOT Telecom would not be permitted to participate in a tender for the allocation of 3.5 GHz frequencies. For the 3.7 GHz frequency range, the Ministry decided that participation in the tender will be open to all licensed domestic operators, including the Company, to allow service on these frequencies for the supply of broadband services in remote areas and as a supplementary means. Concurrently with the determination of the general policy, there were negotiations between the Company and the Ministry for the allocation of alternative frequencies to the Company in return for freeing up frequencies that the Company uses to provide services for its rural and neighborhood radio system subscribers, as requested by the Ministry (see section 2.16.8 below). On March 1, 2009, the Ministry notified the Company that it had decided to allocate an alternative 5MHz band in the 3.6 GHz – 3.8 GHz (the 3.7 frequency range), which is not one of the frequency ranges included in the policy. In addition the Company is eligible to participate in the tender in the 3.7 GHz range, as aforesaid, so that at the end of the day, it may be allocated frequencies in the 3.7 GHz range, at total bandwidth of 15 MHz. To the best of the Company's knowledge, there is no approved equipment that complies with the standard appropriate for this range of frequencies.

C. Technological developments

Technological developments enable competing companies to provide, at relatively low costs, telephony and data communications services over fixed-line IP-based networks, as well as by means of advanced cellular infrastructures. At the same time. the main traditional barrier to the entry of competitors into the sector – the access infrastructure connecting the subscriber to the communications network of the competing operator – is becoming less significant. The rapid growth in the number of cellular subscribers and broadband internet customers, the improved audio quality and increasing bandwidth enabling alternative technologies, have an adverse effect on the number of calls passing through the Company's network, causing a decline in its revenue from telephony services and moderating the growth potential in its revenue from advanced internet and data communication applications.

2.6.5 The Company's preparation and methods for coping with the growing competition

The Company copes with competition in domestic fixed-line telecommunications services in several ways:

A. The Company is launching new communications services and value-added applications, as well as packages of products, including terminal equipment and services, among other reasons, to increase the volume of use of subscriber lines, to respond to customer needs and to enhance the image of technological innovation. The Company invests in improving and modernizing its infrastructure in order to be able to provide advanced products and services for its subscribers.

B. The Company worked to introduce the high-speed broadband internet service and to increase the number of customers it has in this area, including by means of applications for businesses. Deployment of the NGN (as described in sub-section H below) enables customers to upgrade to higher speeds and creates added value for the customer.

C. The Company is working constantly to improve the quality of its services and to retain its customers.

D. The Company has simplified its tariff structure and offers customers a number of alternative payment packages, tracks and special offers.

E. The Company has implemented a new billing system for business and private customers.

F. The Company is working to heighten awareness of the use of the fixed-line telephone and to encourage the use of other services that increase telephone use.

G. The Company is making adjustments on the expense side with the goal of focusing investments in property, plant and equipment in growth activities and in projects for reducing operating costs. Nevertheless, the Company's ability to make such adjustments in the short and medium term is limited, due to its cost structure, which mainly comprises rigid short- and medium-term costs. These costs consist mainly of depreciation expenses and expenses related to salary and benefits. Furthermore, the Company has operating costs such as infrastructure maintenance and leasing as well as maintenance of buildings, which are also rigid short-term costs.

H. The Company is in the throes of setting up the NGN (Next Generation Network), an advanced unified infrastructure for carrying voice communications, high-speed broadband internet services and content, leisure and entertainment applications. On this subject, see also Section 2.7.2 below and Note 10 to the financial statements of the Company for the year ended December 31, 2009.

I. As part of the sale of services to its customers, the Company combines the sale of terminal equipment. (such as home networks, laptops, streamers, and so on, as well as telephony terminal equipment), as a tool for competitive differentiation, customer retention and increased revenue.

2.6.6 Positive and negative factors affecting the Company’s competitive status

Positive factors

A. Nationwide infrastructure deployment through which a variety of services are provided

B. Presence in most businesses and households

C. Strong capital structure and positive cash flow

D. Expansive service infrastructure and various customer interfaces

E. Professional, experienced and skilled staff

F. Strong, well-known brand

Negative factors

Regulation

The Company believes that the various restrictions imposed on it under the existing regulatory guidelines impede its ability to compete in its areas of operation. The following are the main restrictions in this regard:

A. Restrictions in the marketing of service packages jointly by the Company and companies in the Group

The Company is prohibited from offering service packages jointly with companies in the Group, while such packages are offered by its competitors. The absence of such an option is a major disadvantage in the Company's ability to compete. In the matter of the draft amendment of the Company's general license, see section 2.16.2 below.

B. No tariff flexibility

The Company is restricted in its ability to give discounts on its principal services and to offer differential tariffs. Even the tariff packages (which should, inter alia, offer an immediate alternative to the normal tariffs) are so tied up in bureaucracy that they are frequently pointless. For a description of the recommendations of the Gronau Committee adopted by the Minister of Communications in respect of improving the efficiency of the system for approving the basket of tariffs, see section 2.6: Tariff flexibility.

C. Obligation of structural separation

Under its license, the Company is required to maintain full structural separation in the format prescribed in the license, between itself and those subsidiaries and affiliates specified in the license. There is also a separation between the Company's operations and those of Pelephone due to the terms of the merger approved by the Antitrust Commissioner. The restrictions that apply to the Company do not apply to the other entities operating in the communications market, and they put the Company in an inferior position.

D. Universal service obligation

The Company is under an obligation to provide services to the entire public in Israel (universal service), and as a rule, the Company is in compliance with this obligation. No similar obligation is imposed on the special domestic operator licensees, which can offer their services to the Company's lucrative customers (primarily business customers), which represent a significant source of revenue for the Company.

The Company believes that a fund should be established to finance this universal service, so that an operator that does not provide service to whoever requests it will pay into the fund through which the universal service will be funded.

E. Accessibility deficit

The Company's telephony tariffs are prescribed in regulations promulgated by the Minister of Communications with the consent of the Minister of Finance. As a result of a deliberate regulatory policy, the monthly usage tariff for a telephone line is set at a level that does not cover the costs involved in providing it (a situation known as 'accessibility deficit'). This deficit has been reduced over the years, but still exists. Note that in a competition format that relies on the Company's infrastructure and exploits the accessibility deficit (e.g. VOB services), the negative impact of this factor is increasing.

2.6.7 Adoption of the conclusions of the Gronau Committee for the formulation of recommendations concerning the policy and principles of competition in communications in Israel by the Minister of Communications.

On March 12, 2008, a report was published by the public committee, headed by Professor Gronau and appointed by the Minister of Communications in December 2006 to formulate detailed recommendations for a policy and principles of competition in the communications in Israel (the Gronau Committee). On August 13, 2008 the Minister of Communications announced his decision to adopt the conclusions of the committee, subject to a number of changes and emphases so that they would constitute the guiding policy of the Ministry for the near future. Following are the main points of the decisions.

Structural changes in the fixed-line sector

Further to the recommendation to work on the development of the wholesale fixed-line market and to require the owners of the universal infrastructures to sell services wholesale and lease access segments to competitors (and for reasons of technological applicability, at this stage the local loop unbundling obligation would only apply to the Company) – the Minister decided that the Ministry of Communications would start preparation of the regulatory and pricing infrastructure required for establishment of the wholesale market, including arrangements for local loop unbundling (LLU). The committee recommended that the Company's subsidiaries be granted a license to provide bundled service packages[12] consisting of telephony and IPTV services after application of the aforementioned arrangements. On the same date, it will be possible for the subsidiaries of the Company to be granted special domestic operator licenses for providing domestic services other than VOB.

Concurrently, with due attention to the importance which the committee attributed to upgrading the fixed-line communications infrastructure, the Minister would work to create incentives for the Company, which would promote rapid universal deployment of the NGN, to the extent that the Minister believed it justified to do so.

Tariff flexibility for Bezeq – Alternative service packages

To improve the efficiency of the approval process for alternative payment packages, the Minister decided to change the system for their approval so that the Company would be able to offer them 45 days after submitting a detailed application to the Ministry of Communications, unless the Minister of Communications or the Minister of Finance gives notice of his objection to the application. The Minister adopted the recommendations of the committee that as long as the Group’s market share is more than 60%, control of the Company’s tariffs should continue in the format of fixed prices, and for the matter of the alternative payment packages – the smaller the Group's share in fixed-line telephony, the higher the maximum discount permitted (the discount would be 15% as long as market share is higher than 85% (15% discount provided that the market share is higher than 85%; 25% when the market share is between 75% and 85%; and 40% when the market share is between 60% and 75%). It is noted that according to the recommendation, the alternative payment package will be approved only if it is worthwhile for at least 30% of the subscribers who consume the services offered in the package.

Competition in the cellular sector

The Minister instructed the Director General of the Ministry of Communications to work towards advancing the licensing policy for MVNO. On January 20, 2010, the Minister of Communications signed regulations allowing the grant of MVNO licenses. See also Section 3.7 below. .

Multi-channel television – Basic channel package

Further to the committee's recommendation to create a basic package of 5-10 channels, the Minister decided to conduct a more comprehensive examination of all aspects of broadcasting by establishing a committee. On October 12, 2008, the committee announced a hearing. On this matter, see Section 5.1.3.2 below.

Structural separation

The Ministry will work to ensure compliance of companies in the HOT Group with the rules of structural separation laid down in their licenses, with the exception of the option available to the companies to market service packages that include services offered by the companies, contrary to the committee's decision that the rules of structural separation should be enforced in the same format as that applicable to the Company. The rules of structural separation should allow the implementation of the recommendations concerning the wholesale market in general, and its prices in particular. The committee's recommendation would leave in place the structural separation in the Company as long as only two companies own fixed-line infrastructure that is deployed nationwide. Furthermore, should the Minister find, within a reasonable time from introduction of the dismantling arrangement (not more than two years) that the actions of the Company prevent greater competition in the domestic communications market, the recommendation is that he should act to apply structural separation between infrastructure operation and service operation in the Company.

On June 4, 2009, the Ministry of Communications announced an amendment of the license of HOT Telecom concerning structural separation between HOT Telecom and HOT Communications Systems Ltd. (Hot Broadcasts), setting exceptions to the obligation for the structural separation prescribed in HOT Telecom's license.

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[12] In which there is no undertaking that each service in the package can also be purchased separately on the same terms as it is provided service in the package.

International call sector – Entry of players associated with cellular licensees to the international calls market

To promote the recommendation of the committee concerning setting a payment for making an outgoing international call through a cellular network in the framework of the interconnect regulations. In February 2010, an amendment to the cellular licenses was published on this subject – see Section 3.7 below.

General

<u>Additional recommendations of the Gronau Committee adopted by the Minister of Communications</u>

<u>Consumer issues</u> – The OECD recommendations are guidelines for addressing consumer issues. Tariffs set in a contract with customers cannot be changed during the term of the contract, the term of contracts is limited to 18-24 months, and the barrier to transfer due to tying purchase of a handset to purchase of services, will be removed.

<u>Royalties</u> – Adoption of the position taken by the Kroll Commission on the gradual reduction of the rate of royalties payable by licensees, up to cancellation of such royalties in the future. If there is a reduction of taxes during 2008-2012, the royalties will be cancelled. It is appropriate that cancellation of the royalties accompany a parallel reduction in tariffs.

The Company is unable to assess the impact of the decisions and their adoption on its business results and those of its subsidiaries, inter alia, since most of the decisions have not yet been implemented, and as time elapses, some have actually been changed.

See also Sections 3.7, 4.1.2 and 5.1.3.2 below.

2.6.8 On February 14, 2010, the Ministries of Communications and Finance announced the signing of a letter of appointment for a committee, to be headed by Mr. Amir Haik, to consider a new tariff arrangement for the Company (which will replace the existing arrangement), adapting the arrangement to the changing environment of the communications sector and the competition policy, and to consider setting new tariffs for different segments relating to the provision of services in the wholesale market in the fixed line segment by the owners of the universal infrastructures, and call completion tariffs in the fixed-line networks. Furthermore, with the consent of the Minister of Communications, the chairman of this committee will be able to discuss additional subjects that are not included in the letter of appointment. The committee has been asked to submit its final recommendations by one year from the date of its appointment.

2.7 Property, Plant and Equipment, and Installations

2.7.1 <u>General</u>

The Company's property, plant and equipment consists primarily of domestic telecommunications infrastructure, exchanges, various networks, real estate (land and buildings), computer systems, vehicles and office equipment.

2.7.2 <u>Domestic fixed-line telecommunications infrastructure</u>

This infrastructure has five principal components deployed throughout the country.

A. <u>Exchanges</u>

Used for switching calls and transferring them from their origin to their destination based on the signal (dial) received from the subscriber.

B. <u>Transmission network</u>

A system through which there is connectivity between exchanges. This system actually functions as a national backbone that connects the local networks, each consisting of an exchange and an access network to it. The transmission network is based primarily on fiber-optic systems and in part (minimal) on radio systems.

C. <u>Data communications networks</u>

Networks for the provision of data communication services at various speeds and communication protocols.

D. Access network

A system that connects subscriber NEPs to the exchange. The network is based on copper pairs, fiber-optic cables and in part (minimal) on wireless systems.

E. Terminal equipment

Equipment installed at the subscriber site (such as telephones, private exchanges, fax machines, modems, routers, etc.) through which the subscriber receives the service.

NGN

The demand for communication services in Israel, as in the entire world, includes a requirement for increasing bandwidths and an advanced IP platform. In order to respond to this demand, the Company has started to set up, in stages that commenced at the end of 2008, a next generation network (NGN) based on the core of the IP network and deployment of fiber optic infrastructure to street cabinets (a topology known as fiber to the curb – FTTC). With this network and using VDSL2 technology, bandwidths of up to 100 Mbit/s can be provided today in the download channel, as well as innovative value added services. In addition, the NGN allows the Company to improve the efficiency of the network's structure. The project for setting up the new network is being implemented gradually, with the pace of the deployment being tested an set annually. In September 2009, the Company launched the NGN and at the date of publication of this report, about 498,000 subscribers have been connected to it.

On this matter, see also Note 10 to the financial statements of the Company for the year ended December 31, 2009, which are included in this Periodic Report.

2.7.3 Computing

The Company's IT system supports four central areas:

A. Marketing and customer management

The computing system supports, inter alia, management of the customer database, orders for services, follow-up of customer complaints, sales and customer service processes and implementation of the number portability program and billing. The billing and collection system includes production of bills to customers for services provided and for services of other communication operators. This includes the managing of accounts with communication operators.

B. Information systems for engineering infrastructures of the telecommunications networks

Support planning, management, control and maintenance of engineering resources for the purpose of supply and assurance of services. *Inter alia,* the systems manage the number inventory and support massive conversions of numbers and equipment.

C. Information systems for management of Company resources

Support management, control and maintenance of the expenses of the Company, such as financial information (including budget and controls), procurement and inventory processes, property, real estate, human resources and wage controls, vehicle fleet and Company projects.

D. Cross-organization systems

The Company's IT system is large and complex, supports mission-critical work processes and handles very large amounts of data. The system is made up of a large number of systems, some of them old systems developed many years ago, operating on central computers, and some of them modern systems developed and implemented in recent years, operating in open computer environments.

The systems support decision-making processes via a data warehouse system (DWH) operated by the Company. Likewise, the Company operates a website which provides information on the Company's services and enables presentation of information regarding telephone bills, payment of telephone bills and other services. The Company also operates computerized office systems (such as email and resolution follow-ups), knowledge management systems, etc.

2.7.4 Real estate

A. General

The Company's real estate assets come from two sources: assets transferred to the Company by the State under an asset transfer agreement in 1984 and assets to which the Company received or purchased rights after this date, including assets it leases from third parties.

As at the date of publication of this periodic report, the Company has freehold or leasehold title or the right to lease approximately 440 real estate properties around the country. The total area over which the Company has full title or capitalized long-term lease rights (including joint long-term lease rights as set out below), amounts to approximately 1,150,000 sq m of land, of which approximately 335,000 sq m is built up. Six of these properties are in Judea and Samaria, covering lots of approximately 7,000 sq m and built up areas of approximately 500 sq m. (Out of these properties, about 410 account for an area of approximately 1,040,000 sq m of land, while about 270,000 sq m of built-up area are for communications needs and the remainder are for administrative needs.

In addition, the Company has a right to approximately 70 dunams of land at Sakia (near Messubim Junction), for the purposes of storage and offices. The Company received a draft contract for a planning permit for this land from the Israel Lands Administration (ILA) which does not include storage and office purposes, and submitted its reservations regarding the contract to the ILA.

At the date of publication of this Periodic Report, of these properties, 52 are jointly held with the Ministry of Communications and/or the Postal Authority (now Israel Postal Company Ltd.). On June 30, 2004, The Company entered into an agreement with the Postal Authority to define and clarify the rights of both in these properties (see Section 2.17.2C below). The parties are following the provisions of the agreement, inter alia, to separate joint charges and systems.

In addition to these 440 properties, at the date of publication of this Periodic Report the Company holds about 60 properties in Israeli settlements in Judea and Samaria, in a total area of approximately 9,300 sq m of land, on which about 1,500 sq m are built up (all for communications purposes). No written arrangement of the contractual rights in these properties exists, but in the Company's opinion this does not constitute a significant problem.

The Company uses this land for communications operations (such as exchanges, concentration rooms and broadcasting sites) and for other operations (such as transmitters and warehouses). Some of the Company's properties are undeveloped or partially developed, and can be exploited further.

As at the date of publication of this Periodic Report, the Company leases about 170 properties, with a total area of 60,000 sq m, of which 59,000 sq m are built-up (160 of these properties, with a built-up area of 6,500 sq m, are for communications needs and the remainder for administrative needs).

The Company has easements (rights of way, etc.) over other real estate (to erect transmitters and deploy cables). The Company also has about 550 rooms at its disposal (rooms for cables and installations for neighborhood communication needs), with a total area of approximately 8,310 sq m, (all for communications needs), most of which are not regulated by written arrangements of rights with the owners (such as Israel Lands Administration, settling organizations, entrepreneurs of projects on which the properties are situated, and cooperative house committees).

B Registration

At the date of this Periodic Report, the Company's rights in a considerable portion of its land assets are not registered with the Land Titles Registration Office and are therefore merely contractual rights. The Company is in the ongoing process of registering those land assets which can be registered in the Land Registry.

C. Real estate settlement

On March 10, 2004, the settlement signed by the Company, Israel Lands Administration (ILA) and the State (the Settlement Agreement) was validated as a court decision in the matter of most of the real estate assets transferred to the Company under the asset transfer agreement which was executed when the Company commenced commercial operation. The Settlement Agreement provided that the assets that remain in the Company's possession have the status of a capitalized lease, and 17 properties will be returned to the State through the ILA on various dates (through 2010) on the terms laid down in the Settlement Agreement.

At the date of publication of this Periodic Report, the Company has returned 15 properties. Another two properties will be returned to the ILA after the Company receives substitute properties, in accordance with the Settlement Agreement.

D. Sale of real estate assets

Further to a renewed review by the Company's management concerning the sale of its real estate assets, the board of directors approved the continued sale of inactive real estate assets and/or assets that can be relatively easily vacated without incurring significant expense, in accordance with lists presented to it from time to time. Company's real estate assets, and a procedure for approving such transactions. The new NGN should allow the Company to improve the efficiency of its network structure and to sell some of the real estate assets that will be vacated following migration to the new network.

During 2009, the Company sold nine properties with a total area of 44,160 sq m of land and 25,100 sq m of built-up area, for a total sum of NIS 136 million. In addition, following the Settlement Agreement between the Company and ILA, an agreement was signed in June 2009 in which the Company undertook to return the Bayit V'Gan compound to the State within 18 months of execution of the agreement and to waive receipt of a substitute property for it, in consideration of NIS 6 million. The consideration was invested in the purchase of offices for providing services to Israel Broadcasting Authority.

2.8 Intangible Assets

2.8.1 The Company's general license

The Company operates under the terms of a general license which, inter alia, serves as the foundation for its domestic fixed-line telecommunications operations. For a description of the main points of the general license, see section 2.16.2 below.

2.8.2 Trademarks

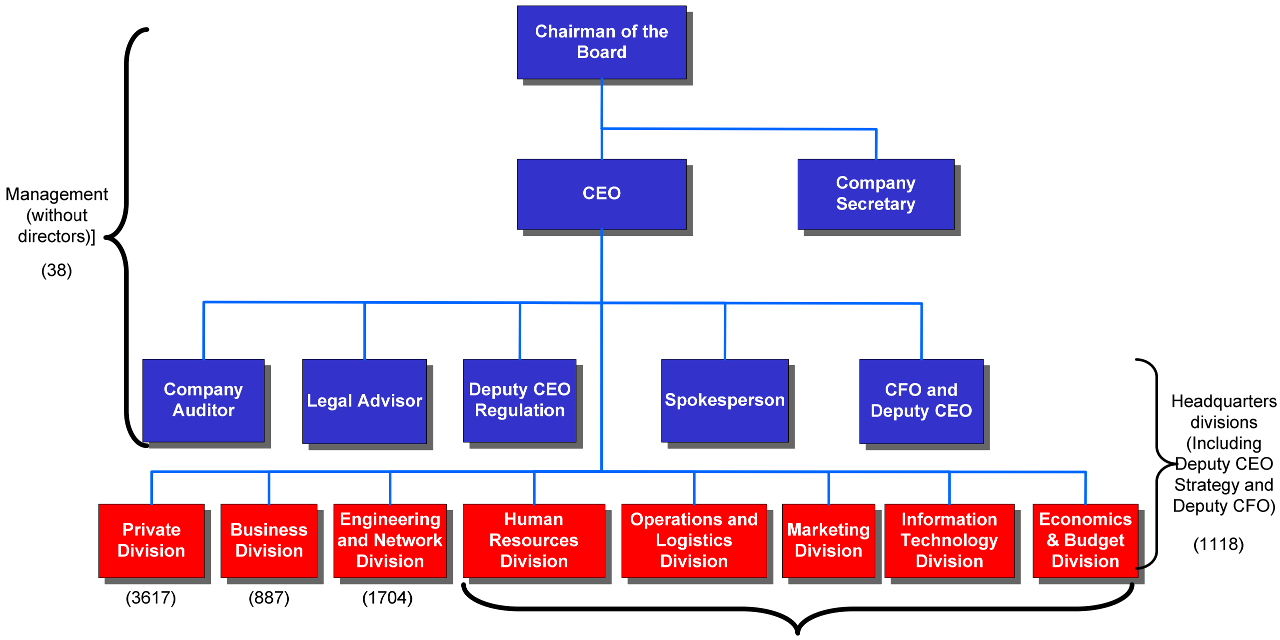
The Company uses trademarks that reflect its products and services. As of the date of publication of this periodic report about 170 trademarks are registered in its name or are in the process of being registered at the Registrar of Trademarks. The main trade marks are **Bezeq** – the Company's name, and **B** – the Company's logo.

The investment in advertising the trademarks is intended to increase the level of public exposure and awareness of the trademarks, so as to build differentiation and uniqueness for the Company which will affect customer purchasing decisions and preferences.

2.9 Human Resources

2.9.1 Organizational structure and headcount according to organization structure

The following is a diagram of the Company's general organizational structure:



* Answers to CEO regarding the Company's activity as a domestic operator and to the board of directors regarding subsidiaries.

On September 4, 2007, the board of directors of the Company resolved, pursuant to section 50(A) of the Companies Law, 5759-1999, and in accordance with Articles 119 and 121.1 of the Company's Articles of Association, that the CEO's powers with respect to the corporations held directly or indirectly by the Company (including Pelephone Communications Ltd., Bezeq International Ltd., DBS Satellite Services (1998) Ltd., Walla! Communications Ltd., Bezeq Online and Bezeq Gold Holdings Ltd.) will transfer to the board of directors, and the board of directors has passed resolutions for the implementation of the above.

2.9.2 Headcount by occupation

Description of employment framework	Number of employees	
	At December 31, 2009	**At December 31, 2008**
Senior managers excluded from application of the Company's collective bargaining agreements. The terms of their employment are set in personal agreements.	65	63
Permanent employees employed under collective agreements.	3,290	3,320
Employees employed under personal agreements that are not part of the collective agreements.	664	600
Employees employed under individual agreements on the terms of the collective agreement (rank rating contracts).	26	183
Employees employed in accordance with the special collective agreement of December 5, 2006, on an hourly basis.	2,195	2,241
Employees employed under the special collective agreement of December 5, 2006, on a monthly basis.	1,124	1,123
Total	**7,364**	**7,530**

Note: **The hourly collective agreement** applies to former Generation 2000 workers and to former temporary hourly agreement workers, as well as to new workers hired on an hourly basis. **The monthly collective agreement** applies to former Generation 2000 workers who were hired in occupations that are monthly by nature, former all-inclusive contract workers, and new workers hired on a monthly basis.

On November 4, 2009, the Board of Directors of the Company approved an early retirement plan for 2010, under which about 171 employees will retire from the Company for a total cost of NIS 225 million, on the terms of the collective agreement from December 2006. The Board also resolved, on the same date, to approve an additional cost of NIS 41 million to supplement the 2009 early retirement plan (retirement of 245 employees at a cost of NIS 177 million on the terms of the same collective agreement). On this matter, see also Note 17 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

2.9.3 Retirement of tenured employees from January 1, 2010

From January 1, 2010 to February 28, 2010, 86 tenured employees retired from the Company.

2.9.4 Company’s investment in further study, instruction employee training and higher education

The Company holds internal training sessions given by professional experts who are Company employees and at times, with the assistance of external organizations, in all the areas of its operations. Total workdays allotted to training activities for all employees in 2009 – approximately 28,376, or an average of 4.5 training days per employee. This training activity includes professional training in technology, sales, management, service and other areas.

The Company operates a service school that works to instill a service-oriented culture and customer-centric service values, as well as providing knowledge and skills in the provision of excellent customer service. The Company also participates in funding higher education and courses in outside institutions.

Total investments in these activities in 2009 amounted to approximately NIS 2.9 million over and above the cost of the workdays of the employees with respect to training and study days.

2.9.5 Nature of employment agreements at the Company

Labor relations at the Company are regulated by the collective agreements between the Company, the workers representatives and the New General Federation of Workers (the Histadrut) and by personal contracts. Additionally, expansion orders to certain general collective agreements apply to Company employees, such as cost-of-living increment agreements.

For a list of the significant agreements relating to labor relations, see section 2.17.4 below.

2.9.6 Employee reward plans

2.9.6.1 2005 stock options plan

On November 15, 2005, the Company published an outline for an offer of the State’s shares to Company employees. The offer was for up to 122,697,648 stock options, which were exercisable for up to 122,697,648 shares of the Company held by the State of Israel and constituting approximately 4.71% of the shares in the Company. Under the terms of the outline, this plan expired on December 10, 2009, after 122,220,328 stock options had been exercised. On this matter, see also Note 27 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

2.9.6.2 2007 stock options plan

On February 22, 2007, the board of directors of the Company approved an employee stock options plan, and on the same date, the Company published an outline for the plan. Under the plan, the Company allotted to its employees (excluding members of its senior management) and free of charge, in accordance with the criteria set in the collective agreement of December 5, 2006, stock options exercisable for shares accounting for 3% of the Company's issued share capital, at an exercise price (adjusted for each kind of distribution, etc.), of 50% of the last closing price of the share prior to the date of allotment.

Accordingly, on March 25, 2007, the Company allotted 78,091,794 options (out of the total number of 78,151,368 options[13]) to employees, exercisable for 78,091,794 ordinary shares of the Company of NIS 1 par value each at an exercise price of NIS 3.201 per share, linked to the CPI for February 2007 (adjustments for each type of distributions etc. applied to the exercise price). The options were locked up for a period of two years from the date of their allotment, and are exercisable over three years from the end of the lock-up period. (At March 1, 2010, 55,260,249 options from this plan had been exercised.)

2.9.6.3 <u>November 2007 stock options plan for managers and senior employees of the Group</u>

On November 20, 2007, the board of directors of the Company resolved to adopt a stock options plan for managers and senior employees in the Company and/or in affiliates, allotting 65,000,000 non-negotiable options, exercisable for up to 65,000,000 shares of the Company and comprising approximately 2.5% of the issued share capital of the Company, and at full dilution, approximately 2.37% of the share capital.

The option warrants will vest in three equal annual portions. The vesting dates of each portion fall at the end of each of the first, second and third years after the grant date, respectively.

The exercise price of each option is NIS 5.50, reflecting a discount of approximately 16.8% compared with the closing price of the Company's shares on the Tel Aviv Stock Exchange on January 31, 2008, the date of approval by the general meeting.

The allotment under the plan is part of the capital gain track, with a trustee as set out in Section 102(b)(2) of the Income Tax Ordinance [New Version], 5721-1961.

The stock options plan and the allotment of all of the options under it were approved by the general meeting of the Company on January 31, 2008, in accordance with the Articles of Association of the Company.

On December 25, 2007, the Company published an outline for an allotment of options from the plan in accordance with the Securities (Details of an outline of an offer of securities to employees) Regulations, 5760-2000, setting out, among other things, the terms of the plan, and also a report on a private placement in accordance with the Securities (Private placement of securities in a listed company) Regulations, 5760-2000.

Pursuant to the resolution of the board of directors on June 26, 2008, the exercise price of each option allotted from that date onwards will be the same as the average closing price of the Company's share in the 30 trading days prior to the date of the board's resolution to grant the options.[14] In addition, the options allotted to the Chairman of the Board will vest in 12 equal quarterly portions.

Since then and at the date of publication of this Periodic Report, 59,383,333 options exercisable for up to 59,383,333 shares have been offered in accordance with the stock options plan (less expired options), including to the CEO of the Company and to the Chairman of its Board of Directors.

On this matter, see also Note 27 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

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[13] The remaining 59,574 options were allotted on January 2, 2008 to two employee-directors following approval of the allotment by the general meeting of the Company's shareholders, at an exercise price of 50% of the share price on the date of allotment of the options (an exercise price of NIS 2.9991 per share). The total value of the benefit was approximately NIS 237,006 at October 21, 2007. See also the immediate report of the Company of October 29, 2007.

[14] With the exception of the allotment to the CEO of a subsidiary on September 25, 2008, on the original terms (exercise price of NIS 5.5 and adjusted for the distribution of a dividend).

2.9.7 The Company's officers and senior management

As of the date of this Periodic Report, the Company has 16 directors[15] and its senior management has14 members.

The Chairman of the Board of the Company is a salaried employee. The terms of his employment were described in an immediate report issued by the Company on April 18, 2008.

The two external directors serving on the board of directors of the Company receive compensation in accordance with the Companies (Rules for compensation and expenses of an external director) Regulations, 5760-2000. The other directors in the Company do not receive any compensation or other pay in respect of their service as directors.

The members of the senior management are employed under personal agreements which include, inter alia, pension coverage, payment of bonuses based on targets, and advance notice months. The Company also allots options for the Company's shares to the members of senior management, at its discretion (see Section 2.9.6 above).

Following the change of control expected in the Company (see Section 1.3.1 above), on December 31, 2009 the board of directors of the Company approved the adoption of a retention plan for the Company's senior managers (the CEO of the Company, of Pelephone and of Bezeq International), as described in an immediate report issued by the Company on that date. Accordingly, each of those CEOs will be awarded a retention bonus in the amount of one months' salary, and their stock options agreements will be amended so that in the event of dismissal (rather than resignation) within one year of the date of the transfer of control, the vesting period of the those of their options not yet vested, will be shortened on the Date of dismissal.

2.10 Raw Materials and Suppliers, Purchase of Equipment, and Suppliers

2.10.1 Raw materials

The principal raw materials used by the Company are exchanges, copper cable, fiber-optic cables, transmission equipment, data communications systems and equipment, servers, routers and XDSL modems. The Company purchases most of the equipment needed for its communications infrastructures from Israeli companies connected with communications equipment manufacturers from around the world. The Company purchases hardware and software from a number of main suppliers. Most of the equipment purchased for data communications, switching, transmission and radio systems was unique equipment, and it has only been possible, over the years, to receive support services from the manufacturer (on this matter, see also Section 2.10.3 below).

2.10.2 Percentage of purchases from main suppliers, and manner of engagement with them

During 2009, the Company had no suppliers from which its purchases exceeded 5% of its annual purchase amounts.

2.10.3 Dependence of suppliers

In the Company's opinion, it is dependent on the Alcatel Group (represented in Israel by Alcatel Telecom Israel Ltd.) and Comverse for public switching equipment and metro transmission; for business customer collection systems the Company is dependent on Amdocs Software Systems, and for transmission, on ECI.

Concerning the Company's relationship with Nortel Group, which is represented in Israel by Nortel Israel (Sales and Marketing) Ltd., the Company and Nortel had an upgrade and maintenance agreement for Nortel exchanges, which was in force until the end of 2007. Prior to the end of the term of the agreement, the Company conducted a comprehensive examination which found that in view of the Company's experience in operating Nortel exchanges, and in view of low probability (based on past experience) of malfunctions that the Company is unable to solve by itself, and in view of the very high costs involved in renewing the agreement, it would be unjustified to renew the agreement on the terms proposed. As a result, the Company's dependence on Nortel was reduced.

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[15] Including two external directors and two directors from among the employees.

2.11 Working Capital

Inventory purchased by the Company is for the most part intended for investment in property, plant and equipment. The Company's inventory policy strives to maintain an inventory sufficient for the Company's needs for average consumption as determined from time to time, with flexibility in exceptional cases that depend on the nature of the consumption and price of the item. Orders from suppliers are made taking into consideration past demand and projections for the future.

On March 2, 2010, the Board of Directors of the Company determined that despite the company's working capital deficit, liquidity is not a problem for the Company.

The following table shows data on supplier and customer credit in 2009:

	Average credit extended (NIS millions)	Average credit days
Customers	863	50
Suppliers	284	EOM + 30

2.12 Investments

For information on investments in subsidiaries, see Note 13 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report. See also Sections 3 and 4 in Chapter D of this Periodic Report.

2.13 Financing

2.13.1 Average and effective interest rate on loans

At 31 December 2009, the Company is not financed by any short-term credit (less than one year).

Distribution of the loans:

Source of financing	Amount at December 31, 2009	Type of currency or linkage	Average interest rate	Effective interest rate
Banks	NIS 400 million	Unlinked NIS	Prime + 0.94%	Prime + 0.98%*
Non-bank sources	NIS 2,733 million	CPI-linked NIS	4.21%	4.22%

* For prime at 2.75% in March 2010.

2.13.2 Limitations on borrowings

A. For the matter of limitations included in Company loans – see Note 14 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report. At the date of the financial statements and at December 31, 2009 and the date of publication of this Periodic Report, subject to the contents of the above Note, the Company is in compliance with all the limitations applicable to it.

B. Bank of Israel restrictions regarding a single borrower and group of borrowers

Directives of the Supervisor of Banks include restrictions on liability of a single borrower and of a group of borrowers towards the banks. These directives could, from time to time, affect the ability of some banks to grant additional credit to the Company. As the Company does not have data and precise information about single borrowers restrictions applicable to the banks, and given the fact that the Company cannot quantify the number of debentures issued by the Company and held by the banks, the Company is unable to estimate when and at what level of debt, if at all, these restrictions will impact the Company's ability to raise credit.

2.13.3 Credit received during the reporting period

On March 12, 2009, the Company raised NIS 400 million in bank credit. The credit was granted by means of unlinked shekel loans for 3 or 4 years, at an average interest rate (including commissions) of prime + 0.97% (at December 31, 2009 – 3.72%).

2.13.4 Credit received after December 31, 2009

The Company has not taken any loans after December 31, 2009.

2.13.5 Variable interest

On raising bank credit at variable interest on March 12, 2009, see Section 2.13.4 above.

2.13.6 Credit rating

The Company is rated by four credit rating agencies. Below are details of the rating of each of the rating companies at the date of publication of this Periodic Report (including the most recent updates):

Rating agency	Rating	Changes in rating	Type of credit rated
Standard & Poors Maalot	AA +	August 25, 2008: The Company's liability rating was raised from AA to AA+ with stable outlook. The raised rating is based primarily on the Group's improved performance and operating efficiency, the stability of the Company's managerial structure and the change to the structure of the business risk as a result of the change in the mix of the Group's revenue. October 13, 2008: Above rating validated, inter alia, following examination of the anticipated impact of exercise of the call option (10.66%) by Ap.Sb.Ar. (see Section 1.3.1) October 28, 2009 – Transfer to Credit Watch with negative implications of the rating of Bezeq International, which is BBB+ and of the rating of the Company's local debenture rating, which is AA+, due to the Company's notice of the entry by its controlling shareholder, Ap.Sb.Ar. Holdings Ltd. into an agreement for the sale of all its holdings in the Company (approx. 30.6%) to 012 Smile Communications Ltd., and the possible impact of the change of control on the capital structure of the Company.	All debenture series
Midroog	Aa1	May 21, 2008: Return of the Company's rating outlook from negative to stable in view of the improvement in the Company's financial results, and the continued presentation of a strong financial profile, compensation for the erosion in the fixed line communications segment by means of operations in the other segments and very low rates of financing despite the distribution of all of the net profit as dividend after the transfer of the control core of the Company. November 3, 2009 – Reconfirmation of rating (Aa1) with stable outlook. The rating is supported by the business strength of the sector in which the Company operates its strong status in the sector, the diverse mix of operations that covers the entire Israeli communications market, and its rapid debt coverage ratio.	Debenture series 4 and 5

Rating agency	Rating	Changes in rating	Type of credit rated
Standard & Poors	BBB+	August 12, 2008: Change in the Company's rating outlook from negative to stable following review of its operating performance and its moderate leverage. The Company's rating relies, inter alia, on its leadership as the national communications operator, its operating efficiency, the range of services it offers in the communications market and its adequate financial profile. October 7, 2008: Rating validity confirmed following review of the exercise of the call option (10.66%) by Ap.Sb.Ar. (see Section 1.3.1) October 28, 2009 – On S&P's notice, see rating of S&P maalot above.	The rating is for the Company
Moody`s	Baa1	November 24, 2008 – Rating remains at Baa1 (stable). September 3, 2009 and February 9, 2010 – Moody's announced that it was leaving the rating at Baa1 (stable).	The rating is for the Company

2.13.7 Estimate of raising funds in 2010 and sources of financing

During 2010, the Company expects to repay some of its loans and to raise additional debt.

The financing options available to the Company are raising debt by means of new bank loans and/or by raising debt or capital on the capital market, raising debt from the sale of series 5 debentures held by a wholly-controlled subsidiary, Bezeq Gold (Holdings) Ltd.;.

2.13.8 Charges and guarantees

For information about the Company's charges and guarantees, see Notes 14 and 20 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

2.14 Taxation

For information about taxation, see Note 9 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

2.15 Quality of the Environment

2.15.1 Non-Ionizing Radiation Law, 5766-2006 (the Law)

The Law regulates the handling of sources of electromagnetic radiation (Radiation Source), their erection, operation and supervision. The Law provides, inter alia, that the erection and operation of a Radiation Source and provision of a radiation measurement service require a permit; sets penal provisions and severe strict liability of a company, employees and officers; imposes recording and reporting obligations on a permit-holder, and grants supervisory powers to the Supervisor of Radiation, including for the matter of the terms of the permit, cancellation of the permit and removal of a Radiation Source. It is noted that the Company's installations, such as broadcasting installations or wireless communication installations, are included in the definition of Radiation Source.

The Company obtained operating permits from the Supervisor of Non-Ionizing Radiation at the Ministry for Protection of the Environment (the Commissioner) for the communication facilities and broadcasting sites it operates.

It is noted that the Commissioner may require building permits as a condition for the continued validity of the operating permits for communications facilities (including broadcasting facilities) he granted, as well as the fulfillment of additional conditions, inter alia, concerning wireless access installations which have category approval granted to the Company by the Supervisor. See also section 2.16.11 below.

The Company has a work procedure for the set-up, operation and measurement of non-ionizing Radiation Sources, and a pertinent compliance procedure which was approved by the board of directors of the Company.

New regulations for non-ionizing radiation, published on January 19, 2009, prescribe payment of a fee for filing an application for a Radiation Source permit. Following approval of the regulations, the Company now pays a fee for erection, operation and category approval permits. (The fee amounts are not material, and are expected to be payable over a number of years.) The regulations also prescribe criminal liability for failure to take and report measurements in accordance with the provisions of the regulations.

2.15.2 Permits

For the matter of permits for broadcasting installations that are required by the Planning and Construction Law, 5725-1965, see section 2.16.11 below.

2.15.3 Claims

For claims on the subject of alleged radiation from the Hillel broadcasting station – see Section 2.18.4 below.

2.16 Restrictions on and Supervision of the Company's Operations

The Company is subject to various laws which govern and restrict its business operations. The principal body that supervises the Company’s operations as a communications company is the Ministry of Communications.

2.16.1 <u>Control of Company tariffs</u>

The Company’s tariffs are controlled by Sections 15 to 17 of the Communications Law.

A. The tariffs for the Company’s supervised services, which are set in regulations promulgated by virtue of the aforementioned Section 15, were updated in accordance with a linkage formula less an efficiency factor, as provided in the regulations and based on the recommendations of public committees for the review of the Company's tariffs.

B. Pursuant to section 15A of the Communications Law, if tariffs are set for the services controlled under the above Section 15, the Minister may, with the consent of the Minister of Finance, approve the request made by the licensee for an alternative payment basket for a package of services.

C. Under Section 17 of the Communications Law, “a Licensee may request reasonable payment for a telecommunications service for which no payment is set in Section 15.” For these types of services provided by the Company (including broadband internet access service, business access and the like), the Company sets the tariffs. For additional provisions relating to tariffs in the Company's general license, see Section 2.16.2C below.

D. In accordance with the Communications (Telecommunications and broadcasts) (Calculation and linkage of telecommunications payments) Regulations, 5769-2009, the Company's tariffs were updated effective from June 1, 2009, using the update formula prescribed in the Communications (Telecommunications and broadcasts) (Calculation and linkage of telecommunications payments) (Amendment) Regulations, 5767-2007,so that the fixed monthly payments for a telephone line and for a line in the combination digital network basic service increased by 3.8%, and the payments for the other controlled services provided by the Company decreased by 0.3183%.

   Furthermore, pursuant to the Communications (Telecommunications and broadcasts) (Interconnect payments) (Amendment) Regulations, 5769-2009, interconnect fees paid by the cellular operators for call completion in the domestic operator network were reduced, and interconnect fees paid by the international call operators for international calls originating or ending in a domestic operator network were reduced by 0.3183%, effective June 1, 2009.

2.16.2 The Company's general license

The policy paper of the Minister of Communications

On March 31, 2004, a comprehensive amendment was made to the Company's general license, by virtue of which, inter alia, the Company operates. The then Minister of Communications attached a letter to the amendment, which contains policy points relating to the ability of the Company to offer discounts for size and service packages, as follows:

Volume discounts –On May 24, 2006, an additional payments package (effective June 1, 2006) was approved by the Ministers of Communications and Finance, which allows the Company to give volume discounts of up to 10%. For the matter of increasing the discounts in accordance with the recommendations of the Gronau Committee, see Section 2.6 above.

Bundles – After the Company's market share in domestic fixed-line telephony in a particular customer segment (business or private) falls below 85%, the Company's license will be amended so as to enable it to submit an application for the Minister's approval, to market a bundle of services in that customer segment, which includes telecommunications services provided by the Company and by a subsidiary, including broadcasts. The Minister's approval to market a bundle of services will be granted depending on the competition situation in the relevant area of telecommunications or broadcasts. The Minister's approval to market a bundle of services will be granted, *inter alia*, with reference to the following: (1) the existence of a group of services in a similar format which is sold by a competitor as a package; (2) the Company and the subsidiary will allow customers to purchase any service included in the bundle separately on identical terms to those offered in the bundle; (3) the bundle is offered to customers on an equal and non-discriminatory basis.

In the Company's opinion, the conditions allowing it to sell bundles with its subsidiaries as described above, detract from the effectiveness of the bundles.

On July 3, 2008, the Company received a draft amendment of the Company's license and the licenses of its subsidiaries Pelephone, Bezeq International and DBS concerning the marketing of bundles. On February 14, 2010, the Company requested an immediate and appropriate amendment to its license since more than a year and a half had elapsed since its market share fell below 85% in the private sector and its market share in the business sector was also now below 85%, and since in that period it had submitted its remarks to the draft of the proposed amendment. Concerning the positions of the subsidiaries on this matter, see sections 3.18.3, 4.1.2 and 5.7.4.2 below.

Main points of the general license

A. Scope of license and obligation to provide universal service

The Company is required to provide basic services, ancillary and other services as set forth in the appendix to the license; the term of the license is not limited in time; the license anchors the Minister's existing powers under the Law, to modify, revoke and suspend the license; the Company is required to universal service on equal and non-discriminatory basis for each type of service, regardless of location or special cost.

B. Principles of structural separation

The Company is required to maintain structural separation between it and a subsidiary, the definition of which, for this purpose, includes Pelephone, Bezeq International, DBS, and Bezeq On-line. Under the rules of structural separation, complete separation is required between the managements of the companies, including in everything relating to the business system, the finance system and the marketing system; complete separation of assets; prohibition against employment of Company employees in the subsidiary and employees of a subsidiary in the Company; prohibition against the transfer of commercial information to a subsidiary (including commercial information about the Company). No Company employee can be appointed a director in a subsidiary, if, as part of his function in the Company he has access to "commercial information" about a competitor, the use of which by the subsidiary is liable to harm competition between it and the competitor (this limitation does not apply to the Chairman of the Company's board of directors).

The Company must set rules and procedures to preserve the confidentiality of commercial information about licensees competing with the Company's subsidiary, and its transference to the subsidiary. The Company has set such rules.

C. It is noted that on March 9, 2009, the Company received a letter from the Director General of the Ministry of Communications announcing that he is considering imposing monetary sanctions on the Company under section 37B(b)(4) of the Communications Law, in the amount of NIS 15.024 million, for alleged violation of the provisions of the Company's general license concerning structural separation. The Company submitted its detailed remarks on April 26, 2009, noting that it had not violated the provisions of its license relating to structural separation, that no such violation can be attributed to it, and a financial sanction cannot be imposed on the Company. In addition, on December 7, 2009, the Company submitted data and a detailed update to the Ministry, relating to enforcement of the rules of structural separation.

D. Tariffs

The Company will provide a service or bundle of services for which no tariff is set in accordance with Sections 15 or 15A of the Law, at a reasonable price, and shall offer them to any person so requesting, without discrimination and at a uniform tariff.

When the Company collects payment for the services of another operator, it shall do so according to that operator's tariffs without any increment, and the tariffs for calls between the Company's subscribers and those of other domestic operators, shall be uniform and inclusive.

E. Operation of company networks and service standards

The Company is required to maintain and operate the network and provide its services 365 days a year, 24 hours a day, including at times of emergency, in an orderly and proper manner commensurate with technical requirements and the nature of the service, and to work towards improving its services. The Company's general license includes an appendix, "Service Standards for the Subscriber", which is to be amended after the Company provides the Ministry with data. The Company submitted to the Ministry its proposal for amendment of the Appendix, adapting it to the current state of affairs and the licenses of other operators, but the amendment has not yet been made.

F. Interconnect and use

Infrastructure services – The Company is required to provide these services to another licensee in such a way that it will enable it to meet the requirements of its license, on reasonable and non-discriminatory terms, and to avoid giving preference to a licensee that is an affiliate. Provisions have been made for making essential information available to another licensee for receipt of the service, and for the matter of provision pf the services In a way enabling it to meet the requirements for service standards imposed upon it and in a way that does not discriminate between recipients of the Company's services and the other licensee's customers.

Interconnect – Provisions have been made which are essentially intended to enable the implementation of interconnect and the provision of services between the Company's network and those of any other public network. Similar provisions exist for enabling use to another licensee.

G. Security arrangements

Provisions have been made for operation of the Company's network in times of emergency. The Company is required to set up and operate its network in a way that prevents its collapse at a time of emergency and enables a reduction of activity in certain sectors.

The Company is required to provide telecommunications services and set up and maintain the terminal equipment infrastructure for the security forces in Israel and abroad, as provided in its agreements with the security forces. Furthermore, the Company provides special services to the security forces as set out in a top secret appendix. The Company will take action to ensure that each purchase and installation of hardware in its telecommunications installations, except for end equipment, will be made in full compliance with instructions that are given to the Company according to Section 13 of the Communications Law.

The Company is required to appoint a security director and comply fully with the security instructions contained in the appendix to the license.

H. Control and reporting

Extensive reporting duties are imposed on the Company, such as filing the reports specified in the license and on-demand reports on various matters.

In addition, the Director General is granted the authority to enter facilities and offices used by the Company, to read and copy documents and demand information and reports from the Company.

I. Miscellaneous

The general license includes cross-ownership restrictions.

Neither the license nor any part thereof is transferable, or may be made subject to a charge or attachment.

Under the amendment to the license, the Company is required to prepare a draft contract it intends to offer to subscribers, and to submit it to the Director General for review upon his demand. The Director General is authorized to instruct that changes be made to the draft. The Company is in the process of preparing such a contract.

The Company is required to furnish a bank guarantee to secure performance of the terms of the license and to indemnify the State for any loss incurred by their violation, in an amount equal to USD 10 million. The Company has furnished the guarantee as required. The Minister may render the guarantee or part thereof forfeit on the terms set out in the license.

The Director General of the Ministry of Communications is authorized to impose a monetary sanction for breach of any of the terms of the license.

2.16.3 Royalties

The Communications Law stipulates that a licensee for the provision of telecommunications services shall pay royalties to the State of Israel on its revenues from providing a telecommunications service, at a percentage to be determined by the Minister of Communications and the Minister of Finance and approved by the Knesset Finance Committee.

The Telecommunications (Royalties) Regulations, 5761-2001 (the Royalties Regulations), expanded the revenue base on which royalties must be paid, while at the same time gradually lowering their percentage. The regulations impose upon whoever received a general telecommunications license for the provision of domestic fixed-line services (including the Company), international telecommunications services and cellular services a duty to pay royalties on its revenues (excluding VAT) from the services listed in the schedule to the regulations (except for areas in the Palestinian Territory) and including revenues from the provision of these services to the security forces pursuant to Section 13 of the Law. On August 31, 2006, an amendment to the Royalties Regulations was published, regulating the lowering of the royalty percentage for all royalty-owing licensees, commencing January 1, 2006, by 0.5% each year, down to a rate of 1% per year from 2010 onwards.

On January 27, 2010, an amendment to the Royalties Regulations was published, whereby the revenues of a domestic operator from providing data communications services, data network management services and high-speed point-to-point lines and links of certain kinds, are exempted from payment of royalties effective January 1, 2004.

2.16.4 Authority with respect to real estate

Pursuant to the provisions of Section 4(F) of the Communications Law, the Minister of Communications granted the Company certain powers in connection with real estate, as set out in Chapter Six of the Law.

Amendment No. 25 of the Communications Law, of 2001, distinguished between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or corporation lawfully established and owned by one of those, and a road (Public Land), and other land (Private Land). With regard to Public Land, the Company and any person authorized by it, can enter and perform work there, provided that approval for deployment of the network has been granted by the local Planning and Construction Committee. The local committee must decide on a request to approve such a plan within 60 days of its filing, and in the absence of a decision, the plan will be deemed to have been approved. In most cases, it is necessary to give the occupier 21 days' notice and the latter may appeal to the Court.

Under the provisions of the regulations for operation and maintenance, if the Company is of the opinion that providing telecommunications service to an applicant requires the installation of a telecommunications device for transmission or switching on the applicant's premises (or in shared premises or common property), the Company is permitted to request that the applicant, as a prerequisite for providing the requested service, allocate a suitable place on the premises for installation of the device, for the sole use of the Company, and it may use the device to provide service to other applicants also.

Deployment of a network on Private Land requires the consent of the landowner, the lessee in perpetuity or the protected tenant, as the case may be. In a condominium, the consent of a majority of the apartment owners is required. Nevertheless, the Law contains provisions concerning deployment of a network in a condominium at the request of an apartment-owner, even in the absence of the consent of the majority of the apartment-owners, and grants authority to the "house committee" and the Supervisor of Condominiums.

2.16.5 Immunities

The Minister of Communications granted the Company certain immunities as listed in Chapter 9 of the Communications Law, pursuant to his authority to grant immunity to a general license holder.

A licensee granted immunities as aforesaid (Immune Licensee), its employees and all persons acting on its behalf, shall not bear liability in tort, with the exception of the following:

(1) Direct damage caused by the restriction or discontinuance of a telecommunications service;

(2) Damage arising out of a deliberate act or gross negligence of the Immune Licensee, its employees or persons acting on its behalf

Additionally, an Immune Licensee, its employees and any persons acting on its behalf shall not be liable for damage caused by:

(1) non-provision, delay, restriction or discontinuance of telecommunications services and auxiliary services, resulting from a deliberate act of the Immune Licensee insofar as such act is necessary for the performance of a telecommunication operation or the provision of a telecommunications service;

(2) An error in providing a telecommunications service or a telecommunications message or an omission from it, failure to deliver or late delivery of a telecommunications message, delivery of a telecommunications message to an incorrect address or an erroneous listing in a subscriber directory or other publication of the Immune Licensee, unless done with gross negligence.

Under Section 13 of the Communications Law, which relates to the provision of telecommunications services to the security forces, a licensee or any of its employees shall bear no criminal or civil liability for any act committed in the performance of an instruction given according to that section, except in circumstances in which the State employee bears liability for the act. (Under the Torts Ordinance, in any action other than negligence, a public servant will have a defense if the act was within his statutory authority or was committed by him in the honest belief that he was acting within that statutory authority.).

2.16.6 Regulations and rules under the Communications Law

At the date of this Periodic Report, regulations in three main additional areas apply to the Company: (1) the termination, delay or restriction of a telecommunications operation or services; (2) installation, operation and maintenance; (3) methods of supervising the actions of the licensee. Furthermore, the Company, with the Minister’s approval, has made rules concerning the Company's services to subscribers.

The regulations and rules mentioned above regulate the conditions on which the Company may disconnect, discontinue and renew the service upon or without the subscriber's request, terminate a service, connect another subscriber to the telephone line of an existing subscriber, and remove telecommunication installations. In addition, the regulations regulate the Company's powers and duties, as well as the rights and obligations of each subscriber. The regulations also regulate provision of the information and entertainment services of suppliers over the Company's network.

According to the regulations, the Company is required to provide its subscribers with the telecommunications services listed in the general license, in a proper and orderly manner.

The Company may, with the consent of the Minister, terminate, disconnect or limit the provision of a telecommunications service if the service becomes technologically outdated, or if the service is abused in such a way as to cause tangible financial harm to the public or a part of it or to the licensee. Pursuant to the regulations relating to methods of supervision of the actions of a licensee, the Minister of Communications appointed a manager (a Ministry employee), who is authorized, *inter alia*, to ensure adherence to the provisions of the Communications Law, the regulations and license, for the types and terms of the telecommunications services, the quality of the services and standard of maintenance.

In addition, provisions exist concerning reporting, according to which every licensee is required to file periodic reports and reports on special events. The rules dealing with the Company's services contain provisions relating, *inter alia*, to sending bills to subscribers, debiting in installments, and the publication of listing in the subscriber directory.

2.16.7 <u>Antitrust laws</u>

A. On June 27, 1995, the Antitrust Commissioner (the Commissioner) declared the Company a monopoly in the following areas: basic telephone services, provision of communication infrastructure services, declassified bi-directional international telephone services (including service for incoming calls) (the declaration on the matter of this service was cancelled in 2001 when the international calls market was opened to competition), and transfer and transmission of broadcasting services to the public.

The Commissioner's declaration of the Company as a monopoly constitutes *prima facie* evidence of its content in any legal proceeding, including criminal proceedings. Accordingly, a plaintiff – a person or consumer organization – wishing to sue the Company, whether in a personal civil action or in a class action, will be excused from proving the fact that the Company is a monopoly, to the extent this proof is relevant its claim, in reliance on the Commissioner's declaration, and the Company will bear the burden of proof of refuting the Commissioner's declaration in this regard.

B. On December 11, 2000, the Commissioner declared the Company a monopoly in the field of “telecommunications infrastructure for the provision of high-speed access services via internet service providers”.

On November 10, 2004, the Commissioner announced that he had decided to split the existing declaration into two separate declarations:

(1) Provision of high-speed access services to subscribers through the access network,

(2) Provision of high-speed access services to ISPs through a central public telecommunications network.

C. On August 26, 2004, the Commissioner approved the merger of Pelephone and the Company (following the Company's acquisition of Shamrock's holding in Pelephone) on terms that limit certain joint operations and the transfer of commercial information, as defined in those terms.

D. In December 2007, the Antitrust Commissioner determined that the Company had abused its status in the market. See Section 2.18.19 below.

E. For the matter of the Commissioner's opposition to the merger of the Company and DBS, and the decisions of the Antitrust Tribunal and the Supreme Court on this matter, see Section 1.1.2 above.

F. The Company has adopted an internal compliance procedure (the Procedure) containing internal rules and a reporting and control array, the purpose of which is to ensure that the activities of the Company and its employees are carried out in accordance with the provisions of the Antitrust Law, 5748-1988 (the Antitrust Law).

G. On November 19, 2009, he Company filed notice of a merger with 012 Smile Communications Ltd., following acquisition of core control in the Company by 012 Smile, as described in Section 1.3.1 above.

2.16.8 The Telegraph Ordinance

The Telegraph Ordinance regulates the use of the electromagnetic spectrum, and applies, inter alia, to the Company's use of radio frequencies as part of its infrastructure. The set-up and operation of a system that uses radio frequencies is subject, under the Telegraph Ordinance, to grant of a license, and the use of radio frequencies is subject to the designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for the designation and allocation of frequencies.

The Government deals with a shortage of radio frequencies for public use in Israel (among other reasons, due to the allocation of a large number of frequencies for security purposes), by limiting the number of licenses granted for the use of frequencies on the one hand, and increasing the fees payable for allocation of a frequency in the lower range, on the other. The Company and the Ministry of Communications have a number of differences of opinion concerning fees which the Company contends it is not required to pay and therefore has not paid them. Following a clarification with the Ministry regarding these disputes, most have been settled. The main sum remaining in dispute relates to fees in Judea, Samaria and Gaza, and amounts, at December 31, 2009, to approximately NIS 68 million.

For an update on WiMAX, see section 2.6.4B above.

2.16.9 Legislation amendments

In April 2008, the Knesset approved an amendment to the Consumer Protection Law on the subject of fixed transactions (the Amendment). Under the Amendment, dealers are required to inform the consumer of the end date of a fixed transaction prior to its end, and of the conditions that will apply after the termination date. In addition, the dealer must obtain the positive consent of the consumer for continuing the contract beyond the fixed period. If positive consent is not obtained, the consumer will be disconnected from the service to which the fixed transaction applied, apart from basic telephone services as defined in the Communications Law (voice services). The Amendment came into force on January 10, 2009. In addition, the Knesset approved an amendment to the Consumer Protection Law in the matter of disconnection from ongoing services (effective October 2008), allowing a private subscriber to disconnect from an ongoing service by mail, electronic mail or telephone, and an amendment to the Consumer Protection Law (effective September 2008) which in certain cases imposes fines if a technician is late, and an amendment to the Communications Law in the matter of junk mail (effective November 2008), whereby, inter alia, a subscriber's explicit permission is generally required for the receipt of advertising by way of electronic mail, facsimile, automatic dialing systems or SMS. Furthermore, on March 15, 2010, an amendment to the Consumer Protection Law will come into force, enabling a consumer to cancel a transaction even after the service has started to be provided and broadening the cancellation rights in the event of deception.

2.16.10 Security arrangements

In addition to the special provisions that apply to the Company in the area of security by virtue of the general license (see section 2.16.2F above), special provisions also apply to it under the Communications (Telecommunications and Broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunications Corp. Ltd.) Order, 5757-1997.

2.16.11 Setting up communications installations

A. The National Outline Plans for Communications, NOP 36 (within the green line) and NOP 56 (in the Administrated Territories) are intended to regulate the deployment and method of setting up communications installations to ensure their functioning throughout the entire country, for the broadcasting and reception of radio, television and wireless communication, while minimizing harm to the environment and the landscape.

B. NOP 36A

(1) Part A of NOP 36, which deals with guidelines for the issue of building permits for small and miniature broadcasting installations, was approved by the Government on May 2, 2002.

The Company has obtained building permits for most of the small broadcasting installations in accordance with NOP 36A. From time to time, a need arises to add broadcasting installations which require that building permits be obtained in accordance with NOP 36A. At the date of publication of this Periodic Report, the Company is attending to the issue of building permits for 18 small broadcasting facilities and is involved in legal proceedings for another seven facilities.

(2) The NOP 36 drafting committee decided that the distinction between NOP 36A and NOP 36B will be based on the safety range for the public, irrespective of the size of the installation. Pursuant to this decision, under the draft amendment of NOP 36A of January 2008, the licensing process for microwave installations, which were previously classified as small broadcast installations and which have a safety range of more than 12 meters, will fall under NOP 36B, which prescribes more stringent conditions for the issue of building permits.

The draft amendment of NOP 36A of January 2008 also prescribes different licensing proceedings, depending on the location and safety range of the installation, where a duty is imposed for each proceeding to deposit deeds of indemnity for compensation under Section 197 of the Planning and Construction Law, in various indemnity amounts (depending on the proceeding).

(3) Given the provisions of the Planning and Construction Law, 5725-1965 and the provisions of the Communications Law, the Company believes that it has no duty to obtain building permits for miniature broadcasting installations, which are “wireless access facilities” under those laws.

With respect to wireless access installations, there are a number of initiatives to cancel the exemption from a building permit. If the Company is required to file an affidavit on exemption from a building permit as set out in section 2.15.1 and/or if the exemption from a building permit is revoked, this could have substantially adverse implications which the Company is unable to assess at this stage. On the implications for the subsidiary Pelephone, see Section 3.18 below.

C. NOP 36B

As noted in paragraph B. above, under the January 2008 draft, the licensing proceeding for broadcasting installations formerly classified as large, which have a safety range of less than 12 meters, will fall within NOP 36A, the current draft of which does not include transitional provisions enabling an abridged licensing proceeding.

The January 2008 draft proposes transitional provisions whereby (1) a building permit issued for a broadcasting installation according to a prior plan which does not comply with the provisions of NOP 36B, will be regarded as irregular use permitted for a period of 24 months from the date of the approval of the Plan; if within that period the operator of the installation submits to the institution that approved the erection of the installation, a permit from the Supervisor of Radiation noting compliance with the safety restrictions prescribed in NOP 36B, the permit will be seen as being in compliance with the provisions of NOP 36B. Otherwise the building permit will expire. (2) A permit may be granted for broadcasting installations erected prior to the approval of the NOP 36B at a broadcasting site that existed prior to January 31, 1984, even if they do not comply with the provisions of the NOP 36B, provided they meet the safety restrictions specified in NOP 36B.

It is noted that most of the Company’s broadcasting installations were set up many years ago (prior to January 31, 1984), some of them by State authorities.

The January 2008 draft also proposes including a provision requiring an applicant for a permit from the local committee to furnish a deed of indemnity in respect if should a ruling is given against the local committee for all of the installations contained in NOP 36B, including broadcast installations erected prior to January 31, 1984, which in earlier drafts of NOP 36B were exempt from the indemnification obligation. The Company has submitted its objection to the inclusion of this provision in NOP 36B.

D. General

On April 17, 2008, the Company submitted its reservations concerning the proposed text of National Outline Plan for Communications – NOP36/A Small Broadcasting Installations, and NOP36/B Large Broadcasting Installations. In brief, the reservations are that the plans as proposed, and in particular as they relate to changing the definitions of large and small broadcasting installations, create practical difficulties which could prevent the Company from granting the public some of the varied services it provides and is obligated by law to provide. The Company's reservations were partially allowed by the investigator appointed in accordance with the Planning and Construction Law to hear reservations concerning NOP 36A and NOP 36B, but were not reflected in the text presented in July 2009 for the approval of the National Council's Sub-Committee for Planning Issues. The Company is working to change the text of the proposed provisions of NOP 36A and 36B.

E. On radiation permits for communications and broadcasting installations, see section 2.15 above.

F. NOP 56 – Communication installations in the Administrated Territories

On July 29, 2008, the Company received notice that NOP 56, which regulates the set-up and licensing of communications installations in the Administrated Territories, took effect in June 2008. The plan includes transition directives for installations set up with a permit and for existing installations.

The plan includes a requirement for obtaining a communications license and approval from the Commissioner of State Property in the Civil Administration.

The Company has started a licensing proceeding for the installations and has deposited 42 files for licensing installations which comply with the terns of the transition period. It has also started attending to the licensing of the other installations in the Administered Territories.

2.17 Substantial Agreements

Following is a brief description of the substantial agreements that are not part of the Company's ordinary course of business, which were signed and/or were in force during the period of this Periodic Report:

2.17.1 Agreements relating to debentures

A. Deed of trust for debentures (series 4) dated May 24, 2004

A deed of trust signed with the Mizrachi Bank Trust Company Ltd. for a series of 1,200,000,000 debentures of NIS 1 par value each, repayable in four equal annual installments on June 1 of each of the years 2008 to 2011, a 4.8% annual interest, linked (principal and interest) to the CPI for April 2004. Of these, 800,000,000 Debentures were issued to the public under the Company's prospectus (the Prospectus) on May 24, 2004, and 400,000,000 were purchased by a wholly owned and controlled subsidiary of the Company, Bezeq Gold (Holdings) Ltd. (Bezeq Gold Holdings) immediately prior to the Prospectus and were listed for trading in accordance with the Prospectus.

B. Deed of trust for debentures (series 5) dated May 24, 2004

A deed of trust signed with the Mizrachi Bank Trust Company Ltd. for a series of 600,000,000 debentures of NIS 1 par value each, repayable in six equal annual installments on June 1 of each of the years 2011 to 2016, at 5.3% annual interest, linked (principal and interest) to the CPI for April 2004. The debentures were issued by the Company, prior to the Prospectus, to institutional investors and to Bezeq Gold Holdings and listed for trading in accordance with the Prospectus.

An addendum to the deed of trust for the debentures in this series relates to the issue of an additional 1,500,000,000 debentures by the Company to Bezeq Gold Holdings on the same terms and listed for trading on the stock exchange (subject to lock-up restrictions).

On March 30, 2005, a further addendum to this deed of trust was signed in respect of the issue of NIS 286,967,000 par value of debentures from the same series.

2.17.2 Real estate

A. Asset transfer agreement between the Company and the State dated January 31, 1984

An agreement between the State and the Company, under which the Company was granted the State's rights in assets which the Ministry of Communications used for providing telecommunication services, and the Company assumes the rights of the

State in those assets and the obligations and liabilities relating to those rights immediately prior to implementation of the Agreement. Moreover, under this Agreement, the State's rights, powers, obligations and duties according to the agreements, as well as the contracts and transactions that were in force for telecommunications services immediately prior to implementation of the Agreement, were transferred to the Company.

B. Settlement agreement of May 15, 2003 between the Company, the State and Israel Lands Administration regarding rights related to land

See Section 2.7.4C above.

C. Agreement between the Company and Israel Postal Authority dated June 30, 2004

An agreement between the Company and Israel Postal Authority to define and regulate the rights of the Company and the Postal Authority in their joint assets. The agreement listed the joint assets and defined the part each party has in them. It was determined that each of the parties shall have exclusive rights to its parts, except for the matter of rights in joint property, building rights or rights for which there is an explicit other determination. For a number of additional assets, the party with exclusive rights in them, in whole, will be one named party.

2.17.3 Agreements with DBS and its other shareholders

A. A founders agreement of December 4, 1998, between the Company, Eurocom Communications Ltd. (whose holdings were subsequently transferred to Eurocom DBS Ltd.), Lidan Business Enterprises Ltd. (whose holdings in DBS were subsequently transferred to Lidan Investment Agencies (1994) Ltd.), and Gilat Communications Ltd. (which transferred its holdings in DBS to Gilat DBS Ltd.), regulating the incorporation and management of DBS and the relationships among its shareholder

B. An agreement dated December 30, 1998 between DBS and its shareholders, regulating, inter alia, the establishment and powers of an executive committee.

C. An agreement from November 2001 between DBS and its shareholders, which amended the dilution formula prescribed in the founders agreement and determined that the holdings of the shareholders in DBS would be adjusted pro rata to their investments in DBS, so that for the dilution, the investments (which were made by way of shareholder loans) as of the date prescribed in the agreement, would bear CPI-linkage differentials and accrued linked interest on an annual basis at a rate of 5.5% per annum from the date of establishment of DBS.

D. An agreement dated December 30, 2002, as amended on August 6, 2003, between DBS and its shareholders, determines priority for shareholder loans given commencing July 10, 2002 over the loans made prior to that date. The agreement prescribed that these loans would bear CPI-linkage differentials and 5.5% annual accrued interest, while the loans extended commencing April 27, 2003 would bear CPI-linkage differentials and 11% annual accrued interest. In addition, the agreement determines a mechanism for the allotment of shares or options for shares to shareholders who invest in DBS so that their holdings in DBS will be adjusted to their adjusted investment in it. The agreement also determined information rights as determined for the shareholders who are interested parties in DBS.

On this matter also see section 5.18.4 below.

2.17.4 Labor agreements

A. A comprehensive pension agreement from September 21, 1989 between the Company, the Histadrut and the joint representation of the workers' committees (the Union), and Makefet Fund – Center for Pensions and Remuneration Cooperative Society Ltd.

The agreement provides a full and autonomous arrangement in everything relating to the pension insurance of Company employees. The agreement applies to all transferred employees (who were transferred from the Ministry of Communications to the Company), to all of the members of the cumulative pension fund who are employed by the Company on the date of execution of the pension agreement and to all of the permanent and temporary employees of the Company, with the exception of special employee groups (students, employees under personal contracts or employees working according to another, alternative arrangement).

B. Special collective bargaining agreement for early retirement, dated November 23, 1997 as amended and extended on September 4, 2000, March 18, 2004, April 17, 2005 and June 28, 2005, between the Company, the Histadrut and the Union

For information about this agreement and about early retirement, see Note 17 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

C. Agreement to affirm rights of September 4, 2000 between the Company, the Histadrut and the Union

A special collective agreement regarding, inter alia, to anchoring the rights of the transferred employees. This agreement affirms the rights of the transferred employees to any pension right to which they were entitled by virtue of their being former civil servants, under the Company's pension agreement, adopted by the Company as part of its pension agreement. Under this agreement, these rights become "personal rights" which cannot be cancelled except by a waiver of personal rights under law (in other words, by personal waiver by the employee himself or herself).

On this matter see also section 2.9.5 above.

D. Generation 2000 agreement of January 11, 2001 between the Company, the Histadrut and the Union

Following an amendment in July 2000 to the Employment of Workers by Human Resource Contractors (Amendment) Law, 5760-2000, a special collective bargaining agreement was signed on January 11, 2001 for hiring new employees and stipulating their terms of their salaries. The agreement applies to new employees and to employees who were previously employed at the Company through human resource companies, in positions listed in the appendix to the agreement (customer service representatives at call centers, administrative workers, typists, warehouse employees, secretaries, mail sorters and distributors etc., and similar administrative workers such as porters, drivers, forklift operators and others). Under the special collective agreement of December 5, 2006, it was agreed that the Generation 2000 agreement would not apply to such employees who were hired by the Company after July 1, 2006. It was also agreed to insert minor amendments into the terms of employment of workers hired under the Generation 2000 agreement.

E. Agreement of April 17, 2005 with and alternative to the Makefet Fund for the matter of early retirement arrangements of Company employees

On April 17, 2005 a special collective agreement was signed between the Company, the Union and the Histadrut, concerning an arrangement with an alternative to the Makefet Fund for all matters relating to early retirement arrangements for Company employees.

Subsequently, on June 28, 2005, an agreement was signed between Harel Insurance Company Ltd. (Harel) and the Company (the June 2005 Agreement), regulating pension payments in respect of early retirement and provisions for old-age and survivor pensions, derived from legislative amendments which were part of the Israeli Economy (Recovery Program) Law, for employees who retired from the Company from the end of 2003 / beginning of 2004 and/or who will retire from the Company in accordance with a special collective agreement for retirement of September 2000 as amended on March 18, 2004 and April 17, 2005. Following execution of the agreement with Harel, the special collective agreement referred to above between the Company, the Union and the Histadrut, was amended on the same date (June 28, 2005).

On February 14, 2008, Harel and the Company signed an amendment to the June 2005 agreement, the main points of which were: (1) The June 2005 agreement would also apply to Company employees who resign from their employment at the Company before December 31, 2013 in the early pension track, in accordance with an option granted to the Company in the special collective agreement of December 5, 2006, if and to the extent that the Company chooses to exercise that option. (2) Reduction of the consideration paid by the Company to Harel for every retiree insured under the

June 2005 agreement for which a policy has not been issued by Harel on the date of execution of the amendment to the June 2005 agreement.

On this matter, see Note 17 to the Company's financial statements for the year ended December 31, 2009, which are included in this Periodic Report.

F. Special collective agreement dated December 5, 2006

A special collective agreement was signed between the Company and the Union and the Histadrut, regulating labor relations at the Company following transfer of control of the Company from the State of Israel to Ap. Sb. Ar. Holdings Ltd., and prescribing a new organizational structure for the Company (see also Section 2.9.1 above).

Under the agreement, all the agreements, arrangements and customs existing in the Company prior to execution of the agreement, including the public sector salary linkage mechanism, will continue to apply only to permanent and longstanding employees of the Company only to whom the agreement applies, subject to changes inserted expressly into the agreement. The employment of existing and new temporary workers would be on the basis of monthly / hourly wage agreements based on a market wage model, by occupation, with a high level of managerial flexibility.

The agreement also provides that in 2006-2008, 975 permanent employees would retire from the Company under early pension or increased severance pay plans. In addition, the Company may, at its discretion, terminate the employment of a further 1,225 permanent employees (245 permanent employees in one or more of the years 2009-2013). The terms of retirement granted to the retirees must be identical, for the most part, to the terms customarily granted at the Company today.

The term of the agreement is from the date of execution through December 31, 2011. The Company has an option to extend the agreement for two more years, through December 31, 2013. The retirement chapter of the agreement shall, in any event, remain in force until December 31, 2013.

In May 2008, an amendment was signed to the new collective bargaining agreement concerning bringing forward completion of application of the organizational structure and concerning bringing forward the dates of retirement and a change in the mix of those who retire pursuant to the new collective bargaining agreement of 2008.

2.17.5 Management agreement

On July 29, 2007, an agreement was signed between the Company and a company owned and controlled by the shareholders of Ap. Sb. Ar., under which the Company was granted regular management and consultancy services, including by means of serving and future directors in the Company and/or in its subsidiaries, in consideration of USD 1.2 million per year. The term of the agreement was three years commencing October 11, 2005 (the date of closing the acquisition of 30% of the shares of the Company by Ap. Sb. Ar.), and on September 28, 2008, the general meeting of the shareholders of the Company approved extension of the agreement for an addition three years on the same terms as the original agreement.

2.18 Legal Proceedings

2.18.1 A number of claims are pending against the Company, dealing with recognition of various salary components as pension components, and recognition of various components in the determining salary for severance pay, as described below:

A. In September 2000, a claim was filed in the Jerusalem Regional Labor Court against the Company by 2,423 retired employees of the Company who were transferred from the Ministry of Communications to the Company when it commenced operations. The plaintiffs were seeking declaratory relief, such that it will be determined that the payments they received for grossing up of tax, clothing allowance and incentive pay are considered part of the regular salary and therefore should be considered as part of their determining wage for the purpose of calculating their pension and the payments made to them upon retirement, and should be included in the calculation of hourly pay value and the calculation of the percentage increments. The plaintiffs are also seeking declaratory relief which will determine that their last, determining, salary for pension should be calculated according to the last salary paid, and not according to the average staff grade which each of them held. The claim was subsequently amended so that all the reliefs relating to the pension rights of the plaintiffs were deleted from the statement of claim. In addition, the plaintiffs narrowed their claim to the incentive pay component and withdrew their claim for grossing up of tax and for the clothing allowance.

In January 2007, another claim was filed by 85 retirees who transferred to the Company from the Ministry of Communications, seeking declaratory relief determining that payment of the grossing up of tax, clothing allowance and incentive pay should be included in the determining salary in the matter of rights by virtue of the Hours of Work and Rest Law and the Annual Vacation Law. This claim was consolidated with the above claim.

On December 16, 2008, the court denied the claim and ruled that the premium paid to the plaintiffs is a true increment and dependent on a condition, and that the premium component should not be include also at the hour value for calculating overtime pay and redemption of annual holiday pay that is paid after the end of employer-employee relations. An appeal against the decision was filed on March 3, 2009.

B. In February 2002, a notice of a party to a collective dispute (the Party Notice) was filed in the Jerusalem Regional Labor Court by the Histadrut in the name of all Company employees. The applicant alleges that payments for grossing up of tax, the administrative on-call duty component and clothing allowances which were and are paid to Company employees, are regular pay which form part of the determining salary of each employee, including with respect to the calculation of payments upon retirement, redemption of holiday pay, grants, acclimatization payments, percentage increments and hourly pay value, and that various payments and provisions should be made in respect thereof, including for pension purposes. The Attorney General joined the claim. In April 2006, the court gave its decision, denying all parts of the Party Notice. An appeal was filed against the decision, in which it was alleged that the decision is procedurally void, and the hearing was returned, with the consent of the parties and the Attorney General, to the Regional Labor Court. Subsequently, the Party Notice was struck out in view of the fact that the plaintiffs' position on the need to file a new party notice was not filed in time. It was agreed that a new party notice would be filed, and that the question of the limitation date would be decided when the party notice was being heard. On February 10, 2010 such party notice was filed as aforesaid, referring only to the standby fee component. Under the party notice the Court is required to rule that the standby fee component be included in the hourly rate for the purpose of calculating the remuneration for overtime hours and for the purpose of calculating annual leave redemption.

C. Some additional individual claims are pending against the Company, filed by employees and former employees, concerning recognition of various salary components, and mainly their recognition as pension components, and recognition of various components in the determining salary for severance pay and for overtime.

2.18.2 In January 2004, a claim was filed in the Tel Aviv Regional Labor Court against the Company and against the Makefet Fund, by 320 employees who retired under a retirement agreement signed in November 1997. The plaintiffs allege that they chose the Pension Track B after having been promised an increment pursuant to the "Yellow Note" agreement, and that this promise was not kept. On December 11, 2008, the decision denied the claim. An appeal filed by the plaintiffs was denied on January 1, 2010. In addition, in March 2008, a similar claim was filed in the same court by another 17 Company retirees.

2.18.3 In September 2000, an action and an application for certification as a class action were filed against the Company in the Tel Aviv District Court. The amount of the claim is estimated at NIS 103 million. According to the plaintiff, the Company unlawfully collected "collection expenses" from its subscribers for bills which were not paid by their due date, since in fact the Company took no collection action until 14 days after the last date for payment as written in the telephone bill. The Court certified the claim as a class action. The Company filed an application for leave to appeal in the Supreme Court, which returned the case to the District Court for reconsideration of the application for certification in the accordance with the Class Action Law. Subsequently, the Court allowed an agreed notice of the parties whereby the definition of the group represented in the application would be changed and would apply to whoever was charged collection fees collected by the

Company from March 11, 1999 to December 7, 2006, and the Court would not be obligated in any way to the decision on the matter of certification of the claim as a class action in the past.

2.18.4 There are four pending claims which were filed between 2003 and 2005 by various plaintiffs against the Company, the Broadcasting Authority and the State, for compensation in respect of .physical injury and property damage allegedly caused by banned radiation from the Hillel broadcasting station. Three of the claims are for physical injury and are being heard in the Central District Court (the amounts of the claims are 1) "more than NIS 15 million", 2) does not assess an amount, and 3) NIS 46 million). The plaintiffs in these three claims filed an application to consolidate their hearing. The court ordered a stay of proceedings, and their renewal, if necessary, only after the plaintiffs comply with the decision of the court in the matter of filing documents and affidavits. The fourth claim is being heard in the Tel Aviv District Court and is for alleged property and financial damages. The original claim was for approximately NIS 141 million, but following non-payment of a fee by some of the plaintiffs and denial of their application for exemption from the fees, some of the plaintiffs were struck from the claim, so that its amount is now approximately NIS 5.3 million.

It is noted that on December 31, 2003, the Company ceased all broadcasts from the Hillel station, at the demand of the State and the Broadcasting Authority. Since that date, the site no longer serves as a broadcasting site.

2.18.5 In January 2002 a claim for payment of monetary compensation of NIS 53 million and for writs of mandamus were filed in the Tel Aviv District Court (in 2007, the case was transferred to the new Central District Court), by an international communications operator against the Company and Bezeq International. The claim is for damages allegedly sustained by that operator due to acts of commission and omission in connection with customer allocation to the international call operators. Alternatively, the operator is suing for restitution of the access fees that it paid to the Company. The plaintiff filed an application to amend the statement of claim. If the application to amend is allowed in full, the amount of the claim (for fee purposes) will be revised to approximately NIS 77 million. The parties were referred to a mediation proceeding. See also Section 4.19.2 below.

2.18.6 On December 25, 2005, a claim was filed against the Company in the Tel Aviv District Court, together with an application for certification as a class action, alleging that the Company unlawfully collects payment for browsing high-speed internet even though is technically unable to provide the service in certain areas at the promised speed. The plaintiffs estimate the amount of the class action at NIS 100 million for all subscribers. On March 6, 2008, the application for certification was partially allowed for a group of subscribers defined in the court's decision. On April 7, 2008, the Company filed an application for leave to appeal the decision of the District Court.

2.18.7 In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification as a class, alleging deception in advertising in the matter of a charge for calls from a Bezeq line to a cellular line. According to the plaintiff, the Company deceived the public in its advertisements for the tariff of the calls, and did not disclose that the charge for interconnect was made according to segments of 12 seconds. The plaintiff estimates the amount of the claim at NIS 68.5 million.

2.18.8 In November 2006, a claim and application for certification as a class action were filed in the Tel Aviv District Court, in the amount of approximately NIS 79 million, alleging that the Company charged customers who connected to its ADSL service a monthly fee rather than a two-monthly fee, due to which they incurred losses and expenses.

2.18.9 In November 2006, a claim and application for certification as a class action were filed against the Company in the Tel Aviv District Court, for the sum of NIS 189 million, alleging unlawful collection of money in cases of disconnection due to non-payment.

2.18.10 In November 2006, a claim and application for certification as a class action were filed in the Tel Aviv District Court against the Company, Pelephone, HOT, Cellcom and Partner, amounting to NIS 158 million. The plaintiffs allege that when completing a call made from a cellular line to a fixed line, if the call is disconnected by the fixed line call recipient (and not by the cellular line call initiator), the Company and HOT delay sending the disconnection signal for about 60 seconds. As a result, they incur a loss which is reflected in air-time costs and interconnect fees. In a procedural arrangement reached between the parties, it was determined that the claim would be heard against the Company and HOT, while the claim against Pelephone, Partner and Cellcom would be heard as part of a similar claim filed against them in August 2006 for NIS 100 million. See also Section 3.21.5 below.

2.18.11 In May 2007, a claim and application for its certification as a class action were filed in the Tel Aviv District Court by a plaintiff who alleged that he had purchased shares of the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors who were or are serving in the Company in the period relevant to the claim, and against Ap.Sb.Ar. Holdings Ltd., which holds about 30% of the Company's shares. The claim alleges that the financial statements of the Company for 2004 and 2005 included immaterial information that was false and misleading, about the Company's annual profits, property, plant and equipment and equity, in view of the retroactive reduction of NIS 320 million of property, plant and equipment which was not being used by the subsidiary Pelephone. The total amount of the claim is NIS 56.5 million.

2.18.12 In September 2007, a claim was filed against the Company in the Tel Aviv District Court, with an application for certification as a class action, concerning the collection of VAT on arrearage interest and on collection expenses and the debiting of collection expenses and commissions. The amount of the class action is estimated at NIS 114 million.

2.18.13 On April 6, 2008, a shareholder in the Company filed an application, pursuant to Section 198 of the Companies Law (after its approach to the Board of Directors of the Company was rejected) for leave to file a derivative action against the Company and a statement of claim against directors of the Company whom the plaintiff alleges approved a transfer of funds from the Company to DBS, in contravention of the decisions of Ministers of Communications, which led to the Company incurring losses of NIS 10 million (the amount rendered forfeit by the Ministry of Communications from the Company's guarantee). On October 15, 2009 the court denied the application, and on November 26, 2009 an appeal against that decision was filed in the Supreme Court.

2.18.14 On October 26, 2008, one of the shareholders of DBS filed a claim for arbitration against the Company and another DBS shareholder, alleging losses she ostensibly incurred as a result of the conduct of the Company and the other DBS shareholder in everything relating to the management of DBS and the use of DBS for promoting purposes alien to the shareholders agreement. The plaintiff is petitioning for cancellation of the agreement, restitution and compensation. The amount of the claim is NIS 160 million.

2.18.15 In December 2009, an application was filed in the Tel Aviv District Court for instruction to be given by the liquidator of the Adanet Business Ltd. (Adanet). In which the court is requested to order the Company and three directors who it appointed to the Adanet board,, jointly and severally, to pay the liquidator all the alleged debts of Adanet, amounting to approximately NIS 54 million, plus linkage statutory differentials and interest commencing November 11, 2003. According to the liquidator, the Company acted knowingly, directly and trough the directors it appointed, to ensure the collapse of Adanet and its subsidiaries in order to rid itself of its obligations to Adanet.

2.18.16 In November 2009, a claim was filed against the Company in the Central District Court together with an application for its certification as a class action, in the amount of NIS 160 million, alleging that the collection of payment for call completion service for those who call 144 information, without giving notice that the call involves payment, is unlawful.

2.18.17 In 2003, the Company filed a claim in the Tel Aviv Regional Labor Tribunal against the Makefet Fund, for compensation in respect of breach of agreements between the Company and Makefet in the matter of calculation of the cost of early retirement of employees who were transferred to the Company from the Ministry of Communications. The total amount of the Company's claim is approximately NIS 280 million. On this matter, see also Note 17 to the financial statements of the Company for the year ended December 31, 2009, which are included in this Periodic Report.

2.18.18 Completed proceeding – A claim and application for its certification as a class action from may 2006, which was filed in the Tel Aviv District Court against HOT and the Company, concerning a malfunction in the telephone line of HOT's network, in the amount of NIS 102 million. On August 6, 2009, the court gave its decision allowing a settlement agreement between the parties, in which HOT would grant the members of the represented group entitled to a benefit the right to receipt of a voice mail box for one year free of charge, or alternatively, the right to receipt of an additional line for one year free of charge, whichever the beneficiary chooses, and the Company would pay the class plaintiff and its legal representative the sum of NIS 170,000 (the plaintiff filed an appeal of the amount adjudged to him).

2.18.19 Completed proceeding - On December 24, 2007, the Company received a ruling from the Antitrust Commissioner, as authorized under Section 43(a)(5) of the Law, stating that the Company abused its status in the market, contrary to the provisions of Section 29A of the Law, in that it did not respond as required and promptly to steps taken during a labor dispute by its employees, in connection with the activities of other communications operators, and in that it was not prepared, according to the ruling, to apply immediately to the Labor Court in the matter of the disconnection between its network and the HOT network. The Company filed an appeal against the Commissioner's ruling, and on December 16, 2009 the Antitrust Tribunal denied the appeal.

2.19 Business Objectives and Strategy

2.19.1 Forward-looking information

It is only natural for a review of Company strategy to involve expectations regarding future developments with respect to customer behavior and needs, the pace at which new services are adopted, technological advances, regulatory policy, the marketing strategy of competitors, and the effectiveness of the Company's marketing strategy.

The Company's strategy and the business objectives derived from it are based on internal research, secondary information sources, and primarily on reports issued by research groups, publications about activities by similar communications providers in Israel and around the world, and the work of consultants who have assisted the Company.

However, there is no certainty that the strategy and main activities described below will actually be realized or will be realized in the manner described below. The circumstances that could lead to non-implementation of the strategy or even its failure, relate to frequent technological changes, regulatory constraints, the design of a sustainable business model for new services the Company plans to provide, and the implementation of a superior marketing strategy by competitors. Furthermore, a change in the ownership of the Company could also lead to changes in its strategy and business objectives.

2.19.2 Summary of strategy and future plans

The Company is working to implement a strategy of turning itself from a company that provides infrastructure only, to a company that provides a variety of products and services that are tailored to customers' needs.

Vision and objectives

The Company has set a goal of consolidating its position as the leading telecommunications company in Israel, while providing end-to-end solutions to business customers and creating a user experience for private customers, and providing quality service and business excellence.

In order to achieve this goal, the Company faces a number of challenges:

A. Maintaining its leading position in an ever-more competitive environment (leadership in service and strengthening values – product innovation, reliability, closeness to customer);

B. Reducing the decline in revenues from core services;

C. Generating new sources of revenue;

D. Adapting the organization to a competitive environment and operational excellence.

In order to implement this strategy and achieve these goals, the Company uses and will continue to use the following:

Business customers

A. Diversification of its products and services;

B. Provision of a comprehensive solution based on the needs of the customer, while applying a policy of commitment to service quality and availability;

C. Encouraging customer migration from basic services to managed solutions for organizational and inter-organizational connectivity;

D. Diversification of value-added services.

Private customers

A. Ongoing penetration of broadband and improving infrastructures to increase bandwidth;

B. Providing differential pricing tracks;

C. Strengthening the positioning of the Company's telephony services, while focusing on advanced applications and the penetration of advanced terminal equipment.

Network

To achieve its strategic goals, the Company is using its best endeavors to improve its existing network and adapt it to comply with its commercial goals, inter alia by deploying optical fibers and making investments in the network core. See also sections 2.6.5 and 2.7.2 above for a description of the NGN.

2.19.3 Development trends in Company activities

A. The Company is working to increase data transmission speeds in the services it provides for its customers. The Company takes marketing initiatives which are designed to transfer its customers to its high-speed internet service. Furthermore, the Company offers its business customers high-speed transmission and data communications services in a variety of protocols.

B. The Company is working towards integrating itself into IP (Internet Protocol) applications. To achieve this, it has set up an IP network as a platform for the services it currently provides and for additional services it plans to offer in the future.

C. The Company has launched fixed-line and wireless home network services that enable multiple computers to connect simultaneously to the internet.

D. The Company has launched a variety of billing tracks for telephony services alongside its basic tariff structure, to increase the use of its services.

2.19.4 Main projects in the planning or execution stage

The main projects being executed by the Company today include deployment of the NGN based on the outline approved by the board of directors, as well as expanding capacity in the Company's networks with the aim of providing its business customers with high speed data transmission and communication services. Additionally, the Company is developing and assimilating advanced computing systems, including CRM and network engineering management, service order and supply management.

2.20 Risk Factors

2.20.1 Intensifying competition

Competition in domestic fixed-line communications is intensifying (see Section 2.6 above). Furthermore, the Company views the cellular telephony market as a market which, to a large extent, is an alternative to the fixed-line domestic telephony market.

The companies that are currently in competition with the Company or that are likely to compete with it in the future enjoy much greater business flexibility than that of the Company, including an ability to cooperate with subsidiaries and associates and to market joint service bundles with them. HOT's ability to market service bundles (triple play) with tariff flexibility, compared with the Company's inability to do so, harms the Company's ability to compete.

2.20.2 Government supervision and regulation

The Company is subject to government supervision and regulation relating, among other things, to licensing for activity, determining permitted areas of activity, determining tariffs, operation, competition, payment of royalties, obligation to provide universal service, ability to hold its shares, relationships between the Company and its subsidiaries and prohibition to terminate or restrict its services (which may force the Company to provide services even when not economically feasible or when it goes against its interests). This supervision and regulation at times lead to State intervention, which the Company believes adversely affects is business operations.

2.20.3 Tariff control

The Company's tariffs for services are subject to government control. Some of these tariffs are stipulated in regulations, and regulations also stipulate a formula for updating them. The practical significance of this mechanism is real erosion in the Company's tariffs. On the uncertainty regarding continuation of the update arrangement of the Company's controlled tariffs, see section 2.6 above.

2.20.4 Difficulties in labor relations and human resources

As part of its preparations for the intensifying competition in the sector and for greater efficiency of operation, the Company must continue to formulate additional plans for organizational changes and make a further reduction in its headcount. The implementation of these plans has involved and is expected to involve coordination with the employees and substantial costs, including the costs of early retirement, over and above the costs arising from existing agreements. The implementation processes of these plans could cause labor unrest in the future, as it has in the past, and hurt the Company's regular business.

2.20.5 Restrictions on relations between the Company and companies in the Bezeq Group

The Company's general license obligates it to ensure that its relationship with its principal subsidiaries in the Bezeq Group does not result in preferring them over their competitors. Separation is required between the managements of the Company and those companies, as is separation between the financial and marketing systems, assets and employees, which causes high administration overheads. The Company is also not allowed, at this stage, to offer joint service bundles with those companies.

In view of the entry of communication companies into direct competition with the Company in most of its areas of operation based on the provision of a bundle of services to the customer, whether directly or through cooperative ventures, the risk that this factor will affect the Company's operations is increasing. Nonetheless, on the matter of a permit to provide non-divisible bundles of services, see section 2.6 above.

2.20.6 Legal proceedings

The Company is a party to legal proceedings, including class actions, which could result in it being ordered to pay significant sums, most of which cannot be estimated. Therefore, provisions have not been made in the Company's financial statements and in those of companies in the Group.

Class-action claims can reach large amounts, as virtually all residents of the country are consumers of the Company's services, and a claim that relates to a minor loss for a single consumer can become a material claim for the Company if it is certified as a class action applicable to all consumers or a significant portion of them. In addition, since the Company provides communications infrastructures as well as billing services to other licensees, parties suing those licensees in other class actions are also likely to try to involve the Company as a party to such proceedings.

For a description of the legal proceedings, see section 2.18 above.

2.20.7 Exposure to changes in exchange rates and inflation

The Company measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities, based on the type of linkage. The Company's exposure to changes in currency exchange rates against the shekel is low. The Company's exposure to inflation changes is high, and therefore the Company takes steps to cover part of the inflation exposure. In addition, the Company has exposure to changes in the interest rates in relation to its borrowings.

2.20.8 Electromagnetic radiation and licensing of broadcast installations

The subject of the electromagnetic radiation emitted from broadcast facilities is regulated mainly in the Non-Ionizing Radiation Law, 5766-2006 (see sections 2.15 and 2.16 above).

The Company is working to obtain permits to set up and operate its various broadcasting installations; however, the difficulties it faces in this area, including difficulties related to the change in policy maintained by the various relevant entities and amendments to statutes and standards, could impact adversely on the infrastructure of the such installations and on the regularity of provision of services using them, and as a result, on the Company's revenues from these services.. The Company's third-party liability policy does not currently cover electromagnetic radiation.

2.20.9 Frequent technological changes

Communications is a field characterized by frequent technological changes and a shortening of the economic life of new technologies. These trends mean a lowering of entry barriers for new competitors, an increase in depreciation rates, and in certain cases, redundancy of technology and networks owned by the Company, the cost of investment in which is still recorded on its balance sheets.

2.20.10 Dependence on macro-factors and levels of business activity in the economy

Market and financial stability and the strength of businesses in the economy in Israel and worldwide have recently been subject to great volatility. During 2009, and in particular commencing from the second half of the year, there have been signs of greater business activity and stabilization, and even a measure of decline in the unemployment rate. The Company estimates that if the local market slides once again – following external or internal events – into a slow-down and a worsening of business activity, then its business results will be harmed, inter alia, as consequence of poorer revenues and the difficulty in selling its real estate assets.

2.20.11 Transition to the new network (NGN)

The Company is deploying its NGN, which to a large extent will replace its traditional networks. In a natural course of events, set-up of a new network based on advanced technology involves operational and business risks, such as damaging the continuity and quality of the services provided for the Company's customers. The Company works hard to minimize the risks, inter alia by means of a comprehensive back-up policy and the use of a number of suppliers in setting up the network.

The above information contains forward-looking information based on the Company's assessments. Actual results might differ significantly from these assessments if a change occurs in any of the factors taken into account in these assessments.

<u>Summary of risk factors</u>

	Extent of effect of the risk factor on Company operations		
	Major	**Moderate**	**Minor**
Macro risks			
Exposure to changes in exchange rates, inflation and interest			X
Sector risks			
Intensifying competition	X		
Government control and regulation	X		
Tariff control	X		
Electromagnetic radiation / licensing of broadcast installations		X	
Frequent technological changes		X	
Company-specific risks			
Exposure in legal proceedings		X	
Difficulties in labor relations		X	
Restrictions on relations between the Company and companies in the Bezeq Group	X		
Dependence on macro factors and levels of business activity in the economy		X	
Transition to the new network (NGN)			X

3. Mobile Radio Telephone – Pelephone Communications Ltd.

3.1 General Information on Area of Operations

3.1.1 Pelephone's field of activity

Four companies operate in Israel's cellular communications market under general license to provide MRT services. Activity in the mobile radiotelephone sector (MRT or Cellular Communications) began with the incorporation of Pelephone in 1985. Pelephone deals in the provision of cellular communications services, and sale and repair of terminal equipment. Pelephone's revenues include, inter alia, the charging for MRT communications customers (payments for call minutes, regular subscriptions, added value services and roaming services), payment for the sale of terminal equipment and in respect of terminal equipment services and revenues from other communications providers for interconnect (see sub-paragraph 3.2 below).

Pelephone is wholly owned by Bezeq.

3.1.2 Legislative and secondary legislation restrictions applicable to Pelephone

3.1.2.1 General license

Pelephone operates in accordance with an operating license from the Ministry of Communications - General License for the Provision of Mobile Radio Telephone Services, which is valid until 2022 (hereafter: the License). The license prescribes conditions and rules that apply to Pelephone's operations, and the competent authorities may amend the licensing conditions subject to the law.

3.1.2.2 Tariff control

The tariffs that Pelephone is permitted to collect from its subscribers are regulated by its license with the exception of tariffs for interconnection between operators for the completion of calls and SMS messages, which are regulated under regulations. In December 2004, the Telecommunications (Telecommunications and Broadcasts) (Payments for Interconnect) Regulations, 5760-2000, were amended in such a way as to gradually reduce tariffs for interconnect to the MRT network regarding call completion, transmission of SMS messages, and to modify the method of calculating the duration of chargeable time beginning in 2009 (see sub-paragraph 3.18.2 below).

3.1.2.3 Royalties

Under its license and under the Telecommunications (Royalties) Regulations 5761-2001, Pelephone pays the State of Israel royalties out of its revenues which bear royalties due to the provision of telecommunications services (see section 3.18.4 below).

3.1.2.4 Environmental matters

The laying and operating of a wireless infrastructure including cellular communications is subject to the provisions of the Non-Ionized Radiation Law and the permits from the Ministry of the Environment that are required in it (see section 3.17 below).

3.1.3 Changes in the volume of activity and profitability in the field

The following are financial and quantitative data regarding Pelephone's scope of operations and profits for 2008-2009:

	2009	2008	2007
Revenue from services	4,256	4,020	3,972
Revenues from sale of end equipment	1,120	693	712
Total revenues (NIS millions)	5,376	4,713	4,684
Operating profit (EBIT) (NIS millions)	1,190	933	804
Operating profit before depreciation and amortization (EBITDA) (NIS mill.)	1,794	1,456	1,283
Number of subscribers at end of period[16] (in thousands)	2,766	2,649	2,622
Average minutes of use (MOU)[17] per subscriber per month	333	352	354
Average monthly revenue per subscriber (NIS) (ARPU)[18]	132	126	131

According to Pelephone's license and the Telecommunications (Payments for Interconnect) Regulations, 5760-2000, as of January 1, 2009, the charge for air time and completing a call was calculated according to segments of one second unlike the charging system in force until then, which enabled charging per segments of 12 seconds or more.

3.1.4 Market development and changes in customer attributes

In recent years, the cellular market has been characterized by lower growth rates than in the past due to saturation of penetration rates. The competition's focus on increasing growth rates encourages the companies in the field to increase the range of services and products offered to customers, to increase their segmentation and make special offers to various target groups, providing specific responses to their needs.

3.1.5 Technological changes affecting the Company's field of activity

3.1.5.1 There are two main technological tracks in Israel's cellular industry:

A. The CDMA track, which developed in the 2.5 generation to 1X and in the third generation to EVDO (CDMA Technology) (see section 3.1.5.2 below).

B. The GSM track, which developed in the 2.5 generation to GPRS and in the third generation to UMTS, and in the 3.5 generation to HSPA – the networks of Pelephone's principal competitors in Israel use this technology.

Pelephone's network used the CDMA track until the end of 2008. During 2008, Pelephone established an additional cellular network using the HSPA/UMTS technology which began operating commercially during January 2009 (for details see section 3.9.1 below).

3.1.5.2 Pelephone launched 3G services in 2004 by means of CDMA 2000 EVDO technology which connects up to CDMA 2000 1XRTT technology that is deployed throughout the country. The EVDO network was deployed in urban areas during 2004-2006 (for details see section 3.9 below).

16 Subscriber data relate to active subscribers having received or made at least one call in the past six months or having paid the company for services. On December 31, 2008, the company adopted a strict subscriber counting policy according to which customers, who receive SMS messages only are not counted as subscribers. This change resulted in a one-time deletion of approximately 92 thousand subscribers.

17 MOU (Minutes of Use) – average monthly minute use per subscriber. This index is calculated in accordance with an annual average of the sum total of outgoing and incoming minutes each month, divided by the average number of subscribers during that month. From January 1, 2009, the charge for calls is according to segments of one second each. The comparative figures are influenced by a change in the method of charging and a decline in the number of subscribers due to the wiping out of subscribers as noted in footnote no. 15 above.

18 ARPU (Average Revenue Per User). This index is calculated by averaging the division of total revenue from cellular services and repairs each month by the average number of active subscribers in that month. The comparative figures are influenced by a change in the method of charging and a decline in the number of subscribers due to the wiping out of subscribers as noted in footnote no. 15 above

3.1.5.3 During the course of 2008, Pelephone established a network using HSPA/UMTS technology. The new network began operating during January 2009 (see section 3.9.1 below). The establishment of the new network enables Pelephone to provide services requiring quicker transmission of information, which permits, inter alia, expansion of the variety of terminal equipment and roaming services. The principal investment in this network was made during 2008.

3.1.5.4 Pelephone uses frequencies in the 850 MHz range in order to operate the CDMA network, and in the 850 MHz and 2100 MHz range to operate the HSPA/UMTS network.

3.1.6 Critical success factors in area of operations and changes therein

In the estimation of Pelephone, the following constitute the principal factors of success in its field of activity:

A. National deployment of a high-quality, advanced MRT network, ongoing maintenance of the network at a high level and significant investments, on an ongoing basis, in cellular infrastructure, for the purpose of improving high-quality coverage around the country, which is a basic condition for the provision of Pelephone's services, and in order to provide customers with the most advanced services, via the most advanced technological infrastructure.

B. Expansion of the variety of terminal equipment.

C. Provision of high-quality call services and advanced/diverse added value services.

D. National deployment of service and sale centers which enable high quality customer support and service which allows the Company to successfully deal with a competitive market.

E. Professional, high-quality, human resources.

F. Marketing strategy for establishing and reinforcing the brand name.

3.1.7 Main entry and exit barriers

3.1.7.1 The principal barriers to enter the area of operations are:

A. The need for a MRT license, the allocation of frequencies, and operations being subject to the regulatory supervision that applies to the market (see section 3.18 below).

B. The need for significant financial resources for making serious investments in infrastructures, which are affected by frequent technological changes, and the importance of providing a response to the needs of the market.

C. The difficulty involved in setting up radio sites due to regulatory restrictions and public objections.

It is important to note that the main entry barriers do not apply to a potential virtual carrier (see section 3.7.2 below).

3.1.7.2 The principal barriers to exit from the area of operations are:

A. Long-term agreements with infrastructure suppliers and property owners with whom Pelephone has entered into lease agreements.

B. Large investments which require long periods to recoup the investment.

C. The obligation to provide services to customers stems from the conditions of the license and agreements, in accordance with conditions prescribed in the operating license.

3.1.8 Substitutes for Pelephone products

The following products and services may constitute a substitute for some of the services provided by Pelephone:

A. Domestic fixed-line telephone and internet services provided by the domestic operators under the licenses granted to them.

B. Telephony services based on VOIP/VOB technology.

C. The supply of wireless internet in public places (hotspot) using WIFI technology.

3.1.9 Competitive environment and changes therein

Until the end of 1994, Pelephone was Israel's sole cellular company (until the end of 1993 – by virtue of Bezeq's license and on its behalf[19]). In May 1994, Cellcom Israel Ltd. posted the successful bid in an invitation to tender for a second operator for MRT service (the Second Operator or Cellcom**).** In February 1998**,** a third operator was selected by invitation to tender – namely Partner Communications Ltd. (the Third Operator or Partner). As of February 2001, MIRS Communications Ltd., (MIRS**)** has been operating as an additional cellular operator. After the entry of the second operator, and later, the third operator, into the cellular market, fierce competition developed among the carriers (primarily between the three main carriers). This competition resulted in market saturation expressed in the diminution of the number of subscribers joining the Company, an increase in the transfer of customers between the cellular companies and an erosion of the prices collected by Pelephone from its customers for services rendered by it. Recently, Cellcom and Partner have entered the ISP (Internet Service Provider), domestic operator, and VOB (Voice Over Broadband) fields, and market bundle packages which include a variety of services which they provide (see section 3.7 below). In addition, the Ministry of Communications recently granted trial licenses for VOC (voice over cellular) service users, which enables voice calls on the HSPA/UMTS network's data channel.

In September 2009, Netvision reported that within the context of the various deployments it is undertaking due to the changes that apply and may become applicable in the telecommunications markets, it is in advanced, preliminary stages of reviewing the possibility of a business integration with Cellcom. According to the report, current regulations do not permit such an integration, and a move of this kind would only be possible if the relevant legislation is amended, and it would be contingent on obtaining various approvals, insofar as they are required by law.

3.2 Products and Services

3.2.1 Services

Pelephone provides its subscribers with comprehensive services of voice transmission, transmission of text messages, data communications and advanced multimedia services as follows:

Basic telephone services (VOICE) – Pelephone's service package includes basic voice services, call completion services and also auxiliary services such as – call waiting, follow-me, voice mailbox, voice conference call and caller ID.

Third generation and advanced services (Added Value Services) – Pelephone offers to its customers value added services such as text message services and information services using SMS, multimedia MMS messages, voice information services using special-purpose asterisks, information and entertainment services via the Internet portal and advanced content services such as games, network games and video games. Among other things, subscribers may choose animation items, different ring-tones and music files from Pelephone's internet portal, and may download them to their handsets. Also, subscribers may receive services connected to their electronic diaries (Outlook services) enabling subscribers, among other things, to use their handsets to peruse and update their electronic diaries, and view their address list. Subscribers can also receive SMS notice of scheduled events in their electronic diaries.

The value added services offered by Pelephone are location-based navigating and other services. These services also enable, while driving, early warning of an approaching police speed trap, guidance as to the fastest route from point to point, and information regarding the nearest points at which certain services needed by the subscriber may be obtained. The service also enables employers to obtain information as to the location of employees who have cellular handsets.

Pelephone offers its customers added value services using third generation technology, including, inter alia, viewing its various television channels such as: music, sports, news

[19] Bezeq's license was in fact amended in April 1994, when it was prohibited from supplying a cellular service. A general license was in fact granted to Pelephone in February 1996, which had retroactive application back to 1994.

and a variety of entertainment channels, the ability to film and transfer video files, GPS cellular services, AGPS based Navigator services, and a high-speed Netstick cellular modem.

At the publication date of this Periodic Report, some 1.5 million subscribers have handsets which enable use of third generation services, of which 800,000 subscribe to the UMTS network.

Roaming services – Pelephone provides roaming services (communications via MRT from various locations worldwide), in accordance with agreements that it has with cellular providers around the world where this technology is used. In order to facilitate similar services in Europe and in other countries where the network is not based on CDMA technology (mainly GSM technology), Pelephone leases handsets to its customers that are adapted to the technology in use in those countries, in accordance with agreements between Pelephone and cellular operators in those countries. Pelephone has agreements which enable its customers to receive services in 207 countries worldwide.

The establishment of a HSPA/UMTS network (see section 3.1.5.3. above) enables increasing the variety of handsets and reducing the marketing gap in the area of roaming services.

With the launching of the HSPA/UMTS network, Pelephone enables its customers with HSPA/UMTS technology handsets to travel around the world with the personal handset and even provides these customers extensive roaming coverage in 207 countries, thanks to agreements with Vodafone, Holland.

Maintenance and repair services – Pelephone offers its customers ongoing repair service, against a monthly payment that provides warranty for the cellular telephone or for a one-time payment at the time of the repair.

3.2.2 Products

Terminal handsets – Pelephone offers its customers various kinds of mobile telephone handsets, vehicle handsets, hands-free sets and assorted accessories which support the variety of services that it provides. When Pelephone launched the HSPA/UMTA network, it expanded the array of terminal equipment offered to its customers and added Nokia, Sony Ericsson and Apple to the collection of handsets it sells.

Pelephone provides its customers with modems and laptops, which allow surfing the web through the Pelephone network.

3.3 Revenue and Profitability of Products and Services

The following are data on Pelephone profitability (in NIS millions):

	2009	2008	2007
Total revenue	5,376	4,713	4,684
Gross profit margin	33%	32%	29%

In 2007, 2008 and 2009, revenues from added value services amounted to 13%, 16% and 20% respectively of revenues from cellular communications (payments for call minutes, fixed subscription fees, added value services and roaming services).

3.4 New Products

In 2009 Pelephone continued to improve and expand its range of added value services and to increase the number of subscribers who use these services, including internet packages using a cellular modem (Netstick), the MUSIX service which offers the listener a broad range of more than 250 thousand songs on the handset and PC, as well as the Super TV service which offers viewing on TV and music channels on the cellular handset.

3.5 Customers

As at the end of 2009, Pelephone had 2.766 million subscribers. Approximately 64% of Pelephone's subscribers are private customers and 36% of Pelephone's subscribers are business customers.

3.6 Marketing, Distribution and Service

Pelephone's distribution system is based on 39 service and sales centers including laboratories spread around the country, which deal in service and sales to customers, treatment of malfunctions or provision of a substitute handset while sending the malfunctioning handset for repair, installation of handsets and customer retention. The distribution system is strengthened with stores and stands spread over 115 points of sale (some of which are operated by Pelephone employees, and others of which are operated by authorized sellers). In addition, there are various sellers that operate a door to door system, and service and sales representatives for the business sector.

Pelephone's subscriber service system includes 13 designated telephone call centers which provide information, service on various matters and in three languages, technical support, data regarding customer billing, added value services, sales and general information.

3.7 Competition

3.7.1 <u>General</u>

Pelephone faces fierce competition from the other cellular operators: Partner, Cellcom and MIRS. This competition brought about an increase in the size of the market, the addition of new subscribers and an erosion of prices. This competition even strengthened as a result of the entry of number portability into force and will even deteriorate upon implementation of the Ministry of Communications' policy concerning MVNO/VOC (see section 3.7.2 below).

At the end of 2009, Pelephone has approximately 2.8 million subscribers, Partner reported approximately 3 million subscribers Cellcom reported approximately 3.3 million subscribers. In addition, Pelephone estimates that Mirs has approximately 0.5 million subscribers.

3.7.2 The following measures were advanced by the Ministry of Communications, aimed at enhancing competition in the sector, in part following a decision made by the government and the recommendations of the Gronau Committee:

3.7.2.1 At the end of March 2008, the Ministry of Communications published a public hearing document concerning policy for regulating commercial telephony services using the Bezeq public network. Commercial telephony services include information, voice and visual services, entertainment, dating services and the like, and subscribers receive them by means of terminal equipment which is connected to the network. It is important to note that commercial telephony services form a source of income in the world of content for Pelephone as well as for other cellular operators. As part of the proposed regulations, the regulator wishes to adjust activity in the commercial telephony services sector in a way that may harm Pelephone's revenues in this sector. The Ministry has yet to set a final policy on this subject.

3.7.2.2 During the budget deliberations for 2009, the Government passed a decision to review the roaming cellular tariffs by an inter-ministerial Government team. In addition, the Ministry of Communications, in cooperation with other relevant Government ministries, will act to apply the European regulation in the roaming tariff field by February 28, 2009. In November, the Ministry of Communications approached the cellular operators and requested extensive and detailed data concerning roaming tariffs. At the time of publishing this report, present, as far as Pelephone is aware, no decisions have been made in this matter.

3.7.2.3 An inter-ministerial team, in cooperation with the Ministry of Communications and the Ministry of Finance, was established which chose an international consulting company (NERA) to review the matter. The subjects to be reviewed are the interconnection tariffs and the conditions for new competitors wishing to enter the cellular market.

During September 2009, a work process began between representatives of Pelephone and those of the Ministry of Communications and NERA. According to the Ministry of Communications work plan, the team is expected to submit its recommendations at the beginning of 2010.

3.7.2.4 During the course of 2009 the Ministry of Communications set up a tender committee to formulate a frequencies tender which is supposed to include various benefits the purpose of which is to remove barriers and significantly ease the entry of a new operator which has infrastructure to the market. In October 2009, the Ministry of Communications published the main points of the planned tender to be compiled by the Tender Committee, specifying that changes may be made in the final tender documents to be published later on. Following are the main points of the tender which were published.

1. 2 frequency bands for two operators will be offered for tender.
2. Only Mirs and new operators who have no relationship with the existing cellular operators and who meet the threshold conditions will be allowed to participate.
3. The minimum price for acquiring a frequency band is NIS 180 million per operator.
4. A mechanism will be determined for refunding the licensing fee and frequency charges for the winner of the tender during the first 5 years of operation, against an increase in the market share in the private sector.
5. The winner of the tender will be exempted from payment of royalties to the state over the first five years of operation.
6. A period of 7 years will be set during which the winner of the tender will be able to deploy its network.
7. If a decision is made to reduce the interconnection tariff, the winner of the tender will be obligated to pay the minimum tariff to be set.
8. To allow the winner to maintain network operations before its network is fully distributed, the Ministry is reviewing regulations for sharing domestic sites / roaming services with the networks of existing cellular operators.

At the beginning of 2010, another team was formed by the Ministry of Communications, Finance Ministry, Interior Ministry and Ministry of the Environment, to address this subject. The purpose of the team is to re-examine ways of facilitating the entry of a new operator which has infrastructure to the market. At the time of publishing this report, the team has made no recommendations and no tender for frequencies has been published.

3.7.2.5 In August 2009, the Ministry of Communications published a request to receive the public's position on regulation of the structure of the market for broadband on MRT services. As part of the hearing, the Ministry of Communications wishes to examine the possibility of separating the supply of access to broadband infrastructure and the connection to ISPs, similar to the segregation which exists on the fixed-line network. Pelephone submitted its position whereby it objects to the proposed suggestion and even presented its position to the Ministry of Communications in a direct hearing in December 2009.

3.7.2.6 In February 2010, an amendment was published to the MRT licenses which prescribed that from August 1, 2010, a new tariff structure will take effect for outgoing calls from MRT to overseas destinations. Accordingly, under the new tariffs, a subscriber will not pay the MRT operator the air-time tariff for the outgoing service from his cellular handset to overseas, but the subscriber will pay a tariff consisting of the international operator's price to be set by the international operators and an interconnect price for MRT, as prescribed in the interconnection regulations. Consequently, when settling the account for such calls, the MRT operators will receive an interconnect tariff per outgoing minute of call overseas, instead of a tariff for air time according to the track held by the subscriber, as is currently the case and until the amendment takes effect. The expected reduction in interconnect tariffs for may affect Pelephone's revenues from outgoing calls to overseas destinations.

3.7.2.7 Mobile Virtual Network Operator – MVNO:

Pursuant to the Government's decision to encourage the entry of virtual operators (MVNO) in Israel's cellular market, in January 2009, the Ministry of Communications published a hearing for the general public in which it asked for comments on the draft license it proposed as a format for granting a MVNO license, as well as the key regulation rules of the Communications Law which the Minister intends setting in order to regulate the conditions and issues for granting MVNO licenses in accordance with the policy proposed by the Ministry in this matter.

During the deliberations on the Budget Law and the Budget Arrangements Law for 2009 and 2010, an amendment to the Communications Law was approved whereby the Minister of Communications was supposed to complete all the procedures required for granting licenses by October 1, 2009. The amendment to the law further determined that if a MVNO license is granted and the owner of such a license holds negotiations with the cellular operators that after 6-9 months do not end successfully and it is proven that the reason is the anti-competitive behavior of the cellular operators, the Minister of Communications shall then intervene in the commercial conditions in accordance with the powers granted to him by law.

In January 2010, the regulations regulating all aspects of the policy for granting MNVO licenses were published. Following are the main points of these regulations.

1. The applicant for the MVNO license must hold a license as a domestic operator or MRT, and shall not have any relationship with an existing MRT operator or any other MVNO.
2. Threshold requirements for applicants for a MVNO license:
    A. Proven experience in operating a Bezeq facility, in the distribution and marketing of Bezeq services, in managing a significant service network. (Such know-how and experience may be provided by an external entity with which the applicant enters into agreement or through the services of senior officers employed by the applicant.)
    B. A guarantee in the amount of NIS 10 million in favour of the State must be deposited when provision of the service commences.
    C. Shareholders' equity of at least NIS 15 million.
3. The regulations include a detailed procedure for submitting an application for a MVNO license. Furthermore, according to the regulations, the Ministry must respond to the applicant/grant the license in case of a proper application within 90 days of submittal of the application.

3.7.2.8 Domestic operator license

On June 3, 2004 the Communications (Telecommunications and Broadcasts) (Processes and Conditions for Obtaining a General Special License) Regulations 5764-2004 were published. Under the aforementioned Regulations, an application may be filed for a special general domestic license, i.e. for a license for the provision of domestic fixed line telecommunications services, which does not involve an obligation to provide service to the entire public everywhere in Israel. Pelephone, as a subsidiary of Bezeq, is obliged, unlike the other cellular companies, to apply to the Minister of Communications and persuade him that the award of a license to Pelephone, as a subsidiary of Bezeq, is such as to promote the competition in the telecommunications field or is in the public interest.

Bezeq's license imposes restrictions on it in all matters pertaining to cooperation with its subsidiaries. In the opinion of Pelephone and Bezeq, to the extent that these restrictions remain in force, without, at the same time, similar restrictions being imposed on the competing MRT operators, they will adversely affect Pelephone's ability to compete with its rivals in the industry. For the restrictions imposed on Bezeq and Pelephone by virtue of the merger conditions, see section 3.18.3 below.

It is noted that Partner and Cellcom, the principal competitors of Pelephone, own such a general domestic license, and in the last year have even increased their activity in the area. This grants them a clear competitive advantage over Pelephone due to the ability of the competitors to offer packages that combine mobile and fixed-line communications.

3.7.2.9 WiMAX technology

In September 2007 the Ministry of Communications published a hearing on the policy of allotting frequencies for operating the WiMAX technology, which is a network technology allowing broadband communication. In accordance with the proposed policy, new operators and the smallest Israeli cellular operator (Mirs) will be given priority in the allotment. Pelephone has submitted its response to the hearing, by which priority should be granted to fourth generation cellular technology that requires use of WiMAX technology frequencies, and has expressed its objection to a tender for the allocation of frequencies that discriminates in favor of MIRS or other operators.

On March 1, 2009, the Ministry of Communications published its policy regarding the allocation of frequencies for WiMAX technology. The main change in respect of the hearing is that the tender for frequencies will be held in September 2009 and Mirs will not be permitted to participate in this tender.

Pursuant to the hearings on the tender for operating a WIMAX network, in March 2009, the Ministry of Communications published a policy document regarding the allotment of frequencies to establish a WIMAX network. According to the policy document, these frequencies will be allocated in two separate tenders. The first will allocate frequencies exclusively to a new operator, and in the second tender, after vacating another frequency band in this frequency range, other operators will also be able to participate, including existing MRT operators. At the publication date of this report, neither of these tenders has been published.

3.7.2.10 Amendments to the MRT license – regarding amendments to the MRT license regarding the promotion of competition in the cellular market, see section 3.18.3 below.

3.7.3 Positive and negative factors affecting Pelephone's competitive position

Positive factors

A. Launching a HSPA/UMTS network, which appeals to additional target audiences and increasing the services provided to the existing customers, including roaming services.

B An advanced product range including DATA solutions for businesses, and a broad spectrum of multimedia and entertainment services.

C. Service system and range of customer service interfaces enabling the provision of high-level service to customers.

D. An extensive distribution system specializing in the provision of solutions appropriate to each type of customer, high-quality human resources.

E. Strong capital structure and positive cash flow.

Negative factors

A As a subsidiary of Bezeq, Pelephone is subject to regulatory restrictions on entering into additional fields of activity and on expanding its customer service baskets, which do not apply to its competitors.

B There are restrictions on joint activity with Bezeq, including in the marketing of joint service bundles.

C. CDMA technology does not enable the provision of roaming services in the same manner as this service is provided by competitors, and the technology is less common around the world. The subscribers joining the HSPA/UMTS network will benefit from broader roaming services.

3.8 Seasonality

Pelephone's revenues and profitability are affected, albeit not to any material extent, by seasonality and holidays. The second and third quarters are characterized by higher revenues than the first and fourth quarters. This is due primarily to different usage patterns prevailing in the summer months compared to the winter months and the holiday season. Seasonal fluctuations primarily affect cellular services revenues, but, as stated, the effect is not material.

3.9 Property, Plant and Equipment

Pelephone's fixed assets include the infrastructure equipment of the network core, radio sites, electronic equipment, computers, motor vehicles, terminal equipment, office furniture and equipment and leasehold improvements.

3.9.1 Infrastructure

Pelephone presently operates communications networks using three digital technologies, as follows:

A. CDMA 2000 1XRTT. The advantages of this technology are the ability to provide advanced services, greater capacity for talk calls and data for a given quantity of frequencies and data communications at a speed of up to 144 KB per second.

B. EVDO – this technology is an upgrade of CFMA 2000 1XRTT, which facilitates communication between the network and the terminal equipment at speeds of up to 2,400 KBS (Downlink), and between the terminal equipment and the network at speeds of 144 KBS (Uplink).

C. HSPA/UMTS method. The advantages of this technology, inter alia, is in supporting download speeds of up to 14.4 Mbps and upload speeds of up to 5.7 Mbps. It should be noted that the actual surfing speed depends on a number of factors, including place, momentary load in the network, transmission support, the internet network performance and the laptop and terminal equipment compatibility.

D. As at the date of publication of the report, Pelephone's UMTS and CDMA infrastructures are based primarily on 4 switching farms connected to approximately 1,994 radio sites (cells), in a countrywide spread.

E. The depreciation period for site equipment is up to 10 years. Depreciation for switching equipment is between 5 and 7 years. The depreciation period of the equipment is determined on the basis of engineering opinions based, inter alia, on generally accepted practice among communications operators in various other countries.

EVDO/CDMA2000 1XRTT network

Pelephone's infrastructure equipment is manufactured by Nortel and Motorola. Each of Pelephone's digital switching networks is manufactured by Nortel, and a Nortel telecommunications network covers most of the coastal plain and Jerusalem (from Ashdod to Haifa). The Pelephone network in the rest of Israel uses the Motorola-manufactured telecommunications network.

Pelephone's investments in EVDO/CDMA2000 1XRTT network infrastructure

The principle investments in 2003 to 2007 were used to upgrade the network to CDMA 200 1XRTT and EVDO technology using equipment purchased from Nortel and Motorola. In addition, in 2006 and 2007, the network capacity was broadened, additional sites were established (some as substitutes for existing sites due to engineering requirements) and the network was adapted to support number portability.

As of 2004, Pelephone began upgrading the CDMA2000 1XRTT network to EVDO technology by means of the addition of a special–purpose carrier for data communications in the urban areas of Israel. This technology enables communication between the network and the terminal equipment at rates of up to 2,400 KBS (downlink) and between the terminal equipment and the network at rate of up to 144 KBS (uplink). The EVDO equipment is manufactured by Nortel. Parallel to setting up the network, a portal was set up for video services enabling customers to view live broadcast channels, to download music clips, entertainment, news, etc. This portal is the key service using EVDO technology.

At the end of 2007 a triennial agreement was signed with Nortel by which it would continue to support and upgrade the 1X and EVDO networks for a total consideration of $ 22.5 million (also see section 3.12.3 below).

In the wake of financial difficulties encountered by the Nortel Group worldwide, Nortel is attempting to protect itself from creditors which may result in the sale of its operations, including CDMA operations.

In 2009, a new agreement was signed with Nortel which includes an upgrade of the networks in 2009 and further support in 2010 and 2011. Pelephone has the ability to terminate this agreement from the third quarter of 2010.

<u>The HSPA/UMTS network</u>

During the course of 2008, Pelephone established a network using HSPA/UMTS technology. The new network is based on two network centers that will be connected to the existing sites and the new sites that are in the process of acquisition/licensing and construction. The sites operating on CDMA technology were converted in order to adapt them to the new technology and the addition of the new radio equipment. The network enables higher transfer speeds of information from the subscriber to the network and from the network to the subscriber using HSDPA and HSUPA technology. The establishment of the new network enables Pelephone to provide services requiring the rapid transmission of information, may partly solve the problem of wireless disturbances (see section 3.24.2.5 below) and enables use of standard terminal equipment supporting HSPA/UMTS technology which enables the diversification of terminal equipment and the expansion of roaming services. During the course of 2008 and 2009, Pelephone invested NIS 908 million in establishing a HSPA/UMTS network. The rest of the investment is expected to be spread over the coming years.

3.9.2 <u>Premises used by Pelephone</u>

Pelephone does not own any land, and it leases the premises which it uses for its operations from others, including Bezeq. The following is a description of the main premises used by Pelephone:

3.9.2.1 The land which Pelephone uses for installation of radio and switching sites, as set out above in section 3.9.1, are spread out around the country, and are leased for various periods (in many cases, for 5 years plus an option to extend the agreement for another 5 years). For site licensing, see section 3.18 below.
Some of the sites leased by Pelephone are Israel Lands Administration (ILA) sites. Pelephone has an agreement regarding payment owed to ILA for the period up to December 31, 2008.

3.9.2.2 The agreement was extended up to December 31, 2009, and the parties also agreed that there would be a further extension until December 31, 2010.

3.9.2.3 Pelephone's head offices have been in Givatayim since 1997, and cover a total area of 17,800 sq m. In January 2010, Pelephone signed an agreement to extend the lease term until December 31, 2015, with an option to extend the lease until November 2020.

3.9.2.4 For the purpose of service and sale operations, Pelephone leases 76 service and sale centers spread out around the country.

3.9.2.5 Pelephone has additional lease agreements with respect to warehouses, offices and telephone call centers which it uses for the purpose of its operations.

3.10 Intangible Assets

3.10.1 MRT license

Pelephone operates under a general license for the provision of mobile radio telephone (MRT) services), which is valid until 2022 (see section 3.18.1.1 below). The license constitutes the basis of Pelephone's activity.

3.10.2 Frequency usage right

Pelephone uses frequencies in the 850 MHz range granted pursuant to its license. Pelephone uses these frequencies for CDMA2000 / 1XRTT / EVDO /UTMS technology. In addition, in 2008, Pelephone exercised its right to receive the allocation of frequencies in the 2100 MHz range, and it uses them with UMTS technology. In January 2009, the Ministry of Communications granted approval for Pelephone to return to the 5MHz frequency range, known as TDD, from the aforementioned band of frequencies.

3.10.3 Trademarks

Pelephone has a number of registered trademarks. The principle trademark is Pelephone.

3.10.4 Customer base

Pelephone has a large number of customers, many of which have entered into agreements to receive Pelephone's services for 18 to 36 months.

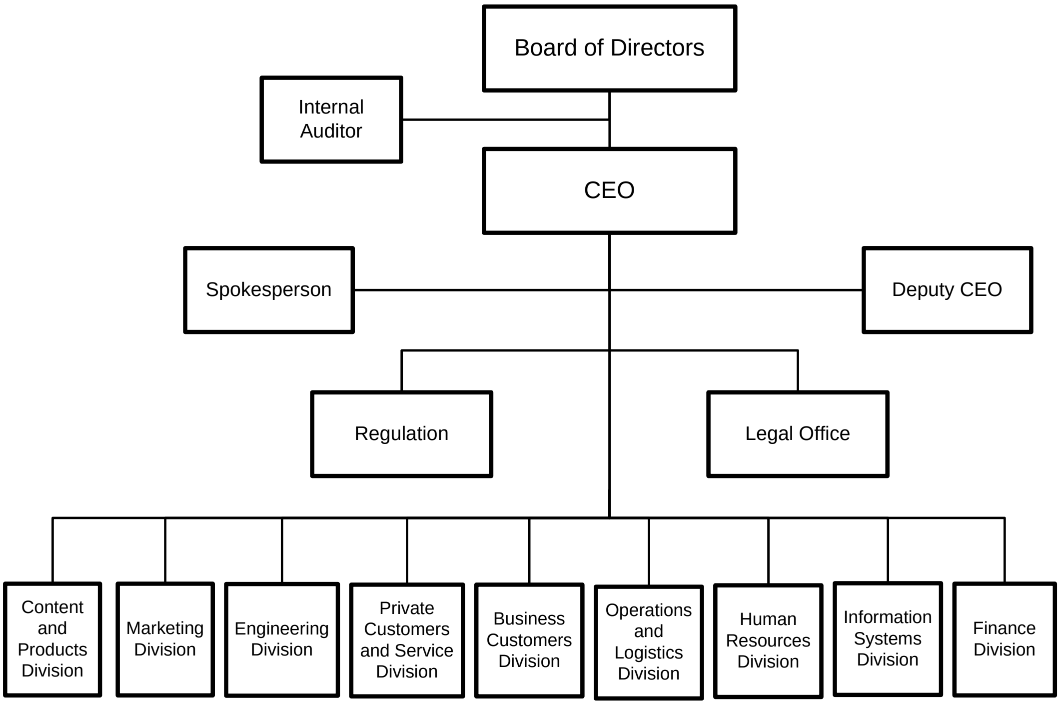
3.10.5 Software, computer systems and databases

Pelephone uses software and computer systems, some under licenses purchased by Pelephone and others developed by Pelephone's IT division. Most of these licenses are restricted in time and are periodically renewed. The main systems that Pelephone uses are Oracle Application and an Amdocs billing system.

3.11 Human Resources

3.11.1 Organizational structure

Set forth is Pelephone's organizational structure:



3.11.2 Employees

The table below describes the number of employees[20] at Pelephone in accordance with its organizational structure:

Division	Number of employees	
	December 31, 2009	December 31, 2008
Headquarters and management	283	286
Content marketing and products division	88	92
Customer service and private sector division	2,398	2,453
Business division	547	499
Operations and logistics division	253	247
Engineering and information systems division	623	624
Total	**4,192**	**4,200**

3.11.3 Instruction and training

Pelephone invests resources in professional training in accordance with the type of employee and occupation. Most training courses take place in service, primarily in the service division. Pelephone's total expenses in 2009 and 2008 in respect of instruction and training amount to NIS 7.5 million and NIS 7.8 million, respectively. There is a high turnover rate for sales and service representatives and telephone call center employees, which requires constant investment in new employees.

3.11.4 Employee and manager reward schemes

Pelephone awards its employees and managers grants and incentives on a monthly, quarterly and annual basis commensurate with their achievement of the targets set for them and in accordance with the type of work done by the employee.

For the options plan for senior officers and the plan to retain Pelephone's CEO, see sections 2.9.6.3 and 2.9.7 above.

3.11.5 Employment contracts

Pelephone employees have standard personal contracts in accordance with their professions and occupations.

3.12 Products and Suppliers

3.12.1 Terminal equipment suppliers

The product inventory of Pelephone includes a range of cellular telephone units, auxiliary accessories (such as batteries, hand-free kits, earphones, data cables and chargers). Pelephone also maintains spare parts to supply repair services to its customers and an inventory of used handsets.

Pelephone purchases the terminal equipment and accessories from a variety of suppliers and importers in Israel. Contractual engagements with most of the suppliers are based on framework agreements setting forth, inter alia, the technical support provided by the supplier for the terminal equipment it supplies, availability of the spare parts turnaround time for repairs. These agreements do not include a commitment to make acquisitions, which are implemented regularly by means of purchase orders.

If a contract with a particular terminal equipment supplier is discontinued, Pelephone may increase the quantity purchased from other terminal equipment suppliers or procure terminal equipment from a new terminal equipment supplier. If the replacement of a supplier is required, as aforementioned, the replacement shall not be immediate, and shall be subject to a special preparatory period for purchasing spare parts and accessories, including the repair capacity for all kinds of malfunctions, to enable the provision of service

[20] The number of employees represents the number of calculated positions at Pelephone (the total number of work hours divided by the monthly quota of work hours).

to customers as agreed. Replacement of a supplier involves the addition of exceptional costs due to the need to purchase equipment a period of re-organizing affairs with the replacement suppliers.

The splitting of terminal equipment purchases between suppliers does not create significant dependency on any one supplier or equipment model.

In preparation for migration to HSPA/UMTS technology, Pelephone had expanded the range of equipment it offers to customers and the number of its terminal equipment suppliers, who are global leaders, from whom Pelephone purchase handsets, spare parts, accessories, and the like.

In May 2009, Pelephone signed an agreement with Apple Sales International (hereinafter: the Manufacturer), to purchase and distribute iPhone devices in Israel. Under the agreement, Pelephone undertakes to purchase a minimum annual quantity of handsets for three years, at prices which are in force with the manufacturer at the actual date of purchase. Pelephone estimates that these quantities account for a considerable proportion of the number of handsets that it expects to sell during the agreement period, and that their cost will account for 5% of the total cost of Pelephone's annual sales and services during this period.

The aforesaid information in this section includes forward-looking information which is based on estimates and forecasts. Actual performance may differ substantially from these estimates, taking note of changes that may occur in business conditions.

3.12.2 Value added service suppliers

Pelephone has agreements with suppliers for content such as information services by voice, SMS or Pelephone's portal, games, animations, ring-tones, location services, content and the rights to broadcast over third generation technology. As is usual in this industry, a large portion of these agreements are based on a model of dividing revenues between Pelephone and the content suppliers for the services provided to customers. Termination of contracts with certain suppliers might cause delays in supplying some of the services pending contracting with substitute suppliers.

3.12.3 Infrastructure suppliers

As set out in section 3.9.1 above, Pelephone's present infrastructure equipment is manufactured by Ericsson, Nortel and Motorola. Pelephone has long-term maintenance, support and software upgrade agreements with these suppliers and depends on them with respect to support of the network equipment that they produce. Regarding other agreements with these suppliers and an agreement for the establishment of an additional network see section 3.9.1 above.

3.13 Working Capital

3.13.1 Inventory policy

Pelephone's inventory mainly includes cellular terminal equipment (new and used) and a variety of accessories (such as batteries, hands-free-sets and earphones). Pelephone also holds spare part inventory.

The period over which inventory is held is derives from Pelephone's service policy and its sales requirements. The requirements require holding an inventory for a period of 3 – 5 inventory months, depending on the type of inventory. As at the end of 2009, the inventory level stands at approximately NIS 235 million.

3.13.2 Returns policy for terminal equipment purchased

As a rule, the return of handset inventory may be implemented by cancellation of a transaction or by the replacement of a handset for another (of the same standard or a higher standard against incremental payment to cover the price difference.)

With respect to remote sales transactions and peddling transactions as defined in the Consumer Protection Law, 5741-1981, return of equipment is permitted up to fourteen days after the date of the transaction, in accordance with the provisions of the Law.

3.13.3 Company policy with respect to product warranty

Pelephone provides service, warranty and maintenance for terminal equipment in accordance with the level of service and repairs to which the customer has subscribed and of course in accordance with the provisions of any law regulating warranties for cellular terminal equipment.

3.13.4 Policy governing credit to customers

Credit in handset sale transactions – Pelephone enables most of its customers purchasing a mobile telephone to pay in up to 36 equal installments.

Credit by monthly charging in respect of MRT services – Pelephone customers are charged once a month in charging cycles taking place on different dates over the course of the month, for consumption of MRT services in the preceding month.

As at 2009, total average customer credit less doubtful debts amounts to NIS 1,806 million.

3.13.5 Credit from suppliers

Pelephone receives credit from its suppliers for periods ranging from 30 days to E.O.M. + 90 days. As at 2009, total average credit from suppliers and service providers amounts to NIS 628 million.

3.14 Investment in Investees and in a Partnership

Pelephone has no active investments in investees and partnerships.

3.15 Financing

3.15.1 General

Pelephone's operations are financed by cash flows from operating activity generated by the company, shareholders' equity, bank loans, debentures, previously by discount of credit cards (see section 3.13.4 above) and supplier credit.

The average interest rate in 2009 for Pelephone loans:

	Long-term loans (Including current maturities)
Banking sources: CPI-linked – NIS	4.58%
Non-banking sources: CPI-linked – NIS	4.64%

3.15.2 Restrictions

3.15.2.1 Undertakings towards banks

As part of the arrangements made with banks in Israel in connection with the provision of credit to Pelephone, Pelephone provided the aforementioned banks with certain irrevocable undertakings to comply with financial covenants, consisting primarily of the following:

A. Pelephone's total debts must not exceed three times its shareholders' equity.

B. Provided total debts exceed shareholders' equity by more than 2.5, Pelephone shall not pay out dividends and shall not pay management fees to shareholders. If Pelephone is in breach of this undertaking, it shall, within 120 days of demand, be required to repay the bank all loans outstanding to the credit of the bank at such time, or, alternatively, to amend the breach by increasing its shareholders' equity or repaying Pelephone's loan in such a way that the aforesaid ratio is preserved.

C. Total debts shall not exceed NIS 3.8 billion (linked to the CPI known as at January 2002). The sum of the debts shall be checked once every quarter in accordance with financial statements reviewed by accountants;

D. Pelephone's assets will not be mortgaged under a fixed or floating charge, in any manner or way, or of any kind or degree, without obtaining the bank's prior written consent to such.

E. Pelephone's shareholders or any third party whatsoever will not be given any security or charge over the assets of Pelephone or any guarantee to secure credit received by the shareholders, without obtaining the prior written consent of the banks to such.

F. Pelephone's shareholders will not be granted any loan or credit without obtaining the bank's prior written consent to such.

G. Information, details and various reports will be provided to the banks.

H. If Pelephone is in breach of these undertakings, then the banks shall be entitled to call for immediate repayment of the amounts of the loans extended to it.

J. Undertaking to a particular bank – in addition to the above undertakings, Pelephone has undertaken to ensure that the cumulative sum of all of its debts and liabilities towards a particular bank shall be no greater than the equivalent of 40% of the cumulative sum of all of Pelephone's debts to financial entities including debenture holders.

3.15.2.2 Immediate repayment of the loan

A lender may call a loan for immediate repayment in certain instances (usually after serving written warning notice on Pelephone), foremost among such instances being: (A) if any debt to the lender was not paid; (B) if Pelephone adopts a liquidation resolution or if application for liquidation or for the appointment of a liquidator is filed against it or if there is cause for its being liquidated, or for the appointment of a receiver or a trustee; (C) if application is filed for the imposition of an attachment or if an attachment is imposed on the assets of Pelephone or if any execution proceeding is taken against its assets or if it ceases to repay its debts; (D) if Pelephone adopts a resolution in favor of restructuring, merger or settlement or if the control therein is transferred without the lender's consent; (E) if Pelephone ceases to repay its debts or reaches a compromise with its creditors or any of them; (F) if Pelephone is in breach of any undertaking that it has assumed toward the lender or if it should transpire that a material declaration by Pelephone toward the lender is untrue; or (G) if an event should has occurred as a result of which any entity shall have the right to call for immediate repayment of Pelephone's debts towards it (even if such concerns does not make use of its right).

3.15.3 Issue of debentures

In 2004-2005, Pelephone issued three series of index-linked debentures by way of private placements to institutional investors in a total sum of NIS 1.133 billion par value, in consideration for their par value

At the time of issue of the debentures, trust deeds were signed with Union Bank Trust Co. Ltd., which acts as trustee for the debenture-holders. Pursuant to this agreement, Pelephone undertakes to pay principal, interest and indexation differences in accordance with the terms of the debentures. The debentures are not secured by any charge, and the conditions of the negative pledge and the financial covenants undertaken by Pelephone towards the Israeli banking system will also apply to the debenture holders (see section 3.15.2 above). The agreement details the conditions for immediate repayment of the debentures, being essentially as follows: (A) If Pelephone does not repay any amount whatsoever being due from it pursuant to these debentures by 30 days from the due date; (B) if a liquidator is appointed for Pelephone; (C) if charges are realized; (D) if an attachment is imposed on material assets of Pelephone; (E) if Pelephone ceases to exist or (F) if Pelephone discontinues its payments or serves notice of its intention to discontinue them. The trustee is entitled to take steps for immediate repayment in order to protect the debenture holders. The agreement moreover sets forth principles for indemnifying the trustee, trusteeship of the receipts, investment of moneys and conditions for convening a general meeting and adopting resolutions.

As at December 31, 2009, Pelephone is in compliance with its commitments to the banks and to the debenture holders.

In 2009, there were no new long-term loans and loans and debentures were repaid in the amount of NIS 241 million.

For additional details regarding the composition of the loans and debentures, the conditions thereof and the date of repayment thereof during the report period, see Note 14 of the Company's financial statements for the year ended December 31, 2009, which are included in this periodic report.

3.15.4 Credit facilities

As at December 31, 2009, Pelephone has bank credit of NIS 223 million.

3.15.5 Guarantees and charges

See Notes 14 and 20 to the Company's financial statements for the year ended December 31, 2009, which are included in this periodic report.

3.15.6 Credit rating

The rating company Maalot assigned Pelephone an AA minus rating on the placements of the debentures (see section 3.15.3 above).

In July 2009, Maalot announced that it would raise the rating of Pelephone's debentures from AA- to AA+. The rating outlook is stable and reflects Maalot's view that Pelephone will continue to be of strategic importance to Bezeq and will continue to post robust profits and generate significant cash flows in the future.

In October 2009, Standard & Poor's Maalot, which rates Pelephone's debentures, announced that it had placed Pelephone's domestic debentures, which are AA+ (AA plus), on a negative credit watch, due to Bezeq's announcement concerning its agreement with a controlling shareholder of the company, FSBR Group Ltd., to sell its entire stake in Bezeq (30.6%) to 012 Smile Communications Ltd., and the possible impact of a change in the control over Bezeq's capital structure (and consequently of Pelephone as well).

3.15.7 Pelephone's estimate of fundraising in the coming year and sources of financing

Pelephone expects to repay a portion of its loans in 2009, and plans additional investments in property, plant and equipment (see section 3.9.1 above). Pelephone does not expect to increase capital or new loans in the coming year.

The above information includes forward-looking information that is based on Pelephone's assessments taking into account its plans and the expectation that such will be realized. Actual results may differ substantially from the assessments set out above, if there is any change in any of the factors taken into account in making these assessments. For risk factors, see section 3.24 below.

3.16 Taxation

See Note 9 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

3.17 Environmental Quality

3.17.1 General

On January 1, 2007 the Non-Ionized Radiation Law, 5766-2006 came into effect. The Non-Ionized Radiation Law replaces the previous legal arrangement regarding non-ionized radiation in the Pharmacists (Radioactive Elements and Products) Regulations 5740-1980 (the Pharmacists Regulations).

The purpose of the law is to regulate radiation sources and their construction and operation, as well as the provision of radiation measurement service. The law requires obtaining a permit from the commissioner for constructing, operating and providing radiation measurement service, other than the construction or operation of a radiation source specified in the Appendix to the law (the Radiation Permit).

The law provides a two-step licensing mechanism: the applicant is to first request a permit to construct a radiation source (the Construction Permit), which will be in effect for no more than three months and can be extended by the commissioner for up to nine months; and then a permit to operate the radiation source (the Operation Permit), which will be in effect for five years or as otherwise determined by the Minister of the Environment in cases or under circumstances determined by him, taking into consideration the type of the radiation source or its location.

As regards the construction permit, by law, provision of the permit is contingent on an assessment of the maximum radiation levels to which human beings and the environment are expected to be exposed from the radiation source, once it is operated, including in the event of a malfunction, and to implementing the measures needed to limit the exposure levels of human beings and the environment to the radiation expected from the radiation source once it is operated, including implementation of technological means that are in use (the Limiting Measures).

As regards the operation permit, by law, provision of the permit is contingent on implementation of the limiting measures and to measuring the exposure levels of human beings and the environment to the radiation generated when operating the radiation source, with these levels not exceeding the maximum exposure levels provided by the commissioner in the law. Furthermore, by law, provision of the operation permit is contingent on presentation of a license under the Communications (Telecommunications and Broadcasts) Law 5742-1982 and the Planning and Building Law, 5725-1965, except when a building permit is not required, in which case the applicant submits a statement to the local committee specifying the reasons that a building permit is not required for the radiation source. If the local council engineer or district planner does not object to granting the operation permit within 21 days from the day the statement is submitted, the applicant will submit an additional statement stating that the aforementioned period has passed and no objection has been received as aforementioned.

The law includes a punitive section by which, inter alia, the construction or operation of a radiation source in contravention of the provisions of the permit and the construction or operation of a radiation source without a permit, after having been warned in writing by the commissioner, are strict liability offenses, in respect of which the punishment for the entity is double the penalty provided in Section 61(a)(4) of the Penal Law , 5737-1977.

A small number of city engineers have acted according to the mechanism provided in the law and have provided notice that some access device or another requires a building permit, and have objected to granting it an operation permit.

The law also indirectly amends the Planning and Building Law, 5725-1965 and provides that a building permit to a cellular broadcasting facility is contingent on the deposit of a deed of indemnity in respect of claims for compensation pursuant to section 197 of the Planning and Building Law, 5725-1965, providing that such a demand is in accordance with the instructions of the national council.

The Minister for Environmental Protection prepared the regulations according to the Non-Ionized Radiation Law (the Regulations). These regulations were promulgated and approved by the Interior and Environment Committee of the Knesset and were published on January 19, 2009.

3.17.2 Anticipated costs and investments

Pelephone conducts periodical radiation tests in order to ascertain that it is in compliance with the permitted operating standards and the standards of the International Radiation Protection Agency. These tests are outsourced to companies authorized by the Ministry of Environmental Protection. Pelephone invests on average NIS 4.5 million per annum in respect of this activity. The Radiation Regulations will require paying fees of approximately NIS 4 million for the provision and renewal of permits required according to the Radiation Law.

3.18 Restrictions on and regulation of Pelephone's operation

The provisions of Non-Ionized Radiation Law described in section 3.17.1 are expected to have an adverse effect on the construction and operation of broadcasting sites in a number of ways including, inter alia, on the following matters: a significant restriction on the possibility of using access devices in highly populated areas; more difficulties in obtaining radiation permits for existing and new broadcasting devices and for changes in their operation; a requirement to pay fees on the construction and operation of existing and new broadcasting devices.

3.18.1 Statutory restrictions

3.18.1.1 Communications Law and licensing obligation thereunder

The Communications (Telecommunications and Broadcasts) Law 5742-1982 stipulates, inter alia, that that telecommunication activity and telecommunication services, including MRT, are subject to a license from the Minister of Communications (in this chapter: the Minister). Pelephone holds a general license for the provision of MRT services. The Minister is empowered to modify the terms of the license, to add thereto or to detract therefrom, while taking into consideration, inter alia, government telecommunications policy, considerations of public interest, suitability of the license holder to provide the services, the contribution of the license to competition in the telecommunications sector and to the level of service therein. Moreover, the Minister is empowered to annul, restrict or suspend a license in a number of situations.

The law authorizes the Director General of the Ministry of Communications to impose financial sanctions for violations of the provisions of the law and of orders and directives issued by virtue thereof, and for violation of the license terms

3.18.1.2 The Wireless Telegraph Ordinance

The Wireless Telegraph Ordinance (New Version), 5732-1972 (the Telegraph Ordinance) regulates the use of electromagnetic spectrum, and applies, inter alia, to the Company's use of radio frequencies, as part of its infrastructure. Under the Telegraph Ordinance, the establishment and operation of a system using radio frequencies requires a license, and the use of radio frequencies requires designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for designation and allocation of frequencies.

For several years, the Government has been coping with the existing shortage of radio frequencies for public use in Israel (inter alia, due to the allocation of a great many frequencies for security uses), by limiting the number of licenses issued for the use of frequencies, on the one hand, while increasing fees payable in respect of the allocation of a low range frequency on the other.

The Wireless Telegraph (Licenses, Certificates and Fees) Regulations 5747-1987, stipulate various fees for business stations (including MRT business stations), MRT, P2P wireless lines and satellite stations). For the allocation of radio frequencies to Pelephone, see section 3.10.2 above.

3.18.1.3 Facilities emitting electromagnetic radiation – for this matter see section 3.17 above.

3.18.1.4 The Consumer Protection Law

During the course of its operations, Pelephone is subject to the Consumer Protection Law, 5741-1981 (the Consumer Protection Law). In December 2005, the Consumer Protection Law was amended so that the prohibition against misleading conduct contained in the Law immediately prior to entry of the amendment into force, and the option of suing on grounds of misleading conduct by a dealer prior to the date of the contract, was extended to include misleading conduct by a dealer after the date of the contract.

In April 2008, the Knesset approved an amendment to the Consumer Protection Law regarding fixed transactions (the Amendment). Under the Amendment, dealers will be required to inform consumers of the date of termination of a fixed transaction prior to termination of such, and of the conditions that will apply after the date of termination. In addition, dealers will be required to obtain the positive consent of the consumer to continue with the contract beyond the fixed period. If positive consent is not obtained, the consumer will be disconnected from the service to which the fixed transaction applied, apart from basic telephone services as defined in the Communications Law (voice services). The amendment came into effect on January 10, 2009. Pelephone is acting accordingly to implement the amendment.

3.18.2 Controlled tariffs

3.18.2.1 Payments for interconnection:

The Telecommunications (Interconnect Fees) Regulations 5760-2000 (the Regulations) prescribe limitations regarding payments to be made or to be received from a domestic operator or another MRT operator under the regulations. In December 2004, the regulations were amended so that the interconnect fees were gradually reduced. At December 31, 2009, the maximum tariffs are as follows:

A. The interconnect fee it will receive for an incoming call to the MRT network: 25.1 Agorot.

B. Payments receivable from another MRT operator for transferring SMS messages on the MRT network: 2.85 Agorot.

C. These tariffs do not include VAT and will be revised once a year, on March 1 of each year, according to the change in the CPI.

3.18.2.2 Charge segments

Concerning the calculation of payment for airtime and completion of a call to the MRT network, as prescribed in the MRT licenses, from January 1, 2009, such charges are made according to one-second segments (unlike the previous method which allowed a charge according to 12-second segments. As a result, from January 1, 2009, payments made by the MRT operator for the interconnect services to the domestic operator's network were also revised.

3.18.3 Pelephone's license

3.18.3.1 General

The general license for the provision of MRT services granted to Pelephone on February 7, 1996 was for a period of 10 years commencing January 1, 1994, with an option of extending it for additional periods of six years each, under the conditions set forth in the license, consisting primarily of compliance with statutory conditions. Following the tender in which Pelephone was allotted third generation frequencies, the license was extended to be valid for 20 years as of September 9, 2002. For the arrangement with the State regarding the right to use frequencies, see Note 19 to the financial statements of the Company for the year ended December 31, 2009 that are included in this periodic report.

Likewise, in April 2001, the Civil Administration for the Judea and Samaria Region awarded Pelephone a general license for the provision of MRT in the region of Judea and Samaria. The provisions of the general license awarded to Pelephone by the Ministry of Communications are applicable to this license (with some changes).

The following are the principal provisions of Pelephone's license in this section the Licensee):

A. Under certain circumstances, the Minister is entitled to modify, restrict or suspend the conditions of the license, and in certain instances to even revoke it.

B. The license is non-transferable, and neither may 10% or more of any means of control in the licensee be transferred either directly or indirectly, nor may any means of control in the licensee or any portion of any means of control be transferred in any manner in such a way as to confer control in the licensee, nor may control in the licensee be acquired, either directly or indirectly, unless the Minister shall have given his consent beforehand.

C. A shareholder in Pelephone or a shareholder in an interested party therein may not mortgage his shares in such a way that realization of the lien will result in a change of ownership of 10% or more of the means of control in the licensee, unless the agreement contains a provision whereby the lien may not be realized except with the prior consent of the Minister.

D. The licensee shall take steps to establish interconnectivity of the network to another public telecommunications network in the State of Israel (including towns, military sites, and military bases in the areas of Judea and Samaria and the Gaza Strip). The licensee is obliged to provide interconnect service on equal terms to any other operator and must refrain from any discrimination in implementing interconnectivity

E. The licensee shall refrain from awarding preference in the provision of infrastructure services to a licensee being a company with an interest [21] over another licensee, whether for the payment for the service, whether in the conditions of the service, whether in its availability or otherwise.

F. The licensee is not entitled to sell, lease or mortgage any of the assets used for the implementation of the license without the consent of the Minister of Communications, except for:

(1) Charging of any of the licensee's assets in favor of a banking corporation duly operating in Israel, for the purpose of obtaining bank credit, provided that notice shall have been served to the Ministry of Communications regarding the lien proposed to be made, whereby there is included in the mortgage agreement a clause ensuring that realization of rights by the banking corporation will not, in any event, result in any damage whatsoever to the provision of the services pursuant to the license.

(2) Sale of items of equipment during an upgrade procedure, including sale of equipment by the trade-in method.

G. The director (under the license: the Director-General of the Ministry of Communications or whoever he shall have empowered for the purpose of the license) is entitled to issue directives concerning number portability such that any subscriber of another MRT licensee may transfer to and become a subscriber of the licensee or receive services from the licensee without changing his or her telephone number, and vice versa, and in such case, the licensee must incorporate into its telecommunications network devices enabling the application of such feature, as instructed by the director.

H. During states of emergency, whoever shall have been statutorily empowered, shall have the authority to issue the licensee with certain instructions as to its mode of operation and/or mode of provision of services.

J. The license sets forth the types of payments that the licensee is entitled to collect from its subscribers for cellular services, mechanisms of setting tariffs, reports the licensee is obliged to submit to the Ministry of Communications and also the duty of serving notice to the Ministry of Communications prior to modifying tariffs. The license also determines the Minister's power to intervene in tariffs, in certain cases.

J. The license commits the licensee to a minimal standard of service, including setting up of service call centers, the determination of a maximum period for repair of malfunctions, an accounts collection procedure and protection of the privacy of the recipient of the service.

K. To secure the licensee's undertakings and to compensate and indemnify the State of Israel for any damage due to acts of the licensee, the licensee is required to furnish a bank guarantee for USD 10 million. The license determines the instances in which such guarantee maybe forfeited.

3.18.3.2 Changes in Pelephone's license

As aforesaid, the Minister is authorized to amend, add to or detract from the conditions of the license. The following are the principal amendments to Pelephone's license that are being examined by the Ministry of Communications or that were recently imposed:

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[21] "Company with an interest" - as defined in the Telecommunications (Processes and Conditions for Obtaining a General License for the Provision of Domestic Fixed Line Telecommunication Services) Regulations 5760-2000. These Regulations define a company with an interest as "a parent company, subsidiary, sister company, interested company, affiliate, related company or partner company" and each of these terms is defined in the Regulations.

A. Pursuant to hearings that were held on the subject of discontinuing the link between a transaction to purchase MRT terminal equipment and the granting of benefits, the Ministry of Communications stipulated that the MRT license held by the cellular companies would be amended so that from November 1, 2009, a licensee may not create any linkage between any benefit in respect of MRT services offered to a subscriber and the fact that MRT terminal equipment in the subscriber's possession is purchased, rented or received from a licensee or any other marketer acting on its behalf. Pelephone implemented this amendment by the date specified.

B. In April 2007, the Ministry of Communications published its decision regarding amendment of the license with respect to changing the mechanism used for identifying users of erotic services as adults. In accordance with the amendment, the denial of access to erotic services will be removed by submitting a written request together with a photocopy of an identifying document or by physically appearing before a service representative. The amendment that was supposed to come into effect on May 25, 2007 has been delayed for the time being according to a temporary injunction issued by the Supreme Court, until the request for the temporary injunction and the petition is heard by a panel of three judges. The temporary injunction was awarded in the framework of a private petition to the High Court of Justice against the aforementioned amendment that was filed in May. The motion included a petition for a temporary injunction suspending the amendment from coming into effect due to the Ministry of Communications notice to the Supreme Court pertaining to a change in its position in the matter of the aforesaid license amendment and its recommendation of an alternative solution. On February 24, 2010 the motion to the Supreme Court concerning the applicant's petition on this matter was erased. Further to the Ministry of Communications notice, the operators hearing, at which a stricter identification mechanism than that in use today was proposed, by addition a personal indentifying particular. Pelephone is currently preparing its response to the hearing.

C. In February 2009, the Ministry of Communications published its final decision on this matter in the context of the new appendix for MRT licenses. The appendix stipulates the changes required in the structure of the customer invoice. The changes on the structure of the invoice took effect in two stages, in September and December 2009.

D. In March 2008, the Ministry of Communications made a decision to implement the amendment to the MRT licenses under which the maximum obligation term for customers who are not business customers would be reduced to 18 months, and the operators would be required to offer customers a reasonable no-obligation alternative. This resolution was passed following a hearing into this matter. The amendment came into effect on April 22, 2008.

E. In October, 2008 the Ministry of Communications published an amendment to the MRT licenses regarding a fixed transaction. Under the amendment, as of December 31, 2008 in communication contracts with new subscriptions for plans which include a commitment period, the operators will be obligated to set the service prices in advance and may not update them until the end of the commitment period. Without derogating from the aforesaid, the operators may lower the preset prices during the commitment period. Pelephone applies the amendment from December 31, 2008.

F. Further to the hearing held on the subject, in July 2008, the Ministry of Communications published a legal opinion stating that it is prohibited to make the purchase of a 3G instrument conditional on the purchase of 3G services. According to this opinion, customers must be offered an economically effective alternative for purchasing a 3G instrument without a package of 3G services requiring monthly payment.

G. According to the policy document of the Ministry of Communications from 2004, Bezeq will be permitted to market joint packages of services with its subsidiaries when its market share for fixed telephony services drops to

85%. In 2008, Bezeq's market share dropped below 85%. Accordingly, the Ministry of Communications announced in June 2008 a hearing including the proposed amendments to Pelephone's license.

According to the proposed amendment, Bezeq and Pelephone will be permitted to market combined packages (for fixed and mobile telephony) but only subsequent to approval being received from the Minister of Communications for marketing the package, provided this package will be completely unbundled, meaning that each component of the package will also be offered to customers, at the same price, outside of the package, and provided that there is proof that there is a similar package on the market. Pelephone submitted its position to the Ministry of Communications.

In January 2009, a secondary hearing was scheduled, according to which Pelephone will be permitted to market a package of services together with Bezeq and subsidiaries in the Group. The joint package must be completely unbundled if it included Bezeq's fixed-line telephony components. On the other hand, unbundling will not apply to the infrastructure component for ADSL or any other component supplied by subsidiaries. Unbundling will apply to the joint package marketed by Bezeq, in other words, all components in the package will be offered to the customer at the same price when sold separately. A proposal was also made for Ministry approval of the joint packages in two stages:

1. Approval in principle from the Minister of Communications, contingent on the availability of similar packages in the market.
2. Individual approval of the joint package, contingent on the submission of an individual application to the Ministry of Communications.

Pelephone is preparing its response to this hearing.

H. At the beginning of January 2010, a ministerial legislative committee discussed a private bill whereby the cellular operators would be obligated to offer post-paid customers the possibility of limiting their monthly bill. This means that the customer will be able to set a maximum sum for his monthly bill, and upon reaching this amount, after consuming the variety of services he subscribes to, the account will be closed, and the customer will no longer be able to utilize the services until the following month. The Ministry of Communications asked to postpone discussion of the proposed bill until a professional review of the subject and its repercussions for the cellular industry has been completed. After postponing the discussion, the Ministry of Communications asked the operators for extensive information on the subject. As requested by the Ministry of Communications, Pelephone submitted its comments, detailing the implications stemming from the proposed law. To implement the law, Pelephone will be required to make significant adjustments to its systems at considerable cost and over a period of two to three years. Pelephone expressed its objection to the proposed bill, as there are alternatives already available to customers who wish to control their monthly bill – the pre-paid track, clarification of bills, blocked services, etc. At the reporting date, the proposed bill was approved by the ministerial legislative committee and at a preliminary reading in the Knesset.

3.18.4 Royalties

Pursuant to the Telecommunications (Royalties) Regulations, 5761-2001 and its license, Pelephone pays royalties to the State of Israel out of its revenues subject to royalties from the provision of telecommunications services, inter alia less revenues and expenses in accordance with the guidelines in the Royalties Regulations. In 2006, these royalties were 3% of its revenues subject to royalties. Under the Regulations, the rate of royalties is to be reduced by 0.5% to 1% from 2010 and onwards, so that in 2007, Pelephone paid royalties at the rate of 2.5%, in 2008 - 2%, in 2009 - 1.5% and from 2010 onwards - 1%. In this regard, see also reference to a lawsuit filed by the State of Israel against Pelephone with respect to non-payment of royalties in Section 3.21.1 below.

3.18.5 Site licensing

Pelephone's MRT service is provided, inter alia, through cellular sites spread over Israel in accordance with engineering requirements. The constant need to upgrade and improve the quality of the MRT services necessitates setting-up cellular sites and changes in configuration and existing antenna systems.

Pelephone deploys two mains types of broadcasting sites under two tracks: macro sites that require a building permit from planning and building councils and wireless access devices (access devices), which are exempt from a building permit in accordance with section 27 of the Communications Law and section 266(C) of the Planning and Building Law 5725-1965 (the Exemption Provision).

The licensing of building cellular broadcasting sites that require building permits is governed by National Outline Plan 36 (NOP 36). The purpose of NOP 36, which came into effect in 2002, is to regulate the deployment and manner of setting-up broadcasting facilities, so that the entire country is covered for transmission and reception, with minimal damage to the environment and the landscape.

The licensing process of NOP 36 requires, inter alia, obtaining a number of approvals from government authorities and regulators, including:

A. Approval for construction and operation from the Ministry of the Environment (see Section 3.17.1 above)

B. Approval of the Civil Aviation Administration in some cases.

C. Approval of the Israel Defense Forces.

Various parties have criticized NOP 36, resulting in the preparation of a proposal for its amendment. At the end of 2005, the State of Israel rejected the proposed amendment to NOP 36 prepared by the planning administration of the Ministry of the Interior and requested that a committee of director generals prepare recommendations on the matter, returning NOP 36 to the national planning and building council for further deliberation.

In the time that has passed since then and in an indirect amendment to the planning and building law that came into effect upon the issuance of the Non-Ionized Radiation Law on January 1, 2006, it was provided that before approving the construction of a cellular broadcasting facility, the local council will request a deed of indemnity for claims for compensation in respect of loss of value pursuant to section 197 of the Planning and Building Law and the indemnity will be according to the instructions of the national council, which will be in effect until approval of the national outline plan regulating this matter. On January 3, 2006, the national council decided that local councils are to request full indemnity (100%) from those requesting such a permit. It was also decided that a committee of editors would examine the recommendations of the director generals' committee. The committee of editors will present its recommendations regarding the need for changing the NOP and its contents. As at the date of this update, Pelephone has deposited 234 deeds of indemnity with various local councils, in accordance with the law.

On December 4, 2007, the national council discussed the matter and decided to transfer a new version of NOP 36 to the district councils for comments and public objections. After receiving the comments and reservations, an expert investigator was appointed to recommend to the subcommittee the principle planning issues of the National Council for Planning and Building regarding the comments and reservations. The hearing of the comments and reservations has been completed and the recommendations are yet to be submitted. This new version, if it should pass all the necessary proceedings and come into effect, will replace the present NOP 36. The new version is more strict and demanding than the present NOP 36 and it is expected to delay, complicate and make it more difficult to obtain building licenses for cellular sites under this track. The amendment to NOP 36 is subject to the approval of the national planning and building council and the State of Israel.

Arguments were raised against the present NOP 36, claiming that it does not regulate the permits for facilities operating under third generation frequencies, which are not included in the list of frequencies attached to NOP 36. Pelephone's competitors have a large number of sites broadcasting under third generation frequencies and have received building permits according to NOP 36. Pelephone disagrees with these allegations and will use the third generation frequencies it acquired from the Ministry of Communications in the same way as its competitors. The proposed new version of NOP 36 includes a clarification for this matter.

Pelephone (and its competitors) encounters difficulties in obtaining some of the required approvals, and in particular approvals from planning and building authorities.

Pelephone's ability to maintain and preserve its MRT service quality as well as the coverage, is partially due to its ability to set up cellular sites and install infrastructure equipment, including broadcasting sites. The difficulties encountered by Pelephone in obtaining the required permits and approvals may adversely affect the existing infrastructure, network performances and the establishment of any additional cellular sites required by the network.

The inability to resolve these problems on a timely basis is also liable to prevent the attainment of the service quality goals specified in its license.

A number of sites established several years ago still do not have approvals from the Civil Aviation Administration and the IDF, even though the applications for the approvals have long since been submitted to them. Similarly, there are administrative or other delays in some planning and building councils in the issue of building permits for sites. Therefore, Pelephone operates a number of broadcasting sites that have not yet received building permits. Pelephone has applied to the planning and building authorities for the building permits and these are at various stages of discussion and approval.

The establishment of a broadcasting site without obtaining a building permit constitutes a breach of the Planning and Building Law, 5725-1965, and in some instances, this has resulted in demolition orders against sites or indictments or the initiation of civil proceedings against Pelephone and some of its officers.

As at the date of this report, Pelephone has succeeded, in most of these cases, to avoid demolition or to delay the execution of demolition orders pursuant to arrangements it reached with the planning and building authorities to resolve the matter of the deficient licensing. These arrangements have not required any admission of guilt by officers of Pelephone and/or their conviction. However, it is not certain that this state of affairs will continue in the future, or that there will be no further instances in which demolition orders are issued and indictments are filed in respect of building permits, including against officers.

Pelephone, similar to other MRT operators in Israel, is liable to be required to dismantle broadcasting sites for which the necessary approvals and permits have not been obtained in accordance with the dates prescribed by law. If it is legally required that sites in a given geographic area be simultaneously demolished, service in that area is liable to deteriorate until substitute broadcasting sites can be built.

The second track under which Pelephone establishes broadcasting sites is the access devices track. Access devices require specific radiation permits according to the radiation law but are exempt from a building permit if they are constructed pursuant to the conditions provided in the exemption provision.

Some local authorities have disputed the applicability of the exemption provision to access devices of a cellular network and to its use. Pelephone's position regarding the applicability of the exemption was accepted in a number of rulings and decisions by local affairs courts and the use of such facilities and the supporting equipment was approved. One verdict in the same instance provided an opposite ruling. Appeals have been filed for some of these rulings and decisions.

On May 22, 2008, Tel Aviv District Court, sitting as a Court of Appeals, handed down a ruling regarding the issue of wireless access devices. The main points of its determination were as follows:

A. The exemption from a building permit does not apply to access devices operating in a cellular network constructed on the roofs of buildings.

B. Wireless access devices, as defined by law, are fixed devices.

C. The antenna is not included the definition of an exception to the requirement for a building permit for an "internal change in an apartment".

The Attorney General's opinion in this respect, which preceded this decision, is described below.

Pelephone disagreed with the district court's ruling and on June 10, 2008, it filed a request for permission to appeal to the Supreme Court In the context of the request for permission to appeal the Attorney General stated, inter alia, that the exemption in Section 266 (C) of the law also applies to wireless access devices.

Two additional rulings were recently passed down in the courts for local affairs regarding access devices. The rulings recognized the legality of installing wireless access devices used by cellular networks, also after this district ruling. In another ruling passed down by the district court, to which Pelephone is not party, limited interpretation was given for the term "building roof" to which the exemption can be applied.

On July 21, 2008, the Union of Local Authorities in Israel and others filed a petition with the High Court requesting an order nisi instructing the Attorney General to appear and explain, inter alia*,* why the enforcement guidelines he issued to municipal prosecutors stating that charges not be filed and administrative demolition orders not be issued for the construction and operation of cellular access devices without a permit should not be cancelled. Furthermore, the High Court was asked to determine, inter alia, that the position of the Attorney General (in a document dated May 1, 2008) contains an extreme lack of reasonableness. Furthermore, a request was made for a temporary injunction to instruct the Attorney General to defer or suspend the validity of the enforcement guidelines or, alternately, to forbid the construction of cellular access devices without a building permit, until the court meets and rules on the petition.

A petition was submitted to the High Court of Justice against the legality of using the exemption provision for cellular network access devices, which was dismissed because of threshold conditions. In this framework, the State Attorney announced that the Attorney General is preparing his opinion on this matter and is holding staff work between the relevant government offices.

On May 1, 2008, the Attorney General expressed his position regarding wireless access devices and stated that he accepts the opinion that the exemption, according to its wording and purpose, also applies to wireless communications devices for cellular communications and represents the balance that the legislator created between the various interests. Despite this, and because of changes and developments in the law and the factual reality, the Attorney General asked that an inter-ministerial committee re-examine the significance and ramifications of continued application of the exemption for cellular devices, the purpose of developing an updated position regarding a worthy justification for the exemption for cellular telephone devices, by the end of 2008.

The team set up by the Attorney General to review the issue of access devices, completed its work and in June 2009 submitted a report on its work. The team's report was published on the websites of the Ministry of the Environment and Ministry of Communications. Representatives of the various ministries disagreed with some of the team's conclusions. The Ministry of Communications supported a continuation of the exemption arrangement for a period of one to two years after approval of NOP 36A1 in view of the licensing difficulties, particularly in urban areas, and a review of the need to continue the exemption in view of the quality of the response that the NOP will provide on this matter. The Ministries of the Interior and the Environment concluded that there is no justification for continuing to apply the exemption arrangement to cellular communications installations. If the position of these ministries is accepted, and the exemption arrangement is discontinued, it will adversely affect deployment options and the quality of service that Pelephone will be able to offer its customers, particularly in densely built-up areas. Before the team's report was published, another appeal was filed in the High Court of Justice against the Attorney General, the inter-ministerial team and others, requesting relief regarding the validity of the Attorney General's position which supports a continuation of exempting wireless access devices from the need for building permits.

In the wake of the team's report, and following a discussion of the subject which took place in September 2009, the Attorney General summarized his position in a document from September 9, 2009, whereby the Communications (Bezeq and Transmission) (Frequencies for Wireless Access Devices) Regulations, 5762-2002, which contain the exemption from a building permit for wireless access devices as prescribed in Section 266C of the Building and Planning Law, 5725-1965, were duly promulgated by authority and by law. Nevertheless, the Attorney General determined that in view of the legal and factual changes which have taken place over the years since the regulations were promulgated, and in view of their importance, which were discussed and clarified during the team's deliberations and in its report, the arrangement in its present format does not properly balance the interest of efficiency and competition with the interests embodied in the Building and Planning Law. The State Attorney further stipulated that the Ministries of the Interior and Communications shall, by the end of October 2009, file amendments which will prescribe conditions limiting and restricting the applicability of the exemption from a building permit and use thereof.

On June 16, 2009, the Forum for Cellular Sanity and others filed a petition to the High Court of Justice for an order nisi to instruct the Attorney General to explain, inter alia, why the State Prosecutor's response regarding Pelephone's application for permission to appeal must not be withdrawn, and to explain why the enforcement instructions issued to the urban claimants by the Attorney General should not be cancelled, whereby indictments are not to be filed or administrative demolition orders to be issued in respect of the erection and operation of cellular access devices without building permits. The Attorney General was also asked to explain why he should not cancel the instructions which allow permits to be granted for erecting access devices without obtaining a building permit. An application for a temporary injunction against the Attorney General was also filed, to instruct the deferral or suspension of the validity of the enforcement instructions and to instruct the deferral or suspension of the instructions given to the relevant permit authorities to continue to allow the erection of cellular access devices without obtaining a permit, until the hearing and decision on the petition takes place or until after the inter-ministerial committee has published its conclusions. The hearing on this petition was amalgamated with the hearing on the claim filed by the Union of Local Authorities, which deals with similar issues. At a HCJ hearing which took place recently on the two petitions, the Attorney General announced that the draft regulations concerning the construction of a wireless access device for cellular communications will be submitted to the Knesset Economic Committee by the end of February 2010. The Attorney General further submitted that if the draft regulations are not filed as above, he will not object to issuing an interim injunction prohibiting the construction of wireless access devices without building permits.

In view of the announcement, no interim injunction was issued at the hearing, and it was determined that the State will issue a revised statement on this matter in March 2010.

The purpose of the regulations submitted to the Economic Committee will be, as noted, to restrict and limit the applicability of the exemption from a building permit and use of such a permit for wireless access devices.

As for the private bills regarding the exemption of cellular wireless access devices from a building permit, the Government decided to formulate its position on this subject taking into consideration the decision of the Attorney General.

Pelephone uses access devices to provide coverage and capacity to highly populated areas. Reducing or preventing use of the access devices track in a given geographical area may have an adverse effect on service in that area until substitute broadcasting sites can be built. If it is legally required that sites in a given geographic area be simultaneously demolished, service in that area is liable to deteriorate until substitute broadcasting sites can be built. As at the date of this report, Pelephone operates 499 wireless access devices.

A number of local authorities have recently presented to the Commissioner of Radiation in the Ministry of the Environment their objection to the construction of access devices, based on a clause in the Non-Ionized Radiation Law prescribing that provision of operation permits for access devices is contingent on the approval of the relevant authority. As a result of these objections the Ministry of the Environment sometimes refuses to issue operation permits to access devices established according to the law in these authorities.

Likewise, Pelephone, similar to other MRT operators in Israel, provides internal relays inside buildings to provide service in the buildings. These relays are small 60-cm devices attached to external antennas. This antenna receives a broadcast signal from a nearby broadcast site, which is then relayed into the building. Radiation emissions from these kinds of small antennas are similar to emissions from cellular terminal equipment. These relays and others have received a class approval from the Ministry of Communications.

Given the planning authorities' lack of clarity in policy matters relating to internal relays and small installations, and the work patterns of all MRT operators in Israel, permits were not sought from the planning authorities in respect of these internal relays and small installations.

3.18.6 Antitrust

The document setting out the terms of the merger between Pelephone and Bezeq includes various restrictions as to cooperation between the companies.

3.18.7 Standards

Pelephone conducts routine durability and quality control tests of its facilities. The quality control and supervision do not detract from Pelephone's responsibility towards its customers for the quality of the services it provides.

In April 1996, the Israel Standards Institute found Pelephone to be in compliance with the requirements of Israel Standard ISO 9001:2000 for mobile radio telephone (cellular) services.

Pelephone received certification on January 11, 2004, valid until October 2010.

Once a year, an inspection is conducted to ensure that Pelephone's operations comply with the requirements of the standard. The last inspection was in December 2009, and was successful. In this inspection, the standard was revised to the 2008 version.

ISO 9001:2000 addresses a series of standards for quality management in the services. This is a standard for quality control systems that defines requisite conditions for compliance with service process standards and also constant improvement and testing of the effectiveness of the quality management system and its components.

Pelephone carried out the required adjustment for obtaining the approval in line with the tendency of the business-industrial world in general of its customers in particular, to contract exclusively with suppliers complying with the standard.

3.19 Material Agreements

For undertakings to banks, see section 3.15.2.1 above.

For trust deeds signed with Union Bank Trust Co. Ltd. at the time of issue of debentures, see section 3.15.3 above.

3.20 Joint Venture Agreements

For joint venture agreements with content suppliers regarding value added services, see section 3.12.2 above.

For roaming agreements, see section 3.2.1 above.

3.21 Legal Proceedings

3.21.1 In December 2000, the State of Israel filed a claim with the District Court in respect of royalties allegedly owed for the period from January 1994 until February 2996. The amount being claimed is NIS 260 million, including principal, linkage differences and interest.

An examination conducted as part of a mediation procedure found that the maximum amount of royalties on Pelephone's revenues from January 1, 1994 to February 7, 1996 was only NIS 118 million (before interest, linkage differences and the sum actually paid).

The Company undertook to pay Pelephone any amount it is ordered to pay the State in a peremptory decision for revenues from MRT services for the period from January 1, 1994 to October 10, 1994. According to the Company, it paid the State for this period under a compromise agreement between the Company and the State of Israel from November 29, 1995.

3.21.2 In September 2001, a claim was filed at the Ramallah District Court by Paltel, the General Public Palestinian Communications Company Ltd., against Pelephone and another company.

The plaintiff alleges that its license grants it, inter alia, the full right and authority to establish, operate and supply, sell and manage services and stations for landline and cellular telephone communications, for providing fixed-line and cellular communications services for an extended period, for part of which it was granted exclusivity.

According to the plaintiff, it began to provide cellular communications services in September 1999, and despite its requests to the defendants, they continue to provide cellular communications services to residents of the West Bank and the Gaza Strip, without restraint and without a license from the Palestinian Communications Authority, thereby violating various provisions of law, prejudicing the exclusive rights of the plaintiff and causing it loss and damage.

The reliefs requested are a permanent judicial injunction preventing the defendants from providing communications services in the areas of the Palestinian National Authority, as well as a financial action for NIS 676 million from Pelephone alone.

At the date of closing this report, the process of serving the claim was halted by the Attorney General and notice by publication which had been sent by registered mail was returned through the Ministry of Justice.

It should also be noted that Pelephone does not recognize the jurisdiction of the court in Ramallah.

Pelephone learnt that the Ramallah court may have given a decision in the claim.

According to the Emergency (Judea, Samaria and the Gaza Strip – Jurisdiction in offense and legal aid) (Territories of the Palestinian Authority – Legal aid in civil matters) Order, 5759-1999, enforcement of decisions given by a court of the Palestinian Authority may only be executed if approved by the Commissioner for Legal Aid at the Ministry of Justice. Pelephone is of the opinion that such a decision – if given – was given without jurisdiction, was contrary to public order and contrary to the provisions of the interim agreement and the Extension of the Effect of the State of Emergency Regulations (Judea, Samaria and Gaza Strip –Jurisdiction in offences and legal aid) Law, 5727-1967.

If an attempt is made to serve this decision for the approval of the Commissioner, or to enforce it in any other way whatsoever, Pelephone will act to prevent such approval and/or enforcement of the decision and/or execution proceedings or their voidance, for the reasons noted above, which were behind the Commissioner's decision to prevent the service of the claim on Pelephone from the outset, as well as that the fact of the claim being heard in the court in Ramallah without service of process in accordance with the Order and agreement, constitutes breach of the agreement and harms the sovereignty of Israel, and that any decision given in such a claim is without effect.

3.21.3 In December 2002, a claim was filed together with an application for approval as a class action, in the Tel Aviv District Court against Pelephone and Cellcom, for the total amount of approximately NIS 4 billion, of which NIS 2.4 billion is against Pelephone.

The claim relates to amounts collected by Pelephone and Cellcom for interconnect fees on incoming calls from May 10, 2996 to October 2, 2000. The plaintiffs claim that every MRT operator is a monopoly in the incoming call service to its network; Pelephone and Cellcom abused their monopoly status by setting high and unfair prices for the incoming call service of their networks; the correct and fair tariff for the incoming call services is 25 agorot per minute, and not as collected in the past by Pelephone and Cellcom, or as set today in the Telecommunications (Payments for interconnect) Regulations, 5760-2000. The claim was rejected in December 2008. In January 2009, the plaintiffs filed an appeal.

3.21.4 In April 2003, an application was filed in the Tel Aviv District Court for approval of a claim as a class action, in a total amount of NIS 90 million, against all the cellular operators. The applicants allege that all three cellular companies formed a cartel among themselves for the collection of a tariff of 38 agorot plus VAT for SMS messages coming into each of their networks. The plaintiffs allege that this is a uniform, inflated, unreasonable and unfair tariff.

The claim relates to the period from March-June 2002 to the date of filing the claim.

3.21.5 In August 2006, a claim was filed at the District Court against Pelephone and against Cellcom Israel Ltd and Partner Communications Ltd., together with an application to approve it as a class action, in the total amount of NIS 100 million (hereinafter: the First Claim).

The claim refers to the time of disconnecting calls made from the cellular network to the Bezeq or HOT networks. The claim alleges that in such calls, where a Bezeq or HOT customer initiates termination of the call, there is an excess charge until the call is actually disconnected.

In November 2006, a claim was filed at the Tel Aviv District Court against Pelephone and against Bezeq, Hot and Partner, together with an application to approve it as a class action, in the total amount of NIS 158 million. Of this amount, NIS 53 million is against Pelephone, together with Bezeq and Hot. (Hereinafter: the Second Claim). In a procedural arrangement reached between the parties, it was determined that the First Claim would be conducted against Pelephone and against Cellcom Israel Ltd. and Partner Communications Ltd., and the Second Claim would be conducted against Bezeq and Hot, and the two procedures would be amalgamated.

In this instance, see also Section 2.18.10 above.

3.21.6 In June 2007, a financial claim and an application to approve it as a class action were filed in the Tel Aviv District Court, against Pelephone.

The aggregate amount of the claim is NIS 239 million, and it relates to a group of customers belonging to the Russian sector of the population and the tariff tracks that were offered to them.

According to the plaintiffs, Pelephone misled the subscribers of the New Immigrants Plan to believe that they would be charged on the basis of 12-second units, whereas in practice they were debited on the basis of one-minute units.

It is also alleged that in order to perpetuate the deception, Pelephone did not provide the subscribers with the price list for the plan, as required under its license.

3.21.7 In December 2007, a claim was filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, together with an application to approve it as a class action in the amount of NIS 1 billion. The claim relates to radiation damage from cellular antennae which were ostensibly erected unlawfully.

3.21.8 In April 2008, a claim was filed at the Tel Aviv District Court against Pelephone, together with an application to approve it as a class action in the amount of approximately NIS 60 million.

The claim is for the refund of amounts which the plaintiffs allege was over-collected from Pelephone's subscribers, and are divided into three causes and three separate groups of plaintiffs:

First: an allegation that Pelephone does not enable toll-free calls to be made from any telephone (in any network) to its service center, in ostensible violation of the provisions of the law. The amount claimed for this cause is NIS 30 million.

Second: an allegation that when making a "dial-on" call from the voice mail box (i.e. continuation of the call from the voice mail directly to the caller who left the message without disconnecting the call), Pelephone also charges for air time for the time until the receiving party (who leaves the message) answers, in ostensible violation of Pelephone's license. The amount claimed for this cause is NIS 10 million.

Third: an allegation that when a subscriber who has signed up for a plan that includes a minutes package, dials within that plan to 1-800 (toll-free) destinations, the full duration of that call is deducted from the minutes package, despite the fact that calls to 1-800 destinations should be at a lower tariff. The claim relates to those subscribers who exceeded their minutes package and were charged for calls in excess of the package. The amount claimed for this cause is NIS 20 million.

3.21.9 In May 2008, a financial claim was filed in the Tel Aviv District Court against Pelephone and a service provider. The claim is in the amount of NIS 479.5 (the statement of claim is headed "Class Action" but does not specify an amount claimed on behalf of the group and does not include separate processes of court – "Statement of Claim" and Application for Recognition as a Class Action" – as required). As noted, the total amount is not defined in the claim. The claim is for a refund of amounts by the service provider, which the plaintiff alleges it collected through Pelephone from members of its customer club for services it provided to those customers.

According to the plaintiff, the agreement between Defendant no. 1 and the members of the customer club, on which basis they became members of the club and monies were collected from them, was flawed, and the aforementioned amounts must therefore be refunded.

The specific allegation against Pelephone is that the debit for the services of the service provider is not clearly differentiated in the phone bill that is sent by Pelephone to its customers, ostensibly in contravention of Pelephone's license.

3.21.10 In May 2008, a claim was filed at the Tel Aviv District Court against Pelephone and others, together with an application to approve it as a class action in the overall amount of NIS 50 million.

The claim is for a refund of excess amounts which the plaintiffs allege was collected from Pelephone's subscribers for "callback services" (calls made from abroad to Israel through a service which the company calls "saver service").

3.21.11 In July 2008, a claim was filed in the Tel Aviv District Court together with an application to approve it as a class action. The inclusive amount of the claim is NIS 240 million.

The claim is for the refund of amounts which the plaintiffs allege was over-collected from Pelephone's subscribers, and is divided into three causes and three separate groups of plaintiffs:

First: an allegation that when making a "dial-on" call from the 144 information service (i.e. continuation of the call to the subscriber whose number was requested, without disconnecting the call), Pelephone charges for air time also for the time until the called party answers, in ostensible violation of Pelephone's license. The amount claimed for this cause is approximately NIS 24 million.

Second: an allegation that the defendant (Pelephone) collects interest in arrears from a subscriber who is late in paying Pelephone, as well as "rescheduling" interest where payments are rescheduled, in ostensible violation of Pelephone's license. The amount claimed for this cause is approximately NIS 48 million.

Third: an allegation that Pelephone collects payment in respect of a standing order, handling fees for the voucher and commission for payment of a voucher at a service center, ostensibly in contravention of its license. The amount claimed for this cause is approximately NIS 168 million.

3.21.12 In January 2009, a claim was filed at the Tel Aviv District Court, together with an application to approve it as a class action, in the inclusive amount of NIS 219 million (plus compensation for distress, to be determined by the Court). The claim is for the refund of amounts collected by Pelephone from its subscribers, according to the plaintiff, in respect of surfing on the handset, by representatives of Pelephone when repairing the handset.

3.21.13 In January 2009, a claim was filed in the Tel Aviv District Court together with an application to approve it as a class action, for the inclusive amount of approximately NIS 570 million. The claim is for the refund of amounts collected by Pelephone from its subscribers, according to the plaintiffs, for surfing on the handset by representatives of Pelephone for backing up the phonebook, when the handset is being repaired. The cause of the claim is similar and even parallel to the cause of the claim in section 3.21.12 above.

3.21.14 In August 2009, a claim was filed in the Central Region District Court together with an application to approve it as a class action. The class is to refund amounts collected by Pelephone for payment by standing order at the bank, on the grounds that such collection is contrary to Pelephone's license and in contravention of the law. The amount of the personal claim is NIS 173. No amount was specified in the class action. The claim includes requested relief of a permanent injunction instructing Pelephone to discontinue collecting this amount, and declarative relief that such collection is unlawful.

3.21.15 In August 2009, a claim was filed in the Petach Tikva District Court together with an application to approve it as a class action. The claim addresses the saving of SMS messages which are sent through the Pelephone network, in Pelephone's systems. According to the plaintiffs, saving these messages is in contravention of the law and of Pelephone's license. The relief requested is as follows: declaratory relief, that the information is held unlawfully, mandamus to delete the information, an injunction to prevent messages being saved in future, as well as undefined monetary relief (to be decided by the Court).

3.21.16 In August 2009, a claim was filed in the Tel Aviv District Court together with an application to approve it as a class action. The claim was filed against Pelephone Communications Ltd., Shamir Systems Ltd., and Unicell Advanced Cellular Solutions Ltd. The amount of the claim is approximately NIS 200 million (not divided among the respondents). The claim is for the refund of amounts collected by the respondents (which are debited through the cellular bill) in respect of services provided by the respondents Shamir and Unicell through the cellphone (information sent by SMS). The claim includes requested relief of mandamus, instructing the respondents to discontinue their practice of such debiting. According to the claim, the plaintiff did not ask to join the service offered by Shamir and Unicell, and charging for such services is therefore unlawful.

3.21.17 In October 2009, a claim was filed in the Tel Aviv District Court together with an application to approve it as a class action. The amount of the claim is NIS 331 million. According to the applicant, Pelephone is in violation of its license by offering benefits for purchasing a handset and a refund of competitors' fines, for a period which is longer than the 18-month commitment period (to 36 months). The claim is for Pelephone to pay its customers compensation, equal to the benefits which Pelephone gives its customers during the period after the 18 months, and to instruct the company to limit the benefits it offers to 18 months.

3.21.18 In December 2009, a claim was filed in the Tel Aviv District Court together with an application to approve it as a class action. The claim is in the amount of NIS 50 million. The claims concerns the exit fee which Pelephone charges subscribers who wish to disconnect from the service under the agreement during the commitment period.

3.21.19 In January 2010, four torts claims were received against Pelephone and the Ganim nursing facility. The claims were filed by Ganim's employees in respect of physical injury they suffered, allegedly as a result of exposure to radiation from Pelephone's cellular aerials which are located at the nursing facility. Each claim specifies damage of NIS 1.7 million, where the amount of the claim is at the discretion of the magistrate's court where the claims were filed. At this stage, the possibility is being investigated of handling these claims by the insurance company as part of Pelephone's insurance cover, as it was on the relevant dates.

3.21.20 In February 2010, a claim was filed in the Jerusalem District Court, together with an application to approve it as a class action. The claim is in the amount of NIS 50 million. According to the plaintiff, the Company collects a full exit fee from customers who wish to terminate their agreement during the commitment period, despite the fact that under the agreement, according to the plaintiff, the Company should collect a proportionate exit fee (relative to the period remaining until the end of the period. In addition, according to the plaintiff, the Company acted in contravention of its representations and the law by collecting an exit fee in respect of a basic TV package, despite the fact that the package was given to the plaintiff free of charge. The claim is for the refund of amounts subsequently collected by the Company. The application also includes requested relief of an order instructing the Company to cease such charges.

3.21.21 **<u>Procedures which have been concluded</u>**

A. In February 2007, a claim in the amount of NIS 167 million was filed at the Tel Aviv District Court concerning a high charge in respect of calls overseas – in August 2009, the claim was dismissed following a request for withdrawal by the plaintiff.

B. In June 2008, a claim in the amount of NIS 64 million was filed at the Tel Aviv District Court concerning the refunding of a fee paid for a voucher, which according to the plaintiff Pelephone charged unlawfully – in January 2010 the claim was dismissed.

C. In October 2008, a claim in the amount of NIS 716 million was filed at the Tel Aviv District Court concerning the collection of amounts in respect of browsing with third generation handsets – in January 2010, the claim was dismissed.

D. In February 2009, a claim in the amount of NIS 80 million was filed at the Central District Court concerning the erasure of voice messages saved in the voice-mail system after a certain period – in July 2009, the plaintiff announced his withdrawal of the claim, thus ending the claim.

E. In November 2009, a claim was filed in the Jerusalem District Court in the amount of NIS 900 million, concerning "kosher" tracks which Pelephone markets to the religious and ultra-orthodox sector – in February 2010, the claim was dismissed.

3.22 Goals and Business Strategy

Pelephone’s principal strategic goals are:

1. To increase revenue and improve profitability
2. To maintain leadership in third generation
3. To increase its market share in the long term

To achieve its goals, Pelephone operates on a number of principal levels:

1. Increasing customer satisfaction

   Pelephone acts to increase customer satisfaction and strengthen customer loyalty to Pelephone’s services. These actions are reflected by the improvement of the service system, offers to upgrade terminal equipment, and benefits for Pelephone customers under a marketing package reinforcing the Pelephone-customer relationship. Pelephone uses an advanced measurement system to monitor customer satisfaction, so that it may learn from it and constantly make improvements.

2. Third generation leadership

   Pelephone has set itself the goal of being a third generation leader. In 2008, Pelephone continued to maintain its leadership in this area and it presently has the largest number of subscribers with third generation handsets compared to its competitors. This leadership is reflected in increased revenue from 3G services and by the number of subscribers joining such services.

3. Managing migration of customers to HSPA/UMTS

   To lever the new technology, to improve customer satisfaction and maximize revenues, Pelephone acts to prioritize migration of customers from CDMA to HSPA/UMTS.

4. Continued investment in infrastructure

   Pelephone acts constantly to improve cellular service so that it can offer its customers the most advanced services, high speed access, high reception quality and full national deployment.

The above information contains forward-looking information, which is based on Pelephone's assessments taking into account past experience, surveys regarding the state of the sector in which Pelephone operates, and its own future plans. Actual performance may differ substantially from these assessments, if there is any change in any of the factors taken into account in making these assessments. For risk factors, see section 3.24 below.

3.23 Outlook for Development in 2009

In 2010, a number of negative and positive factors are expected to affect Pelephone’s activities, the main ones being:

3.23.1 Third generation services

Pelephone expects that during 2010, it will continue to increase the number of customers using 3G on the HSPA/UMTS network, it will expand the supply of services, and as a result Pelephone will continue to increase its revenue in this sector.

3.23.2 International roaming services

With the growth in the number of its HSAP/UMTS subscribers, revenues from the roaming services are expected to increase.

3.23.3 Innovative value added services

In 2010, Pelephone is expected to continue to improve its existing services and to widen its range of advanced value added services, which will help improve brand perception and increase revenue from existing customers.

3.23.4 Regulation

In 2010, Pelephone expects revenue to be adversely affected by regulation of policy, license amendments, consumer legislation and various administration provisions that are expected to come into effect during the year, including a possible reduction of the interconnect fee subsequent to a review of the subject by the Ministry of Communications, the ban on price increases in a fixed transaction, and the introduction of MVNO.

The above information contains forward-looking information, which is based on Pelephone's assessments taking into account past experience, surveys regarding the state of the sector in which Pelephone operates, and its own future plans. Actual performance may differ substantially from the assessments set out above, if there is any change in any of the factors taken into account in making these assessments. For risk factors, see section 3.24 below.

3.24 Risk Factors

The Israeli market in which Pelephone operates is stable by nature, however, there are risk factors deriving from the macro-economic environment, the unique qualities of the sector in which Pelephone operates, and risk factors that are unique to the Company.

3.24.1 Macro-economic risks

Exposure to changes in the exchange rates, interest rates and rates of inflation – Pelephone is exposed to risks due to changes in the exchange rates, as most of its terminal equipment, accessories, spare parts and infrastructure are purchased in US dollars, whereas Pelephone's revenues are in shekels. A reduction of the shekel against the dollar may affect Pelephone's profitability if it is unable to adjust the sale price in the short term. Accordingly, Pelephone invests a considerable part of its cash balances in deposits which are exposed to changes in their actual yield resulting from changes in the rate of inflation. Pelephone's loans and debentures which are linked to the CPI bear fixed interest so that any change in the interest rate will affect their fair value but not their book value.

3.24.2 Sector risks

3.24.2.1 Investments in infrastructure and technological changes – The cellular market in Israel and in other countries is characterized by material capital investments in the deployment of infrastructure and in subscriber equipment. The frequent technological changes in infrastructure and terminal equipment and the fierce competition in various market segments impose a heavy financial burden on the companies operating in the market, requiring them to update their infrastructure technology from time to time or to introduce new devices into the market at heavy cost.

3.24.2.2 Customer credit – Pelephone's sales to its customers are mostly credit-based. Some of this credit is secured using credit insurance which includes policyholder's deductibles, and some is secured by sureties provided by customers. The part of this credit, which is not covered by either insurance or sureties, is exposed to risk. Due to the wide distribution of its customers, Pelephone assesses that there is a low risk of substantial harm to its business results.

3.24.2.3 Regulatory developments – In the area of Pelephone's operations, there is a trend to legislate and impose standards on issues such as the environment, increased competition, tariffs, product liability and the methods used for repairing products. These regulations might, inter alia, make it much more difficult to construct cellular sites, impairing network quality, and increasing the costs of services and marketing. Due to the strong competition, it might not be possible to roll those costs in full onto consumers, which could erode profits in the sector. Furthermore, regulatory intervention and the uncertainty it entails may have an adverse effect on the Pelephone's ability to plan its business activity.

3.24.2.4 Competition – The cellular market in Israel is characterized by a high degree of saturation and strong competition, and is exposed to influences due to technological and regulatory developments (see Section 3.7 above).

3.24.2.5 Electromagnetic radiation – Pelephone operates hundreds of transmission facilities and sells terminal equipment that emits electromagnetic radiation (see section 3.17 above). Pelephone is taking steps to ensure that the levels of radiation emitted by these transmission facilities and terminal equipment do not exceed the levels of radiation permitted in the directives of the Ministry of Environment Protection (levels adopted in accordance with international standards). Even though Pelephone acts according to the directives of the Ministry of Environment, if health risks are found to exist or if the transmission sites or terminal equipment are found to emit more radiation than that allowed in radiation standards, constituting a risk to health, the effect could be negative following a reduction in the use of Pelephone's services, difficulty in renting sites, claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity that were deposited with the planning authorities with respect to section 197 of the Planning and Building Law. Pelephone's third-party liability policy does not currently cover electromagnetic radiation.

3.24.2.6 Site licensing – The establishment and operation of cellular antennas are subject to building permits from the various planning and building committees, a process that involves, inter alia, a number of approvals from State entities and regulatory bodies. For details of the difficulties encountered by Pelephone in the establishment and licensing of sites, see section 3.18 above. These difficulties may impair the quality of the existing network and even more the deployment of the new network.

3.24.3 <u>Pelephone's risk factors:</u>

3.24.3.1 Terminal equipment quality – Pelephone might be exposed to losses in the event of malfunctions in the terminal equipment that it sells, including indirect damages that could result from such malfunctions.

3.24.3.2 Property risks and liabilities – Pelephone is exposed to various property risks and liabilities. Pelephone employs the services of expert professional external insurance consultant in this field. Pelephone has insurance policies which cover the usual risks which Pelephone is exposed to within the limits of the conditions of such policies, including various forms of property insurance and liability insurance, loss of profits, third party liability insurance and officers' insurance.

3.24.3.3 Serious malfunctions in information systems – Pelephone's information systems are networked throughout the country through designated communications lines and through the internet. Pelephone's business is highly dependent upon these systems. Wide-scale malicious harm or malfunction might adversely affect Pelephone's business and results.

3.24.3.4 Serious malfunctions in the communications network – Pelephone's communications network is deployed around the country through network core sites and antenna sites. Pelephone's business is totally dependent upon these systems. Wide scale malicious harm or malfunction might adversely affect Pelephone's business and results.

3.24.3.5 Damage by natural or other disasters, war, damage to the switching farm and/or servers used by Pelephone for its core activities could have an adverse effect on Pelephone's business and its results.

3.24.3.6 Legal proceedings – Pelephone is a party in legal proceedings, including class actions, which will possibly result in its being charged for material amounts that cannot presently be estimated and generally no provision has been made in Pelephone's financial statements for these proceedings. Class actions may reach high amounts, since approximately one third of the residents of Israel are Pelephone consumers, and a claim relating to a small amount of damage to a single consumer may grow into a material claim against Pelephone if certified as a class action applicable to all or a large proportion of those consumers for legal proceedings to which Pelephone is a party.

3.24.3.7 Pelephone uses two frequency ranges: 850 MHz and 2100 MHz. These frequencies are exposed to interruptions and could impair service quality of networks operated by Pelephone. The factors that could cause interruption include the fact that the 850 MHz frequency is also used for cable television broadcasts, television stations broadcasting in the Middle East (mainly in Cyprus) on the same frequency causing interruption in the Pelephone's EVDO/XRTT1 network. In addition, in view of the peace treaty with Jordan, Pelephone is precluded from using part of the frequency range that is suitable for the CDMA network, which is used by Jordan operators. In addition, development of digital multi-channel television broadcasts could aggravate the disturbances in this network.

The above information contains forward-looking information, which is based on Pelephone's assessments. Actual performance may differ substantially from the assessments set out above, if there is any change in any of the factors taken into account in making these assessments.

The following are the risk factors as described above, and their effect in the opinion of management, on its business performance:

Effect of risk factor on all of Pelephone's activity			
Risk factors	**Major**	**Moderate**	**Minor**
Macro-economic risk factors			
Economic slowdown		X	
Exposure to changes in the exchange rates, interest rates and inflation		X	
Sector risk			
Investments in infrastructure and technological changes	X		
Customer credit			X
Regulatory developments	X		
Competition	X		
Electromagnetic radiation*			
Site licensing	X		
Pelephone's risk factors:			
Quality of terminal equipment		X	
Property risks and liabilities			X
Serious malfunctions in information systems	X		
Serious malfunctions in the communications network	X		
Legal proceedings		X	
Restrictions applicable to frequencies and disturbance in frequency use		X	

* Pelephone is unable to assess the effect of this risk on its operations.

4. Bezeq International Ltd. - International communications and internet services

4.1 General

4.1.1 Structure and changes to area of operations

Bezeq International, the leading internet and international communications services provider in Israel was established in 1996 as a subsidiary, wholly-owned by the Company. It provides a communication solutions bundle for its customers in the private and business sectors, in four key areas of operation:

1) Internet access services;
2) International telephony services;
3) Network end point (NEP) services;
4) Data and ICT solutions.

Bezeq International's telephone services, similar to services of other international operators competing in the market, are primarily based on the company's domestic network and on the cellular network for connecting the subscriber to the international switchboard.

4.1.2 Legislative and statutory restrictions applicable to Bezeq International

The communications market in Israel is primarily regulated by the Communications (Telecommunications and Broadcasts) Law 5742-1982 ("the Communications Law") (see section 4.17 below).

4.1.2.1 General license

Bezeq International operates under a general license for providing voice, data and internet services (in this chapter: "the License"), which is valid until 2022. The provisions of the license regulate, inter alia, the method for determining tariffs charged by Bezeq International for its services, their updating and collecting the payments for these services.

4.1.2.2 Special general domestic operator license

On February 8, 2009 the Ministry of Communications granted Bezeq International’s subsidiary, B I P Telecom. Ltd., an exclusive general domestic operator’s license to provide domestic broad band telephony (VOB) services.

On August 2, 2009 Bezeq International began providing domestic broad band telephony (VOB) services to its private customers

On December 30, 2009, in view of the Ministry of Communication's announcement that the Company's market share for domestic telephony in the business sector declined to below 85%, the foregoing license was amended permitting Bezeq International to provide the services under the license to its business customers as well.

4.1.2.3 Special license for providing internet access services

On August 10, 2009, Bezeq International received a special license to provide internet access services. The services that Bezeq International is permitted to provide under this license were previously provided under the general license for providing Bezeq International's services. This license equates Bezeq International with all of the other internet providers operating under similar licenses. The license is valid until August 29, 2014.

4.1.2.4 Royalties

Under its license and the Telecommunications (Royalties) Regulations 5761-2001, Bezeq International pays the State of Israel royalties on most of its revenues from providing international call services and point to point lines, deducting permitted expenses and excluding of revenues from customers determined in these regulations. Pursuant to the provisions of the Telecommunications (Royalties) (Amendment) Regulations, 5766-2006, the royalties rate for 2009 was fixed at 1.5% and as of January 1, 2010 the rate will be 1%. In this regard see also section 2.16.3 above.

As of the publication date of the periodic report, there is a dispute between Bezeq International and the Ministry of Communications with regard to the amounts paid in excess by Bezeq International as royalties.

4.1.2.5 NEP license

On December 31, 2006, the Ministry of Communications approved the transfer of BezeqCall's NEP license to Bezeq International. As of the date of the full merger, Bezeq International has been providing NEP services under this license.

4.1.2.6 Gronau Committee report

For recommendations of the Gronau Committee and their adoption by the Minister of Communications, see section 2.6 above.

Bezeq International estimates that the Minister's decision will not have an effect on the company's business operations, however it is not able at this stage to estimate the possible long term impact, since the application of the changes in its areas of operation require, based on the Minister's decision, completion of the lengthy process of regulation infrastructure preparation, the nature of which is uncertain at this stage, and the creation of new market structures for this infrastructure, which it is still unclear whether and when they will take place.

4.1.2.7 Amendment to the general license – sale of service bundles

On July 3, 2008, Bezeq International received a letter from the Director General of the Ministry of Communications, regarding an amendment to the general license for the sale of service bundles, which includes the services of Bezeq International and Bezeq. The letter included draft amendments to the general licenses of Bezeq International and Bezeq. In its response to this letter and in the framework of the hearing held at the Ministry of Communications on July 20, 2008, Bezeq International informed the Ministry of Communications that it objects to the amendment of its general license, in the proposed wording, because on the one hand, this amendment will not ease the restrictions imposed on Bezeq International and Bezeq for the sale of joint service bundles, and on the other hand, the proposed amendment will have an adverse effect on its current situation and it discriminates against the company in comparison to the competitors. In the course of this hearing, further amendments were made to the draft amendments to the licenses of Bezeq International and the Bezeq, and again, this was not to the satisfaction of Bezeq International. On February 11, 2009, another hearing was held with the Director General of the Ministry of Communications. In this hearing, Bezeq International was assured that the Ministry of Communications would consider cancelling or updating the proposed amendment, to avoid discriminating against Bezeq International versus the competitors.

4.1.2.8 Hearing concerning the arrangement of the structure of the MRT network broad band services market

On August 21, 2009 the Ministry of Communications published a request for public positions concerning the matter of arrangement of the market structure for broad band services over the MRT network. The Ministry wishes, with its request, to examine the proper arrangement standard for these services. A Ministry of Communications decision in this matter, which will change the current arrangement, similarly to the one applicable to the fixed internet access services, may have a significantly positive impact on Bezeq International's business.

4.1.2.9 Changes in the tariff structure for MRT network and overseas communications

On January 31, 2010, the Ministry of Communication decided to adopt the Gronau Committee decision and to enforce the arrangement for fixed line overseas communications for outgoing MRT overseas calls via an international operator only, based on its tariffs, and it will pay the MRT operator for the transfer of the calls based on the tariff fixed in the Interconnect Regulations. The decision also stipulates that the international operator will not be entitled to raise its international communications rate for subscribers calling via the MRT network above the fixed line communications rate to the same destination, and with the addition of the difference between the interconnect price to the MRT network and the interconnect price to the fixed line network. The appropriate amendment to the international operator and MRT licenses will become effective on August 1, 2010. Bezeq International estimates that the decision may have an impact on the scope of international call services it provides to the MRT customers. The decision also constitutes an elementary condition for MRT operators entering the international call market, which may have a material impact on Bezeq International's businesses.

4.1.3 Main entry and exit barriers

4.1.3.1 The main entry barrier in the international call market is the requirement of a license under the Communications Law and investments in infrastructure, which is affected by frequent technological changes. However, change in the licensing policy, as set forth below, and expansion of the use of VoIP technology in this field, significantly reduces the effect of these barriers.

4.1.3.2 The main entry barrier into the data and internet services market stems from investments in infrastructure (international capacity, access to the internet network and broad service network).

4.1.3.3 The main exit barriers for these markets stem from long-term agreements with infrastructure suppliers and from investments that require a long periods of time to provide returns. Furthermore, Bezeq International is committed to providing service to its customers during the period of their contract.

4.1.4 Substitutes for Bezeq International products

In the international call market, the use of VoIP technology enables transfer of international calls over the internet, for other users of this technology, as well as for TDM network users, through the use of software products and services of communication providers abroad. The attractive cost of using these services lead to a steady growth in the number of users, and as a result – a decline in the revenues of Bezeq International. Furthermore, some service providers operating in the international call market do not have a license (illegal operators) and therefore do not bear the restrictions imposed on Bezeq International by virtue of the license and the provisions of the law.

4.1.5 Structure of competition and changes in the sector

4.1.5.1 In the first year of its operation, from June 1996 to July 1997, Bezeq International was the exclusive provider of international telephony services in Israel. In July 1997, two other international operators entered the market: Barak I.T.C. (1995) – International Telecommunications Services Company Ltd. and 012 Golden Lines Ltd. This led to a sharp fall in the prices of international calls and extensive growth in the capacity of the market. In April 2004, the Communications (Telecommunications and Broadcasts) (Procedures and Conditions for the Receipt of a General License for International Telecommunications Services) Regulations 5764-2004, came into effect. On the publication date of this report, the Ministry of Communications has granted general licenses to provide international telecommunications services to three more operators: Internet Gold-Golden Lines Ltd. (Internet Gold), NetVision Ltd. and Xfone Communication Ltd., all of which commenced operations by the end of 2004. The expansion of competition led to an additional fall in the prices of international calls, although, unlike 1997 when competition began, the volume of international traffic did not undergo a significant increase, since prior to the expansion of competition, call prices did not constitute a factor preventing the public from using the service. The expansion of competition had an adverse effect on the results of Bezeq International's operation and on its financial condition.

4.1.5.2 In 2007, Barak merged with NetVision, forming NetVision 013 Barak and Internet Gold merged with Golden Lines, forming 012 Smile.

4.1.5.3 During the fourth quarter of 2008, Partner Communications Ltd. ("Partner") entered the internet access and IP based content and telephony operations and began marketing its products to the general public on January 1, 2009. Consequently, Partner entered, as a competitorto the markets in which Bezeq International operates.

4.1.5.4 During January 2010, HOT announced its intention to enter the ISP market. Bezeq International is preparing and adjusting its work plans to its assessments in this regard.

As at the date of the periodic report, licenses for providing internet services have been granted to some 70 companies, among them are five of the aforementioned international operator licensees.

4.2 Products and Services

Below are details of the principal products and services provided by Bezeq International.

4.2.1 Voice services

In the voice services sector, Bezeq International provides international direct dialing (IDD) services to business and private customers; toll-free number services for business customers overseas; telephone card services enabling prepaid and postpaid dialing, mainly from overseas to Israel, for business and private customers; and the 1809 service for dialing from Israel to other countries by dialing 1809.

4.2.2 Internet services

In the internet services sector, Bezeq International provides internet access services for private and business customers, including terminal equipment and support, with an emphasis on broadband internet based on ADSL or cable infrastructures; hosting services – site storage and server services in a designated installation for business and private customers, including value-added services (such as monitoring and control); information security services, services securing customers' internet and LAN connections using the required terminal equipment or software, including monitoring; data services with international data communication IP solutions for business customers, including global deployment if necessary; and wireless (WIFI) access – fast wireless access solutions for private and business customers, including in various public locations (hotspots).

4.2.3 International data services

Supply of international data communication solutions for business customers, includes customized global deployment.

The customer is able to choose from a range of advanced data communication methods:

- DIA is a reliable and scalable P2P public IP platform manufactured by BT Infonet. The service allows global internet access (ISP) through one internet provider, and is designed as an optimum solution for the current requirements in business VPN connectivity.
- iWorks is a global offnet internet service that complements DIA, supplied as a one-stop-shop service through Bezeq International. The service provides full connectivity to public internet, through local providers in each country.
- IP VPN secure service enables transfer of multiple applications on a consolidated network, including data applications, real time and mission critical.
- Bezeq International supplies a range of private P2P services through optic cables running from Israel to Europe, for which the company has long-term leasing rights.

4.2.4 PBX services

Following the merger with BezeqCall, Bezeq International markets and maintains communication systems in the Israeli market, exchanges, telephony networks and IP communications. As part of the service contracts, Bezeq International supplies direct maintenance of a range of exchange manufacturers. The services are given to gateways, exchanges and network end points (NEP) designated for use with both internal and external lines.

4.2.5 Business customer service:

In addition, Bezeq International provides IT services to its business customers. As part of the comprehensive business IT solution, Bezeq International provides extensive communications services, including: data and overseas communication services, server and website hosting services ("Hosting Services"), technical maintenance and support services, networking and system services, outsourcing and out-tasking services, security and risk management solutions and IP based services.

4.3 Revenue

Bezeq International's revenue (in NIS millions):

	2009	2008	2007
Total revenue	1,318	1,306	1,304

4.4 New Products

4.4.1 Server Farm

In January 2009, Bezeq International inaugurated a new server farm in Israel. The farm joins the existing server farms of IDC and is expected to host thousands of servers. The establishment of the farm is part of Bezeq International's strategy to become well established in the business sector, especially among small and mid-sized businesses which at the present time prefer to conduct their IT by outsourcing. The new server farm established by Bezeq International is a "green" farm based on an energy saving infrastructure. The farm applies Bezeq International's advantages as a leading internet provider in Israel by being directly connected to the back bone of the company via Gig10 links. In this way, the customers can benefit from maximum flexibility in managing their band widths and from a wide range of sophisticated services such as hosting and management of servers, virtual servers and a range of administered services – backup, information security, attack prevention, monitoring, statistics construction, overseas Israel traffic distribution, groundbreaking broadband service, FTP file transmission services and more.

4.4.2 Key new products launched in 2009:

4.4.2.1 **Private NGN** – in October 2009 Bezeq International launched a separate internet network intended to enable its private high speed customers (minimum 10MB) to benefit from better surfing experiences. The establishment of the new network and its separation from the network serving lower speed surfers, allows the new network surfers to benefit from an upgraded surfing experience that includes increased broadband and capacity, designated technical service and support call centers and a range of other services and technology advantages.

4.4.2.2 **Domestic network** – Level 1 – selling domestic wireless networks with advanced encoding and security capacity and top-of-the-line internal firewall software.

4.4.2.3 **Premium Support** – support service offering a solution for a variety of problems and topics such as domestic network, mailing software, operating media message software and more. The service includes: An exclusive 24 hour access 1-800 number for service customers, telephonic domestic network installation, including connecting all the computers to the network, wireless definitions, defining encoding and network security for the network, defining printer and file sharing over the network, opening communication channels for using software and applications, solutions for a range of problems via expert remote control takeover, initial installation and solutions for media messaging software problems, support for advanced mailing software definitions, opening accounts in community network sites and more.

4.4.2.4 **Help Desk Call Center** – a service center that deals with customer calls on all IT matters (software/application problems and hardware problems, operating systems and communications). The call center staff members are experts in operating various monitoring tools, connectivity tools and local and broad networks, and they have in-depth knowledge of the relevant hardware (processors, printers, modems, routers and more), various operating systems (NT, Novell, MF, Win), various measuring tools and communication protocols.

4.4.2.5 **Online Access** – an innovative state-of-the-art MS-Exchange solution for diary sharing, remote access and mobile accessibility to all the information in the Outlook software. The service users can benefit from online diary sharing enabling a secretary direct access to the calendars of managers and employees, remote access and connection to cellular palm computers via PushMail technologies. The solution provides an alternative to a mail server at the customer's site with SaaS (Software as a Service) configuration.

4.4.2.6 **Express Support** – serves as an alternative to business IT management, where the service components provide support, maintenance and computer breakdown services in the business. The solutions, provided under a SLA contract, provide uniform service supported by the customer's terminal infrastructure and system components by combining expert operation at the customer's premises with back office teams at Bezeq International.

4.5 Marketing, distribution and service

4.5.1 Marketing

The marketing department coordinates all the operations for a number of permanent suppliers, among them advertising companies representing Bezeq International, which are used by Bezeq International to remain in contact with the advertising media (television, internet, radio and the daily national press), production and post-production companies (this changes depending on the requirements of each campaign), design and printing companies, and sales promotion and PR companies. Bezeq International believes that the loss of contact with any of its permanent advertising or marketing suppliers will have no significant effect on its marketing and distribution channels.

4.5.2 Private Market Sales Channels

4.5.2.1 Recruitment center for internet and incoming voice call services providing solutions for demand, and recruitment center for internet and outgoing voice calls based on various files.

4.5.2.2 Retention center for internet and incoming voice call services providing solutions for customers wishing to leave Bezeq International and retention center for internet and outgoing voice call services which handles existing customers proactively.

4.5.2.3 National direct sales setup conducting door-to-door operations, operating points of sale and managing customers.

4.5.2.4 Distribution channel setup including external centers and field systems for resellers and dealers.

4.5.3 Corporate Market Sales Channels:

4.5.3.1 New customer recruitment center – for SMB customers under the ingoing and outgoing call model, using files.

4.5.3.2 Increased existing customer volume center – for SMB customers under the ingoing and outgoing call model, using files.

4.5.3.3 Customer retention center, which handles the heaviest customers in the SMB sector, retains them and increases revenues from them. This center also acts as a second line regarding customer retention matters.

4.5.3.4 National direct sales setup conducting door-to-door operations, operating distributors and recruiting SMB customers.

4.5.3.5 Telemeeting center for setting and coordinating meetings with potential SMB and SME customers.

4.5.3.6 SME sector, which coordinates customer managers who recruit and manage medium-sized customers on an ongoing basis.

4.5.3.7 ENT sector, which coordinates customer managers who recruit and manage strategic customers on an ongoing basis.

4.6 Competition

The main characteristic of market competition in 2009 was the merging of communication groups and offering of comprehensive services and products. Three central groups operate alongside the Bezeq Group in the market today: the IDB Group, Partner Group, HOT group and several independent players.

4.6.1 <u>Voice services</u>

4.6.1.1 At the end of 2009 there were four competitors in the market: 014 Bezeq International, 013 Netvision, 012 Smile and 018 Xfone.

Bezeq International estimates that its market share in outgoing international calls from customers is approximately 36%.

4.6.1.2 <u>General characteristics of competition in 2009</u>

4.6.1.2.1 About 50% of households make international calls at least once a month.

4.6.1.2.2 The various sectors are extremely important (emphasis on immigrants originating from the former USSR) and marketing operations are designed accordingly.

4.6.1.2.3 The product is a commodity.

4.6.1.2.4 The market is a price market.

4.6.1.2.5 There is low consumer involvement due to the low costs.

4.6.1.2.6 Fierce competition and penetration of VoIP technology increase competition for customers.

4.6.2 <u>Internet services</u>

There are a number of competitors in this market, including Bezeq International, 013 NetVision, 012 Smile, Partner (as described in section 4.1.5.3) and two minor niche players. In Bezeq International’s estimation, its market share in the internet service sector is 36%. To the best of Bezeq International's knowledge, HOT is acting to enter the ISP market. As at the date of this report, HOT has not yet been granted a license for providing internet access services.

4.6.2.1 <u>General characteristics of competition in 2009</u>

4.6.2.1.1 Some 73% of Israeli households are connected to the internet and 95% of these have broadband connections.

4.6.2.1.2 There are two alternatives for customers in the market: ADSL, the leading Bezeq infrastructure, and the HOT infrastructure.

4.6.2.1.3 HOT frequently cooperates with Bezeq International’s direct competitors. HOT acts to restrict Bezeq International's internet operations. In addition, as noted above, HOT announced its intention to enter the independent internet access operations through its subsidiary, HOT NET.

4.6.2.2 Main developments in 2009

4.6.2.2.1 Continued slow-down in the growth rate of high-speed internet compared to previous years.

4.6.2.2.2 Upgrade of the internet infrastructures (Bezeq and HOT) and increased speeds offered to the customers – Bezeq's NGN network and HOT's UFI network (DOCSIS) enables the internet access providers and the infrastructure providers to offer a range of speeds from 10MB through 100MB.

4.6.2.2.3 Strengthening of the trend of selling bundle and triple packages in the market. This means that infrastructure suppliers have an effect on the market behavior.

4.6.2.2.4 Purchase of value added services.

4.6.2.2.5 Continued importance of price for the customer. At the same time, and in view of the market saturation, emphasis is placed on strengthening customer loyalty.

4.6.3 Solutions for the business sector – Bezeq International Business

Characteristics of the business sector in 2009

From the aspect of customer orientation and with the aim of increasing revenues from business customers, Bezeq International continues to supply integration services to businesses, providing full solutions in areas such as system, networking, IT, hosting, voice, data, ISP and wireless (wireless networks).

There is a full solution model for the customer, without relying on external suppliers, and the customer has one contact person with responsibility for the process (one supplier, one responsibility).

With the introduction of integration solutions, Bezeq International is facing new competitors in this field, such as Binat, Taldor, and IBM.

The other companies that are in competition with Bezeq International, and which, as well as the Bezeq Group fall into two main communications groups, are also trying to reinforce this field and competition is expected from that direction as well.

4.6.4 NEP services

The traditional field of telephone exchanges is characterized by a large number of competitors and by fierce competition, which has given rise to an erosion of service prices. The most prominent competitors are Tadiran, Eurocom, GlobeCall and Tel-Yad.

The data communications and IP telephony sector is characterized by the entry of new players – IT companies – into the world of voice. These are companies such as Binat, Teldor, Netcom, and IBM, which are substantially different from traditional NEP companies and are on a higher technological level. Telecommunication companies are also conglomerating and new operators, are entering the market, with the intention of providing customers with total communications solutions, such as telephony, transmission, data communications, internet, and information security.

4.7 Seasonality

In general, the revenues and profitability of Bezeq International are affected in a minor way by the seasons and holidays. There are seasonal fluctuations in the following services:

- Voice services for the business sector – decrease in August and during the Passover / Tabernacle holidays.
- Voice services for the private sector – increase in the summer months and towards the end of the Gregorian year.
- Internet services and NEP equipment – increased sales usually achieved in the fourth quarter.
- Internet services for the business sector – a decrease in the summer months owing to the closure of educational institutions (customers in this sector are not billed for the internet services to which they subscribe during the summer vacation).

4.8 Property, plant and equipment

In the past, Bezeq International referred to international communications infrastructure (underwater cables and international switches) which Bezeq International leases (mainly from Mediterranean Nautilus Limited) as property, plant and equipment. Upon adoption of IFRS, the rights of Bezeq International in international infrastructure can no longer be regarded as property, plant and equipment. For reference to Bezeq International's contract with the infrastructure supplier Mediterranean Nautilus, see section 4.11.5 below.

Towards the end of 2004, Bezeq International signed an agreement with Veraz, to purchase SoftSwitch switches, which, during the course of 2005, replaced the Alcatel S-12 voice switches (at this stage, these switches are still being used as a non-substantial component in Bezeq International's voice service systems). These switches are used to route Bezeq International's voice traffic. The value-added services, including dialing cards, are based on an intelligent network (IN), which was also replaced in 2005 as part of the upgrade of its voice setup.

Bezeq International's technological infrastructures, which support voice, data and internet setups, are deployed in four sites to provide services with high survivability. In 2005, Bezeq International set up another site in London, England to supply advanced services to its customers.

Bezeq International has a long-term lease for the two main structures in which it is based, for average periods of 6 years.

4.9 Intangible assets

4.9.1 Licenses

Bezeq International operates within the framework of a general license for the provision of international telecommunications service. The license constitutes the basis for Bezeq International's operations.

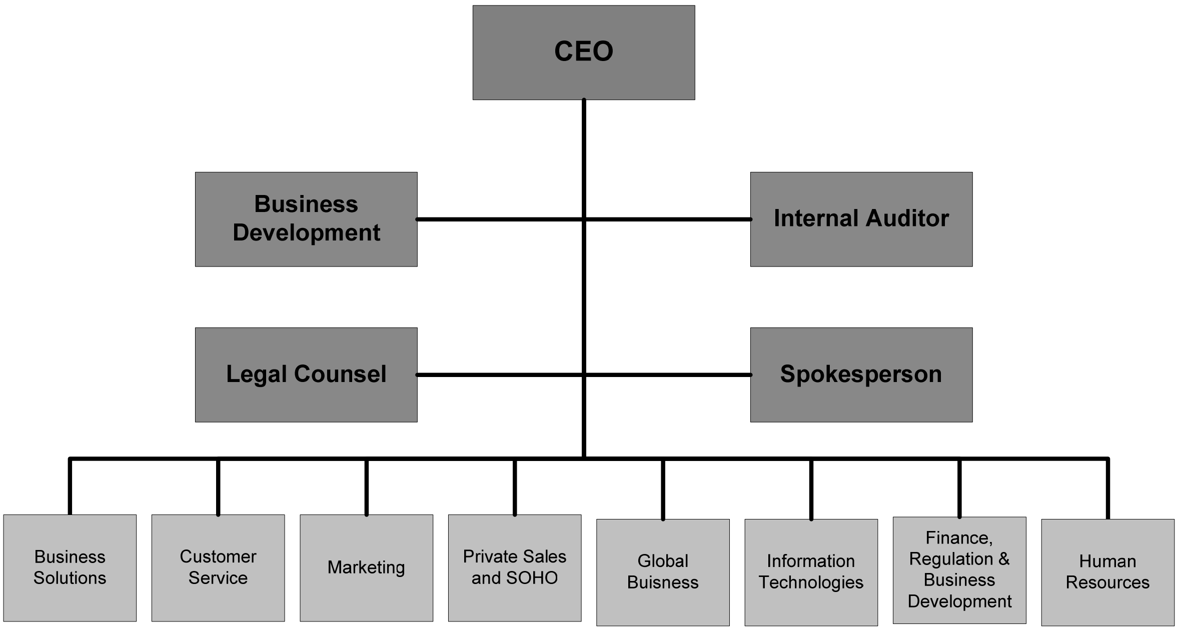
As of August 10, 2009, Bezeq International's internet access services are provided under a special license for providing internet services, which is valid until August 29, 2014. For further information in this matter see section 4.1.2 above.

4.10 Human resources

The number of persons employed by Bezeq International (employees of the company, employees of human resource firms and outsourcing) is 2,445, of which 995 are corporate headquarters employees.

Organizational structure

Below is the organizational structure of Bezeq International:



All of Bezeq International's employees have standard personal contracts based on their professions and positions.

Bezeq International has a number of employee groups whose wage structure includes a component of performance-linked commissions and incentives. These groups include sales employees, telephone sales representatives, and telephone service and support representatives.

Employees have a leasing arrangement enabling employees to receive vehicles at a fixed cost in accordance with the terms of an agreement between Bezeq International and a leasing company. Employees also have an arrangement for pension and health insurance that is fully subsidized by the company.

Bezeq International invests resources in professional training in accordance with the type of employee and the field in which he or she operates, such as technological training and qualification, manager development courses and more.

4.11 Suppliers

4.11.1 SigValue

In February 2005, Bezeq International signed an agreement with SigValue to purchase an intelligent network system, the cost of which is not material. Bezeq International is dependent on this supplier for some of its services based on the intelligent network.

4.11.2 Tadiran

Bezeq International has an agreement with Tadiran Information Systems Ltd. (which was acquired by IBM) which is implemented by IBM Global Services (Israel) Ltd. (IBM) for the maintenance and development of service absorption and pricing and billing systems. Bezeq International is dependent on this service from IBM.

4.11.3 Contact Center

In 2004, Bezeq International set up a contact center (a system integrating switchboard, collaborative system comprising computer, switchboard and interactive voice response). This setup is used by Bezeq International's service, support and sales centers, and is based on Avaya technology. Bezeq International has an agreement with IBM for ongoing support and maintenance.

4.11.4 Foreign Operators

Bezeq International has financial relations with some 100 foreign operators in approximately 240 destinations worldwide. The substantial foreign operators in terms of size and cost of traffic passing through these operators include British Telecom, Rostelecom, Paltel, and AT&T.

4.11.5 Mediterranean Nautilus Limited

Bezeq International is dependent upon international communications infrastructure provider Mediterranean Nautilus Limited, which supplies it with most of the international communications infrastructure that it requires through a seabed cable running from Israel to Europe. From there onwards, Bezeq International uses other infrastructure for connecting to the rest of the world.

4.11.6 Rights and Obligations in BezeqCall

All of the rights and obligations of BezeqCall under joint venture, marketing and sale agreements to which BezeqCall has been a party, were transferred to Bezeq International, giving it the right to market and supply installation, support and maintenance for equipment sold as part of NEP services. The most significant agreements are with LG, Nortel, Cisco, and Tadiran.

4.12 Working Capital

Bezeq International's cash item includes bank deposits for immediate withdrawal as well as fixed-term deposits on which there are no usage restrictions and which the repayment date, on the investment date, does not exceed three months. Bezeq International holds cash amounts that allow it operational flexibility. Bezeq International has significant receivables and payables balances. With regard to its credit policies, see section 4.13 below. Bezeq International holds stocks for sale and for maintenance, including computer, communications and switchboard equipment. The period for holding stocks derives from the sales and service policy requirements. Based on these requirements, Bezeq International holds stocks according to various categories for periods of 3-4 months on average. The Company's inventory policies aims to hold sufficient stocks for the Company's average requirements as set forth from time to time, with flexibility for unusual cases, based on the nature of the use of the item and its price. Orders from suppliers are placed taking into account past demand and projected forecasts.

4.13 Credit Policies

4.13.1 <u>Credit to customers</u>

4.13.1.1 Most of Bezeq International's customers have credit terms of EOM + 45.

4.13.1.2 Equipment sold to internet customers is usually billed in 24 installments.

As part of the NEP services, Bezeq International makes sales to its customers through payments in many installments. In this way, Bezeq International gives its customers credit, which they repay in installments. To reduce the exposure which might derive from long-term credit to its customers, Bezeq International checks their financial resilience, sets ceilings for the maximum credit available to customers and registers a charge over the equipment sold, pending full repayment of the credit.

4.13.2 Credit from suppliers

Bezeq International receives credit from its suppliers for 30 to 120 days (usually 90 days).

4.14 Investments

4.14.1 Walla Communications Ltd.

On December 31, 2009, Bezeq International held 34.24% (32.41% after full dilution as at December 31, 2008) of the share capital of Walla! Communications Ltd. (Walla). Walla is an Israeli company whose shares are listed on the Tel Aviv Stock Exchange. Walla provides internet services and is an internet portal provider.

Walla ended 2008 with a net profit of NIS 17.4 million and 2009 with a net profit of NIS 20.1 million.

During the first half of 2009, Bezeq International was informed of negotiations Ha'aretz was conducting with several entities, concerning the sale of its shares in Walla. Clarification of the nature of these negotiations revealed a dispute between the parties concerning the interpretation of part of the provisions of the contract signed between them for arranging the obligations and rights of the parties concerning all matters pertaining to the management of Walla with respect to the need for prior approval for any sale of rights and obligations and including shares. Pursuant to the provisions of the contract, a dispute between the parties was recently arbitrated before Dr. E. Winograd, former President of the Tel Aviv District Court. On February 17, 2010 the arbitrator's ruling was handed down, determining that Ha'aretz is entitled to sell its shares in Walla without the need to receive Bezeq International's consent.

For additional details regarding Bezeq International's investment in Walla, see Note 12 to the company's financial statements for the year ended December 31, 2009, which are included in this periodic report.

4.14.2 B-Zone Partnership

On October 23, 2006, Bezeq International entered into an agreement with 2+ (Two Plus) Wireless Solutions Ltd. (2+) for the establishment of a general partnership called B-Zone (the Partnership). Each party holds 50% of the partnership. The purpose of the partnership is to set up, support and manage wireless browsing networks in public areas, enabling high-speed internet connection and collecting payment from the end-user for internet access (the Area of Operations). Under the agreement, each of the partners transferred its operations in the partners' area of operations to the partnership, effective from the date of commencement of the partnership's operations. After the partnership was set up, it signed an agreement with 2+ to provide outsourcing services for the partnership, whereby 2+ attends to the day-to-day operation and management of the partnership.

4.14.3 Bezecom

On December 21, 2006, Bezeq International signed an agreement with DSNR Communications Ltd. for the establishment of a joint company, under which Bezecom Ltd. was established in January 2007 (Bezecom). Bezecom was set up as part of the expansion of Bezeq International's global operations, together with the DSNR Group, which specializes in online marketing. The purpose of Bezecom is to provide communication services to end-users worldwide, inter alia through a unique communications solution to provide telephony services.

4.15 Financing

4.15.1 General

As of the date of the periodic report, Bezeq International has no liabilities to banks and is not using its approved credit line. The source of Bezeq International's finance in recent years has been a positive cash flow from operating activities.

4.15.2 Bank guarantees

In accordance with the requirements of the Ministry of Communications, Bezeq International provided a bank guarantee of NIS 9.4 million and NIS 1.5 million to fulfill all of the conditions of the license for provision of international telecommunications services. As at the balance sheet date, Bezeq International has provided additional bank guarantees of NIS 8.9 million.

In accordance with the requirements of the Ministry of Communications, Bezeq International provided bank guarantees in the amount of NIS 10 million to fulfill all of the conditions of the exclusive general license for providing domestic fixed line telecommunication services to B I P Telecom. Ltd., a subsidiary of Bezeq International.

4.16 Taxation

At December 31, 2009, the Company has a carried forward capital losses in the amount of NIS 31.1 million.

Furthermore, the company has tax assessments that are deemed final through 2004, inclusive.

See Note 9 to the Company's financial statements for the year ended December 31, 2009, which are included in this periodic report.

4.17 Restrictions and Supervision of Operations

4.17.1 <u>Legislative restrictions</u>

The Communications (Telecommunications and Broadcasts) Law, 5742-1982 and the general license to provide international telecommunications services:

Under the Communications Law, implementation of telecommunications operations and provision of telecommunications services, including international telecommunications services and internet access services, require a license from the Minister of Communications. The Minister is authorized to amend the terms of the license, add to them or detract from them, while taking into consideration, inter alia, the government's telecommunications policy, interests of the public, compliance of the licensee to provision of services, contribution of the license to competition in the telecommunications industry, and the level of service therein.

The law authorizes the Director General of the Ministry of Communications to impose financial sanctions for violations of the provisions of the law and of orders and directives issued by virtue thereof, and for violation of the license terms.

A recently introduced amendment to the provisions of the Communications Law permits the Minister of Communications to prescribe telecommunications services that do not require a license. Pursuant to his declarations, the Ministry of Communications intends to exempt the supply of internet access services.

In view of these provisions of the Communications Law, all Bezeq International's telecommunications services are provided by virtue of the provisions of the licenses granted to it and pursuant to the terms therein, as set forth in Section 4.1.2 above.

4.17.2 **Payment for interconnection**

The Telecommunications (Interconnect Fees) Regulations, 5760-2000 (the Regulations) regulate the payments made to the domestic operator or the cellular operator.

With regard to payments to be made by Bezeq International, as an international licensee, for the completion of traffic on a cellular network, on March 1, 2008, the present tariff of NIS 0.25 for completion of a call was reduced to a maximum tariff of NIS 0.22.

These tariffs are updated once a year, in accordance with the percentage of the change in the CPI.

4.17.3 **Royalties**

For payment of royalties, see sections 2.16.3 and 4.1.2.3 above.

4.17.4 **Standards**

Bezeq International holds ISO 9001:2000 certification for quality management systems and ISO 7799 certification for information security management systems issued by the Israel Standards Institute.

4.18 Joint venture agreements

On January 18, 2010 Bezeq International signed an exclusive partnership agreement with British Telecom (BT) for providing global communications services to Israeli and multi-national companies operating in Israel. As part of the strategic agreement, Bezeq International will operate as the exclusive partner of BT Alliance in Israel and will market IT services and products from the global British Telecom's range of services.

4.19 Legal Proceedings

4.19.1 On September 16, 2001 a renewed lawsuit and petition to recognize a class action was filed against Bezeq International and the State of Israel, based on the claim that Bezeq International's tariffs for Bezeq International services for the period from May 10 1996 through July 8, 1997 were exorbitant and unreasonable and constitute exploitation of Bezeq International's status as a monopoly. This was based on the reduction in the prices when the overseas call market was opened for competition. On December 25, 2003, the Court accepted the petition, by virtue of the Antitrust Law and approved the lawsuit as a class action suit. In February 2004, the plaintiff filed an appeal with the Supreme Court against the ruling of the District Court with respect to the pretext set forth in the Unjust Enrichment Law. In January 2004, the State and the Company filed applications for leave to appeal to the Supreme Court in this matter. The Supreme Court consolidated the hearing in the three foregoing cases (the plaintiff's appeal and the application for leave to appeal of the Company and the State)

4.19.2 On January 27, 2002, a competitor international communications operator filed a lawsuit for monetary compensation in the amount of NIS 53 million against Bezeq International and the Company with the Tel Aviv District Court for damages it claims were caused to it based on several excuses pertaining to the delay in implementing customer subscriptions, management of a central customer file and the Company's campaign to encourage public telephone calls. Subsequent to the failure of the initial mediation proceedings, the plaintiff filed a motion to amend the lawsuit, in which it requested changing all the heads of torts and adding new factual claims. The parties applied for further mediation proceedings which are currently underway. In this regard see also section 2.18.5 above.

4.19.3 During the second quarter of 2008, four claims were filed against the Bezeq International in the Tel Aviv District Court. The claims related to the use of international calling cards to the Philippines, Thailand and Nepal and applications for approval as class actions. The plaintiffs, who are foreign workers, claim that the calling cards provide an average of 50%

of the units of time indicated to the purchasers of the cards. The plaintiffs also allege that Bezeq International deducts the time spent when unsuccessfully attempting to call someone from the card, contrary to the declaration, not by units of round minutes as indicated, providing misleading information about the number of units on the card and formed a cartel with other international communication companies that raised the prices of calling cards. The plaintiffs seek court permission to file their claim as a class action on behalf of groups of people that include anyone who purchased the relevant calling cards for use in calls during the seven year period prior to fining the claim or during the proceedings themselves. The plaintiffs estimate that the damages caused to all the members of the group by Bezeq International is NIS 1,101 million. The plaintiffs also petitioned the Court to order the defendants to cease its conduct as set forth above.

4.19.4 In July 2008, Bezeq International received two claims which were filed in the Tel Aviv District Court, together with a motion to recognize them as class action suits in the matter of charging customers at a dollar exchange rate higher than the representative dollar exchange rate. The plaintiffs, Bezeq International customers, claimed that Bezeq International charged customers who, based on agreements with them, pay for the services according to a dollar tariff, at a higher dollar exchange rate than the representative dollar exchange rate, which they claim is contrary to the agreements with them. The plaintiffs petitioned to recognize their lawsuits as class action suits on behalf of any persons or corporation that engaged in a contract with Bezeq International in which the price per call was set in dollars and Bezeq International charged them according to a higher exchange rate than the representative dollar exchange rate. Since the facts and legal arguments in both cases are similar, consent was filed according to which one of the claims will be erased and only the first claim to be filed will be heard, which does not specify the amount claimed and which is estimated by the plaintiffs to be tens of millions of shekel.

4.19.5 On May 4, 2009, Bezeq International received a claim, together with a motion to approve it as a class action suit, which was filed in the Tel Aviv District Court and which deals with raising of the tariffs for internet access services following the first year in operation and charging the plaintiff for services that it claims it did not order. The applicant requests reimbursement of the excess amounts it claims to have paid and which amount to NIS 2,800 and for the entire group of customers, for whom the price of the services provided to them was raised after the first year, to be NIS 216 million

4.19.6 On January 24, 2010 Bezeq International received a lawsuit together with a motion to approve it as a class action suit, which was filed at the Central District Court against Bezeq International and four other communication licensees, with regard to the defendants' obligation to bear the costs of telephone calls to the technical support call centers for their services. The plaintiffs request reimbursement of all the amounts the consumers were charged when they called a support call center and were required to pay for the call to the MRT operator and/or any other entity, and estimated the total amount of the claim against Bezeq International at NIS 105 million. It should be noted that a similar lawsuit was also filed against the Company (in the amount of NIS 23 million) and against DBS (in the amount of NIS 4 million).

4.19.7 Completed proceeding – a lawsuit and motion to approve a class action dated February 8, 2009, which was filed at the Central District Court against Bezeq International, its subsidiary and the members of the boards of directors of both companies, claiming that sending advertisements to the electronic mail box without consent constitutes a violation of the provisions of the Communications Law. The amount claimed in the class action is NIS 840 million. In May 2009, subsequent to the recommendation of the Court, the plaintiffs withdrew their lawsuit and informed the counsel for Bezeq International that they undertake not to file, directly or indirectly, a new claim instead of the one withdrawn. With this, the proceedings were terminated.

4.19.8 Completed proceeding - In November 1997, a lawsuit and application to approve the lawsuit as class action was filed in the District Court against Bezeq International, the Company, the Chairman of Bezeq International's board of directors and the former CEO of Bezeq International, in an amount estimated by the plaintiffs at NIS 50 million. The suit claims that the Antitrust Commissioner stated that Bezeq International adversely exploited its status in the overseas call market and intentionally implemented a policy of misguiding the public in the matter of the rate for overseas calls. The Supreme Court ruling was handed down in May 2009, rejecting the plaintiff's appeal, and to uphold the ruling of the

District Court not to approve the lawsuit as class action. On November 8, 2009, the Supreme Court handed down its ruling, rejecting the plaintiff's petition of June 2009 to hold an additional hearing. With this, the proceedings were terminated.

4.20 Goals, Business Strategy and Expected Development

4.20.1 <u>Bezeq International's goals for 2009</u>

As part of the preparations for 2009, Bezeq International set itself a number of key goals outlining the nature of its operations and reflecting the strategy which it adopted during the year.

4.20.1.1 To leverage changes in the market and continue quantitative and perceptual leadership.

4.20.1.2 To expand the range of telecommunication services and solutions.

4.20.1.3 To create differentiation and adapt the service experience to customer requirements.

4.20.1.4 To empower and develop the company's human resources.

2009 was characterized by continued growth and increases in Bezeq International's revenues and operating profits.

In 2009, Bezeq International increased the range of communications solutions that it provides to its commercial customers. Bezeq International views the ICT market as having growth potential and plans to further establish its status in this area.

In 2009, Bezeq International continued to invest in its customer service system, which provides service and technical support to its business and private customers.

4.20.2 <u>Bezeq International's goals for 2010</u>

As part of the preparations for 2010 and further to the strategies of the past years, Bezeq International set itself a number of key goals outlining the nature of its operations and reflecting the Company's vision, according to which Bezeq International will continue leading the markets in which it operates, retaining its customary marketing income, developing into new areas of operation and generating maximum value for its shareholders.

The foregoing information is based on information that Bezeq International currently has as at the date of publication of this report, and contains estimates made by Bezeq International, its work assumptions or intentions, as at the date of publication of this report.

The above forecast may not be realized at all or may be realized in part only, due to regulatory changes liable to harm the ability of Bezeq International to provide solutions to existing or changing market requirements, and all the other risk factors listed below.

4.21 Risk Factors

4.21.1 <u>Changes in exchange rates</u>

The main currency used by Bezeq International is the new Israeli shekel, which is also its reporting currency. There is a special risk in the nature of Bezeq International's international transactions: most of its operations (sales) derive from customers in Israel. In addition, Bezeq International provides its services to customers all over the world and collects payments from them in foreign currency, mostly the US dollar. On the other hand, Bezeq International consumes services from suppliers outside Israel and pays for these services in foreign currency, mostly the US dollar. The changes in the exchanges rates of the currencies in which Bezeq International operates opposite the Israeli shekel expose the company to exchange rate differences on the gap created, which could have an adverse effect on its cash flow as well as on its profitability by increasing finance expenses. To protect itself against currency exposure, Bezeq International enters into hedging transactions and purchases other financial instruments.

4.21.2 Competition

For the effect of the competition on Bezeq International's businesses, see section 4.6. above.

4.21.3 Investments in infrastructures, technological changes and dependence on suppliers

See Section 4.11.

4.21.4 Government supervision and regulation

For the application of the provisions of the law and licensing policy and their effect on Bezeq International, see sections 4.1.2 and 4.1.3.1 above.

4.21.5 Legal proceedings

Bezeq International is a party to legal proceedings, including class actions, which could result in its being required to pay substantial sums. A provision has been made in Bezeq International's financial statements for the proceedings, which, according to the assessment of the company's legal counsel, could require the use of Bezeq International's financial resources. For legal proceedings to which Bezeq International is a party, see section 4.19 above.

4.21.6 Dependence on suppliers

See Section 4.11 above.

This information contains forward-looking statements, based on the assessments of the company. The actual results may differ materially from these assessments if there is a change in any of the factors taken into account in these assessments.

Summary of risk factors

	Effect of risk factor on Bezeq International's operation		
	Major	**Moderate**	**Minor**
Macro risks			
Exposure to changes in the currency exchange rate			X
Sector risks			
Increasing competition		X	
Investments in infrastructure and technological changes		X	
Government supervision and regulation	X		
Special risks for Bezeq International			
Exposure in legal proceedings		X	
Dependence on suppliers			X

5. Multi-Channel Television – D.B.S. Satellite Services (1998) Ltd. (DBS)

5.1 General Information on the Area of Operations

DBS, known also by its trade name YES, provides multi-channel satellite broadcast services to subscribers. DBS was founded on December 2, 1998, and has been providing this service since July 2000.

This service enables the provision of multi-channel encrypted digital television broadcasts and value-added services to subscribers who receive the broadcast at home via a small antenna dish from which broadcasts are transmitted to a domestic decoder in the subscriber's home and connected to the television set.

Most of DBS's income derives from subscription fees and additional payments made by viewers.

At December 31, 2009 DBS had 570,000 subscribers.

DBS is the only company in Israel currently operating in the satellite multi-channel television broadcasting sector, even though neither the law nor the license awarded to it grant it exclusivity.

5.1.1 Structure of area of operations and changes therein

The area of broadcasts is regulated and activity is carried out by means of various broadcast licenses. The heavy regulation of the field of broadcasting includes the obligation to obtain a license, the obligation to operate in accordance with the relevant provisions of the Communications Law, the provisions of the various licenses and the conditions thereof, and ongoing supervision of the Ministry of Communications and the Council for Cable TV and Satellite Broadcasting (the "Council").

Multi-channel television broadcasts have been provided in Israel since the early 1990s by companies supplying cable television broadcasts. These companies operated first under regional franchises under exclusivity conditions which were granted to them, and since 2002 they have operated by virtue of long-term broadcast licenses which replaced the franchises. In November 1999 these companies were declared to have a monopoly, under the Antitrust Law, 5748-1988, in the field of multi-channel television broadcasting in the franchise regions in which they operated at the time. Since the end of 2003, the cable corporations have worked jointly in several areas of operations under the brand name HOT. In December 2006, the cable corporations merged into a single merged Cable Company, HOT Cable Communications Systems Ltd. which supplies cable television services to all of the subscribers of the merged cable corporations (the "Cable Company"). The Cable Company holds all of the rights in a limited partnership which owns the cable network infrastructure, including the terminal equipment and broadcasting centers, and which provides communications services, internet access and telephony services.

For the all-in-one services package offered to subscribers which includes, in addition to the multi-channel television services, an internet access infrastructure (high speed broadband) as well as fixed-line telephony services (the package which includes these three services is also known as "Triple Play"), see section 5.1.8 below.

For the advanced television services package with added features, including VOD, PVR and HD, see sections 5.1.4 and 5.2 below.

For streaming of video content over the internet, see section 5.1.4.2 below.

A terrestrial distribution system for digital radio broadcasts began operations in August 2009 (see section 5.1.3.1 below). DBS estimates that said distribution system may in the future also serve as an infrastructure for the provision of television services to mobile end devices which will compete with the services offered by DBS.

5.1.2 Statutory restrictions and special constraints

The Communications Law requires that a broadcasting license be obtained in order to transmit satellite television broadcasts to the public. In January 1999 DBS received the above-mentioned broadcasting license under the provisions of the law and pursuant to the Telecommunications (Proceedings and Conditions for the Grant of a Satellite Broadcasting License) Regulations 5758-1998 (the "Broadcasting License").

As the result of an amendment to the Broadcasting License in February 2009, the license is valid until January 19, 2017. At the end of this period it will be renewable for additional periods of six years each, subject to the conditions of the license. (For additional licenses granted to DBS, see section 5.10.1 below).

Operations in broadcasting and in other fields of communication are subject to licensing, supervision and the policy decisions of the Ministry of Communications with regard to aspects defined in the law and the communications licenses (which relate mainly to matters regarding competition, consumers, and technical and engineering aspects). As a result of the coherence and overlap between broadcasting and other areas of communications, and the operations of the Cable Company and related telephony and internet entities, broadcasting is materially influenced by the policy and supervision of the Ministry of Communications in various areas that relate to or touch on broadcasting.

The broadcasting operations of DBS and the Cable Company are also under the ongoing supervision of the Council. The Council sets policy and makes rules regarding the content of broadcasts, the duty regarding original Israeli productions, the division of content into genres, broadcasting ethics, consumer protection and other matters in the area of broadcasting policy. The Council is also responsible for enforcing broadcasting legislation, approving the channels that DBS wishes to broadcast, or to cease broadcasting, and is also authorized to amend the broadcasting licenses of DBS and the Cable Company under the conditions set out therein.

The Council has authority in the field of consumer protection, so that the setting and updating of price lists and offers to customers require its consent or the giving of prior notice (in respect of DBS's activities being subject to legislation and the supervision of the Ministry of Communications and the Council, see also section 5.17 below).

The government may initiate changes to the identity and nature of the bodies supervising the operations of the entities responsible for licensing and supervision of broadcasters (including DBS).

In 2005, the government decided to consolidate the Council's activities with those of the Second Television and Radio Authority and the Public Broadcasting Regulation Administration into a unified commercial broadcasting authority. This decision was anchored in a government bill, but to the best of DBS's knowledge, the bill has not been discussed. In addition, to the best of DBS's knowledge, the government has previously examined setting up a communications authority which would replace the Ministry of Communications and the authorities described in section 5.1.1 above, and which would have all their powers, despite the abovementioned consolidation.

5.1.3 <u>Market developments in the area of operations</u>

In recent years, a number of trends which affect competition have emerged in the broadcasting industry:

5.1.3.1 Pursuant to an amendment to the Second Television and Radio Authority Law, 5750-1990 of February 2008, the Second Television and Radio Authority set up a system which transmits the television channels of the Israel Broadcasting Authority (Channel 1 and Channel 33), the commercial television channels (Channel 2 and Channel 10) and the Knesset Channel (Channel 99) to the public freely, nationwide, via a terrestrial transmission service using digital technology, backed up by a digital satellite system ("DTT"). This broadcasting system is a partial substitute for DBS's transmissions and, in DBS's assessment, is likely to cause substantial harm to its revenues. In January 2008, a private bill was submitted to the effect that DTT would also include the transmission of two special channels which are broadcast at the date of this report (the Russian language channel – Channel 9 – and the Music 24 Channel), as well as the Educational Television channel. DBS believes that increasing or varying the number of channels transmitted via this system is likely to increase the extent to which the system will substitute for DBS's services, and therefore, might increase the harm caused to DBS's revenues.

The private bill regarding the inclusion of the two special channels and the Educational Television channel in DTT was passed in its preliminary reading in the

Knesset. Several private bills were also submitted concerning the addition of channels to the bundle of channels designated for broadcasting via DTT and to the best of DBS's knowledge they are in the initial stages of legislation.

At the date of this report the expansion of the above-mentioned DTT is under discussion by the Knesset's Economy Committee in the Television Broadcasting Bill (Legislation Amendments), 5770-2009.

In February 2009 the Minister of Finance issued a directive determining that set-top boxes for receiving DTT broadcasts would be exempt from purchase tax (despite the fact that purchase tax at the rate of 10% is levied on DBS's set-top boxes).

5.1.3.2 Further to the government decision of August 2008 and the bill which led to the publication in October 2008 of the National Economy Arrangements (Legislative Amendments for Achieving Budget Goals and Economic Policies for the 2009 Fiscal Year) Bill 5769-2008 (the "Efficiency Bill"), in May 2009 the government decided to amend the Communications Law in order to anchor the following arrangements in legislature.

A. As of August 1, 2012 DBS and the Cable Company will be obligated to allow any subscriber to connect to a package including Channel 1, Channel 33, Channel 2, Channel 10 and the Knesset Channel (in this paragraph - the "Basic Package") against payment for the connection to the broadcasting center, which will be calculated on the basis of subscriber connection costs plus reasonable profit; to allow any subscriber to purchase any other broadcast offered by them separately and not to make the purchase of one broadcast conditional upon the purchase of another broadcast, where the determination of a tariff for the purchase of a number of broadcasts shall not be conditional as aforesaid; to set a price based on usage cost plus reasonable profit that will be paid by Basic Package subscribers to the Cable Company and to DBS for transferring their broadcasts; pursuant to the government decision, the Council, with approval from the Minister of Communications and the Minister of Finance, and subject to the conditions set forth in the decision, will be able to postpone, no later than January 1, 2011, the date on which the Basic Package will become available for a period which shall not exceed one year.

B. DBS and the Cable Company will be authorized to broadcast commercials from January 1, 2012, and the Council will set rules in respect of maximum broadcast time for the various types of channels for a period of three years, which will enable the gradual broadcast of commercials; the Council, with approval from the Minister of Communications and the Minister of Finance, and subject to the conditions set forth in the decision, has been authorized to postpone, no later than January 1, 2011, the date of the permit for the broadcasting of commercials for a period which shall not exceed three years.

C. That the broadcasting licensees will transmit to all their subscribers broadcasts from the holder of a special cable broadcasting license without collecting payment from subscribers beyond the access fees.

D. An order will be legislated in respect of the broadcast of joint channels in the format set forth in section 6(20)1 of the Law, which has expired. In addition, the Government decided to instruct the Council to examine cancellation of the restrictions applicable to the special license holders for cable broadcasts that do not exist for DBS and the Cable Company and the establishment of an inter-ministerial committee headed by a representative of the Ministry of Communications to examine the method of arrangements in the commercial television broadcasting sector.

E. The government also decided that if the Communications Law is amended in accordance with the proposals in the relevant sections of the bill, to instruct the Minister of Communications and the Minister of Finance to apply to the Finance Committee for approval of regulations exempting broadcasting licensees from payment of royalties from the date on which they will be obligated to provide the Basic Package.

F. In addition, the government decision adopted the recommendations of the Mordecai Committee in all matters pertaining to the transfer of the Second Authority franchise holders from franchise holders to license holders and the establishment of a National Communications Authority, and it also determined the establishment of a committee to examine the advertising commissions paid by advertisers and entities selling advertisements to the advertising companies.

At the date of this report, the above issues are under discussion in the Television Broadcasting (Legislative Amendments) 5770-2009 Bill which is being discussed by the Knesset Economy Committee.

DBS believes the further the bill proceeds along the path toward legislation, the greater will be the harm caused to its revenues.

For the adoption by the Minister of Communications of the Gronau Commission's conclusions concerning the formulation of policy and competition rules in the arena of broadcasting in Israel, see section 2.6.8 above. On August 13, 2008, the Minister published his decision to adopt the Gronau Commission's recommendations (subject to a few changes and conditions). Nonetheless, the Minister decided that since the Commission focused on the field of telecommunications and an analysis of the broadcasting sector was not discussed in full, a commission will be set up to formulate recommendations and a policy in respect of rules of competition in the multi-channel and commercial television sector. At the date of this report, this commission has not yet been established.

5.1.3.3 In November 2009 the Council instituted a new policy in respect of multi-channel television sports broadcasts since June 2009. According to the decision, content protection for the basic sports channel (Channel 5) and Channel 5+ was expanded and restrictions were imposed on live broadcasts on the paid sports channels. DBS believes that this decision is liable to harm its revenues from the paid sports channels.

In September 2009 the Council published a decision regarding the granting of a special license to DBS and the Cable Company for a movies and series channel. In the decision the Council decided to amend its previous decision so that special licenses would be granted for movie channels, and to examine, within six months from the date of the decision, the possibility of cancelling the prohibition in the Council's current policy on granting special licenses to movie channels. Furthermore the Council decided to relax certain aspects of the obligation imposed on holders of special licenses to invest in original productions. In February 2010 the Council published details of a hearing regarding its intention to remove the existing restriction whereby one licensee may not hold more than three channels.

5.1.3.4 In March 2009, the recommendations of the inter-ministerial committee headed by the Director-General of the Ministry of Communications and appointed in accordance with the government decision mentioned in section 5.1.3.2 were sent to the Minister of Communications for an examination of the method of regulating commercial television broadcasting, including changing the current franchise regime based on the Second Television and Radio Authority Law, 5760-1990 (the "Second Authority" and the "Second Authority Law"), to a license regime. The recommendations stipulated, inter alia, that from 2012: (1) the franchise regime based on the Second Authority be changed to a licensing regime for key channel broadcasts; (2) DTT be expanded to enable the transmission of broadcasts from any key licensed broadcaster; (3) holders of licenses for multi-channel broadcasts be permitted to broadcast commercials; (4) license holders for multi-channel broadcasts be bound to offer a narrow package including the Basic Package (as defined in section 5.1.3.2 above) and broadcasts of a new license holder for key channel broadcasts. Furthermore, the narrow package would include broadcasts of the holders of special cable broadcasting licenses and holders of licenses for designated channels subject to payment of transfer fees by the license holders; (5) license holders for multi-channel broadcasts would be exempt from payment of royalties to the State. The Commission also recommended the establishment of a national communications authority which would unite the activities of the Council and the Second Authority. If the Commission's recommendations are adopted, they are liable on the one hand to lead to a reduction in DBS's expenses due to the payment of royalties and an increase in its revenues as a result of the permit to broadcast commercials and on the other to harm its revenues as a result of the obligation to offer a narrow package and as a result of the expansion of DTT. At the report date, the Minister of Communication's decision regarding the adoption of the Commission's recommendations has not yet been published. Furthermore, the recommendations require legislative amendments and their application therefore depends on the formulation of legislation and the wording of the legislation that is formulated, if any.

5.1.3.5 In August 2009 the Supreme Court upheld an appeal from the Antitrust Commissioner of a judgment of the Jerusalem Antitrust Tribunal which granted approval to an application to merge the Company and DBS by increasing the Company's holdings in DBS to 58.4%, subject to the existence of a number of conditions determined in the judgment. The judgment stipulated that this merger would not be approved.

5.1.3.6 In March 2009 the Ministry of Communications and the Council published a hearing regarding the regulation of broadcasts on new broadcasting platforms and technologies. The hearing requested, inter alia, reference to the characterization of the new services in respect of which the need for regulation was examined, including the nature and designation of the content, the manner of its transmission, the end-user viewing device, the need to distinguish between linear broadcasts and VOD broadcasts, the manner in which the services are offered, the identity of the offering entities, the degree of involvement of the service providers in various aspects of the service and the expectations of a reasonable consumer with regard to regulatory protection. Requested in addition was reference to the desired scale of regulation, and inter alia, in the matter of restrictions on adult broadcasting, protection of minors, classification and marking of broadcasts, original production obligations, prohibition on the broadcasting of commercials and broadcasting ethics. In addition, reference was requested in respect of the need for protection of new competitors and the effect regulation would have on the current regulation. DBS submitted its position in the hearing in May 2009. In general DBS is demanding that every television broadcast, both multi-channel television and television broadcasts in general be subject to the same regulatory regime irrespective of infrastructure or range from which the television broadcast reaches the subscriber's home. DBS is demanding equality of regulation for all television broadcasting entities. If DBS's position regarding an equal playing field is not accepted, it demands cancellation of the regulation to which it is subject.

In July 2009 the Minister of Communications appointed a commission headed by the ministry's Director-General and chairman of the Council to formulate recommendations regarding the need for and format of regulation of the transmission of visual content via certain networks. The commission's conclusions have not yet been published.

5.1.4 <u>Technological changes that materially impact the area of operation</u>

5.1.4.1 Technological developments and changes which have taken place in the field of digital broadcasting enable the provision of "personal television" services, which include bi-directional services that enable reciprocal communications between the individual subscriber and the service provider, and immediate provision of the service individually selected by the subscriber. The principal service in this field at present (also in Israel) is the provision of television services upon the immediate demand of subscribers, also known as Video on Demand ("VOD services") In the reporting year, VOD services have been provided only by the Cable Company and this has had a material effect on competition in the field of broadcasting (for details, see section 5.7.5 below and for the expected launch of VOD services by DBS, see section 5.4 below).

5.1.4.2 Around the world, transfer services of video content over broadband have developed, whether in closed / managed systems or over the public internet, and this is known as IPTV (Internet Protocol Television). These services and capabilities enable the consumer to watch video content (either by transferring content to all users or by transferring individually upon demand), where the content is viewed sometimes on a personal computer and at other times on television. In Israel, this service has not yet been developed in a closed network, and broadband infrastructure owners might act to launch such services in the future, and entry of another service provider into this field might adversely affect the players in the broadcasting arena. However, at the date of this report, video content is being transferred over the internet (in both local sites designed for Israeli audiences and foreign sites, and via file sharing software), and the development of this trend might substantially affect the broadcasting arena, which is currently based on designated infrastructures, and might enable the supply of varied video content without the need for a designated infrastructure system. (For possible use by DBS of the internet to transfer video content to its subscribers see section 5.4 below).

5.1.5 <u>Critical success factors in area of operations and changes therein</u>

DBS regards the following factors as critical to the success of its operations:

5.1.5.1 Differentiation, innovation and originality in the content, branding and packaging of its broadcasts compared with the broadcasting content of its competitor, the Cable Company. These factors are reflected in the purchase and production of content, which includes current movies, documentary programs and many series containing unique and innovative characteristics, as well as in the production and purchase of original Israeli programming. For such purpose, ongoing investment is required in the area of production and purchase of the content of broadcasts supplied to DBS customers.

5.1.5.2 The ability to offer subscribers personal television services, and in particular, VOD services and PVR and HDPVR machines. (See section 5.7.5 below).

5.1.5.3 The ability to offer a bundle of communications services including television services and other services such as telephony services and internet services (see section 5.7.5 below).

5.1.5.4 Differentiation at the customer service level constitutes a material success factor in DBS's ability to retain customers in the broadcasting market.

5.1.6 <u>Main entry and exit barriers for the area of operations</u>

5.1.6.1 The main entry barriers into the area of operations are: (a) the need for appropriate licenses under the Communications Law; (b) the immense investments required of carriers in the area of operations, including for the purpose of setting up an appropriate infrastructure and purchasing and producing content; (c) the limited size of the broadcasting market which reduces the size advantage characteristic of the broadcasting field around the world; (d) saturation of the broadcasting market.

Recently, some of these entry barriers have started to crumble as a result of regulatory changes (such as DTT – see section 5.1.3.1 above) and as a result of technological developments enabling the transfer of content over alternative infrastructures (such as IPTV – see section 5.1.4.2 above)

5.1.6.2 The principal exit barriers are: (a) the regulatory barrier – termination of operations under the Broadcasting License depends on a decision of the Minister of Communications to cancel the license prior to the end of the license term, under the conditions set out in the license, including arrangements for ensuring the continuation of broadcasts and services and minimization of harm to subscribers. The licensee is required to continue providing the services under the broadcasting license until the date prescribed by the Minister or until completion of such arrangements as the Minister may instruct, whichever is the later; (b) long-term contracts with important suppliers, entities which granted DBS long-term loans and subscribers.

5.1.7 Substitutes for and changes in products in the sector

With respect to multi-channel television broadcasts, the following principal services can be classified as substitute products:

5.1.7.1 The variety of terrestrial channels and other channels broadcast to the Israeli public free of charge. These channels include Channel 1 (belonging to the Israel Broadcasting Authority), Channel 2, the third commercial Channel (Israel Channel 10), the Knesset channel. In addition, many foreign channels that can be received in Israel via relatively inexpensive end equipment are another substitute product to DBS's services.

5.1.7.2 DTT, see section 5.1.3.1 above, which constitutes an alternative service to multi-channel broadcasts.

5.1.7.3 Access to video content via broadband infrastructure, including the internet (see section 5.1.4.2 above)

5.1.7.4 Partner Ltd, a cellular operator in Israel, recently launched a venture which is in principle its entry to the ISP sector, the VoIP service sector and the content and broadcasts (particularly VOD) sector.

DBS estimates that content services via the television screen, provided by the cellular companies or any of them, will become a substitute service for the multi-channel television market.

5.1.7.5 DVD libraries

5.1.7.6 DBS is fighting online pirate multi-channel television services which include, inter alia, linear channels to the Russian and Arab sectors in particular, operated by companies which are not based in Israel.

5.1.8 Competition structure and changes therein

The concentrated and complex ownership structure in the areas of content, communications and infrastructure in Israel is likely to lead to control by groups in each chain of content production, packaging and supply. The Cable Company which, together with its associated corporations, has a broad deployment of advanced broadband infrastructures, markets and sells a package of services including multi-channel television services, high-speed internet infrastructure, and fixed-line telephony. The sale of a service package containing the above three kinds of communications services (known as "triple play") while DBS, which does not have the infrastructure for providing telephony and high-speed internet access services, and is even prevented from offering such a package together with the Company (see section 5.7.4.20 below) does not offer a similar package, is a principal component differentiating the offer to potential subscribers.

In August 2009 the Second Television and Radio Authority began operating a digital-terrestrial service which transmits five basic channels which are not digitally encrypted. A designated set-top box is required for each receiver. For further details see section 5.1.3.1 above.

5.2 Products and Services

DBS's broadcasts provide its subscribers with a wide variety of channels: there are approximately 150 different video channels (of which 20 are pay per view channels and 10 are HD channels) and

20 radio channels, 30 music channels and 20 information channels (including portals), and interactive services.

The broadcasts include a basic package which each subscriber is required to purchase as well as additional channels chosen by the subscriber, whether as a package or whether as a single channel, based on plans defined from time to time by DBS, with the approval of the Council and pursuant to the terms of the broadcasting license.

The main channel packages marketed by DBS in addition to the basic package are the movie package, the entertainment package, the children's package, the music package, the sports package and the science and nature package. These channel packages appeal to different target populations depending on their viewing habits and preferences.

As part of its operations, DBS also allows its subscribers to purchase movies and programs on a pay-per-view basis, from a list of movies and programs which is updated from time to time.

On March 2, 2010, DBS launched VOD services (see section 5.7.5 below).

DBS markets decoders, called personal video recorders, with the capacity to record content broadcast on the various channels on a hard disk, known by the brand name “yesMax” (“PVR Decoders”). The PVR Decoders interface with DBS’s electronic broadcasts and enable receipt of special services, including ordering recordings in advance, recording series and pausing live broadcasts. The PVR Decoders also enable viewing of the content stored in the decoder’s memory which is updated from time to time by DBS. DBS believes that the marketing of PVR Decoders to DBS’s subscribers constitutes a partial solution for the lack of VOD services.

At the end of 2007, high definition television (HDTV) broadcasts, which can be received through special decoders, were launched in Israel. These broadcasts which, at the date of this report, are provided for a limited number of channels, allow superior quality viewing. DBS estimates that although, at the date of this report, this service is relatively limited, the development of this service may have a significant impact on its broadcasting area of operations.

In April 2009, DBS began marketing PVR Decoders enabling reception of HDTV broadcasts in addition to the other services supplied by the PVR Decoders (“HDPVR Decoders”).

In 2009 DBS achieved a significant increase in the number of its subscribers using PVR and HDPVR Decoders.

Content viewing on a website – in August 2007, DBS launched a content site on the internet in cooperation with Walla! Communications Ltd., which allows viewing of various forms of content, some of them at a fee.

5.3 Revenue and Profitability of Products and Services

Following is a table containing a breakdown of DBS’ revenue (in NIS millions):

	2009	2008
Revenues	1,530	1,513
Gross profit	488	421

5.4 New Products

VOD services – at the end of 2009 DBS began trialing VOD services via the internet (the unmanaged network). This method has limitations with regard to the types of decoders enabling service reception (in the preliminary stage this service will be offered only to owners of HDPVR Decoders and only at a later stage to owners of other decoders), and with regard to availability of services owing to restrictions on the internet infrastructure and bandwidth installed in customer homes. DBS launched this service on March 2, 2010.

5.5 Customers

The overwhelming majority of DBS's subscribers are private customers. DBS's subscriber agreements regulate the rights and obligations of subscribers in their relations with DBS, including the types of services offered and the payments which DBS may collect (the “Subscriber

Agreement”). The Subscriber Agreement has been approved by the Council and by the Standard Contracts Tribunal. At the date of this report the validity of the approval granted by the Standard Contracts Tribunal has expired and DBS is working to obtain approval from the Council for amendments to the Subscriber Agreement after which the amended Subscriber Agreement will be resubmitted for approval to the Standard Contracts Tribunal.

5.6 Marketing and Distribution

Marketing of DBS services is by way of publication in the various media. DBS’s sales operations are carried out via three main distribution channels:

5.6.1 Sales people working to recruit subscribers.

5.6.2 Call centers that receive telephone enquiries from customers wishing to receive DBS services or additional services, as well as telemarketing campaigns to potential subscribers.

5.6.3 External resellers under contract with DBS. DBS is somewhat dependent on external resellers working to recruit subscribers among one of DBS’s target groups.

The distribution channels, except for the external resellers, are operated by DBS employees.

5.7 Competition

5.7.1 Competitors in the broadcasting market

The subscriber multi-channel television market in Israel is estimated at approximately 81% of all homes in Israel.

DBS’s principal direct competitor, as mentioned in section 5.1.1 above, is the Cable Company.

DBS estimates its share of the multi-channel television market at December 31, 2009, to the best of its knowledge, at approximately 38% of the number of subscribers.

In addition, DTT services which transmit multi-channel television services to non-subscribers began in August 2009 and they also constitute competition for DBS. DBS is unable to estimate the number of users of DTT services. (For details, see section 5.1.3.1 above).

5.7.2 Broadcasting characteristics of the competitors

DBS’s competitor is the Cable Company. (For the operations of the Cable Company see section 5.1.1 above).

DBS transmits its broadcasts using a digital broadcasting method only, by means of tiering and purchasing channels and single programs at various price levels, whereas the Cable Company broadcasts to most of its subscribers using a digital broadcasting method and the above-mentioned tiering, while for the remainder it uses an analog broadcasting method, which allows for lower-quality viewing, does not enable display of an electronic program guide and requires the purchase of a uniform channel package without the option of choosing broadcasting segments (for further implications of this difference, see section 5.7.4 below).

For the characteristics of DTT services, see section 5.1.3.1 above).

5.7.3 Characteristics of the current competition

In 2008 and 2009 DBS achieved relatively moderate subscriber growth, as illustrated below.

	2009	2008
Increase in number of subscribers	11,005	10,361
Rate of growth	2%	1.9%

At present, competition in the broadcasting arena is focused on broadcast content, on the proposed channel packages, on the price of channels and packages, on service, and on the offer of additional services, including VOD services that are provided by the Cable Company, PVR Decoders, HD broadcasts and HDPVR Decoders. Competition is also characterized by offers of other communications services as part of a "service package" (see section 5.7.5 below).

5.7.4 Positive and negative factors regarding the competition

5.7.4.1 DBS's management estimates that DBS has competitive advantages, the principal ones being:

A. DBS makes use of advanced digital technology which contributes to picture and sound quality; enables a friendly, fast and convenient user interface for subscribers watching its broadcasts; it enables translation of the broadcast content into foreign languages and the addition of dubbing into other languages (such as Russian), as chosen by the subscriber (in most of DBS's "home channels"); and enables the user to choose a language interface from four options (Hebrew, English, Arabic and Russian). In addition, DBS transmits wide-screen broadcasts in a variety of channels which allows subscribers to watch broadcasts in wide-screen format (which is similar to the format used in cinemas) on television sets. DBS broadcasts a number of channels using sound technology known as Dolby Digital (which is only supported by some of the decoders). DBS also markets HD services (see section 5.2 above).

B. DBS's broadcasts are transmitted via satellite, and therefore the broadcasts can also be received in remote or isolated areas where there is no access to a cable infrastructure. The infrastructure available to DBS also enables transmission of content outside Israel's borders. At the date of this report, DBS does not market its broadcasts outside Israel's borders.

C. The quality and variety of content broadcast by DBS to its subscribers.

D. The level, quality and availability of DBS's customer service, both telephone service and technical service.

E. Accessibility and fast installation of equipment for receiving DBS broadcasts for customers living in buildings that are not connected to a multi-channel television infrastructure in remote or isolated areas.

5.7.4.2 However, DBS's competitive operations suffer from inferiority or from adverse factors in a number of areas, the main ones being:

A. Inferiority of infrastructure in respect of the option of offering 'personal television' services such as VOD (see section 5.1.4.1 above).

B. Some of the Cable Company's customers are customers of analog cable systems (see section 5.7.2 above). Insofar as such customers wish to switch to the digital system, the Cable Company has much greater access to them. The analog broadcasting system allows its subscribers to receive lower-cost broadcasts without using a digital decoder.

C. The directives issued by the administration of the Ministry of Communications relating to the bi-directional transfer of subscribers between DBS and the Cable Company and use of the infrastructure installed in subscriber homes, require 36 hours' notice before disconnection of an existing subscriber of the Cable Company (and vice versa in the case of disconnection of an existing DBS subscriber). The Cable Company can exploit this time frame to make special offers to existing subscribers about to leave it for DBS in order to retain their custom. In addition, where the internal wiring infrastructure is owned by the Cable Company, the administration's directives stipulate that payment must be made therefore (and vice versa). However, at the date of this report, neither the Cable Company nor DBS is in full compliance with the administration's directives. (For this and the hearing being conducted by the Ministry of Communications in respect of internal wiring, see section 5.17.3 below).

D. DBS has infrastructure inferiority which does not permit it to transmit telephony and internet services over its infrastructure, as opposed to the Cable Company whose infrastructure enables the provision of such services. This inferiority is even greater given the regulatory restrictions imposed on DBS and on the Company, which restrict DBS's ability to offer telephony services using the Company's infrastructure, and the lack of any realistic ability to market the telephony services of the Cable Company. For information regarding the hearing on the matter of the restrictions on offering services together with the Company's services, see this section 5.7.4.2.

E. A "service package" as described in section 5.1.8 above – a trend for offering a group of communications services has developed in the broadcasting arena as a marketing method to recruit and retain customers and demand from consumers and potential customers for an "all-inclusive service package" continues to grow. This package provides multi-channel television, high-speed internet infrastructure services and fixed-line telephony services supplied by one provider at a price lower than that for the separate purchase of each service.

Regulatory restrictions of structural separation, include restrictions in the joint marketing of products and services, between the Company and its subsidiaries and certain affiliates. So long as these restrictions remain in force, and at the same time, there are no similar restrictions on the Cable Company (and its related corporations in the field of telephony and internet) they harm DBS's ability to offer a service package at a competitive price.

Enquiries from the Ministry of Communications reveal that the Ministry believes that DBS is not permitted to market the Company's telephony services and this is contrary to DBS's view.

In July 2008, the Communications Ministry informed DBS that it was considering amending the Company's license and as a supplementary amendment, also amending DBS's license in a way which would make it possible to offer a service package based on the following principles:

1. The service package would be divisible so that it would be possible to purchase any of the services offered in the service package separately at the price at which it is offered in the services package.
2. A service package not offered by the Cable Company would not be offered.
3. Approval to market the service package would be granted on the basis of an advance application from DBS to the Ministry of Communications.
4. The directives relate to the service offered by DBS in conjunction with each of the Company's services.

In its response to the letter from July 2008, DBS raised objections to the proposed amendment to its license. In addition, DBS argued in its response that the granting of an option to market a divisible service package does not provide a genuine solution to the service package offered by the competition and that the amendment should apply to the marketing of telephony services by the Company only and not to other services such as internet infrastructure services. DBS also argued that the mechanism for supervising service packages should be changed in a manner which does not require advance approval from the Ministry of Communications but only a reporting obligation, and that the availability of service packages containing the Company's services should not be limited to those also offered by the Cable Company.

In January 2009, the Ministry of Communications notified DBS of its plans to make certain changes to the license amendments under consideration. As part of the amendments it would be permitted to offer any service package offered by another corporate group in Israel (even if it is not offered in practice); benefits were granted for service package containing broadcasting and infrastructure and internet services only; the Ministry of Communications regulated the approval mechanism for service packages and their amendments. In February 2009, DBS reiterated its objection to amendments to its license, its demand to be allowed to market a non-divisible service package and its opposition to the supervisory mechanism being considered by the Ministry of Communications, as well as to any restriction on the marketing of television services in conjunction with the internet infrastructure services offered by the Company.

In addition, DBS is subject to the restriction on obtaining a license to supply telephony services itself over broadband internet (VOB), whilst telephony services are offered to subscribers of the Cable Company.

A. DBS has significant expenses involved in leasing space segments, which are necessary for the purpose of providing DBS's broadcasts.

B. DBS views the development of the capacity to transmit video content via the internet, including IPTV services as being a factor that might adversely affect its competitive standing in the broadcasting field, including as a result of the entry of additional competitors into the field of multi-channel broadcasts.

C. DBS regards DTT as a factor which could adversely affect its competitive position (for details, see section 5.1.3.3 above).

5.7.5 <u>Principal methods for coping with competition</u>

The following are the main methods used by DBS to deal with competition in the field of broadcasting:

A. Content – DBS acts to purchase, produce and broadcast high-quality, innovative and varied content, creating differentiation of its content;

B. Branding – cultivation, promotion and differentiation of the YES brand;

C. Service – DBS places an emphasis on its customer service and technical service systems;

D. It offers deals to existing and potential subscribers;

E. Technology – continuing investments in technological capabilities and quality of DBS's broadcasts; emphasizing technological innovation;

F. Personal television – DBS regards the supply of "personal" television broadcasts as an integral part of the services provided by those operating in the broadcasting market in this modern era, and a significant component of the total bundle of services offered to subscribers.

   Advanced decoders – DBS places an emphasis on the broadest possible penetration of PVR and HDPVR decoders. The Cable Company also markets PVR Decoders to its subscribers, although to the best of DBS's knowledge, at significantly lower penetration rates. The Cable Company announced that it intends launching PVR services via the cable network and without the need for a special decoder.

   VOD – DBS launched VOD services (see section 5.4 above). This service has been provided by the Cable Company since 2005.

G. HD – DBS attaches great importance to the supply of high-definition (HD) television services and is marketing HD and HDPVR decoders to its customers and broadcasting a variety of channels using this technology.

5.8 Production Capacity

The number of channels which DBS is capable of broadcasting to its subscribers depends on the number of space segments at its disposal. At the date of this report, DBS uses all the space segments at its disposal and so an increase in the number of channels it broadcasts would require additional space segments. DBS leases space segments from a third party (see section 5.18.1).

5.9 Property Plant and Equipment

DBS broadcasts to its subscribers via an engineering setup which contains a ground broadcasting center located in Kfar Saba as well as a secondary broadcasting site situated close to the Re'em Junction, broadcasting to the satellite the content received at the broadcasting centers via optical fibers, cassettes and direct satellite reception from the leased space segments on the Amos 2 and Amos 3 satellites (for lease conditions see section 5.18.1 below) and receiver dishes and decoders located in subscriber homes, enabling reception of the satellite broadcasts and decoding in accordance with the broadcasting package purchased by the subscriber.

At the reporting date, DBS broadcasts various channels from any broadcasting center. Most of the home channels (channels produced by DBS) are broadcast from the broadcasting center in Kfar Saba and the other from the broadcasting center at Re'em. Furthermore, DBS maintains digital archives at the broadcasting centers for storing broadcasting content.

5.9.1 Rental of buildings

DBS's principal offices, including its management offices, the broadcast center and other operations departments, are in three buildings in the eastern industrial zone in Kfar Saba, in an area covering approximately 10,330 sq m, alongside which there is a parking lot and adjacent facilities: An area of 8,335 sq m (which also contains the broadcasting center) is leased from a third party. This lease period will expire in October 2014, and DBS has an option to extend the contract by a further five years, and this with a price increase of 5%. Another 1,994 sq m are in an adjacent building which is leased from a third party. This lease period expires in July 2010.

In addition, DBS runs three operational centers, one being in the Nesher industrial zone (some 1,612 sq m in area, which is leased from a third party until May 2011), the second is located in the industrial zone at Kanot (some 1,487 sq m in area, which is leased from a third party until July 2011), and the third in Beer Sheva, some 1,100 sq m in area, which is leased until October 2012, (with two options to extend the lease; the first – for an extension of three years until October 2015 and the second – for an extension of five years until October 2020), which are used as technical service, telephone service and sales centers for subscribers. DBS also runs two employee recruitment centers. In addition to the three operational centers, DBS also runs a 1,540 sq m logistics warehouse located at Airport City, which is leased from a third party until May 2013 (with an option to extend the lease until May 2015).

5.9.2 Terminal equipment

DBS installs a receiver dish and other terminal equipment in subscriber homes, among them, decoders used as a receiving and decoding unit for the reception signals, which constitute an infrastructure to the subscriber's television screen as well as smart cards used to decode the encrypted broadcasts, which are transmitted via the NDS encryption system (see section 5.13.1 below).

Some decoders are leased to subscribers in return for a fixed leasing fee paid during the broadcast reception period and some are lent to subscribers (some of these loans are made in return for a deposit which is reduced over the subscription period). A small number of the decoders are sold to subscribers who then own them.

5.9.3 Broadcasting equipment

DBS's property plant and equipment also includes the broadcasting and reception equipment at the central broadcasting center at Kfar Saba, which includes the reception systems at the broadcasting centers, the compression, encryption, playing and uplink systems, and the compression systems at the secondary broadcasting center at Re'em Junction.

5.10 Intangible Assets

5.10.1 Licenses

DBS owns the following main licenses:

5.10.1.1 Broadcasting license valid until January 2017 – this license is material to DBS's operations and constitutes the regulatory permit for its broadcasting operations (for the conditions of this license, see section 5.17.2 below).

5.10.1.2 License for satellite television broadcasts in the Judea and Samaria region valid until 2010, and by virtue of this license whose provisions are similar to those of DBS's main broadcasting license, DBS broadcasts to the Judea and Samaria region. In February 2009, DBS applied to the Civil Administration for an extension of the license until 2014.

In May 2009 a representative from the Civil Administration notified DBS that the Administration was planning to extend the broadcasting license in Judea and Samaria until 2014 together with the license for Israel, although this extension still requires a final decision from the Administration.

In February 2010 DBS requested from the representative of the Civil Administration that this license have the same validity as the broadcasting license, i.e. until January 2017.

5.10.1.3 License to perform uplink operations (transfer of broadcasts from DBS's broadcasting center to the broadcasting satellite and implementation of setup and ancillary operation activities), which is valid until January 2014 or until the end of DBS's broadcasting license, whichever is the earlier. This license is material to DBS's operations and constitutes the regulatory permit for the transmission of broadcasting messages from the broadcasting center to the broadcasting satellites and from them to subscriber homes.

5.10.1.4 License for the provision of uplink/downlink services to other communication licensees which is valid until October 2013. At the date of publication of this report, DBS does not use this license.

5.10.2 Trademarks

DBS owns a variety of trademarks designed to protect its various brands and services. The main registered trademarks relate to the protection of its trading name (Yes), its key content channel names, the names of some of its channel packages and of its unique terminal equipment which it installs in subscriber homes.

5.10.3 Costs of subscriber acquisition

See Note 9 to DBS's Financial Statements for the year ended December 31, 2009, which are attached to this Periodic Report.

5.10.4 Software

See Note 9 to DBS's Financial Statements for the year ended December 31, 2009, which are attached to this Periodic Report.

5.10.5 The balance of the intangible assets (after depreciation) amounts to NIS 67,043,000.

5.11 Broadcasting Rights

5.11.1 DBS holds the broadcasting rights of television content purchased from the owners of intellectual property rights in such content. Sometimes, DBS purchases the right to sell these content broadcasting rights to third parties together with the rights themselves, for the purpose of broadcasting the content again. At the date of this report, revenues from these sales do not amount to a significant percentage of DBS's revenues.

5.11.2 The broadcasting of content in which DBS owns broadcasting rights involves the payment of royalties to the owners of intellectual property rights in musical works, scripts and content direction – i.e., copyright and performers rights in sound recordings for actual broadcasting, including under the Copyright Law, 5768-2007 and the Performers and Broadcasters Rights Law, 5744-1984. Payment of royalties as aforesaid is done via a number of organizations that operate in Israel which collect the royalties for the owners of the intellectual property rights and in return provide the broadcasting entities with blanket licenses. For some of these licenses which represent principal royalty payments, the final sum owed by DBS for uses under the license is prescribed in accordance with the final sum paid by the Cable Company to the licensee for every subscriber, either in the case of an agreement between them and the licensee or in the event of a judicial ruling on a dispute between the parties, the consideration owed by DBS shall in no event exceed that paid currently under the license. Payments by DBS under these licenses are based mainly on a fixed payment and sometimes on various pricing methods, including those that depend on an increase in the number of subscribers as aforesaid.

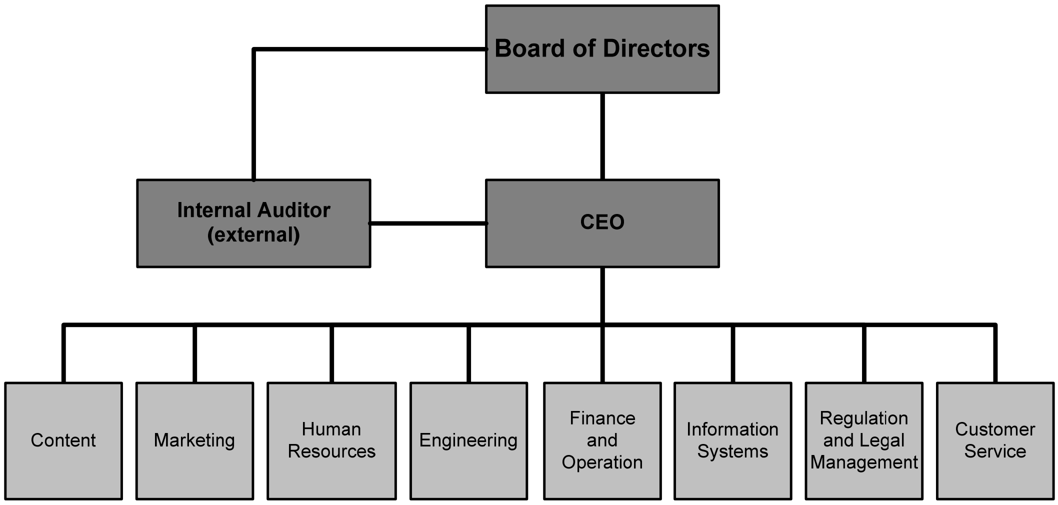
5.11.3 At present, the trend of transmitting content over non-television media creates some uncertainty as to the payment of royalties for such transmission, inter alia due to the fact that to the best of DBS's knowledge, some of the authors are not represented by the aforesaid organizations in respect of this media.

5.11.4 DBS participates, fully or partially, in investment in original productions that it broadcasts. In consideration for its investment, DBS is usually entitled, in addition to the right to broadcast the content as part of its transmissions, to rights in such content, in the percentages set out in agreements with the producers. Sometimes, DBS is also entitled to grant authorizations to use rights and to participate in revenues stemming from additional uses of content in addition to their broadcast by DBS.

5.12 Human Resources

5.12.1 Organizational structure

DBS has eight departments, each one headed by a VP who is a member of DBS's management. DBS's departments are: marketing, customers (including recruitment of customers and service), content, engineering, finance and operations, human resources, regulation and legal administration, and information systems:



5.12.2 DBS personnel by division

Division	Number of Employees	
	At December 31, 2009	At December 31, 2008
Marketing Department	31	31
Customer Service	1,705[22]	1,584
Content Department	72	65
Engineering Department	92	82
Finance and Operations Department	117	110
Human resource department	43	40
Regulation and Legal Administration Department	3	3
Information Systems Department	88	77
Management and Spokesperson	7	7
Total	2,158	1,999

22 The increase in the number of employees in this department stems in part from the absorption of employees for the customer service center in Beer Sheva, who in the past were employed by Bezeq On-line Ltd, which provided DBS with these call center services.

5.12.3 Training and development of human resources

DBS provides regular training for its customer service, technical service and sales personnel via its training center.

DBS trains its employees on an ongoing basis and also carries out manager training and support on an ongoing basis.

5.12.4 Employee remuneration schemes

A. In September 2008, 4,250,000 Company option warrants were allocated to the CEO of DBS, which are exercisable into Company shares at the exercise price of NIS 5.239352 per option warrant (as will be adjusted according to the Company's distribution of dividends as of allocation date). The option warrants will vest in three equal annual portions, whereby the vested options will be exercisable for up to 5 years from the vesting date of the third option portion. This allocation was made after the Antitrust Commissioner confirmed that she does not object to it and after the allocation was approved by DBS and the Company. The fair value of the option warrants on the allocation date was NIS 10,280,000.

B. An existing annual bonus plan is in place for the CEO of DBS for 2010, based on the rate for the achievement of certain goals as defined in the plan. (For details of DBS's CEO's additional remuneration, see note 20 to the financial statements of DBS for the year ended December 31, 2009, which are attached to this Periodic Report. An annual bonus plan also exists for other officers. Furthermore, annual bonuses are granted to other DBS department managers and employees at DBS's discretion.

5.12.5 Benefits and nature of employment agreements

DBS employees are employed under personal employment agreements, on the basis of a monthly salary or an hourly salary (usually service representatives and telephone sales representatives). The salaries of sales personnel, service personnel and collection employees consist of a base salary and commissions / bonuses based on performance. The employment agreements are usually for a non-specific period, and each party may terminate the agreement by prior notice in accordance with the agreement or the law.

In January 2010 the New General Federation of Laborers (the "Histadrut") began to set up a preliminary union of DBS employees. This union is in its initial stages. At this stage the Histadrut has set up two action committees and it also claims that it represents more than one third of the technicians who are DBS employees, and that it is entitled to conduct collective negotiations with DBS on their behalf. At this stage DBS is investigating the Histadrut's argument in respect of the technicians as well as its request to be allowed to enter the workplace. The Histadrut refused to furnish DBS the signed application documents in its possession. DBS gave notice to the Histradrut that, in its opinion, at this stage there is no justification to consider the group of employees that the Histadrut calls "YES Technicians" as an independent and separate negotiation unit. DBS informed the Histadrut of the dates, the places and the conditions under which its representatives may enter DBS premises. DBS rejected the Histadrut's claims regarding apparent damage to the employees who are active in the unionization and made a counter claim of trespass against the Histadrut's representatives, asserting that they disrupted the employees' work and caused damage to DBS's property.

DBS employs people at the telephone service call center on the weekly day of rest and on days of rest prescribed by the State and it has an appropriate permit for such employment.

5.13 Raw Materials and Suppliers

5.13.1 Main raw materials

The main raw materials used by DBS for its broadcasting operations are:

A. Television content

In order to provide its broadcasts DBS purchases broadcasting rights of programs destined for inclusion in content channels and it also produces, by means of a third party, programs destined for inclusion in content channels (local productions)

The broadcasting rights purchased by DBS are presented in DBS's books on the basis of their cost, where the costs of the broadcasting rights relating to the screening of movies and television programs includes payments made to rights providers pursuant to the agreements with them.

The broadcasting rights are amortized in accordance with their purchase agreements, on the basis of the actual content screening (where the part which is not amortized by the end of the agreement period is amortized in full at the end of the agreement period) or in equal parts on the basis of the rights agreement period.

The costs of local productions made for DBS which, under purchase agreements, may be broadcast a number of times or which may be sold to third parties are deemed to be part of DBS's broadcasting rights inventories, and their cost is amortized over the period of their expected use, or in accordance with the estimated number of future screenings of such programs, but in any event, they are amortized in full upon expiration of the broadcasting rights under the contract.

In addition, DBS enters into agreements to obtain licenses to broadcast channels in consideration of a set annual payment or a payment dependent on the number of subscribers for the relevant channel.

In view of the proliferation of content providers from which DBS purchases broadcasting rights, DBS does not have a main provider and is not materially dependent on one single content provider. However, in the Israeli sports broadcasting sector there is dependence, at the date of this report, on the purchase of broadcasting rights for local sport channels from two providers of this content.

B. Space segments

DBS leases rights in satellite space segments by means of which DBS broadcasts from the satellites to the reception dishes installed in subscriber homes. The space segments are leased by means of long-term agreements with the owner of the rights in the space segments (see section 5.18.1 below).

DBS is dependent on the continuing regular availability of the space segments (see section 5.18.2 below).

C. Digital decoders

DBS purchases digital decoders for the purpose of receiving and decoding its encrypted broadcasts in customer homes.

The key agreement by means of which DBS purchases digital decoders is the agreement between it and Advanced Digital Broadcast S.A. ("ADB") and Eurocom Digital Communications Ltd. (in this section "Eurocom") from August 2000 as amended from time to time, in which Mr. Shaul Elovitch, an interested party in DBS, is also an interested party (the "ADB Agreement"). Under the ADB Agreement, DBS purchases decoders from ADB from time to time in accordance with purchase orders which DBS sends to Eurocom. DBS was also awarded a warranty period for the set-top boxes and support service therefore from Eurocom.

In 2009, DBS purchased HDPVR decoders from Eurocom for NIS 54 million.

In July 2004, DBS entered into an agreement with UEC Technologies (Pty) Limited ("UEC") for the development, manufacture and supply of PVR Decoders. The agreement is for 5 years and it is automatically renewed for additional one-year terms, unless one of the parties gives notice otherwise. DBS was also awarded a warranty period for the set-top boxes and support services, including a local repair laboratory.

In 2009 DBS purchased PVR decoders from UEC for NIS 23 million.

DBS is dependent on ADB through Eurocom for the purchase and maintenance of the decoders, including the PVR and HDPVR decoders. Replacing the supplier of the decoders with another supplier does not in itself involve additional material cost, yet a replacement would entail a significant preparation period in order to adapt the decoders of the replacement supplier to DBS's broadcasting and encryption system and this would lead to loss of revenues for DBS. Maintenance of decoders by a different supplier which did not supply the decoders is liable to involve additional costs and difficulties.

D. Operating and encryption systems

DBS purchases services and hardware for its broadcasting and encryption operating services from NDS Limited ("NDS"). DBS is dependent on the regular supply of these services.

DBS's agreement with NDS is based on a contract from October 2000 as amended from time to time, for the development, licensing, supply, training, assimilation and maintenance of software and equipment for encryption and broadcasting operations and ancillary operations required for DBS's multi-channel broadcasting system, including development of a smart card which is inserted into a special decoder drive, used to control the subscriber's viewing options. The smart card may be updated using a satellite broadcasting signal. NDS undertook to adapt its equipment and services to the decoders purchased by DBS in accordance with the provisions of the agreement. NDS also undertook to provide DBS with support services and provide a warranty for its products. Pursuant to the agreement DBS may order and pay for additional broadcasting equipment and software and also make modification to the existing ones under the conditions set forth in the agreement. The provisions of the agreement were also applied in January 2006, mutatis mutandis, to the advanced (second generation) version of the smart card. In addition, DBS has also entered into a number of agreements with NDS for the development and implementation of a system of applications to enable DBS to offer its subscribers interactive services via PVR decoders, HDPVR decoders, HD decoders and VOD services. DBS pays for NDS services and products based mainly on the number of set-top boxes that it uses and the number of its active subscribers. In November 2009 an amendment to the agreement with NDS was signed whereby the term of the agreements was extended until December 2013, in which, inter alia, the sections relating to the consideration were amended.

5.14 Working Capital

5.14.1 Customers

DBS collects subscriber fees from its customers at the end of each calendar month for the previous calendar month. At December 31, 2009, net customer balance amounted to approximately NIS 160,152,000 net.

5.14.2 Supplier credit

The average supplier credit period in 2009 was 116 days.

5.14.3 Deficit in working capital

At December 31, 2009, DBS's deficit in working capital amounted to NIS 724,972,000.

5.15 Financing

5.15.1 Average interest rate for loans

5.15.1.1 Shareholders

The loans granted to DBS by its shareholders (among them the Company) are divided into three types:

A. CPI-linked non-interest bearing loans

B. CPI-linked loans bearing annual interest of 5.5%

C. CPI-linked loans bearing annual interest of 11%

These loans were included in DBS's Financial Statements at their discounted value based on the interest rate of 11.64%-15.63%, constituting the fair value for July 2007. The current financing expenses in the Financial Statements are recorded in accordance with these rates, with the addition of linkage to the index. For further information, see Note 17A(3) to DBS's Financial Statements for the year ended December 31, 2009, which are attached to this Periodic Report.

5.15.1.2 Institutional bodies

The loans provided to DBS by institutional bodies in 2005 (see section 5.18.5 below) are linked to the consumer price index and bear interest at an annual rate of 11%.

Debentures (Series A) of DBS are linked to the consumer price index and at the date of this report, bear annual interest at a rate of 8.4% (see section 5.15.8 below).

5.15.1.3 Banks

Short-term credit – the average interest rate for this credit for 2009 was 4%. The effective interest for 2009 was 4.07%.

Long-term credit – long-term loans bearing fixed interest for the period until the end of 2010 at an average annual rate of 5.52%.

5.15.2 Credit restrictions applicable to the corporation

Under a financing agreement between DBS and a consortium of banks that provided DBS with banking finance, as re-expressed in August 2003 and amended from time to time (the "Financing Agreement" and the "Banks", respectively), DBS must comply with all the following financial criteria:

A. Minimum overall income

B. Minimum operating surplus

C. Minimum operating surplus less DBS's investment in decoders and modems

D. Maximum and minimum supplier credit

E. Minimum targets for coverage of the bank debt and debt balances

F. Maximum overall financing requirements

G. Maximum churn rate

The values for compliance with the financial criteria are variable and are measured quarterly (except for a different measure for the criterion of the maximum subscriber churn rate). Non-compliance grants the Banks the right to demand early repayment of the loans and the right not to provide DBS with the balance of any unused credit line.

In 2006, DBS began gradual repayment of its bank credit with an installment plan ending in 2013.

In July 2007, the finance agreement was amended by means of an appendix. This appendix contains, inter alia, a mechanism as part of the above amendment for determining the rate of receipts of issues of DBS debentures (series A), including future extensions of the series, if any, to be used for repayment of the bank credit. (For details of the debenture issue see also Note 15 to DBS's Financial Statements for the period ended December 31, 2009, which are attached to this Periodic Report, and also section 5.15.8 below.

5.15.3 At the date of this report, DBS has reached an agreement in principle with the Banks, which has not yet become a binding agreement, whereby:

A. Another bank will join DBS's bank consortium under the conditions of the Financing Agreement.

B. The loan to be made available by the additional bank will be used mainly for repayment of the existing bank credit and its balance for DBS's financing purposes.

C. The bank credit reimbursement period will be extended so that it concludes at the end of 2015.

D. The financial conditions with which DBS must comply under the financing agreement (see section 5.15.2 above) will be amended and will be replaced by other conditions which will be suited to DBS's business plan.

5.15.4 In addition to the abovementioned financial commitments, pursuant to the Financing Agreement additional restrictions anchored therein apply to DBS, the main ones being:

A. Restrictions on its compliance with the business plan, updating of the plan and engaging in operations that are not an integral part of its current operations.

B. Restrictions on the assumption of third-party liabilities, including the receiving and granting of credit.

C. Restrictions on the distribution of profits and payment of management fees or similar payments to shareholders.

D. Restrictions on the creation of pledges and sale of certain assets without consent from the Banks.

E. Restrictions on DBS's transactions with interested parties, changes of ownership in DBS, the purchase of securities in any corporation and the offering of its securities to the public (including the issue of debentures).

F. Restrictions on the shareholder loans given to DBS, including their inferiority to the bank credit (and to debentures issued to the public, if any), and restrictions on the repayment thereof prior to repayment of the bank credit in full, except in respect of shareholder loans given to DBS after April 1, 2004, which DBS may repay on account thereof prior to full repayment of the bank credit, under the conditions set out in the Financing Agreement (DBS and the Banks have agreed that they will view the loans received by DBS from institutional bodies in 2005 (see section 5.18.5 below) as being part of the aforesaid shareholder loans, and accordingly, DBS may repay them under certain restrictions as set out in the Financing Agreement, prior to full repayment of the bank credit).

G. Restrictions on the allotment of shares or other DBS securities without consent from the Banks, except for the allotment of securities to DBS shareholders which was permitted under the conditions set out in the Financing Agreement.

DBS is bound to make mandatory repayment of sums that it receives in respect of the issue of shares or debentures to the public, sale or transfer of property and certain cash flow surpluses of DBS, on the conditions and at the rates set out in the Financing Agreement. DBS may, voluntarily, effect early repayment sums received in respect of issue of shares or debentures to the public, which may remain after the aforesaid mandatory repayment, on such conditions and at such rates as are set out in the Financing Agreement.

The Financing Agreement also stipulates provisions regarding various reports which DBS is required to provide to the Banks, including in respect of examination of its compliance with the financial conditions.

The Financing Agreement stipulates a list of events which constitute breach thereof, and which entitle the Banks, under the conditions set out in the Financing Agreement, to make the bank credit immediately repayable.

5.15.5 DBS has created a floating charge in favor of the Banks, and has created fixed charges in favor of the Banks over its rights under material agreements to which it is party, over its unissued registered capital, over its goodwill, over certain intellectual property rights, and over the insurance rights to which it is entitled under the insurance policies issued to it (the charge does not apply to DBS's rights under its broadcasting license). These charges were taken at equal rank, *pari-passu*, with similar charges created by DBS in favor of the holders of its debentures (Series A) (see section 5.115.8 below).

5.15.6 The shareholders of DBS, with the exception of the Company, have pledged the DBS shares that they hold in favor of the Banks, to guarantee the sums provided by the Banks and which they will provide to DBS. Most of the shareholders also pledged their rights to repayment of the shareholder loans granted to DBS in favor of the Banks and confirmed to the Banks that pending repayment of the full bank credit, the shareholder loans would be inferior to the bank credit, that they would not effect disposition thereof and that they would not require that they be repaid nor any security in respect thereof. In view of the restrictions on the Company's ability to pledge its assets as a result of the negative pledge created by the Company in favor of its creditors, on November 23, 2000 the Company gave a guarantee of DBS's debts to the Banks, provided that the amount which the Banks receive in repayment by the Company of its guarantee does not exceed the value of its shares in DBS on the date on which the Banks realize the shares which the other shareholders pledged in their favor. The Company also gave an undertaking to sell its shares if the shares pledged by the Banks are sold. Pursuant to a deed of amendment of the guarantee of May 2, 2002, the Company consented that in the event of realization of the collateral given by the other shareholders the Company would waive repayment of the shareholder loans it granted to DBS. The Company also consented that its guarantee would also apply, mutatis mutandis, to the options allotted to it by DBS and to the right to receive them.

The shareholders in DBS with the exception of Gilat DBS Ltd., gave an undertaking to the Banks inter alia not to oppose the sale or other realization of their shares in DBS, which had been pledged or in respect of which a guarantee had been given (by the Company), so that the bank could make the sale in the form of a friendly liquidation.

5.15.7 At the date of this report, DBS is not in compliance with some of its undertakings under the Financing Agreement to take out insurance in respect of its operations and assets. DBS is negotiating with the Banks for relief in respect of these insurance undertakings, which will enable it to comply with these undertakings. In December 2009, the Banks and DBS signed an amendment to the Financing Agreement, whereby, subject to the terms of this amendment, DBS is under no obligation to take out satellite failure insurance (which is one of the above insurances).

In the assessment of DBS's management, the sources of funding at its disposal as a result of the above amendment to the Financing Agreement will be sufficient for its needs for activities in the coming year, in accordance with the cash flow forecasts approved by the board of directors of DBS. If additional sources are required in order to meet operational requirements for the coming year, or the above amendment is not signed or does not take effect, DBS shall adapt its operations so that it will not require sources in addition to those at its disposal.

At December 31, 2009 DBS was in compliance with the financial covenants under the Financing Agreement (which were updated in March 2009).

5.15.8 **<u>Private issue of debentures</u>**

In July 2007, DBS raised the sum of approximately NIS 620 million as part of a private issue to institutional investors of registered debentures (Series A) which were listed on TACT Institutional at TASE (the "Debentures"). For the purpose of this issue, the Debentures were rated as BBB- / stable by Maalot the Israel Securities Rating Company Ltd. which, to the best of DBS's knowledge, has changed its name to Standard & Poors Maalot Ltd. ("Maalot"). In August 2008 Maalot announced that it had authorized this rating.

The Debentures are to be repaid in eight annual principal payments, in July 2010-2017, the principal payments in each of the years 2010-2013 being at a rate of 8% of the par value of the Debentures, and the principal payments in the rest of the years 2014-2017 being at a rate of 17% of the par value of the Debentures. The Debentures are linked to the consumer price index as of the index for June 2007, and bear annual linked interest at a rate of 7.9% per annum (subject to various possible adjustments in accordance with the conditions of the Debentures) which shall be paid in half-yearly installments in January and July of each of the years 2009-2017. DBS has not undertaken to list the Debentures for trading on the TASE, however, if the Debentures are listed for trading on the TASE, the annual interest to be paid on them from the listing date shall be reduced to 7.4%. Since the Debentures were not listed for trading on the TASE by July 31, 2008, the annual interest rate paid on them increased, in accordance with the terms and conditions of the Debentures as of July 31, 2008, to 8.4% as long as they are not listed (and if they are listed on a later date, the interest rate will be decreased from that date to 7.4% as aforesaid). In addition, if DBS does not comply with the financial commitments set out in the Financing Agreement between it and the Banks, and as a condition of the waiver by the Banks of such a breach, DBS shall undertake to pay the Banks a supplement on the bank credit margin, and if at that time the Debentures are not listed for trading, then as long as it pays the Banks the above-mentioned supplement on the bank credit margin and the Debentures are not listed for trading, DBS shall pay the Debenture holders an annual interest supplement at the same rate.

Additional provisions have also been made in the Debentures, including in respect of related payments, payment dates, and the method of convening of general meetings of Debenture holders.

In respect of the issue of the Debentures, DBS and Hermetic Trusts (1975) Ltd. (the "Trustee") executed a deed of trust in July 2007 (for the main points of the deed of trust, see section 5.18.3 below).

The Debentures are secured by a first degree floating charge, with no restriction on the amount, on all of DBS's assets (apart from exceptions stemming from the provisions of the Communications Law) created by DBS in favor of the Trustee, including a condition restricting the creation of additional charges (apart from charges and actions during the ordinary course of business and charges and actions permitted under the deed of trust) and a first degree fixed charge, with no restriction on the amount, on the rights and assets of DBS, pledged by it in favor of the Banks (apart from exceptions stemming from the provisions of the Communications Law) (the "Trustee's Guarantees"). The Trustee's Guarantees are ranked first and equal (pari passu) to the floating charges and fixed charge created by DBS in favor of the Banks, to guarantee the bank credit (the Banks' Guarantees), without taking into account the dates of creation of the various guarantees and/or the dates of registration of such with the Companies' Registrar and/or the Registrar of Pledges. The creation of other pledges by DBS in favor of the Banks shall be subject to the consent of the Trustee, unless such pledges are also registered in favor of the Trustee. In the event of realization of the Trustee's Guarantees and/or the Banks' Guarantees and/or realization of the assets which are the object of these guarantees, including by the holders of other securities who have received a pledge on these assets, the proceeds of the realization shall be distributed pro rata between the Trustee, the Banks and the aforesaid holders, where each holder of a pledge shall receive its pro rata share of the proceeds, equal to its pro rata share of the debt (as defined in the deed of trust) divided by the total debt secured by these assets.

For the purpose of rating the debentures, DBS has undertaken to Maalot (and to it alone) that it shall not make payment on account of the shareholder loan prior to the end of the life of the Debentures.

(For further details of this issue, see Note 15 to the Company's Financial Statements for the year ended December 31, 2009, which are attached to this Periodic Report).

5.15.9 <u>The Corporation's credit facility</u>

Credit framework	Used by 31.12.2009	Used by February 23, 2010
960,000	893,000	883,560

(NIS thousands)

(For details, see Note 29 to DBS's Financial Statements for the year ended December 31, 2009 which are attached to this Periodic Report.

For the position taken by the Ministry of Communications regarding limitations on the shareholder loans granted by the Company to DBS, Note 5.D to DBS's Financial Statements for the period ended December 31, 2009, which are attached to this Periodic Report.

5.16 Taxation

See Note 28 to DBS's Financial Statements for the period ended December 31, 2009, which are attached to this Periodic Report

5.17 Restrictions on and Supervision of the Corporation

5.17.1 <u>Subjection of activities to specific laws</u>

DBS's operations are regulated by and subject to a special extensive system of laws (from primary legislation to administrative directives and Council decisions). The above legislation, secondary legislation, resolutions of the Council and administrative directives have a material impact on DBS and its operations. Likewise, legislation and secondary legislation in the fields of communications and consumer protection have a material impact on DBS.

Restrictions are applicable to DBS under the Communications Law and the regulations promulgated pursuant thereto. The Communications (Telecommunications and

Broadcasting) (Proceedings and Conditions for Granting of a Satellite Broadcasting License) Regulations, 5758-1998 (the “License Regulations”), determine the processes and conditions for receipt of a broadcasting license, and also various restrictions applicable to a licensee during the term of the license. The License Regulations prescribe, inter alia, suitability conditions for a satellite broadcasting licensee, relating to the direct or indirect holdings of the broadcasting licensee and the interested parties therein, in cable broadcasting franchisees, in franchisees pursuant to the Second Television and Radio Authority Law, 5750-1990, and in proprietors of daily newspapers.

In October 2008, the Ministry of Communications informed DBS that since Bank Leumi Ltd. (in this section: “Bank Leumi”) is part of the consortium of banks in whose favor some of the DBS shareholders pledged the DBS share capital held by them on the one hand, and on the other hand Bank Leumi's holding in part of the share capital of Keshet Broadcasting Ltd., the franchise holder in accordance with the Second Television and Radio Authority Law, 5750-1990, as of October 31, 2008, the date on which the transfer provision set forth in the License Regulations for the granting of a license expired in respect of a parallel holding as aforesaid at a rate exceeding 25% of the franchise holder's equity, one of the qualification restrictions set forth in the License Regulations, in the opinion of the Ministry of Communication, will be applicable with regard to DBS. In September 2009 Bank Leumi announced that its subsidiary had entered into an agreement to sell all its holdings in Keshet Broadcasting Ltd., subject to the existence of conditions precedent. To the best of DBS's knowledge, as long as this transaction is completed, the pledge of DBS's shares to Bank Leumi will not constitute a breach of the above-mentioned qualification restriction as far as the Ministry of Communications is concerned.

Pursuant to the Communications Rules (Broadcasting Licensee) 5747-1987 (the “Communications Rules”), various obligations and restrictions apply to DBS, including those relating to broadcasting content and investment in local productions.

Pursuant to the Telecommunications (Telecommunications and Broadcasting) (Television Broadcasts via Satellite) (License Fee and Royalties) Regulations, 5759-1999 (the “Royalty Regulations”), DBS, as a satellite broadcasting license holder, is obligated to pay royalties at the rate of 1% of its revenues from the provision of broadcasting services. In 2009 DBS completed the payment of royalties which it owed for previous years, in accordance with an agreement it signed with the State.

Under section 6WW of the Communications Law, the license may prescribe the maximum prices that a subscriber may be billed for. At the date of this report, no such prices have been prescribed.

In accordance with the requirements of the broadcasting license and regulations determined by the Council, for each of the years 2009 and 2010 DBS must invest in local productions an amount which shall not be less than 8% of its revenues from subscription charges.

In October 2009 the Council notified DBS, inter alia, that there was a shortfall in its investment in local productions of external production channels which DBS needs to make up during 2010 and 2011. The chairman of the Council also imposed a financial penalty on DBS for this reason. In addition, the Council notified DBS that it was not in compliance with its obligation to invest in television and cinema movies, complicated drama and types of drama for 2008 (including its failure to make up past shortfalls) and that it was also under an obligation to make up this shortfall in 2010 and 2011. A financial penalty was imposed on DBS for this noncompliance as well.

Under the requirements of the law and the license, DBS is required to allow channel producers determined in law to make use of its infrastructures in order to broadcast to its subscribers, in return for payment to be set out in an agreement, and in the absence of any agreement, in consideration for payment to be prescribed by the Minister, after consultation with the Council. For further information relating to the hearing announced by the Ministry of Communications with regard to transmission fees to be paid by independent channel producers as aforesaid, see section 5.17.3 below.

Pursuant to the Consumer Protection Law, there is an obligation to notify the date of the termination of the agreement period and consent from the customer must be obtained before the agreement may be extended beyond its original term.

5.17.2 Operations subject to broadcasting license

DBS's operations are subject to the provisions of its broadcasting license. The Communications Law, the License Regulations and the broadcasting license stipulate a number of grounds on the basis of which the Minister of Communications can terminate, restrict or make the broadcasting license conditional, after consultation with the Council and the granting of a hearing to the broadcasting licensee, among them, violation of the provisions of the law or rules and regulations pursuant thereto, a material violation of the terms of the broadcasting license or a non-material violation which was not corrected after a warning from the Minister or the Council, the cessation of broadcasts for an unreasonable period of time or the total cessation of broadcasts for 14 consecutive days, noncompliance of the licensee with the restrictions determined in relation thereto in the License Regulations, and the appointment of a receiver or temporary liquidator for the licensee or the issuing of a liquidation order, all pertaining to the licensee.

The Minister of Communications, in consultation with the Council, and after granting the broadcasting licensee an opportunity to make its arguments and consider the harm to its rights, may change the terms of the broadcasting license, inter alia, for the purpose of the goals stipulated in the license. In addition, the Council alone has concurrent authority to amend the broadcasting license, provided that the broadcast licensee is first given an opportunity to make its arguments.

5.17.3 Principal restrictions by virtue of the law and broadcasting license

The Communications Law and Broadcasting Regulations stipulated the following principal general conditions: The broadcasting license may not be transferred or attached; encumbrance of the broadcasting license, as much as it may be encumbered under the law, requires prior written approval from the Minister of Communications; transfer, encumbrance or attachment of any of the assets of the broadcasting license from August 2001 onwards, which were not granted advance permission in the license, require approval from the Minister of Communications, except for encumbrance of an asset in favor of a banking corporation (in this respect, DBS received the consent of the Ministry of Communications for an encumbrance that DBS sought to create inter alia on the “license assets” in favor of the trustee for the debenture holders); an encumbrance placed on any of the broadcasting license's assets shall only be realized in the manner prescribed by the Minister of Communications; DBS's broadcasts and their scope, in accordance with the Broadcasting License, are subject to the provisions of the law; a change, directly or indirectly, in the control of DBS, a change in the holding of the means of control (of any type whatsoever) in a percentage of 10% or more and a change in the holding of the means of control in any percentage resulting in a person becoming a rights holder of the licensee (as defined in the License Regulations) or ceasing to be a rights holder requires prior written approval from the Minister of Communications, after consultation with the Council. If the change in the holding of the means of control does not exceed 15% of the holding of the means of control in a company whose shares are listed on the Stock Exchange, this approval is not required in respect of the listed shares and their accompanying rights, provided that it is not a change in the control thereof and a report is delivered as set forth in the license. Reporting requirements were stipulated concerning holders of the means of control and restriction on encumbrance of the means of control; cross-ownership in the licensee is prohibited as set forth in the License Regulations; competition pertaining to the provision of broadcasts and services shall not be prejudiced, including terminal equipment or other telecommunications services, by any agreement, arrangement or understanding to which the broadcasting licensee, any body in which the broadcasting licensee, an officer of the broadcasting licensee, or any holder of rights in a company owning a broadcasting license (and also an officer of the owner of a right therein) are parties, unless approved in advance and in writing by the Council; advertising broadcasts are prohibited (this prohibition also applies to the Cable Company) except for the transmission of foreign channels containing advertisements which are not aimed primarily at Israel and except for sponsorship and service broadcasts, under restrictions prescribed by the Council.

The broadcasting license also stipulates conditions for the establishment and operation of a satellite broadcasting system; subscriber service conditions, including the obligation to receive approval from the Council and Standard Contracts Tribunal of the subscriber agreement; the obligation to connect applicants and the prohibition of preconditions; the obligation to provide the services throughout the year; prohibition on discriminating among subscribers, with the exception of offering different rates to reasonably categorized types of subscribers; maintaining a subscriber service center, maintaining a supply and maintenance system and ongoing maintenance of terminal equipment and protection of subscriber privacy; conditions for the cessation or disconnection of service and conditions governing supervision of the operations of a broadcasting licensee and the obligation to submit reports to the Ministry of Communications, and conditions governing the compliance with standards of the terminal equipment installed by DBS.

The broadcasting license stipulates provisions regarding the types of payments that the broadcasting licensee may collect from its subscribers. The licensee is under an obligation to give written notice to the chairman of the Council of any change in the price list approved by the Council, immediately upon its publication or upon notice of a change to subscribers, whichever is the earlier, and the chairman may, if he is of the opinion that such a change might harm competition, mislead the public, discriminate among subscribers, cause unfair competition, or that it does not comply with the provisions of the law, the regulations, the rules, the license or the Council's policy, instruct the licensee not to change the price list or give notice that he intends to place the change before the Council for discussion. If the chairman does not give the licensee notice as aforesaid prior to the date of commencement of the change, the change shall come into force. In respect of price reductions, discounts and promotions (for a restricted period), DBS is required to notify the chairman of the Council no later than the date of publication or commencement, whichever is the earlier, and the chairman may intervene if he finds that they mislead the public or discriminate between subscribers.

The broadcasting license sets out a number of provisions that relate to the content of DBS's broadcasts, including the Council's approval of the channels broadcasted by DBS and related amendments (including the content of DBS's Basic Package)and approval of the electronic program guide (EPG) which is part of DBS's digital service to its subscribers.

DBS is also required to transmit the television and radio channels broadcasted nationally in Israel, including the educational television channel and the broadcasts of a dedicated channel. At present, DBS transmits the broadcasts of two dedicated channels, the Music Channel (Music 24) and a Russian language channel (Israel Plus), in consideration of a payment which the Minister is required to set. DBS and the aforesaid dedicated channels are in legal proceedings in respect of a debt for the transmission fee that DBS is claiming from the channels, including in respect of the Minister's power to require them to pay such a transmission fee.

In March 2009 the Ministry of Communications published details of a hearing regarding the transmission fee to be paid to DBS by the producer of an independent channel, including the broadcaster of a dedicated channel for the use of its channels. It noted that the result would constitute a basis for settlement of the dispute between DBS and the dedicated channels (in the absence of an agreement between them), where the amount of the payment to be determined in the hearing would be applicable from 2007 until the end of 2013, and the method of its calculation could be used by the parties as a foundation for calculating the size of the payment up to 2006. The Ministry of Communications noted that its economic opinion which was attached to the hearing could serve as a basis for settlement of other disputes arising between DBS and other independent channel producers. According to this economic opinion, usage fees would total approximately NIS 2 million for an independent channel producer which is not financed by subscription fees. DBS submitted its position in the hearing in June. At the date of this report, the Ministry of Communications had not announced its decision in respect of the hearing.

In February 2010 DBS and Music 24 Ltd. signed an agreement regulating the size of the transmission fees to be paid to DBS.

In July 2009 a bill was passed in its preliminary hearing whereby the dedicated channels would be exempt from payment of transmission fees to the Cable Company. To the best of DBS's knowledge, the bill has been passed by the Ministerial Committee for Legislation but the Minister of Communications has lodged an appeal of this decision. In March 2010 a joint committee formed from the Economy Committee and Absorption and Immigration Committee are expected to discuss the preparation of the first reading of a bill.

According to the communications rules, DBS, including its associated entities which are defined in the communications rules, may own up to 30% of the local channels broadcast by DBS. (This is in contrast to the 20% applicable to the Cable Company).

In 2001, the Ministry of Communications issued administrative directives which regulate how a subscriber switches from the services of the cable companies to DBS and vice versa, and the use of infrastructures in the subscriber's home. The directives also prescribe a duty to pay monthly usage fees for infrastructure owned by another multi-channel television service provider. Since the administrative directives were issued, DBS and the cable companies have submitted mutual complaints of violation of the directives by the other party, and voluminous correspondence has been exchanged by DBS and the Ministry of Communications on the matter. In August 2005, the Ministry of Communications notified DBS and the cable companies that in view of their numerous violations of the administrative directives, it had examined the matter and was now considering their cancellation, inter alia, in view of the mechanism for purchasing the wiring prescribed in the Communications Law, which enables a subscriber to purchase the wiring in his home for NIS 120.

In November 2005, DBS submitted its position to the Ministry of Communications, stating that the administrative directives should remain in place, while cancelling the notice obligation, which requires notice to be given to a party whose subscribers disconnect from its services. DBS also argued that the provisions of the law granting ownership of infrastructure to the multi-channel television provider that installs it in the homes of its subscribers should be rescinded. At the very least, argued DBS, if the directive remains in place, its proper interpretation should not grant the cable companies ownership of the wiring they installed in private homes. DBS also stated that the amount prescribed in the law as the consideration to be paid for purchasing the wiring (NIS 120), has no foundation and that if the directive is retained, the amount should be considerably reduced.

In March 2006, the Cable Company gave notice to the director-general of the Ministry of Communications that in light of DBS’s breaches of the administrative order, it was ceasing to accept disconnection notices sent to it by DBS, and indeed, the Cable Company ceased accepting any notices under the administrative order, including connection plans and termination notices. DBS dismissed the claims made by the Cable Company and argued that by refusing to receive notices from DBS, not only was the Cable Company in breach of the administrative orders, it was also in breach of the provisions of its license and of the agreements by means of which it had entered into agreements with its customers, since it continued charging subscribers a subscription fee despite knowing that such subscribers had disconnected from its broadcasts. DBS also demanded that the Ministry of Communications order the Cable Company to stop charging subscribers immediately upon receipt of notice of disconnection. To date, the Ministry of Communications has not yet commented on the issue, and the Cable Company continues not to accept notices from DBS.

In the opinion of DBS's management, if the administrative orders are cancelled, without an appropriate alternative arrangement enabling one supplier to make use of another’s infrastructure in subscriber homes, this will constitute a material barrier to the switching of subscribers between the various suppliers.

5.18 Material Agreements

Following is a summary description of the principal agreements likely to be considered as material agreements not in the normal course of DBS's business which have been signed and/or are valid in the period of the Periodic Report:

5.18.1 <u>Space segment lease agreements</u>

First space agreement

In order to transmit satellite broadcasts DBS signed an agreement in April 1999 with HLL Communications Ltd. (“HLL”), in which an interested party is also an interested party in DBS, and with Israel Aircraft Industries (IAI) for the leasing of space segments in the Amos 1 satellite as amended in May 2003 (the “First Space Agreement”). The lease period for Amos 1 terminated in June 2008.

In September 2009 DBS and IAI signed a settlement arrangement in respect of DBS's debts to IAI under the First Space Agreement.

Second space agreement

In May 2000, DBS signed another agreement with HLL to lease space segments on the Amos 2 satellite, as amended in May 2003 (the “Second Space Agreement”), whereby

DBS is to lease from HLL on the start date of the lease no fewer than 12 space segments on the two satellites (of which 8 on Amos 1), and one year later, shall lease two additional segments on Amos 2 on the same polarity, so there will be no need to adjust DBS's receiver dishes. According to the Second Space Agreement, the capacity that was leased on Amos 1 was transferred to Amos 2 and to Amos 3, whose positioning in space was completed in July 2008.

Pursuant to the Second Space Agreement, the lease period for the space segments on Amos 2 and Amos 3 is for 12 years from the date on which Amos 2 was positioned in space (which took place during April 2004) or until the end of the life of Amos 2, the earlier of the two. The consideration for the lease determined in the Second Space Agreement consists of annual lease fees to be paid in monthly installments, the amount of which depends on the total number of segments which DBS, its shareholders and lessors affiliated with it and/or with its shareholders, as defined in the Second Space Agreement will lease on Amos 2 and Amos 3. The Second Space Agreement brings together space segments which are to be used as reserve capacity for the leased capacity on Amos 2, and alternative capacity if the leased capacity becomes unusable, and awards DBS the right of first refusal to lease other space segments on Amos 2 under the terms specified in the agreement.

HLL has undertaken to act to extend the lease period for the space segments beyond the current lease period, and for this purpose to endeavor to station a subsequent satellite in a suitable position, with similar technical characteristics, so that it will not be necessary to make changes to the receiver systems of DBS subscribers, under the conditions determined in the agreement, until December 31, 2013, provided that an appropriate agreement for the continuation of the satellite's life is signed by the parties, as shall be determined in said agreement, pursuant to which DBS will lease at least 14 space segments in consideration of annual leasing fees under similar commercial conditions.

In July 2008, an amendment to the Second Space Agreement was signed between DBS and HLL, according to which, inter alia:

1. DBS will lease 13 space segments instead of 14 from HLL.
2. DBS will temporarily terminate the lease of the 13th space segment. Pursuant to an amendment to the agreement, each of the parties may, with advance notice, renew the lease of this space segment.
3. A mechanism was set up for partial backup on Amos 3 in the event of non-availability of space segments on Amos 2.

At the date of this report, DBS is leasing ten space segments on Amos 2 and two space segments on Amos 3. The leasing fee in 2009 amounted to approximately NIS 109 million.

5.18.2 <u>Financing agreement with the Banks</u>

For a summary of the main points of the agreement, see section 5.15 above and Note 29 to the Company's Financial Statements for the year ended December 31, 2009, which are attached to this Periodic Report.

5.18.3 <u>Deed of trust relating to debentures (Series A)</u>

In respect of DBS's issue of the Debentures (Series A), a deed of trust was signed in July 2007 by DBS and the Trustee. The deed makes various provisions regarding the relationship between DBS and the holders of the Debentures (via the Trustee) including in respect of the possibility that DBS might increase the Debenture series and issue additional debentures and/or securities. A restriction is also prescribed depending on DBS's EBITDA in respect of DBS's right to grant first liens to the holders of additional securities as aforesaid, and/or allow them to participate in liens in favor of the Trustee, without requiring the Trustee's consent.

The deed of trust sets out various events, the occurrence of which requires the Trustee to convene a meeting of holders of the Debentures, in which, if the event has not yet been dealt with, the holders may resolve, in a resolution requiring a 75% majority of the Debenture holders represented at the vote, to make the Debentures immediately repayable (in which case, the Trustee must realize the securities granted to it). The events include failure to make timely payment of an amount owed by DBS after a warning period; appointment of a temporary liquidator, temporary or permanent receiver to DBS and/or over all or most of DBS's assets, the passing of a resolution to wind up DBS (except for winding up for the purpose of merger with another company and/or a restructuring of DBS), institution of proceedings against DBS under section 350 of the Companies Law or grant of an order under such provision, and the imposition of attachment orders or certain acts in execution of judgment, not cancelled within the periods set out in the deed; realization of the Banks' guarantees (as defined in section 5.15.8 above) or realization by third parties of pledges over most of DBS's assets; making another series of DBS's Debentures immediately repayable, if the balance to be paid out is greater than the sum set out in the deed; termination of DBS's business or an intention so to do, and the creation of circumstances giving rise to a real probability that DBS will cease paying its debts or running its business; cessation of rating of the Debentures by any rating company for the period and under the conditions set out in the deed (so long as DBS is not a reporting corporation under the Securities Law); and if DBS breaches or does not fulfill any material condition or undertaking included in the Debenture or the deed of trust (except for non-payment as aforesaid) which the Trustee may deem to be prejudicial to the rights of the holders of the Debentures, and such breach is not remedied within the warning period set out in the deed.

DBS has also undertaken, under the deed of trust to carry out various acts and to deliver various documents and approvals to the Trustee and/or provide access to DBS's information and documents, in the events and under the conditions set out in the deed of trust.

(For the principal conditions of the Debentures and the securities created by DBS under the deed of trust, see section 5.15.8 above).

5.18.4 Agreements with DBS shareholders

A. The founders agreement dated December 4, 1998 between the Company, Eurocom Communications Ltd. (whose holdings were later transferred to Eurocom DBS Ltd), Lidan – Business Ventures Ltd (whose holdings in DBS were later transferred to Lidan Investment Agencies (1994) Ltd) and Gilat Communications Ltd. (whose DBS holdings were later transferred to Gilat DBS Ltd), which regulates the establishment of DBS, its administration and the relationships between the shareholders[23].

B. An agreement dated December 30, 1998 between DBS's shareholders and DBS regulates, inter alia, the setting up of an executive committee and its authority.

C. An agreement dated November 2001 between DBS's shareholders[24] and DBS, modified the dilution formula set forth in the founders agreement and stipulated that the holdings of DBS's shareholders would be adjusted to the pro rata share of their investments in DBS, so that for the purpose of dilution, the investments (made by way of shareholders' loans) would bear, as of the date fixed in the agreement, CPI linkage differentials and an annual cumulative linked interest rate of 5.5% from the date of the establishment of DBS.

D. An agreement dated December 30, 2002 as amended on August 8, 2003, between DBS shareholders and DBS, prioritizes shareholders' loans granted subsequent to July 10, 2002 over earlier loans. The agreement also stipulated that these loans would bear CPI linkage differentials and an annual accrued linked interest rate of 5.5%, while loans granted after April 27, 2003 would bear CPI linkage differentials and an annual accrued linked interest rate of 11%. Furthermore, the agreement stipulated a mechanism for the allotment of shares or share options to shareholders who would invest in DBS, so that their holdings in DBS would be adjusted to their adjusted investments in it. The agreement also stipulated the information rights for the shareholders who are parties thereto.

5.18.5 Agreements with institutional organizations

According to agreements of March and April 2005, loans were provided to DBS by a number of institutional bodies, in the total sum (principal) of NIS 100 million, linked to the CPI and bearing interest at an annual rate of 11%, the date of repayment of which is December 31, 2013. This credit was taken on inferior terms in respect of payment, compared with the bank credit, with exceptions similar to those that apply to shareholder loans provided by DBS's shareholders after April 1, 2004. These loans were received on

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[23] DBS is not a party to this agreement. As a result of the changes in holdings in DBS, Polar Communications Ltd. joined the shareholders' agreements. In January 2010 some of Polar Communications Ltd.'s holdings in DBS were transferred to Naniach Ltd. and Yoav Harlap which also joined the DBS shareholders' agreements.

[24] Gilat DBS Ltd. did not sign this agreement, however it did not dispute it and subsequently signed an amendment to this agreement.

the basis of three different loan agreements between DBS, the Company and each of the institutional organizations, and to guarantee repayment of the 2005 institutional loans, the Company gave an undertaking to repay sums on account of the loans, the amount of which would be determined based on the formula set out in the agreements (which is conditional, inter alia, on a positive valuation of DBS), as set out in Note 16 to DBS's Financial Statements for the period ended December 31, 2009, which are attached to this Periodic Report. The lenders, the Company and the Banks also agreed that in the event of realization of the Company's guarantee to the Banks (see section 5.15.6 above), the lenders would be entitled (proportionately to their respective shares) to a proportionate share of the receipts from the realization, at the rate set out in the agreements.

5.19 Joint Venture Agreements

5.19.1 Until July 2009 DBS acted as a distributor of surfing services on the Company's website.

5.19.2 For the joint venture between DBS and Walla! Communications Ltd. in respect of the website, see section 5.2 above.

5.20 Legal Proceedings

5.20.1 On July 6, 2006 DBS filed a statement of claim in the Tel Aviv District Court against Pace Micro Technology plc. In the financial claim for NIS 31.5 million DBS requested that the court order the defendant to pay its direct expenses for the repair of a model of defective set-top boxes which was manufactured and supplied by the defendant pursuant to a framework agreement from August 1999 between DBS, the defendant and Eurocom Digital Communications Ltd. ("Eurocom") where in the agreement it undertook to provide repair services for the set-top boxes.

On July 15, 2007 a statement of defense was filed by the defendant and in conjunction therewith it filed a statement of counterclaim against DBS and against Eurocom, jointly and severally, in the amount of NIS 42.6 million.

The defendant argues in its statement of defense and counterclaim that the liability for the flaws of the decoders should not be laid at its doorstep but at the doorstep of DBS and/or of Eurocom, and it argues that this is, inter alia, because the set-top boxes were not characterized as suitable by the counter defendants, they did not undergo proper testing by the counter defendants, and because at least some of the decoders were not properly installed in subscriber homes by DBS or by its contractors.

In the light of these and other arguments, pursuant to the statement of counterclaim, the defendant argues that it incurred harm caused by the need to repair the decoders even after expiry of the contractual warranty period, by supplying parts, by providing personnel services and by various payments allegedly made by the defendant to Eurocom. Alternatively, the defendant claims lost expenses and loss of profits amounting to US$ 15 million. For fee purposes the claim amounts, as aforesaid, to NIS 42.6 million.

5.20.2 On October 3, 2007 an application for certification of a class action against DBS was filed in the Tel Aviv District Court in connection with reception disturbances in DBS's broadcasts and with problems in the functioning of DBS's service setup. During the disturbances in September 2007 the applicant argues that daily malfunctions and long interruptions in television broadcasts were caused to DBS's subscribers which took the form, inter alia, of severe disturbances of picture and sound, and DBS's service center was not operational and it was impossible to receive service or assistance from it.

On January 16, 2008 the applicant filed a notice in court stating that it had reached agreement with the plaintiff in CC 2466/07 in which an action and an application for its certification as a class action had been filed against DBS, on the same matter as this case whereby the action would be heard in this case only, and the claim in CC 2466/07 would be struck out. On April 27, 2008 the claim in CC 2466/07 was struck out.

The applicants estimated the amount of the claim at NIS 121 million.

Closed lawsuits

5.20.3 On April 2, 2007 an application for approval of a class action against DBS and the Sports Channel Company Ltd. (the producer of Channel 5, Channel 5+, Channel 5 Live and Channel 5 Gold) and its managers (who were later deleted from the claim) was filed in the

Tel Aviv District Court in connection with the broadcasts of Channel 5 Live in which it was argued that the broadcasting of Channel 5 Live involves the transfer of content from Channel 5+ to Channel 5 Live, and this is contrary to a "basic promise from DBS which had been ratified in previous legal proceedings". The applicant who is suing DBS on the grounds of breach of contractual undertaking, breach of duty of good faith in a contractual agreement, and unjust enrichment, estimated the amount of the claim at approximately NIS 63 million. On Feb 28, 2010, the court rejected the application for approval of the claim as a class action.

5.20.4 In December 2002, a claim and application for certification as a class action was filed in the Tel Aviv District Court against DBS, the Council for Satellite TV and Cable Broadcasting and the Ministry of Communications in respect of the broadcasts of the sports channel 5+ . The applicants argued its broadcasts contravene the conditions set out in the Council's approval of its broadcasts, and divest channel 5 of content, in contravention of the conditions of the above approval. In November 2006, a settlement was signed by the plaintiffs and DBS, under which DBS undertook to broadcast various sports transmissions as part of Channel 5, for one full season of the relevant sports, during the years 2006 and 2007, and other sports during 2007 and 2008. The settlement was approved in February 2007 and the benefit (for customers of DBS and the cable companies alike) was estimated at US$ 10 million, and legal costs were awarded to counsel for the plaintiffs in the amount of NIS 2.5 million and to the plaintiffs NIS 0.4 million. DBS and the Cable Company decided that the division between the parties would be 30%-70% and accordingly, in April 2007, DBS's share (30% of the total amount) was transferred to the class plaintiffs.

5.20.5 In September 2009 an application to approve a class action which had been filed against DBS in December 2005 in the Tel Aviv District Court was dismissed in limine in a claim which was based on various arguments for financial compensation for subscribers who had contacted DBS by telephone and not in writing. The applicant's individual claim was for NIS 20,000 and requested financial compensation for all the other customers in a sum which would equal the excess amounts collected from them over and above what had been agreed by telephone.

5.20.6 In August 2009, an application for certification of a class action filed against DBS in August 2008 in the Tel Aviv District Court was struck out by agreement. The subject of the application was the non-disconnection of the applicant from the television services of the Cable Company and the continued billing by the Cable Company for the provision of services. The applicant did not state the exact (or approximate) value of the class action on the grounds that it could not be estimated at that stage, however it did note that its value exceeds the amount which the Magistrates' Court is competent to award (i.e. NIS 2,500,000). The individual claim was in the approximate amount of NIS 5,000.

5.20.7 In September 2008, a court judgment gave legal force to a settlement agreement signed in June 2009 which dealt with an application for approval of a class action filed against DBS in November 2006 in the Tel Aviv District Court, in a claim based on various arguments for financial compensation for subscribers who elected to terminate their agreements with DBS and DBS allegedly failed to reimburse them all the money owed to them from the deposits they paid DBS. The applicant did not specify the total damages incurred by the members of the group on the grounds that these data were in the possession of DBS. It argued that its damages at the date on which the claim was filed amounted to NIS 546.74 and it estimated the cumulative damage of the members of the group to be in excess of NIS 16 million.

The agreement stipulates that without admitting to any of the plaintiff's arguments DBS will compensate subscribers in respect of whom the above-mentioned has been argued, so that existing customers of DBS will not be entitled to expect DVDBox movies free of charge and subscribers who have left DBS's services will be entitled to financial compensation of NIS 25 – NIS 50 as determined in the agreement of 5 DVDBox movies free of charge if they choose to rejoin DBS. It also stipulates that the representative plaintiff will be entitled to payment of NIS 50,000 and its lawyers will be entitled to NIS 450,000.

5.21 Goals and Business Strategy

5.21.1 DBS's goals are to continue the trend of increasing DBS's revenues, by continuing a gradual increase in the number of DBS subscribers, and by continuing the increase in average revenue per subscriber (ARPU).

5.21.2 In order to achieve these goals, DBS intends to invest considerable efforts in the fields of marketing and sales and in appropriate marketing strategies designed to continue subscriber recruitment; retention of existing customers and to increasing revenues from them; creation of differentiation and innovation in its broadcasting content which is to be increased in comparison with the content of the Cable Company; increasing the content purchased by each subscriber and expanding DBS's value-added services. These efforts include DBS's drive to increase the penetration of advanced services, among them the PVR and HDPVR Decoders and HD services among its subscribers in such a way that DBS's revenues will be increased along with its subscribers' loyalty to DBS's services. DBS is also working on the launch of VOD services.

5.21.3 DBS's goals in respect of increasing the number of subscribers and the ARPU are based on forecasts by DBS's management, on the current trend in the broadcasting market and on DBS's assumptions regarding competition in the broadcasting arena and the regulation which applies and which will apply to DBS's operations and the restrictions which are imposed or will be imposed on DBS and its operations, taking into account the restrictions which apply and will apply to the Company, which affect DBS. However, the forecasts of DBS's management will not be realized because of changes in demand in the broadcasting market, increased competition in this field, the entry of additional entities into the broadcasting field or alternative fields and in light of the regulatory restrictions which are imposed or will be imposed on DBS or on its joint ventures with the Company (see section 5.7.4.2 above). Realization of DBS's goals in respect of the launch of VOD services also depend on the availability of the types of decoders used to receive this service in customer homes (see section 5.4 above). Increasing the penetration rates of PVR Decoders depends also on the availability of such decoders and the manufacturer's supply dates.

5.22 Risk Factors

Following is a list of the threats, weaknesses and risk factors of DBS (the "Risks") deriving from its general environment, the industry and the special nature of its operations. It should be emphasized that the Risks set out below are rated according to various levels of likelihood of occurrence, and DBS believes that the likelihood of occurrence of some of them would be very low. However, each risk has an effect irrespective of the likelihood that it will arise.

5.22.1 **Macro risks**

5.22.1.1 Financial risks – a material part of DBS's expenses and investments are linked to fluctuations in the exchange rate of the US dollar. Therefore, sharp fluctuations in the exchange rate will have a material effect on DBS's business results. In addition, loans taken out by DBS from banks, from its shareholders and from institutional entities are partly linked to the consumer price index and therefore sharp rises in inflation could have a material effect on DBS's business results.

5.22.1.2 Recession / economic slowdown – an economic slowdown in the market, a rise in unemployment rates and a decrease in disposable income might bring about a decrease in the number of DBS's subscribers, a decrease in DBS's revenues and harm to its business results.

The current economic recession, which includes, inter alia, by increased unemployment and reduced available income, together with the accelerated competition, is liable to lead to the aforesaid damages. Furthermore, if the economic slump causes harm to operations or termination of the operations of significant suppliers, it is possible that this will have a negative impact on DBS's operations.

5.22.1.3 Security situation – a continued unstable security situation in large areas of Israel which disrupts the day-to-day lives of residents, could have an adverse effect on DBS's business results.

5.22.2 **Sector risks**

5.22.2.1 Dependence on licenses – DBS provides multi-channel television broadcasts in accordance with a broadcasting license and other licenses. A breach of the provisions of the licenses as well as of the law under which the licenses are issued could bring about, subject to the license conditions, the cancellation, amendment or suspension of the licenses and consequently material harm to DBS's ability to continue operating in the field, as well as the imposition of monetary sanctions on DBS.

5.22.2.2 Regulation – DBS's operations and broadcasts are subject to obligations and restrictions set out in legislation and to a system of licensing, oversight and approvals from various regulatory bodies, and consequently DBS is likely to be influenced and restricted by policy considerations dictated by these entities and by their decisions and changes in communications legislation. The degree of regulatory intervention is very high and regulatory changes could affect DBS's operations and cause material harm to its financial results.

In addition, the operations of DBS, as a company supplying services to the public, is subject to consumer protection legislation.

5.22.2.3 Strong competition – the field of broadcasts is characterized by a very high penetration rate and very strong competition, which requires DBS to constantly and continually be investing in recruiting and retaining customers; and dealing with high transfer rates of customers between DBS and the Cable Company. The offer of a bundle of services containing multi-channel television, internet and telephony, which are not offered in this format by DBS, as well as the Cable Company's high penetration rates for VOD services also increase the Cable Company's ability to compete. Non-provision of VOD services by DBS when the Cable Company does offer such services to its customers also harms DBS's ability to compete. For further information regarding potential new competitors and alternative services to the broadcasting market see section 5.7 above.

5.22.2.4 Development of new technology – the risk in the development of new technologies is that they will turn existing technology into obsolescent technology, which will result in a need for large monetary investments in order to retain competitive standing. Alternatively, if new technologies are developed that enable entry into the field of multi-channel broadcasts without making heavy financial investments, the entry barriers into the field might be lowered and this will constitute a threat to DBS's competitive status. For IPTV technology see section 5.1.4.2 above.

5.22.2.5 Setting up alternative multi-channel broadcast infrastructures – the introduction of DTT as well as amendments to legislation and regulations might enable the setting up of additional infrastructures or systems for the provision of television services that might constitute a substitute for DBS's services or the expansion of existing ones which could harm its financial results.

5.22.2.6 Types of payments and supervision of tariffs – DBS's license determines the kinds of payments that DBS is permitted to collect. In addition, the Council has the power not to approve amendments to the price list or campaigns or discounts initiated by DBS. These restrictions affect DBS's ability to conduct its own commercial price policy.

5.22.2.7 Piracy – DBS is exposed to viewers' attempts to use pirate connections in order to receive DBS broadcasts without paying subscription fees.

5.22.2.8 Exposure to claims regarding broadcast of content that breaches legal provisions – DBS is exposed to claims regarding the broadcasting of content that breaches legal provisions, including breach of intellectual property rights, breach of privacy, damage to its good name, broadcast of prohibited content, etc. Its agreements with content suppliers and program producers usually include an undertaking by the supplier / producer to indemnify DBS in the event of content that breaches the provisions of the agreement and the law.

5.22.3 <u>Special risks of DBS</u>

5.22.3.1 DBS's need to receive approval from financing banks in order to carry out its operations – the implementation of certain operations and proceedings are dependent upon the receipt of prior approval from the Banks. This restriction could hinder DBS's operations.

5.22.3.2 Exposure to the provision of immediately repayable credit as a result of non-compliance with loan agreements – failure by DBS to comply with the provisions of the Financing Agreement or with the provisions of the deed of trust signed with the trustee for the Debenture holders might, in accordance with and subject to the provisions of each of the aforesaid agreements respectively, give the relevant lenders grounds to make all of the credit provided to DBS immediately repayable and realize the securities provided by DBS and its shareholders to the Banks. This realization of securities by the Banks constitutes grounds for making the debentures immediately repayable, whereas making the debentures immediately repayable constitutes grounds for making the bank credit immediately repayable.

5.22.3.3 Restrictions that are the result of the ownership structure – regulatory restrictions restrict DBS's ability to raise finance from its shareholders and it is restricted in cooperating with the Company in order to offer a package of communications services which can compete with the Cable Company. These restrictions have a material effect on DBS's business situation and its competitive ability – see sections 5.1.2 and 5.1.3.4 above.

5.22.3.4 Existence of sufficient cash flow – DBS is required to maintain a cash flow which is sufficient for compliance with its business plan and with repayment of its loans. Failure to repay these loans on time constitutes grounds for making the bank credit and debentures immediately repayable in accordance with and subject to the provisions and restrictions of the Financing Agreement and the deed of trust, respectively.

5.22.3.5 Malfunction of and damage to satellite – DBS broadcasts through space segments on the Amos 2 and Amos 3 satellites stationed in identical points in space. Operational malfunction or damage to one of the satellites is liable to disrupt and reduce the scope of DBS's broadcasts, and such disruption and reductions are expected to be more significant in the event of a failure of Amos 2. Nonetheless, the duplication of the satellites by means of which broadcasts are transmitted to subscribers enables a significant reduction of the risk entailed by damage to one of them, and improves the survival ability of the broadcast. If there is a malfunction in one of the satellites, it will be possible to broadcast most of DBS's channels via the existing space segments on the other satellite, and perhaps even via additional segments on the same satellite that might be made available to DBS, but not all the channels broadcast. DBS is not insured against loss of revenues caused by satellite malfunction.

DBS's estimate as aforesaid in this paragraph is forward-looking information – this estimate is based on the supply of space segments by the supplier with which DBS has an agreement. This estimate might not be realized or might be realized to some or other extent if DBS is not permitted to carry out the above-mentioned channel transfer.

5.22.3.6 Dependence on the holders of rights in space segments – DBS is very materially dependent on HLL as the exclusive holder of rights and the sole supplier of the space segments used by DBS.

5.22.3.7 Dependence on providers of software, equipment, content, infrastructure and services – DBS is dependent on certain providers of software, equipment, content and services, including broadcast encryption services, and failure to receive their products or services might harm DBS's ability to function or its growth rate.

5.22.3.8 Dependence on use of internal wiring – DBS depends on the use of internal wiring in some subscriber homes, which is owned by the Cable Company, and the use of which is effected in accordance with the administrative directives. As set out in section 5.17.3 above, in 2005, the Ministry of Communications gave notice that it was considering cancellation of the administrative directives. If the administrative directives are cancelled, without an appropriate alternative arrangement enabling one supplier to make use of the infrastructure of the other in subscriber homes, this will constitute a substantial barrier to DBS's subscriber recruitment.

5.22.3.9 Damage to broadcasting centers – Damage to a broadcasting center might cause a significant difficulty for continued broadcasts, however, the splitting of broadcasts into two broadcasting centers (Kfar Saba and Re'em Junction) significantly reduces the risk involved if one sustains damage and improves the possibility that most of the broadcasts will survive. If one broadcasting center is damaged, DBS can continue broadcasting the primary channels from another broadcasting center (while the Kfar Saba center is able to broadcast a greater number of channels). All the broadcasting centers have an identical encryption system and therefore backup is also available for the encryption system in the event of damage to one of the broadcasting centers.

DBS's estimate as mentioned in this paragraph is forward-looking information. This estimate is based on the provision of backup services from the supplier with which DBS has an agreement in the event of damage to the Kfar Saba broadcasting center. This estimate might not be realized or might be realized to some or other extent if DBS is not permitted to receive such backup services.

5.22.3.10 Malfunction of DBS's computer systems – a significant malfunction in DBS's central computer systems is liable to harm its operational capacity. DBS has a remote backup site which is intended for activation and provision of partial computer services within a few hours in the event of malfunction, however, it will be impossible to implement certain of DBS's operational capacities without the proper operation of the central computer systems.

DBS's estimate as mentioned in this paragraph is forward-looking information. This estimate is based on the functioning of the remote backup site. This estimate might not be realized or might be realized to some or other extent if this functioning is not enabled.

5.22.3.11 Technical inferiority and the inability to offer integrated services – DBS's technology is technically inferior to that of its competitors. This technical inferiority prevents DBS from providing telephony and internet services, and various interactive services, including VOD, on its infrastructure, and requires it to purchase these services or to enter into joint venture agreements in order to provide such services to its customers.

5.22.3.12 Inability to offer an integrated analog and digital package – DBS provides its customers with digital decoders only, whilst the Cable Company can provide both analog and digital decoders. The offer of two kinds of decoders reduces the cost of equipment subscribers, and improves the Cable Company's ability to compete.

5.22.3.13 Defects in the encryption system – DBS's broadcasts are based on the encryption of broadcasts transmitted via satellites and encrypted via smart cards that are installed in the decoders in subscribers' homes. Defects in the encryption system or a breach thereof could make it possible to view broadcasts without payment being made to DBS, thereby causing a reduction in revenues and a breach of the agreements between DBS and its content suppliers.

5.22.3.14 Exposure caused by the broadcasting of channels without an agreement – DBS broadcasts approximately 10 channels to its subscribers from their broadcasting origin as unencrypted satellite broadcasts, and which can be received in Israel (even without a decoder) without any agreement with the owners of the broadcasting rights. DBS makes an effort to regulate contracts with owners of broadcasting rights.

5.22.3.15 Exposure to class actions – given the large number of its subscribers, DBS is exposed to class actions and the more subscribers, the greater the exposure to class actions in significant sums. For applications pending against DBS (for the certification of claims as class actions, see section 5.20 above).

5.22.3.16 Compliance with conditions and directives of the Ministry of the Environment regarding the broadcasting center – in the event of failure to comply with the conditions and directives from the Ministry of the Environment in respect of the broadcasting center, DBS is exposed to the sanctions prescribed in law.

5.22.3.17 Secondary allocation of frequency range – the frequency range used by DBS to transmit its broadcasts from the broadcasting satellites to the satellite dishes installed in subscribers' homes, which is allocated pursuant to a license from the Ministry of Communications is defined as a frequency range with a secondary allocation, so that an Israeli entity is permitted to make primary authorized use of the frequency range. If the owner of the primary allocation uses this frequency range, disruptions may occur to the quality and/or availability of DBS's broadcasts to its subscribers which could cause harm to DBS's financial results. At the date of this report, to the best of DBS's knowledge, the owner of the primary allocation has not made use of these frequencies in such a way as to cause significant and/or ongoing disruptions to DBS's broadcasts.

5.22.3.18 Disturbances to broadcasts – since DBS's broadcasts are wireless transmissions from broadcasting centers to broadcasting satellites and from them to the receiver dishes in subscriber homes, the broadcast of wireless signals in the same frequency range, whether or not they originate in Israel, and extreme weather conditions of heavy rain, hail or snow could cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and may cause material harm to its financial results.

5.22.4 The following table sets out the risk factors based on their nature and ranking according to their effect as assessed by DBS's management. Note that DBS's assessments below regarding the level of exposure of DBS to a risk factor reflects the level of impact of such a risk factor on the assumption that the risk factor is realized. This is not an assessment or a weighting to the chances of the above-mentioned realization. Likewise, the order of appearance of the risk factors above and below is not necessarily based on the risk inherent in each risk factor, or the probability of its occurrence:

	Level of Effect		
	Major	**Moderate**	**Minor**
Macro risk			
Financial risks		X	
Security situation		X	
Recession / economic slowdown			X
Sector risk			
Dependence on licenses		X	
Changes in regulation	X		
Fierce competition	X		
Development of new technology	X		
Tariff control		X	
Piracy			X
Exposure to claims for broadcasting infringing content			X
Specific risk			
Need to receive approval from financing banks for DBS's operations			X
Exposure to bank credit becoming immediately repayable due to non compliance with financing agreements	X		
Restrictions caused by ownership structure		X	
Need for sufficient cash flows	X		
Satellite malfunction and damage	X		
Dependence on space segment supplier	X		

	Level of Effect		
	Major	Moderate	Minor
Dependence on suppliers of content, equipment and infrastructure	X		
Dependence on suppliers of essential content		X	
Damage to broadcasting centers	X		
Malfunction of computer systems		X	
Technical inferiority and inability to offer integrated services		X	
Inability to offer integrated analog and digital packages			X
Encryption system	X		
Exposure caused by broadcasting of channels without agreement			X
Legal proceedings		X	
Compliance with environmental quality restrictions		X	
Secondary allocation of frequencies			X
Disruptions of broadcasts	X		

Date

Bezeq – The Israel Telecommunication Corp. Ltd

Names and titles of signatories:

Shlomo Rodav, Chairman of the Board

Avi Gabbay, CEO

Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs for the year ended December 31, 2009

We respectfully present the Directors' Report on the state of affairs of "Bezeq" – The Israel Telecommunication Corp. Limited ("the Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter referred to as "the Group"), for the year ended December 31, 2009.

Commencing August 21, 2009, the Company ceased to consolidate the financial statements of DBS into its financial statements, and from that date its investment in DBS is stated by the equity method. At the date of termination of consolidation, the Company set the fair value of its investment in DBS at NIS 1,175 million,[*] and recognized a profit of NIS 1,538 million (see Note 5 to the financial statements). However, the Company is still reporting on the multi-channel television operation as a segment in the financial statements.

The Group's balance sheet in 2007 and 2008 include balances of the multi-channel television segment; however, the statements of income for those years have been restated and do not include the results of operations in that segment.
Furthermore, the cash flows of the Group in 2007 and 2008 include the operations of that segment.

The Group continues to report on four main segments in its financial statements:

1) **Domestic fixed-line communications.**
2) **Cellular**
3) **International communications, internet service and NEP**
4) **Multi-channel television**

Profit for the reporting year (including the profit from termination of consolidation) amounted to NIS 3,541 million compared with NIS 1,521 million in the prior year. The profit attributed to the owners of the Company amounted to NIS 3,603 million, compared with NIS 1,627 million in the prior year.

The exceptional increase in profit stemmed from setting the fair value of the Company's investment in DBS as aforesaid in the third quarter of 2009. A further increase in profit for the year stemmed from a rise in revenues from NIS 11,015 million to NIS 11,519 million, and a decrease in finance expenses from finance expenses of NIS 140 million to finance income of NIS 31 million. This rise was moderated by an increase in total costs from NIS 8,375 million to NIS 8,547 million. The increase in profit was in all the main segments (reduction of the loss in the multi-channel television segment). See below for further details.

[*] In this translation of the Directors' Report, all amounts should be understood by the reader to be rounded to the nearest million or thousand, as the case may be.

A. EXPLANATIONS OF THE BOARD OF DIRECTORS FOR THE STATE OF THE CORPORATION'S AFFAIRS, THE RESULTS OF ITS OPERATIONS, ITS EQUITY, CASH FLOWS AND OTHER TOPICS

1. Financial position

A. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs)

B. The Group's assets at December 31, 2009 amounted to NIS 13.94 billion, compared with NIS 14.31 billion on December 31, 2008, of which NIS 5.3 billion (38%) are property, plant and equipment, compared with NIS 6.04 billion (42%) on December 31, 2008.

The decrease in the Group’s assets stemmed primarily from the termination of the consolidation of DBS in the financial statements of the Company and from recording the Company's investment in DBS by the equity method (DBS's assets at December 31, 2008 amounted to NIS 1.13 billion). The decrease was reflected mainly in property, plant and equipment and in broadcasting rights. Intangible assets also decreased due to the write-off of the goodwill. The decrease offset the fair value determination of the investment in DBS on the date of termination of the consolidation at NIS 1,175 million.

In the fixed-line domestic communications segment, total assets increased, excluding investment in associates, compared with the prior year by NIS 87 million. The increase stemmed mainly from a rise in the cash balances, which was offset by a decrease in deferred tax balances.

In the cellular segment, assets increased from NIS 4.64 billion on December 31, 2008 to NIS 4.99 billion at December 31, 2009. Most of the increase was due to a rise in trade balances, mainly as a result of increased revenue from sales of terminal equipment on installments. Inventory balances of terminal equipment also increased. The increase was moderated by a decrease in cash balances, mainly due to dividends paid.

In the international communication, internet and NEP services segment, assets increased from NIS 994 million on December 31, 2008 to NIS 1,106 million on December 31, 2009. Most of the increase is in other long-term assets, in respect of additional purchases of usage rights in capacity for expanding the ability to operate in the segment.

In the multi-channel television segment there was a moderate increase in total assets, from NIS 1,132 million on December 31, 2008 to NIS 1,206 million at December 31, 2009, which was derived mainly from an increase in broadcasting rights and in net investment balances in intangible assets.

C. The Group's debt to financial institutions and debenture holders at December 31, 2009 amounted to NIS 4.14 billion, compared with NIS 6.1 billion on December 31, 2008. The decrease is mainly due to the termination of the consolidation of DBS in the Company's financial statements (DBS's debt to financial institutions and debenture-holders at December 31, 2008 was NIS 1.75 billion). In addition, there was a decrease in the cellular segment due repayment of debentures and loans. In the domestic fixed line communications segment, debt decreased due to the repayment of debentures but the decrease was moderated by receipt of loans.

2. Results of operations

A. Principal results

The Group’s revenue in 2009 amounted to NIS 11.52 billion, compared with NIS 11.01 billion in the prior year, an increase of 4.6%. Most of the increase stemmed from the cellular segment, and was partially offset by a decrease in the domestic fixed-line communications segment.

The Group’s depreciation and amortization expenses in 2009 amounted to NIS 1,485 million compared with NIS 1,458 million in the prior year, an increase of 1.9%. Most of the increase was in the cellular segment, which was partially offset by a decrease in the domestic fixed-line communications segment.

In 2009 the Group’s salary expense amounted to NIS 1,990 million compared with NIS 2,161 million in the prior year, a decrease of 7.9%. The decrease stemmed from a decline in salary expenses in all the segments consolidated by the Company in its financial statements.

The Group's operating and general expenses in 2009 amounted to NIS 4,871 million compared with NIS 4,660 million in the prior year, an increase of 4.5%. The increase stems primarily from a rise in expenses in the cellular segment, which was moderated by a decrease in expenses in the domestic fixed-line communications segment.

Other operating expenses, net, amounted to NIS 201 million compared with NIS 96 million in the prior year, an increase of 109.4%. The increase stemmed from the domestic fixed-line communications segment.

B. **Operating segments**

Below are operations data by segment presented in accordance with the Group's operating segments:

Revenue by operating segment	1-12/2009		1-12/2008	
	NIS millions	% of total revenue	NIS millions	% of total revenue
Domestic fixed-line communications	5,303	46.0%	5,498	49.9%
Cellular	5,376	46.7%	4,713	42.8%
International communications, Internet and NEP	1,318	11.4%	1,306	11.9%
Multi-channel television services	1,530	13.3%	1,513	13.7%
Other	74	0.6%	75	0.7%
Adjustments*	(2,082)	(18.0%)	(2,090)	(19.0%)
Total	11,519	100%	11,015	100%

* Mainly multi-channel television operations not included in the consolidated financial statements.

Operating profit by operating segment	1-12/2009		1-12/2008	
	NIS millions	% of total revenue	NIS millions	% of total revenue
Domestic fixed-line communications	1,523	28.7%	1,475	26.8%
Cellular	1,190	22.1%	933	19.8%
International communications, Internet and NEP	261	19.8%	242	18.5%
Multi-channel television services	248	16.2%	177	11.7%
Other	4	5.4%	-	-
Adjustments*	(254)		(187)	
Total	2,972	25.8%	2,640	24.0%

* Mainly multi-channel television operations not included in the consolidated financial statements.

Domestic fixed-line communications segment

Revenue:

Revenue in 2009 amounted to NIS 5.303 billion compared with NIS 5.498 billion in the prior year, a decrease of 3.5%.

The decline in the segment's revenue stemmed mainly from a decrease in the number of lines and in call traffic, and from a decrease in interconnect fees to the cellular networks (with a concurrent decrease in the expense). Other services in the segment also declined, including a decrease in revenue from satellite services due to the sale of the segment's satellite communications operation in November 2008. The decrease was moderated mainly by an increase in revenue from high-speed internet, data communication and transmission.

Costs and expenses:

Depreciation and amortization expenses in 2009 amounted to NIS 794 million compared with NIS 852 million in the prior year, a decrease of 6.8%. The decrease was derived mainly from the end of the depreciation of property, plant and equipment.

Salary expenses in 2009 amounted to NIS 1,094 million compared with NIS 1,202 million in the prior year, a decrease of 9%. The decrease in salary expenses stemmed primarily from a rise in the attribution of salary to property, plant and equipment, *inter alia,* due to work on deployment of the NGN.

Operating and general expenses in 2009 amounted to NIS 1,690 million compared with NIS 1,873 million in the prior year, a decrease of 9.8%. The decrease stemmed primarily from a decrease in interconnect expenses to the cellular networks together with a decrease in revenues from interconnect fees, from an increase in expenses capitalized for investment, and from the application of efficiency measures which led to a decrease in operating expenses. The royalty expense also decreased, mainly following amendment of the Communications (Telecommunications and broadcasts) (Royalties) Regulations, 5761-2001. The amendment includes exemption, commencing January 1, 2004 (see Note 19C to the financial statements), from payment of royalties in respect of revenue from high-speed data communication services. As a result, the royalty expense decreased in the fourth quarter of 2009 by NIS 32 million.

Other operating expenses, net, in 2009 amounted to NIS 202 million compared with NIS 96 million in the prior year. The increase in expenses stemmed primarily from an increase in retirement expenses for early retirement severance pay from NIS 165 million in 2008 to NIS 267 million in 2009 (see Note 17D to the financial statements).

Profitability:

Operating profit in the segment in 2009 amounted to NIS 1.523 billion compared with NIS 1.475 billion in the prior year, an increase of 3.3%. The improvement in operating profit stems from the changes described above in the revenue and expense items.

Cellular segment

Revenue:

In 2009 revenue in the segment amounted to NIS 5.376 billion compared with NIS 4.713 billion in the prior year, an increase of 14.1%.

The increase stemmed from a rise in revenue from the sale of terminal equipment, due mainly to a rise in prices with the transition to the new network. Revenue also increased from services as a result of an increase in the number of subscribers and a rise in average revenue per user (ARPU), primarily from increased revenue from content services.

Costs and expenses:

Depreciation and amortization expenses in 2009 amounted to NIS 603 million compared with NIS 523 million in the prior year, an increase of 15.3%. The increase stems mainly from operation of the new network using HSPA/UMTS technology alongside the existing network. Amortization expenses for subscriber acquisition also increased.

Salary expenses in 2009 amounted to NIS 601 million compared with NIS 638 million in the prior year, an increase of 5.8%. The decrease in the salary expense stemmed primarily from a decrease in the share-based payment plan for managers, as well as from a decrease in the average number of positions.

Operating and general expenses in 2009 amounted to NIS 2.982 billion compared with NIS 2.619 billion in the prior year, an increase of 13.9%. The increase stemmed primarily from a rise in the prices of terminal equipment purchased, and from an increase in the number of active cellular sites.

Profitability:

Operating profit in the segment in 2009 amounted to NIS 1,190 million compared with NIS 933 million in the prior year, an increase of 27.5%. The improvement in operating profit stems from the changes described above in the income and expense items.

International communications, internet and NEP segment

Revenue:

In 2009, revenue in the segment amounted to NIS 1.318 billion compared with NIS 1.306 billion in the prior year, an increase of 1%. The increase in revenue stems primarily from internet services, and relates to an increase in the number of broadband customers, an increase in call transfer activity among communications operators worldwide, an increase in integration operations, and an increase in data operations. Conversely, revenue from outgoing traffic minutes declined, mainly as a result of a decrease in traffic volume. Revenue from sales of private exchanges (PBX) also decreased.

Costs and expenses:

Depreciation expenses in 2009 amounted to NIS 84 million compared with NIS 80 million in the prior year, an increase of 5%. The increase stems from further acquisition of usage rights in capacities and amortization of subscriber acquisition expenses.

Salary expenses in 2009 amounted to NIS 242 million compared with NIS 260 million in the prior year, a decrease of 7%. The decrease in the salary expense stems from a reduced headcount, a decrease in the share-based payment plan for managers, and from capitalization of sales staff commissions for subscriber acquisition.

Operating and general expenses in 2009 amounted to NIS 731 million compared with NIS 724 million in the prior year, an increase of 1%, concurrent with changes in the segment's income.

Profitability:

Operating profit in the segment in 2009 amounted to NIS 261 million compared with NIS 242 million in the prior year, an increase of 7.9%. The improvement in operating profit stems from the changes described above in the income and expense items.

Multi-channel television segment (stated by the equity method)

Revenue:

Revenue in the segment in 2009 amounted to NIS 1.530 billion compared with NIS 1.513 billion in the prior year, an increase of 1.1%. The increase in revenue stemmed mainly from a rise in revenue from advanced services and premium channels, and from an increase in the number of subscribers. Conversely, as a result of revision of the internet agreement with the Company, revenue from internet services decreased by NIS 45 million in 2009.

Costs and expenses:

Depreciation and amortization expenses in 2009 amounted to NIS 234 million compared with NIS 250 million in the prior year, a decrease of 6.4%. The decrease resulted from extension of the customer commitment period in campaigns, which affected the depreciation rate for installations.

Salary expenses in 2009 amounted to NIS 206 million compared with NIS 195 million in the prior year, an increase of 5.6%. The increase stems from an increase in the number of telephone service center attendants, and from expansion of the technical service array while reducing outsourcing services.

Operating and general expenses in 2009 amounted to NIS 842 million compared with NIS 890 million in the prior year, a decrease of 5.4%. The decrease in these expenses stemmed primarily from a reduction in internet operations following the revised agreement with the Company, offset by a rise in content costs.

Profitability:

Operating profit in the segment in 2009 amounted to NIS 248 million compared with NIS 177 million in the prior year, an increase of 40%. The improvement in operating profit stems primarily from the above-mentioned increase in income and expense items.

C. **Finance income, net**

The Group’s net finance income in 2009 amounted to NIS 31 million compared with net finance expenses of NIS 140 million in the prior year.

The reasons for the material decrease in the Group's financing expenses are the following:

In 2009, income from hedging transactions increased. The Group's debt to financial institutions and debenture holders is mainly linked to the CPI, and finance expenses are affected by changes in that index. In the reporting year, the rate of the rise in the CPI decreased compared with the prior year, so that revaluation of the liabilities led to a decrease in finance expenses of the Group compared with the prior year. In addition, there was a decrease in financial debt. Furthermore, income was recorded from the realization of an investment of a venture capital fund (Stage One).

Most of the change stems from the domestic fixed-line communications segment, for the reasons described above.

D. **Income tax**

The Group's tax expenses in the reporting year amounted to NIS 807 million, representing 27.2% of pre-tax profit, compared with NIS 719 million in the prior year and 28.7% of pre-tax profit. Most of the decrease in the tax rate for pre-tax profit is due to the reduction in the tax rate and taxes of prior years. The decrease was offset by the decrease in deferred tax assets, net, as a result of the lower tax rate, as explained in Note 9 to the financial statements.

E. **Discontinued operation**

Profit from a discontinued operation in 2009 amounted to NIS 1.379 billion, compared with a loss of NIS 265 million in the prior year. For additional information, see Note 5 to the financial statements.

F. **Key data from the Group's consolidated income statements** (in NIS millions)

	Q1 2009	Q2 2009	Q3 2009	Q4 2009	2009	2008	Increase (Decrease)	%
Ongoing operations								
Income	2,791	2,872	2,924	2,932	11,519	11,015	504	5%
Costs and expenses(1)	1,992	2,054	2,049	2,452	8,547	8,375	172	2%
Operating profit	799	818	875	480	2,972	2,640	332	13%
Finance income (expenses) net	30	(1)	(16)	18	31	(140)	171	-
Profit after finance income (expenses), net	829	817	859	498	3,003	2,500	503	20%
Equity in profits (losses) of associates	2	2	(12)	(26)	(34)	5	(39)	-
Profit before income tax	831	819	847	472	2,969	2,505	464	19%
Income tax	221	222	259	105	807	719	88	12%
Profit for the year from ongoing operations	610	597	588	367	2,162	1,786	376	21%
Profit (loss) for the period from discontinued operation(2)	(1)	(95)	1,475	-	1,379	(265)	1,644	-
Profit for the period	609	502	2,063	367	3,541	1,521	2,020	133%
Attributable to:								
The Company's equity holders	608	541	2,088	366	3,603	1,627	1,976	121%
Non-controlling interest	1	(39)	(25)	1	(62)	(106)	44	42%
Profit for the period	609	502	2,063	367	3,541	1,521	2,020	133%

Comparison of 2009 fourth quarter results with the results of the third quarter

Details of the material changes:

1. Total costs and expenses increased in the fourth quarter by NIS 403 million compared with the prior quarter. Most of the increase stems from the domestic fixed-line communications segment, as a result of recording a provision of NIS 267 million for early retirement (see Note 17D to the financial statements).

In addition, the salary expense increased by NIS 51 million, of which NIS 25 million in the domestic fixed-line communications segment following revision of actuarial liabilities.

Expenses form the purchase of terminal equipment in the cellular segment also increased, by NIS 55 million, and selling expenses increased by NIS 20 million.

2. In the third quarter of 2009, profit from an operation that was discontinued during that quarter was included (see Note 5 to the financial statements).

3. Shareholders' equity

Equity attributed to the Company's controlling shareholders at December 31, 2009 amounted to NIS 6.54 billion, accounting for 47% of the total balance sheet, compared with NIS 4.71 billion and 33% of the total balance sheet as of December 31, 2008. The increase in shareholders' equity stems primarily from the Group's profit, which was partially offset by the distribution of a dividend on NIS 1.94 billion during the year.

4. Cash flows

Consolidated cash flow for 2009 includes the cash flow from the operations of DBS through August 20, 2009 (for details of the amounts, see Note 5 to the financial statements).

Consolidated cash flows generated by operating activities in 2009 amounted to NIS 3.91 billion, compared with NIS 3.41 billion in the prior year, an increase of NIS 500 million. Most of the increase stems from the domestic fixed-line communications segment. There is also a rise in the international communications, internet and NEP segment, which was offset by a decrease in the cellular segment. The source of the increase in cash flows from operating activities is mainly an increase in operating profit, a change in the balances of trade payables and other payables, and a decrease in payments in respect of early retirement. The increase was partially offset mainly by an increase in the balances of trade receivables and inventory in the cellular segment.

Cash flows generated by operating activities are one of the sources of financing for the Group's investments, which during the reporting year included NIS 1,363 million invested in development of communications infrastructures and NIS 349 million in intangible assets and deferred expenses, compared with investments amounting to NIS 1,300 million and NIS 469 million, respectively, in the prior year. In addition, NIS 134 million were invested in current investments, net, compared with realization of NIS 321 million in the prior year.

In the reporting year, the Group repaid debts and paid interest of NIS 1,145 million, of which NIS 682 million was on account of debentures, NIS 109 million on account of loans, and NIS 354 million on account of interest payments. In contrast, the Group received loans of NIS 400 million, short-term credit of NIS 48 million, and NIS 129 million in proceeds from the exercise of stock options for employees – compared with repayment of debt and interest payments of NIS 1,155 million in the prior year.

In the reporting year, a cash dividend of NIS 1.94 billion was paid, compared with NIS 1.51 billion in the prior year.

The monthly average balance of short-term bank credit in 2009 amounted to NIS 54 million. The monthly average of long-term liabilities to financial institutions and debenture holders in 2009 amounted to NIS 5,367 million.

Average credit from suppliers in the reporting year was NIS 1,322 million and the average short-term customer credit was NIS 2,451 million. The average long-term customer credit was NIS 753 million.

The working capital surplus of the Group at December 31, 2009 amounted to NIS 10 million, compared with a working capital deficit of NIS 1,290 million as of December 31, 2008. Most of the decrease in working capital stems from the termination of the consolidation of the financial statements of DBS in the financial statements of the Company (the working capital deficit of DBS at December 31, 2008 was NIS 1,330 million). In addition, working capital improved in the cellular segment, which was offset by an increase in the working capital deficit in the domestic fixed-line communications segment and a decrease in working capital in the international communications, internet and NEP segment.

The Company has a capital deficit of NIS 769 million at December 31, 2009. The Board of Directors of the Company reviewed the Company's projected cash flows, including sources of credit and the options for raising it, and determined that despite the working capital deficit, the Company does not have a liquidity problem.

The above information includes forward-looking information based on the Company's assessments. Actual results might differ significantly from those assessments if a change occurs in one of the factors taken into account in making them.

5. Explanations of the Board of Directors relating to exposure to market risks and their management (Part B below)

Below are summaries of the sensitivity test tables shown in part B.

Sensitivity to changes in the USD/NIS exchange rate

2009	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 3.775	-5%	-10%
Total	(116)	(57)	(1,206)	58	116

2008	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 3.802	-5%	-10%
Total	(92)	(45)	(1,183)	45	88

Sensitivity to changes in the CPI

2009	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	1.5%	0.2%	0.1%		-0.1%	-0.2%	-1.5%
Total	(51)	(6)	(3)	(3,814)	3	6	51

2008	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	1.5%	0.2%	0.1%		-0.1%	-0.2%	-1.5%
Total	(75)	(10)	(5)	(6,815)	5	10	75

Sensitivity to changes in real shekel interest

2009	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Total	(56)	(27)	(2,768)	29	63

2008	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Total	78	40	(5,417)	(40)	(80)

Sensitivity to changes in nominal shekel interest

2009	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	10%	5%		-5%	-10%	-12%
Total	(7)	(6)	(3)	1,606	3	7	7

2008	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	10%	5%		-5%	-10%	-12%
Total	13	10	6	948	(6)	(11)	(14)

Sensitivity to changes in the dollar interest rate

On December 31, 2009 the Group's exposure to changes in the dollar interest rate is negligible.

2008	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	10%	5%		-5%	-10%	-15%
Total	**20**	**13**	**7**	**(532)**	**(7)**	**(14)**	**(21)**

Termination of the consolidation of the financial results of DBS reduced the Group's exposure to changes in the CPI by NIS 2.574 billion, the exposure to changes in the real shekel interest rate by NIS 2.062 billion, the exposure to changes in the nominal interest rate by NIS 804 million, and the exposure to changes in the dollar interest rate by NIS 535 million. The exposure to changes in the dollar exchange rate decreased as a result of the termination of the consolidation by NIS 632 million, most of which was offset by a rise in the volume of firm commitments with other suppliers.

The linkage bases report at December 31, 2009 shows a decrease of NIS 3.021 billion in the CPI-linked liabilities, net, compared with the report on December 31, 2008, of which NIS 2.551 billion is in respect of termination of the consolidation of DBS. The decrease is also attributed to repayment of debentures and loans in the Group. For additional details, see Note 32 to the financial statements.

In 2009, the Company implemented a policy of financial risk management adopted by the Board of Directors of the Company on June 26, 2008 (see Section B. below).

6. The link between the compensation awarded pursuant to Article 21 and the contribution of the recipient to the corporation, for each of the five highest-salaried officers

The Board of Directors believes that the compensation paid to the five senior officers as described in Section 7A of Chapter D of the Periodic Report is fair and reasonable considering the size of the corporation, the scope and complexity of its operations and business, and the assignments and responsibility shouldered by the senior officers. The considerations guiding the Board of Directors of the Company (or of the subsidiary, as the case may be) in determining the compensation of the senior officers were based, *inter alia*, on the status and position of each of them, his contribution to the advancement of the corporation and its financial results. Moreover, the Board of Directors believes that compared with companies that have published their financial statements at the date of this report, the scope of remuneration of these senior officers does not deviate from what is customary to similar corporations in Israel.

B. EXPOSURE TO AND MANAGEMENT OF MARKET RISKS

Responsibility for management of the Company’s market risks

The person responsible for management of the Company's market risks is Deputy CEO and CFO Alan Gelman. For details of his education and experience, see Section 12(c) in Chapter D of the Periodic Report.

Market risks and the Company's risk management policy

The Company is exposed to market risks as a result of changes in interest rates, exchange rates, inflation, the prices of raw materials and equipment, and the prices of securities.

In 2009, the Company acted in accordance with a financial exposure management policy adopted by the Board of Directors of the Company on June 26, 2008. Pursuant to that policy, the Company takes partial hedging actions depending on the circumstances and its own judgment, primarily for reducing its exposure to a change in the CPI and to a change in foreign currency exchange rates. The Company monitors and reviews the Group's exposure management every month, including, when necessary, making recommendations for change if required, in the exposure management.

In cases where the responsible level considers a deviation from targets, its recommendations are brought to the Board of Directors of the Company.

Inflation – The Company has a significant surplus of liabilities over CPI-linked assets, and the bulk of its financial exposure stems from the risk of a rise in inflation. The rate of inflation also affects the Company's operating income and operating in the course of the year.

In addition, the Company's tariff updating mechanism, which was laid down in regulations and is reviewed once a year, is influenced by the CPI. As a result, the annual rate of inflation and its distribution over the year can have a material influence on the erosion of the Company's tariffs and on its revenues over the year. The rate of inflation affects the Company's expenses but some of these, mainly the salary expense, have other direct or indirect linkage mechanisms.

In order to minimize the exposure to inflation, the Board of Directors of the Company decided to implement full or partial hedging, at its discretion, in accordance with the following:

A. Hedging activity will be implemented mainly by means of CPI-shekel forward transactions which guarantee a defined rise in the CPI over a designated period.

B. Transactions will be made after deliberation and in accordance with market trading restrictions and on occasions where the price is deemed to be attractive in relation to the Bank of Israel Average Inflation Target.

C. It will be possible to reduce a hedging position by closing existing transactions before their expiration date.

D. As long as this exposure is more than NIS 500 million, the hedging rate will not be less than 20% of the exposure and will not exceed 80%; where the exposure is less than NIS 500 million, the hedging rate will not exceed 50% of the exposure.

The Company made hedging transactions against the CPI in order to minimize the risk.

The Company incurred no material costs in making these hedging transactions since they were made as forward transactions. The financial statements include finance income of NIS 60 million from these transactions.

Interest – The Company's exposure to change in the interest rate largely depends on the character of its financial liabilities and assets as well as future financing needs. Most of the Company's debt bears fixed interest, and therefore a change in the interest rate will affect its fair value rather than its carrying value.

The Company has investments in negotiable bonds that are stated in the Company's books at their market value. This market value is influenced by changes in the interest rates in the economy. At the date of publication of the financial statements, these investments are negligible.

At the date of this report, the Company does not hedge against the exposures described above. It is not inconceivable, however, that it will do so in future market circumstances. Furthermore, the Company takes into account such influences when considering the types of loans it takes and when managing its investment portfolio.

Exchange rates – A change in the shekel exchange rate constitutes economic exposure in that it can affect the Company's future profit and cash flows, mainly the repayment of currency-linked liabilities and payments for the currency-linked purchase of equipment and raw materials.

In order to minimize this exposure, the Board of Directors decided that the Company should hedge its accounting exposure against exchange rate risks, subject to the following principles and rules:

a. The unhedged equity exposure to exchange rate risks will not exceed a sum equivalent to USD 200 million

b. Purchase and/or investment transactions will be made, if at all, on the date of the purchase and/or investment decision, and that decision will be part of the purchase and/or investment decision itself.

The Company incurred no significant costs in making hedging transactions against the exchange rate, since they were made as forward transactions. The financial statements include finance income of NIS 0.5 million from these transactions.

Prices of raw materials and equipment – The cash flow generated by the Company's operations is used partially for investment in equipment. The prices of the equipment are affected by the indices to which they are linked, including industry price indices, exchange rates and global prices. The Company does not hedge against this exposure.

Copper scrap prices – The Company is exposed to changes in copper prices that result in a change in the residual value of its copper cable infrastructure. In preparation for withdrawing the copper cables at the same time as deploying the NGN, and in view of the significant flows expected from sale of the copper and the volatility of its price, the Board of Directors of the Company approved, after the balance sheet date, principles for making transactions to hedge the exposure to the value of the copper assets that will be sold as part of the NGN project.

Risks and risk management in the consolidated companies

According to the decision of the Board of Directors, each of the companies in the Group is required to maintain a risk management policy and routinely monitor performance. The persons responsible for management of the market risks in the principal consolidated companies are the CFOs of those companies. Pelephone's policy is to partially hedge its accounting and cash flow exposure to market risks based on its assessments and expectations of the parameters affecting the risk.

For more information about financial risk management in the Group, see Note 31 to the financial statements.

Linkage base report – Note 32 to the Financial Statements includes information on the linkage terms of the financial balances in the Group.

Below is an analysis of the sensitivity of the Group's assets and liabilities to changes in foreign currency exchange rates, the CPI, interest rates, and market prices of securities.

Sensitivity analysis for 2009 (in NIS millions)

Sensitivity to changes in the USD/NIS exchange rate – 2009

The table shows the items sensitive to changes in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was examined, as were off-balance-sheet items. The firm commitments are off-balance-sheet commitments, denominated in and/or linked to the dollar and therefore sensitive to changes in the exchange rate. The fair value of the firm commitments was calculated by discounting future cash flow. The Group has minor exposure to changes in the exchange rate of other foreign currencies, with the exception of the US dollar.

	Profit (loss) from changes		**Fair value**	**Profit (loss) from changes**	
	10%	**5%**	**At a dollar rate of 3.775**	**-5%**	**-10%**
Cash	2	1	23	(1)	(2)
Trade receivables	6	3	60	(3)	(6)
Long-term trade receivables	1	-	5	-	(1)
Investments	3	2	31	(2)	(3)
Trade payables, other payables and credit balances	(26)	(13)	(257)	13	26
Firm commitments – suppliers	(93)	(46)	(929)	46	93
Firm commitments – rent	(4)	(2)	(36)	2	4
Guarantees	(10)	(5)	(101)	5	10
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	4	2	(1)	(2)	(4)
Dollar/shekel put option	1	1	(1)	(1)	(3)
Dollar/shekel call option	-	-	-	1	2
Total	**(116)**	**(57)**	**(1,206)**	**58**	**116**

Sensitivity to changes in the CPI – 2009

A sensitivity analysis of 5% and 10% (up and down) was prepared on an inflation assessment of 2% per year, based on the Average Inflation Target at the Bank of Israel. Also analyzed was an extreme scenario of 1.5% per month (up and down), according to a historical review of the past ten years (a monthly change of 1.5% in April 2002) of change in the CPI.

The Group has an investment in loans to an associate which is treated by the equity method, and a liability in respect of debentures and loans that are linked to the CPI. The Group also has firm commitments (for rent, vehicle leasing agreements and agreements with suppliers), which are linked to the CPI. The fair value of the firm commitments was calculated by discounting future cash flow.

	Profit (loss) from changes			**Fair value**	**Profit (loss) from changes**		
	1.5%	0.2%	0.1%		-0.1%	-0.2%	-1.5%
Loans to an associate treated by the equity method	18	2	1	1,182	(1)	(2)	(18)
Trade receivables	-	-	-	35	-	-	-
Long-term trade receivables	1	-	-	91	-	-	(1)
Other liabilities and provisions	(6)	(1)	-	(412)	-	1	6
Firm commitments – vehicle leasing	(3)	-	-	(158)	-	-	3
Firm commitments – suppliers	-	-	-	(25)	-	-	-
Firm commitments – rent	(7)	(1)	-	(490)	-	1	7
Guarantees	(1)	-	-	(37)	-	-	1
Debentures issued to financial institutions and others	(11)	(1)	(1)	(734)	1	1	11
Debentures issued to financial institutions and others	(5)	(1)	-	(345)	-	1	5
Debentures issued to the public – Series 4	(11)	(1)	(1)	(733)	1	1	11
Debentures issued to the public – Series 5	(30)	(4)	(2)	(1,974)	2	4	30
Bank loans	(4)	-	-	(235)	-	-	4
Hedging instruments not recognized for accounting							
CPI forward transactions	8	1	-	21	-	(1)	(8)
Total	**(51)**	**(6)**	**(3)**	**(3,814)**	**3**	**6**	**51**

Sensitivity to changes in real shekel interest rates – 2009

The Group's companies have an investment in an associate accounted by the equity method at fixed interest and linked to the CPI, as well as a liability in respect of CPI-linked debentures at fixed interest. These instruments are sensitive to changes in the real shekel interest rate. The fair value of the loan to an associate was calculated by discounting future cash flow at an average interest of 10.36%, which is the effective rate that includes the risk component of the associate.
Debentures issued to the public – Series 4, were traded on December 31, 2009 with a yield of 0.32% and an average duration of 0.9. Debentures issued to the public – Series 5, were traded on December 31, 2009 with a yield of 2.18% and an average duration of 3.57 Changes in the fair value of the debentures was calculated by discounting future cash flow. The fair value of the debentures is stated at the stock market value, i.e. by multiplying the market price on December 31, 2009 by the quantity of the issued nominal value. The fair value of non-negotiable debentures was calculated by discounting the future cash flow at an average interest rate of 0.82% to 4.25%. CPI linked bank loans sensitive to changes in real shekel interest rates, were discounted at an average interest rate of 2.44%.

	Profit (loss) from changes		**Fair value**	**Profit (loss) from changes**	
	10%	**5%**		**-5%**	**-10%**
Long-term receivables	-	-	50	-	-
Loans to an associate treated by the equity method	(79)	(40)	1,182	42	86
Debentures issued to financial institutions and others	7	4	(734)	(4)	(7)
Debentures issued to financial institutions and others	-	-	(345)	-	-
Debentures issued to the public – Series 4	-	-	(733)	-	-
Debentures issued to the public – Series 5	15	8	(1,974)	(8)	(15)
Bank loans	1	1	235	(1)	(1)
Hedging instruments not recognized for accounting					
CPI forward transactions	-	-	22	-	-
Total	**(56)**	**(27)**	**(2,768)**	**29**	**63**

Sensitivity to changes in nominal shekel interest rates – 2009

The sensitivity analysis of the shekel interest rate includes another scenario (12% up and 12% down), which examines the most extreme daily change that occurred in the past ten years (a daily change of 12% in December 2001). The Group has trade receivables that are paid in installments. The fair value of these balances was calculated by discounting the future cash flow at an average interest rate between 3.957% and 5.26%.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	10%	5%		-5%	-10%	-12%
Trade and other receivables paid in installments	(9)	(7)	(4)	1,504	4	8	9
Investments, deposits and debit balances	-	-	-	83	-	-	-
Hedging instruments not recognized for accounting							
CPI forward transactions	2	1	1	21	(1)	(1)	(2)
Dollar / shekel forward transactions	-	-	-	(1)	-	-	-
Options							
Dollar / shekel put option	-	-	-	(1)	-	-	-
Total	**(7)**	**(6)**	**(3)**	**1,606**	**3**	**7**	**7**

Sensitivity analysis 2008 (in NIS millions)

Sensitivity to changes in the USD/NIS exchange rate – 2008

The table shows the items sensitive to fluctuations in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was examined, as were off-balance sheet items. The firm commitments are off-balance sheet commitments, denominated and/or linked to the dollar and therefore sensitive to changes in the exchange rate. The fair value of the firm commitments was calculated by discounted future cash flow. The Group has minor exposure to changes in the exchange rate of other foreign currencies, with the exception of the US dollar.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 3.802	-5%	-10%
Cash	1	1	12	(1)	(1)
Accounts receivable	7	3	70	(3)	(7)
Long-term accounts receivable	1	1	15	(1)	(1)
Investments	5	3	50	(3)	(5)
Suppliers	(25)	(13)	(251)	13	25
Firm commitments - suppliers	(42)	(21)	(417)	21	42
Firm commitments – space segments	(54)	(27)	(539)	27	54
Firm commitments – vehicle leasing	(1)	(1)	(14)	1	1
Firm commitments - rent	(4)	(2)	(36)	2	4
Guarantees	(7)	(4)	(75)	4	7
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	22	11	3	(11)	(22)
Options					
Dollar/shekel sale option	2	2	(3)	(3)	(7)
Dollar/shekel purchase option	3	2	2	(1)	(2)
Total	**(92)**	**(45)**	**(1,183)**	**45**	**88**

Sensitivity to changes in the CPI – 2008

A sensitivity analysis of 5% and 10% (up and down) was conducted on an inflation assessment of 2% per year, based on the Average Inflation Target at the Bank of Israel. The analysis of sensitivity to changes in the CPI includes an additional scenario of 1.5% per month (up and down) which examines the most extreme monthly change in the CPI which occurred in the past ten years (a monthly change of 1.5% in April 2002).

The Group has debentures and loans from banks and other sources, which are linked to the CPI. The Group also has firm commitments (for rent, vehicle leasing and agreements with suppliers), which are linked to the CPI. The fair value of the firm commitments was calculated by discounting the future cash flow.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	1.5%	**0.2%**	**0.1%**		**-0.1%**	**-0.2%**	**-1.5%**
Accounts receivable	-	-	-	24	-	-	-
Long-term trade receivables	1	-	-	35	-	-	(1)
Other liabilities and provisions	(2)	-	-	(155)	-	-	2
Other long-term liabilities	-	-	-	(6)	-	-	-
Firm commitments – vehicle leasing	(3)	-	-	(215)	-	-	3
Firm commitments – suppliers	(1)	-	-	(36)	-	-	1
Firm commitments - rent	(9)	(1)	(1)	(588)	1	1	9
Guarantees	-	-	-	(8)	-	-	-
Debentures issued to financial institutes and others	(8)	(1)	(1)	(554)	1	1	8
Debentures issued to financial institutes and others	(12)	(2)	(1)	(820)	1	2	12
Debentures issued to financial institutes and others	(11)	(1)	(1)	(724)	1	1	11
Debentures issued to the public – Series 4	(15)	(2)	(1)	(1,031)	1	2	15
Debentures issued to the public – Series 5	(27)	(4)	(2)	(1,810)	2	4	27
Bank loans	(5)	(1)	-	(317)	-	1	5
Loans from others	(2)	-	-	(156)	-	-	2
Loans provided by the minority in a subsidiary	(7)	(1)	-	(449)	-	1	7
Hedging instruments not recognized for accounting							
CPI forward transactions	26	**3**	**2**	(5)	**(2)**	**(3)**	**(26)**
Total	**(75)**	**(10)**	**(5)**	**(6,815)**	**5**	**10**	**75**

Sensitivity to changes in real shekel interest rates – 2008

The Group's companies have index-linked debentures at fixed interest. These debentures are sensitive to changes in the real shekel interest rate. Debentures issued to the public – Series 4 – were traded on December 31, 2008 with a yield of 3.83% and an average life of 1.36. Debentures issued to the public – Series 5 – were traded on December 31, 2008 with a yield of 3.92% and an average life of 4.32. The fair value of non-negotiable debentures was calculated by discounting the future cash flows.

The fair value of the debentures is presented at the stock market value, in other words, by multiplying the market price on December 31, 2008 with the quantity of the issued nominal value. The fair value of non-negotiable debentures was calculated by discounting the future cash flows at an average interest rate of 4.16% to 9.1%. Loans from banks and other institutions are linked to the CPI and sensitive to changes in real shekel interest. These loans were discounted at an average interest rate of 5.68% – 11.30%.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	**5%**		**-5%**	**-10%**
Debentures issued to financial institutes and others	2	1	(554)	(1)	(2)
Debentures issued to financial institutes and others	11	5	(820)	(5)	(11)
Debentures issued to financial institutes and others	24	12	(724)	(12)	(25)
Debentures issued to the public -Series 4	5	3	(1,031)	(3)	(5)
Debentures issued to the public - Series 5	29	15	(1,810)	(15)	(30)
Bank loans	4	2	(317)	(2)	(4)
Loans from others	8	4	(156)	(4)	(8)
Hedging instruments not recognized for accounting					
CPI forward transactions	(5)	(2)	(5)	2	5
Total	**78**	**40**	**(5,417)**	**(40)**	**(80)**

Sensitivity to changes in nominal shekel interest rates – 2008

The sensitivity analysis of the shekel interest rate includes another scenario (12% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 12% in December 2001). The Group has accounts payable in installments. The fair value of these balances is calculated by discounting the future cash flow at an interest rate of 7.5%. The Group has unlinked loans from banking institutions at fixed interest. The loans were discounted at an average interest rate of 7.52%.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	**10%**	**5%**		**-5%**	**-10%**	**-12%**
Shekel deposits	-	-	-	556	-	-	-
Accounts receivable repaid in installments	(8)	(7)	(3)	1,041	3	7	8
Deposit investments and debit balance	(1)	(1)	-	128	-	1	1
Long-term accounts receivable	-	-	-	34	-	-	-
Loans from banking corporations	17	14	7	(808)	(7)	(15)	(18)
Hedging instruments not recognized for accounting							
CPI forward transactions	5	4	2	(5)	(2)	(4)	(5)
Dollar / shekel forward transactions	-	-	-	3	-	-	-
Options							
Dollar / shekel sale option	-	-	-	(3)	-	-	-
Dollar / shekel purchase option	-	-	-	2	-	-	-
Total	**13**	**10**	**6**	**948**	**(6)**	**(11)**	**(14)**

Sensitivity to changes in US dollar interest rates – 2008

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 15% in June 2003).

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	**10%**	**5%**		**-5%**	**-10%**	**-15%**
Dollar deposits	-	-	-	5	-	-	-
Firm commitments – space segments	20	13	7	(539)	(7)	(14)	(21)
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	-	-	-	3	-	-	-
Options							
Dollar / shekel sale option	-	-	-	(3)	-	-	-
Dollar / shekel purchase option	-	-	-	2	-	-	-
Total	**20**	**13**	**7**	**(532)**	**(7)**	**(14)**	**(21)**

C. CORPORATE GOVERNANCE

1. Group involvement in the community and donations

The Group companies are active in the community through donations to not-for-profit associations and social organizations which promote education, welfare and other causes. Activities are expressed in monetary donations, contributions of communications infrastructures, and the encouragement of volunteering by employees in a range of activities for the community.

The guiding principle of the Company's contribution to the community this year was support for programs aimed at narrowing social-educational gaps that exist due to non-availability of the world of computers and the internet ("the digital divide").

In 2009, the Group donated NIS 12.1 million, and intends to increase its donation budget for 2010.

2. Disclosure of the process for approval of the Company's financial statements

The Company organ charged with overall control is the Board of Directors, which appointed a Balance Sheet Committee which has the following composition and functions:

A. The majority of the members of the committee have accounting and financial expertise, and one external director is a member.

B. The Balance Sheet Committee discusses the financial statements before they are discussed by the Board of Directors, and makes a recommendation to the Board concerning their approval. The committee invites the auditors to attend these discussions. The committee discusses and makes recommendations to the Board on the following matters: setting accounting policy, and setting procedures relating to reporting and to financial records.

C. The Balance Sheet Committee monitors changes in accounting principles and discusses their impact on the Company; it discusses subjects that arise during the auditing process, and discusses changes in the internal reporting set-up.

D. The Balance Sheet Committee follows up and controls the implementation of the accounting policy decided upon, and applies the procedures set for reporting and financial records.

E. The Balance Sheet Committee gives its opinion on the subjects listed above, as well as on other financial and accounting subjects, when it discusses the financial statements and when a specific issue of importance arises concerning any one of the above subjects.

F. The Balance Sheet Committee advises the Board of Directors on the scope of the auditors' work and their fees.

G. The Balance Sheet Committee is responsible for the Board's contact with the auditors concerning their work.

The financial statements were discussed by the Balance Sheet Committee and forwarded for the approval of the Board of Directors. The Board discussion was attended by the following officers: Board members Shlomo Rodav, Mordechai Keret, Menachem Inbar, Michael Grabiner, Stephen Grabiner, Adam Chesnoff, Yoav Rubinstein, Elon Shalev, Aryeh Saban, Ki Kiara, , David Gilboa, Rami Nomkin, Yitzchak Edelman and Yehuda Porat. Also attending were the following officers: Avraham Gabbay – CEO, Alan Gelman – Deputy CEO and CFO, and Amir Nachlieli – General Counsel. Others present were representatives from Somekh Chaikin, the Company's auditors.

3. Disclosure concerning the auditor' fees

Below are the fees paid to the auditors of the main companies in the Group for auditing services and audit-related services:

Company	Auditor	Details	2009 (NIS '000)		2008	
			Fee	Hours	Fee	Hours
Bezeq	Somekh Chaikin	Audit and audit-related services	2,323	10,125	2,107	9,800
		Other services	368	1,122	716	2,610
Pelephone	Somekh Chaikin	Audit and audit-related services	1,278	5,475	800	3,950
		Other services	107	320	279	870
Bezeq International	Somekh Chaikin	Audit and audit-related services	517	2,335	472	2,250
		Other services	76	195	24	110

The auditors' fees were discussed by the Balance Sheet Committee and approved by the boards of directors of the Company and of each of the Group companies. The fees were determined on the basis of the hours worked and the hourly tariff in the prior year and with adjustment for changes and events which occurred in the reporting year.

4. Directors with accounting and financial expertise and independent directors

A. The Company's Board of Directors determined that the minimum number of directors who have accounting and financial expertise, as required by the provisions of the Companies Law, is one (and together with the external directors – two). The Board of Directors believes that this number will enable it to fulfill its statutory duties and the duties imposed by the documents of association, including review of the financial condition of the Company and preparing and approving the financial statements, taking into consideration the volume and complexity of its operations

B. Serving directors in the Company who have the above skills are Shlomo Rodav (chairman), Zehavit Cohen, Menachem Inbar, Adam Chesnoff, Yoav Rubenstein, David Gilboa, Mordechai Keret (external director) and Yitzchak Edelman (external director). For information about their relevant education and experience, see Section 11 in Chapter D of the Periodic Report.

C. The Company has not adopted in its articles the "Directive concerning the percentage of independent directors" as defined in Article 19(2)(e) of the Companies Law.

5. Disclosure regarding an internal auditor in a reporting corporation

A. The Company's internal auditor

1. Name: Malka Dror
2. Date of commencement of office: August 14, 2006 (appointed as substitute), and from June 28, 2007, permanent appointment
3. The internal auditor complies with the conditions set forth in Article 3(A) of the Internal Audit Law. Qualifications: BA in Economics (Hebrew University); CISA (Certified Information Systems Auditor) – USA)
4. The internal auditor complies with the provisions of Article 8 of the Internal Audit Law and Article 146(B) of the Companies Law.
5. Method of employment: the internal auditor is a Company employee.

B. Method of appointment

Audit Committee discussions at its meetings on June 17, 2007 and June 21, 2007.

The committee recommended appointing Malka Dror as the Company's internal auditor. Subsequently, the committee recommended appointing her to the Company management and granting her salary conditions and associated rights that are within the range of those granted to VPs in the Company. The Board of Directors approved the appointment on June 28, 2007.

Summary of the reasons for approving the appointment

The Board of Directors approved the appointment of Malka Dror, who served as acting internal auditor, as internal auditor following the recommendation of the Audit Committee, due to her qualifications and professional experience.

Duties, authority and tasks of the internal auditor

The authority and responsibility of the Company's internal auditor are laid down in the Company's internal audit procedure. The procedure was revised and approved by the Audit Committee on May 19, 2009.

Duties of the internal auditor according to the Company's internal audit procedure

To examine the propriety of the operations of the Company and the actions of its officers and office-holders from the following aspects: compliance with the law, regulations and any statute applicable to the Company; good business practice; maintenance of the principles of good management, efficiency, thrift and integrity; whether they were carried out lawfully by a qualified person, whether they were accepted for business reasons and are beneficial to the achievement of the Company's defined goals; compatibility with the policy and decisions made by Board of Directors and Company management.

Authority of the internal auditor according to the Company's internal audit procedure

The Company's internal auditor may demand and receive any information, explanation and document required at her discretion for the performance of her function, and every Company employee is obliged to furnish any document or information at the Company's internal auditor's first request. The internal auditor will be invited to all meetings of management, the Board of Directors and its committees. The internal auditor may, with the approval of the Audit Committee chairman, examine a complaint received by the auditing unit as part of the auditing work.

C. The organizational superior of the internal auditor

According to a resolution of the Company's Board of Directors on May 27, 2009, the internal auditor answers to the CEO. Prior to that date, the internal auditor was organizationally subordinate to the Chairman of the Board.

D. Work plan

1. The work plan is annual.

2. **Considerations in determining the internal audit work plan**

   The guiding principle behind the annual work plan of the internal audit is the risk inherent in the Company's processes and operations. To assess the risks, the audit prepares a 'control risk survey' of the Company at least once every three years. As part of this survey, the audit examines, in cooperation with the Company's senior management, the material exposures and risks in the Company's operations and the control environment existing for management of these risks. The survey findings are used to compile the topics for the annual and multi-year work plan.

   The considerations taken into account in compiling the work plan are these: reasonable coverage of all the Company's areas of operation according to exposure to the material risks.

3. **Entities involved in compiling the work plan**

   The internal auditor, management, the CEO, the Audit Committee, the Chairman of the Board.

4. **Entity accepting and approving the work plan**

   The Audit Committee.

5. **The auditor's discretion to deviate from the work plan**

   The auditor may propose subjects at her discretion or at the request of the CEO, and she may also recommend reducing or halting an audit of a topic approved in the work plan. In any event the approval of the Audit Committee chairman is required.

6. During the reporting year the auditor did not examine any material transactions made.

E. The audit's response to corporations comprising a material holding

The work plan of the audit unit does not include an audit in corporations which are material holdings. All the corporations that are material holdings of the Company have their own internal auditors (either as employees or outsourced). The audit reports are discussed in the audit committees and/or boards of directors of these corporations, on which senior officers of the Company serve. The internal auditor may, under the internal audit procedure and at her discretion, receive the audit reports of the subsidiaries' statements and hold a work meeting with each of the auditors of the subsidiaries at least once a year, to discuss the audit plan and its implementation in the subsidiary company.

F. Scope of employment

1. **Number of hours of employment in the year**
   The audit's work plan for 2009 included 9,000 audit hours. The internal audit unit at the end of the reporting year employed five full-time internal auditors in addition to the Company's internal auditor.

2. **Reduction in volume of internal auditor's work in the reporting year**
   In accordance with the audit procedure, the internal auditor submitted an annual work plan for 2010 to the Audit Committee, which is derived from the multi-year plan. The Audit Committee approved the work plan for 2010, from which a decision was derived to reduce the audit budget by 20% in 2010 compared with the 2009 budget. The 2010 budget allows for the employment of 4 auditors in addition to the Company's auditor (i.e. a reduction of the staff of one internal auditor from the beginning of 2010).

G. Preparation of the audit

1. **Work standards**
   Bezeq's internal audit is prepared according to the binding standards of the Institute of Internal Auditors (I.I.A.).

2. **The Board's criteria for ensuring that the auditor complies with all the requirements of the standards**
   In December 2004 an external audit investigation of Bezeq's internal audit unit was carried out in compliance with a standard of the I.I.A. The conclusion of this audit was that the work of the Company's internal audit unit complies with accepted professional internal audit standards.

H. Access to information

The internal auditor is furnished with documents and information as stipulated in Section 9 of the Internal Audit Law, and she is granted permanent direct access to the Company's information systems, including financial data.

I. Internal Auditor's report

The internal auditor submits the audit reports in writing.

The internal auditor routinely submits the audit reports during the reporting year to the Chairman of the Board, the CEO, the Audit Committee chairman and members. The Audit Committee conducts regular discussions of the audit reports.

The Audit Committee held 12 meetings in the reporting period and discussed 19 audit reports. Following are the dates of submission of the auditor's reports and the dates of the discussions by the Audit Committee in the reporting year:

No.	Submission date	Committee discussion date
1	December 31, 2008	January 15, 2009
2	December 31, 2008	January 15, 2009
3	December 16, 2008	February 3, 2009
4	December 18, 2008	February 3, 2009
5	January 25, 2009	February 3, 2009
6	January 27, 2009	February 3, 2009
7	January 22, 2009	March 3, 2009
8	February 26, 2009	March 3, 2009
9	February 18, 2009	March 3, 2009
10	February 26, 2009	April 23, 2009

No.	Submission date	Committee discussion date
11	February 2, 2009	May 19, 2009
12	June 10, 2009	June 18, 2009
13	May 28, 32009	June 18, 2009
14	June 11, 2009	June 18, 2009
15	June 30, 2009	September 23, 2009
16	August 12, 2009	September 23, 2009
17	September 16, 2009	September 23, 2009
18	November 8, 2009	November 19, 2009
19	November 1, 2009	December 12, 2009

J. The Board of Directors' assessment of the work of the Internal Auditor

Based on this section and the reports received from the internal auditor, the members of the Company's Board of Directors believe that that the scope of the Company audit performed in 2009, the nature and continuity of the internal auditor's activities as well as the work plan, are reasonable in the circumstances and they achieve the objectives of the audit.

K. Compensation

1. The terms of employment of the internal auditor were discussed and approved by the Audit Committee and the Board of Directors as follows: Monthly salary of NIS 40,000 linked to the CPI from the date of appointment, and an annual target-based bonus set in advance by the Audit Committee and approved by the Board of Directors, of up to 50% of the annual salary excluding associated expenses.
2. Pursuant to a resolution of the Board of Directors on March 10, 2008, 100,000 stock options were allotted to the internal auditor as part of an allotment to middle managers in the Company under an outline pi8ublished on March 11, 2008.
3. The board of directors believes that the compensation of the internal auditor does not affect her professional judgment.

6. Code of ethics

In October 2007, the Board of Directors of the Company re-adopted a code of ethics. The code establishes rules and principles of behavior for guiding the actions of officers, managers and employees in the Company. The code was formulated in the Company in 2005, and the new version incorporates a number of changes and revisions. The Board of Directors authorized the Company's management to ensure the assimilation of the code of ethics in the Company, and decided that it would become part of the binding procedures of the Company. At the end of 2008 the code of ethics was assimilated at the Company's management level. Since 2009 its assimilation among Company employees is being accomplished as part of routine management.

7. The authority of the CEO

On September 4, 2007, Shlomo Rodav was appointed Chairman of the Board of Directors of the Company. On the same date, the Board resolved, in accordance with Section 50(A) of the Companies Law, 5759-1999 and with Articles 119 and 121.1 of the Company's Articles of Association, that the authority of the CEO in everything relating to the corporations held, directly or indirectly, by the Company, would transfer to the Board of Directors. Resolutions on the implementation of that decision were passed on subsequent dates.

8. Disclosure concerning the stages of the corporation's preparation and progress in implementation of the provisions of the Securities (Periodic and immediate report) (Amendment) Regulations, 5770-2009 ("the Regulations", in the matter of the internal audit ("Implementation of the project"), at the date of this report

A. On November 24, 2009, the Knesset Finance Committee proved an amendment to the Securities (Periodic and immediate reports) Regulations, 5730-1970 ("the Amendment"). The Amendment requires reporting corporations whose securities are listed on the Tel Aviv Stock Exchange, to make a declaration attesting to the effectiveness of their internal audit of financial reporting and disclosure. The Amendment defines a roadmap for its gradual implementation, so that by the date of the periodic Report for the year ended December 31, 2010 ("the Start Date"), the Company must include in that report the following three disclosures:

1. A report of the board of directors and management of the Company concerning the effectiveness of the internal audit of the financial reporting and disclosure.
2. A declaration signed by the CEO and by the most senior financial officer, that to their knowledge, the financial statements contain no misstatement of a material fact and that no representation of a material fact needed so that the representations made in them will not be misleading, is missing from the financial statements, and that they properly reflect, in all material respects, the financial condition, results of operations and cash flows of the corporation. They must also declare that they disclosed to the auditors, to the board of directors and to the audit committee of the Company all information concerning significant flaws and material weaknesses in the internal audit and any fraud, that they have set controls and procedures to ensure the propriety of the financial reporting and disclosure, and they have assessed the effectiveness of the internal audit.
3. The opinion of the Company's auditors on the effectiveness of the internal audit.

Under the provisions of the Amendment, in the period from the date of publication of the Amendment to the Start Date, the Directors' Report will contain details about the stages of the Company's preparation and progress in implementation of the Amendment.

B. Below is disclosure concerning the actions taken by the Group up to the date of the report for the year ended December 31, 2009:

1. The Group commenced preparation for implementation of the project at the beginning of 2009. This included a preparation plan for implementation of the project which includes a definition of the content of the work required following performance of the risk assessment on the subject of financial reporting and disclosure, the formulation of detailed timetables, and determination of the managerial entities who would monitor the project's progress among the companies consolidated in the Group's financial statements.
2. The person overseeing implementation of the project in the Group is the Deputy CEO and CFO, Alan Gelman.
3. The processes deemed by the Group to be extremely significant for financial reporting and disclosure in the Company's consolidated financial statements were determined following a risk assessment of financial reporting and disclosure. In making that assessment, the Group relied on quantity criteria derived from the results of its operations and on quality criteria, which include, inter alia, reference to the following subjects: the size and composition of the accounts included in the accounts system; sensitivity to loss due to error; contingent liabilities or fraud; scope of operations; the complexity and homogeneity of the transactions included in an account or disclosure; the level of subjectivity in an account or disclosure; the existence of transactions with related parties in an account, and changes from prior periods in the characteristics of an account or disclosure.

   These are the processes:

   a. Revenue
   b. Salary
   c. Property, plant and equipment

   The relevance of these processes among the companies consolidated in the Group's financial statements was reviewed following the assessment of the financial reporting and disclosure risks.

D. DISCLOSURE CONCERNING THE FINANCIAL REPORTING OF THE CORPORATION

1. Critical accounting estimates

Preparation of the financial statements in accordance with IFRSs requires management to make assessments and estimates that affect the reported values of the assets, liabilities, income and expenses, as well as the disclosure in connection with contingent assets and liabilities. Management bases these assessments and estimates on past experience and on valuations, expert opinions and other factors which it believes are relevant in the circumstances. Actual results might differ from these assessments with different assumptions or conditions. Information about the primary topics of uncertainty in critical estimates and judgments in the application of the accounting policy is provided in the financial statements (see Note 2E). We believe that these assessments and estimates are critical since any change in these assessments and assumptions could potentially and materially affect the financial statements.

Estimated useful life of property, plant and equipment

The estimated useful lives of property, plant and equipment serve to determine the depreciation expenses that will be recorded in the reporting year. The main part of the communications infrastructure is managed according to asset groups. The depreciation rates are based on the average useful life of an asset group and not of each individual asset. The useful life of an asset group is examined periodically and is based on past experience, taking into consideration expected technological changes, company plans or other changes. If such changes occur earlier than foreseen or differently from expectations, the remaining useful life of such assets might be shortened. This results in an increase in future depreciation expenses. If the changes occur later than expected, the remaining useful life may be extended, and this results in a decrease in the depreciation expenses. Given the significant amounts of the Group’s depreciation expenses, such changes can have a material effect on the results of the actions and the financial position of the Group.

Assessing the value of items of property, plant and equipment

Certain items of property plant and equipment were re-valued to fair value upon the transition to IFRSs, based on their deemed cost, which was determined on the basis of their value on the transition date (January 1, 2005) according to the Group’s estimate based on the valuation of an external appraiser. In addition, the costs of dismantling, clearing and restoring sites were capitalized to the date of transition to IFRSs.

The residual value of the Company's copper cables was determined on the basis of the Company's assessment. The Company is exposed to changes in the prices of copper, which cause a change in the residual value of the copper infrastructure (see Note 10B to the financial statements).

The use of estimates and assessments affects the items of property, plant and equipment and the depreciation expense (see Note 10 to the financial statements).

Employee benefit liability

These liabilities are based on actuarial calculations that include numerous calculation assumptions which can be different in practice. The assumptions relate, *inter alia*, to interest rates for capitalization, mortality tables, wage creep and turnover rates.

(Concerning changes in estimates due to these liabilities, see Note 17 to the financial statements.)

Deferred taxes

Deferred taxes are calculated at the tax rate expected to be in effect on their date of utilization. The tax benefit is included in the financial statements since according to the Company's business plans realization of the tax benefit is foreseeable. By nature, actual business results may differ from the business plans, and this can affect the future realization of the tax benefit (see Note 9 to the financial statements).

Provisions and contingent liabilities

The Group’s companies have contingent liabilities in amounts for which the possible maximum exposure is considerable. Among these include class actions with extremely significant amounts pending against Group companies.

Every year the Company makes estimates of the potential liabilities associated with every claim and action. It is naturally very difficult to determine the outcomes of the claims. The Company uses its best judgment and the assessments of its legal advisers to determine whether the Company is likely to bear the costs of settling claims and whether they can be reliably estimated.

Taking into consideration the uncertainty inherent in legal claims, it is possible that all or some of them will be concluded with the Company being ordered to pay amounts materially different from the provisions included in the financial statements, if any. (For details of provisions and contingent liabilities, see Notes 16 and 18 to the financial statements.)

Discontinued operation
On the date of termination of the consolidation of D.B.S. Satellite Services Ltd., the Company determined its investment on that company at fair value, and allocated the fair value to tangible assets. This was done by an external assessor, whose valuation was also based on various assessments and estimates (see Note 5 to the financial statements).

Measurement of recoverable amounts of cash-generating units
Recoverable amounts of cash-generating units are measured in order to assess the possibility of impairment of the unit's assets (including goodwill). The measurement involves estimates of the cash flows expected from the units (see Note 11 to the financial statements).

Share-based payments
Share-based payments re-measured by means of an economic model that includes estimates in various parameters (see Note 27E to the financial statements).

Provision for doubtful debts
The financial statements include a provision for doubtful debts which is generally calculated as a percentage of the trade receivables balance based on assessments for the future and past experience, and specifically in respect of debts which it is doubtful can be collected. Actual results might differ from these assessments and estimates, and affect the results of operations accordingly (see Note 8 to the financial statements).

2. Due to the significant amounts of the claims filed against the Group, the auditors drew attention to the matter in their letter to the shareholders that preface the financial statements.

3. Events after the balance sheet date

On March 2, 2010, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company, the distribution of a dividend to the shareholders in the amount of NIS 2,453 million.

E. DETAILS OF SERIES OF DEBT CERTIFICATES

1.

		Series 4 debentures	Series 5 debentures
A	Issue date	June 1, 2004	June 1, 2004
B	Total par value on issue date	NIS 1,200,000,000	NIS 2,386,967,000
C	Its par value	NIS 600,000,000	NIS 2,386,967,000(1)
D	Par value reassessed for report date (linked to the CPI)	NIS 685,856,639	NIS 2,728,528,607(2)
E	Accumulated interest	NIS 19,203,986	NIS 84,357,009
F	Fair value	NIS 733,140,000	NIS 3,126,688,073
G	Stock exchange value	NIS 733,140,000	NIS 3,126,688,073
H	Interest type	Set at 4.8%	Set at 5.3%
I	Principal payment dates	June 1 every year through June 1, 2011	June 1 every year from 2011 through 2016
J	Interest payment dates	June 1 every year through 2011	June 1 every year through 2016
K	Linkage	The principal and interest are linked to the CPI (base index April 2004)	The principal and interest are linked to the CPI (base index April 2004)

(1) Of which NIS 880.1 million par value held by a wholly-owned subsidiary.
2) Of which NIS 1,006.84 million held by a wholly-owned subsidiary.

Trust company – Mizrachi Tefahot Trust Company
The contact person in the trust company is Assaf Weiss, Adv. His email address is: assafw@umtb.co.il. The trustee's address is 123 Hahashmonaim Street, Tel Aviv.

2. For details of the ratings of the series of debt certificates, see Section 2.13.6 in Chapter A of the Periodic Report. The rating reports are attached in an appendix (in Hebrew).

3. During and at the end of the reporting year the Company met all the conditions and commitments under the deed of trust and there were no conditions establishing cause to present the certificates of liability for immediate repayment. No collateral was given to secure payment for the holders of the certificates of liability. There is no encumbrance whatsoever on the certificates of liability.

F. MISCELLANEOUS

1. On October 25, 2009, the controlling shareholder in the Company, Ap.Sb.Ar. announced to the Company that it had entered into an agreement with 012 Smile Communications Ltd. for an off-board sale. For details, see Section 1.3.1 in Chapter A of the Periodic Report.
2. For the 2010 outlook of the Bezeq Group, see Section 1.6 in Chapter A of the Periodic Report.

We thank the managers, employees and shareholders of the Group's companies.

Shlomo Rodav Chairman of the Board of Directors	Abraham Gabbay CEO

BEZEQ THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2009

The information contained in these financial statements constitutes a translation of the financial statements published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

Consolidated Financial Statements for the Year Ended December 31, 2009

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Auditors' Report to the Shareholders of
"Bezeq" The Israel Telecommunication Corp. Limited

We have audited the accompanying consolidated statements of financial position of "Bezeq" The Israel Telecommunication Corp. Limited (the Company) as at December 31, 2009, 2008 and 2007 and the consolidated income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows, for each of the three years, the last of which ended December 31, 2009. These financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors' Regulations (Manner of Auditor's Performance), 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Group, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the abovementioned other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its consolidated subsidiaries as at December 31, 2009, 2008 and 2007 and their results of operations, changes in its equity and cash flows, for each of the three years, the last of which ended December 31, 2009, in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Securities Regulations (Annual Financial Statements) - 2010.

Without qualifying our opinion, we draw attention to the claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 18B and 18D.

Somekh Chaikin
Certified Public Accountants

March 2, 2010

Consolidated Statements of Financial Position as at December 31

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Assets				
Cash and cash equivalents	6	**580**	786	1,203
Investments, including derivatives	7	**154**	33	389
Trade receivables	8	**2,491**	2,373	2,403
Other receivables	8	**171**	211	247
Inventory		**263**	158	203
Current tax assets		**-**	-	11
Assets held for sale		**40**	34	17
Total current assets		**3,699**	3,595	4,473
Investments, including derivatives	7	**130**	187	233
Trade and other receivables	8	**887**	576	535
Broadcasting rights, net of rights exercised		**-**	253	243
Property, plant and equipment	10	**5,303**	6,036	6,064
Intangible assets	11	**1,885**	2,674	2,526
Deferred and other expenses	12	**426**	411	367
Investments in equity-accounted investees (mainly loans)	13	**1,219**	32	37
Deferred tax assets	9	**392**	550*	681*
Total non-current assets		**10,242**	10,719	10,686
Total assets		**13,941**	14,314	15,159

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Liabilities				
Debentures, loans and borrowings	14	**862**	1,780	1,913
Trade payables	15	**1,091**	1,381	1,533
Other payables	15	**697**	850	745
Current tax liabilities		**118**	45	57
Deferred income		**36**	62	47
Provisions	16	**380**	355	392
Employee benefits	17	**505**	412*	716*
Total current liabilities		**3,689**	4,885	5,403
Debentures	14	**2,716**	3,943	4,420
Bank loans	14	**558**	214	307
Loans from institutions	14	**-**	158**	136**
Loans provided by non-controlling interest in a subsidiary	14	**-**	449	375
Employee benefits	17	**294**	265	261
Deferred income and others		**5**	27**	36**
Provisions	16	**71**	64	57
Deferred tax liabilities	9	**70**	65	-
Total non-current liabilities		**3,714**	5,185	5,592
Total liabilities		**7,403**	10,070	10,995
Equity				
Total equity attributable to Company shareholders		**6,544**	4 ,715	4, 537
Non-controlling interest		**(6)**	(471)	(373)
Total equity	21	**6,538**	4,244	4,164
Total liabilities and equity		**13,941**	14,314	15,159

Shlomo Rodav
Chairman of the Board

Avi Gabbay
CEO

Alan Gelman
Deputy CEO and CFO

* Retrospective application by restatement, see Note 2F(3)
** See Note 3U.

Date of approval of the financial statements: March 2, 2010

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

Consolidated Statements of Income for the Year Ended December 31

	Note	2009 NIS millions	2008* NIS millions	2007* NIS millions
Continuing operations				
Revenue	22	**11,519**	11,015	11,136
Costs and expenses				
Depreciation and amortization	10,11,12	**1,485**	1,458	1,509
Salaries	23	**1,990**	2,161	2,192
General and operating expenses	24	**4,871**	4,660	5,075
Other operating expenses - net	25	**201**	96	39
		8,547	8,375	8,815
Operating profit	29	**2,972**	2,640	2,321
Finance income (expense)	26			
Finance expense		**(398)**	(494)	(616)
Finance income		**429**	354	434
Finance income (expense), net		**31**	(140)	(182)
Profit after financing income (expense), net		**3,003**	2,500	2,139
Share in profits (losses) of equity-accounted investees	13	**(34)**	5	6
Profit before income tax		**2,969**	2,505	2,145
Income tax	9	**807**	719	666
Profit for the year from continuing operations		**2,162**	1,786	1,479
Discontinued operations				
Profit (loss) for the year from discontinued operations	5	**1,379**	(265)	(118)
Profit for the year		**3,541**	1,521	1,361
Attributable to:				
Shareholders of the Company				
Profit for the year from continuing operations		**2,157**	1,781	1,398
Profit (loss) for the year from discontinued operations		**1,446**	(154)	(68)
		3,603	1,627	1,330
Non-controlling interests				
Profit from continuing operations		**5**	5	81
Loss from discontinued operations		**(67)**	(111)	(50)
		(62)	(106)	31
Profit for the year		**3,541**	1,521	1,361

* Restatement due to discontinued operations, see Note 5

Consolidated Statements of Income for the Year Ended December 31 (contd.)

	Note	2009 NIS millions	2008* NIS millions	2007* NIS millions
Earnings per share	28			
Basic earnings per share (in NIS)				
Profit from continuing operations		**0.82**	0.68	0.54
Profit (loss) from discontinued operations		**0.55**	(0.06)	(0.03)
		1.37	0.62	0.51
Diluted earnings per share (in NIS)				
Profit from continuing operations		**0.80**	0.68	0.53
Profit (loss) from discontinued operations		**0.54**	(0.07)	(0.03)
		1.34	0.61	0.50

* Restatement due to discontinued operations, see Note 5

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

Consolidated Statements of Comprehensive Income for the Year Ended December 31

	Note	2009 NIS millions	2008* NIS millions	2007* NIS millions
Profit for the year		**3,541**	1,521	1,361
Items of other comprehensive income				
Actuarial gains (losses) from a defined benefit plan	17	**(13)**	(2)	14
Miscellaneous		**(1)**	(9)	4
Taxes for items of other comprehensive income	9	**3**	1	(4)
Other comprehensive income for the year, net of tax		**(11)**	(10)	14
Total comprehensive income for the year		**3,530**	1,511	1,375
Attributable to:				
Shareholders of the Company				
Comprehensive income for the year from continuing operations		**2,146**	1,771	1,412
Comprehensive income (loss) for the year from discontinued operations		**1,446**	(154)	(68)
		3,592	1,617	1,344
Non-controlling interests				
Comprehensive income for the year from continuing operations		**5**	5	81
Comprehensive loss for the year from discontinued operations		**(67)**	(111)	(50)
		(62)	(106)	31
Total comprehensive income for the year		**3,530**	1,511	1,375

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of comprehensive income was changed. See also Note 2F(1) for a description of first-time adoption of the accounting standards.

* Restatement due to discontinued operations, see Note 5

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

Consolidated Statements of Changes in Equity for the Year Ended December 31

	Share capital	Share premium	Translation reserve	Capital reserve for transactions between a corporation and a controlling shareholder	Capital reserve for options for employees	Deficit balance	Total	Non-controlling interests	Total equity
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
	Attributable to the shareholders of the Company								
Balance at January 1, 2009	**6,132**	**-**	**(4)**	**390**	**362**	**(2,165)***	**4,715**	**(471)**	**4,244**
Comprehensive income for the year	-	-	(1)	-	-	3,593	3,592	(62)	3,530
Dividends to Company shareholders	-	-	-	-	-	(1,941)	(1,941)	-	(1,941)
Share-based payments	-	-	-	-	49	-	49	-	49
Exercise of options for shares	55	275	-	-	(201)	-	129	-	129
Derecognition of non-controlling interests for deconsolidation of a subsidiary (se Note 5)	-	-	-	-	-	-	-	551	551
Dividend paid to non-controlling interests net of funds transferred	-	-	-	-	-	-	-	(24)	(24)
Balance at December 31, 2009	**6,187**	**275**	**(5)**	**390**	**210**	**(513)**	**6,544**	**(6)**	**6,538**

* Retrospective application by restatement, see Note 2F(3)

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

Consolidated Statements of Changes in Equity for the Year Ended December 31 (contd.)

	Share capital	Translation reserve	Capital reserve for transactions between a corporation and a controlling shareholder	Capital reserve for financial assets ready for sale	Capital reserve for options for employees	Deficit balance	Total	Non-controlling interests	Total equity
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
	Attributable to the shareholders of the Company								
Balance at January 1, 2008	6,132	-	390	4	287	(2,276)*	4,537	(373)	4,164
Comprehensive income for the year	-	(4)	-	(4)	-	1,625	1,617	(106)	1,511
Dividends to Company shareholders	-	-	-	-	-	(1,514)	(1,514)	-	(1,514)
Share-based payments	-	-	-	-	75	-	75	-	75
Transfers by non-controlling interests	-	-	-	-	-	-	-	8	8
Balance at December 31, 2008	6,132	(4)	390	-	362	(2,165)*	4,715	(471)	4,244

* Retrospective application by restatement, see Note 2F(3)

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

Consolidated Statements of Changes in Equity for the Year Ended December 31 (contd.)

	Share capital	Share premium	Capital reserve for transactions between a corporation and a controlling shareholder	Capital reserve for financial assets ready for sale	Capital reserve for options for employees	Deficit balance	Total	Non-controlling interests	Total equity
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
	Attributable to the shareholders of the Company								
Balance at January 1, 2007	6,309	1,623	384	1	287	(2,857)*	5,747	(564)	5,183
Comprehensive income for the year	-	-	-	3	-	1,341	1,344	31	1,375
Dividends to Company shareholders	-	-	-	-	-	(760)	(760)	-	(760)
Distribution of dividends to shareholders without fulfilling the profit criterion	(177)	(1,623)	-	-	-	-	(1,800)	-	(1,800)
Change in repayment date of the loan provided by a non-controlling interest in a subsidiary	-	-	-	-	-	-	-	160	160
Payments to a former senior officer	-	-	6	-	-	-	6	-	6
Balance at December 31, 2007	6,132	-	390	4	287	(2,276)*	4,537	(373)	4,164

* Retrospective application by restatement, see Note 2F(3)

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

Consolidated Statements of Cash Flows for the Year Ended December 31

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Cash flows from operating activities				
Profit for the year		**3,541**	1,521	1,361
Adjustments:				
Depreciation	10	**1,337**	1,394	1,482
Amortization of intangible assets	11	**266**	289	270
Amortization of deferred and other expenses	12	**28**	20	17
Profit from deconsolidation of a subsidiary	5	**(1,538)**	**-**	-
Share in losses (profits) of equity-accounted investees	13	**34**	(5)	(6)
Finance expenses, net	26	**362**	561	373
Capital gain, net	25	**(64)**	(68)	(88)
Share-based payment transactions	27	**49**	75	-
Payments to a former senior officer		**-**	-	6
Income tax expenses	9	**807**	720	672
Proceeds (payment) of derivatives, net		**11**	(38)	(9)
Change in inventory		**(114)**	42	(6)
Change in trade receivables	8	**(584)**	(10)	(437)
Change in other receivables	8	**37**	(44)	4
Change in other payables	15	**55**	15	(18)
Change in trade payables	15	**192**	(225)	36
Change in provisions	16	**36**	(34)	105
Change in broadcasting rights		**(49)**	(11)	(74)
Change in employee benefits	17	**115**	(302)	(300)
Change in deferred and other income		**(41)**	50	(11)
Income tax paid, net		**(565)**	(535)	(430)
Net cash flows from operating activities		**3,915**	3,415	2,947
Cash flows for investment activities				
Investment in intangible assets and deferred expenses	11,12	**(349)**	(469)	(273)
Proceeds from the sale of property, plant and equipment and deferred expenses		**90**	147	177
Change in current investments, net		**(134)**	321	647
Purchase of property, plant and equipment	10	**(1,363)**	(1,300)	(973)
Proceeds from realization of investments and long-term loans		**93**	19	66
Purchase of investments and long-term loans		**(4)**	(8)	(8)
Dividend received		**6**	13	3
Interest received		**29**	64	116
Net cash used for investment activities		**(1,632)**	(1,213)	(245)

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (contd.)

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Cash flows for financing activities				
Issuance of debentures	14	**-**	-	1,814
Bank loans	14	**400**	-	50
Repayment of debentures	14	**(682)**	(714)	(1,927)
Repayment of loans	14	**(109)**	(148)	(840)
Short-term borrowing, net	14	**48**	(50)	(37)
Dividend paid	21	**(1,941)**	(1,514)	(2,860)
Interest paid		**(354)**	(243)	(389)
Proceeds of derivatives, net		**43**	52	77
Dividends paid to non-controlling interests less funds transferred, net		**(24)**	8	-
Proceeds from exercise of options to shares		**129**	-	-
Net cash used for financing activities		**(2,490)**	(2,609)	(4,112)
Net decrease in cash and cash equivalents		**(207)**	(407)	(1,410)
Cash and cash equivalents at January 1		**786**	1,203	2,632
Exchange rate differences		**1**	(10)	(19)
Cash and cash equivalents at the end of the year	6	**580**	786	1,203

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The consolidated financial statements of the Company as at December 31, 2009 include those of the Company and its subsidiaries (together –"the Group"), as well as the interests of the Group in associates. The Group is a principal provider of communication services in Israel (see also Note 29 – Segment Reporting).

B. The controlling shareholder of the Company is Ap.Sb.Ar. Holdings Ltd. which held 30.61% of the Company's shares at December 31, 2009.

On October 25, 2009, Ap.Sb.Ar. notified the Company that it had entered into an agreement with 012 Smile Communications Ltd for an off-floor sale of all the Company's shares that it holds. Completion of the transaction is subject to the receipt of the regulatory approvals required by law no later than April 25, 2010. Subsequent to completion of the transaction, Ap.Sb.Ar. is not expected to hold shares in the Company.

C. The Company is subject to various sets of laws that regulate and restrict its business activities, including its tariffs. The Company's tariffs are regulated by the Communications Law. The Company's service tariffs, which are prescribed in regulations are automatically updated in accordance with a linkage formula. The Company was declared as a monopoly in its core operations. All of the Group's segments are in competition. The operations of the Group are subject, in general, to government regulations and supervision. The intensifying competition and changes in the communications market could have an adverse effect on the business results of the Group.

D. As of August 21, 2009, the Company no longer consolidates the reports of DBS Satellite Services (1998) Ltd. ("DBS) in its financial statements. The investment in DBS is stated according to the equity method commencing from that date. See Note 5 below.

NOTE 2 - BASIS OF PREPARATION

A. Definitions

In these financial statements –

(1) International Financial Reporting Standards ("IFRSs") – Standards and interpretations adopted by the International Accounting Standards Board (IASB), which include International Financial Reporting Standards (IFRSs) and International Accounting Standards (IAS), including interpretations for these standards as determined by the International Financial Reporting Interpretations Committee (IFRIC) or interpretations determined by the Standing Interpretations Committee (SIC), respectively.

(2) The Company: "Bezeq" The Israel Telecommunication Corporation Limited.

(3) The Group: "Bezeq" The Israel Telecommunication Corporation Limited and its subsidiaries, as listed in Note 13 – Subsidiaries

(4) Subsidiaries: Companies whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Group.

NOTE 2 - BASIS OF PREPARATION (CONTD.)

A. Definitions (contd.)

(5) Associates: Companies, including a partnership, in which the Group's investment is included, directly or indirectly, in the financial statements on the equity basis

(6) Investees: Subsidiaries or associates

(7) Related party: As defined in IAS 24, *Related Parties*

(8) Interested parties: As defined in paragraph (1) of the definition of an "Interested Party" in section 1 of the Securities Law, 5728-1968

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

B. Statement of compliance

The Group has prepared the consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS"), and in accordance with the Securities Regulations (Annual Financial Statements), 5770-2010.

The consolidated financial statements were approved for publication by the board of directors on March 2, 2010.

C. Functional currency and presentation currency

The consolidated financial statements are stated in New Israel Shekels ("NIS"), which is the functional currency of the Group and are rounded to the nearest million. The shekel is the currency representing the principal economic environment in which the Group operates.

D. Basis of measurement

The consolidated financial statements were prepared on the basis of historical cost except for the following items:

- Derivative financial instruments are measured at fair value.
- Financial instruments at fair value through profit or loss are measured at fair value.
- Available-for-sale financial assets are measured at fair value.
- An investment in a deconsolidated investee was stated at fair value and from that date, is accounted using the equity method, as described in Note 5.
- Assets are stated at deemed cost, residual value as described in Note 10.
- Liabilities for employee benefits, as described in Note 17.
- Deferred tax assets and liabilities are measured according to the tax rates that are expected to apply to the temporary differences on the date of their realization.
- Provisions are recognized according to the most likely outcome. Future cash flows are capitalized at the pre-tax interest rate.

The methods used to measure fair value are explained in Note 4. The value of non-monetary assets and equity items measured on the basis of historical cost was adjusted for changes in the CPI up to December 31, 2003, since until that date Israel was considered a hyperinflationary economy.

NOTE 2 - BASIS OF PRESENTATION (CONTD.)

E. Use of estimates and judgment

When preparing the financial statements in accordance with IFRSs, management is required to make judgments and use estimates and assumptions that affect application of accounting policies and the amounts of assets, liabilities, income and expenses. It is clarified that actual results might differ from these estimates.

When formulating accounting estimates used in preparing the Company's financial statements, management is required to make assumptions as to circumstances and events that involve considerable uncertainty. In exercising its judgment when making the estimates, management relies on past experience, various facts, external factors and reasonable assumptions appropriate to the circumstances of each estimate.

The estimates and assumptions are reviewed on an ongoing basis. Changes in the accounting estimates are recognized in the period in which the estimates are revised and in each future period affected by them.

Information concerning critical estimates when applying accounting policy that have the most significant effect on the financial statements is included in the following notes:

- Note 5 - Discontinued operations
- Note 8 - Provision for doubtful debts
- Note 9 - Use of losses for tax purposes and deferred tax assets and liabilities recognized
- Note 10 - Estimated useful life and residual value of items of property, plant and equipment, and determining deemed cost
- Note 11 - Measurement of recoverable amounts of cash-generating units
- Notes 16 and 18 - Provisions and contingent liabilities
- Note 17 - Measurement of a defined benefit liability and employee benefits
- Note 27 - Measurement of share-based payments

F. Changes in accounting policy – Initial implementation of accounting standards

(1) Presentation of financial statements

Commencing from January 1, 2009, the Group applies IAS 1 – *Presentation of Financial Statements*, revised ("the Standard"). The Standard permits the presentation of one statement of comprehensive income (a statement combining profit or loss and other comprehensive income) or two statements (a separate income statement and a statement of comprehensive income). The Company opted to present two separate statements. The Company also presents a statement of changes in equity, after the statement of comprehensive income.

NOTE 2 - BASIS OF PRESENTATION (CONTD.)

F. Changes in accounting policy – Initial implementation of accounting standards (contd.)

(2) Segment reporting

Commencing from January 1, 2009, the Group applies IFRS 8 – *Operating Segments* ("the Standard"). The Standard states that segment reporting should be presented in accordance with the "management approach", namely – in accordance with the format of the internal reports to the Group's chief operational decision-maker.

(3) Employee benefits

Commencing from January 1, 2009, the Group applies IAS 19 – *Employee Benefits*, revised ("the Amendment"), in accordance with Improvements to IFRSs for 2008. The Amendment addresses the definition of "short-term employee benefits" and "other long-term employee benefits" to refer to when the liabilities are due to be settled. Accordingly, certain benefits were treated as short-term benefits and there was a change in the method for their measurement. Amendment was applied retrospectively and as a result the Group recorded a decrease of NIS 8 million in capital.

(4) Discontinued operations

Since the Company opted for early application in its financial statements for 2008 of IFRS 3 (revised) and IAS 27 (2008) (see Note 3A (1) below), the Company also opted for early application of IFRS 5 (revised). According to the revised standard, loss of control of a subsidiary is accounted for as a discontinued operation, regardless of whether the Company retains a non-controlling interest in its former subsidiary (for example, when the investee becomes, after loss of control, an equity-accounted associate). In the reporting period, the Company lost its control in DBS (see Note 5), and from the date of loss of control, DBS is an associate of the Company and the investment therein is accounted for by the equity accounting method. Accordingly, the Company presented the operations of DBS as discontinued operations in the income statement and included the required disclosures in the notes, including restatement of the income statements of prior reporting periods.

(5) Investment in associates

IAS 28 – *Investments in Associates, revised (the Amendment)* In accordance with the Amendment, impairment of an investment in an associate is tested by testing the entire carrying amount of the investment. Accordingly, an impairment loss recognized on the investment is not specifically allocated to the goodwill included in the investment but to the overall investment, and therefore the full amount of an impairment loss that was recognized in the past may be reversed when the conditions for reversal of IAS 36 are met. Application of the standard did not have a material effect on the Group's financial statements.

NOTE 3 - SIGNIFICANT ACCOUNTING PRINCIPLES

The IFRSs set out below have been applied consistently in all periods presented in these consolidated statements by the Group entities, except for as described in Changes in accounting policy – Initial implementation of accounting standards in section 2F above.

A. Accounting treatment of investees

(1) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Group has the ability to direct the financial and operating policy of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that confer effective control are taken into account. The financial statements of subsidiaries are included in the condensed consolidated financial statements from the date that control is acquired until the date that control ceases.

The Group opted for early application of IFRS 3 – *Business Combinations* (revised) and IAS 27 – *Consolidated and Separate Financial Statements (2008)* commencing from January 1, 2008.

A. IAS 27 – *Consolidated and Separate Financial Statements (2008)* refers to the accounting treatment of rights that do not confer control (non-controlling interest) and deals mainly with the accounting treatment of changes in the non-controlling interest after acquiring control, the accounting treatment of loss of control in a subsidiary, and allocations of profit or loss to the equity holders of the parent and to the non-controlling interests. Under the Standard, on loss of control in a subsidiary, the balance of the investment is stated at fair value at that date. The change in fair value of the balance of the investment is recognized in the income statement.

B. IFRS 3 – *Business Combinations* (revised) relates also to business combinations made by contract only. The definition of a business combination focuses on the acquisition of control, including contingent consideration. The acquirer can elect to measure any non-controlling interest at fair value at the acquisition date, or at its proportionate interest in the fair value of the identifiable assets and liabilities of the acquiree. When an acquisition is achieved in successive share purchases (step acquisition), the identifiable assets and liabilities of the acquiree are recognized at fair value when control is obtained (against profit or loss).

(2) Special purpose entity

A special-purpose entity (“SPE”) is included in consolidation if, based on an assessment of the substance of its relationship with the Group and the SPEs’ risks and rewards, the Group concludes that it controls the SPE.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES – (CONT)

A. Basis of consolidation (contd.)

(3) Associates (accounted by the equity method))

Associates are those entities in which the Group has significant influence, but not control, over financial and operating policy. Associates are accounted for using the equity method, and are first recognized at their cost or at fair value at the date control is lost. The investment includes goodwill calculated at the acquisition date and is presented net of accumulated impairment losses. The consolidated financial statements include the Group's share in the income and expenses of equity-accounted investees, adjustments to align the accounting policy with that of the Group, from the date that significant influence commences until the date that significant influence no longer exists. When the Group's share of losses exceeds its interest in an equity-accounted entity, the book value of those interests is reduced to nil and no further losses are recognized except to the extent that the Group has an obligation to support the entity or has made payments on its behalf.

When the Group holds additional long-term interests in the associate, which are a part of the Group's net investment in the associate, and when the Group's proportionate share in the additional interests is different to the Group's share in the capital of the associate, the Group recognizes its share in the additional losses of the associate at its proportionate share in the additional interests according to the percentage of the Company's participation in all the levels of the additional interests and according to the order of priority of the additional levels of interests. If, subsequently, the Group recognizes its share in the profits of the associate, the Company recognizes its share in the profits at its relative share in the additional interests, until the Group's share in the accumulated losses of the associate is equal to or lower than its share in the capital of the associate.

(4) Transactions eliminated upon consolidation

Intra-group balances and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealized profits arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associates. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

B. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate at that date.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES – (CONT)

C. Financial instruments

(1) Non-derivative financial instruments

Initial recognition of financial assets
The Group initially recognizes loans and receivables and deposits as they are incurred. Regular way purchases are recognized initially at the trade date when the Group becomes party to the contractual provisions of the instrument. Financial instruments comprise investments in shares and debentures, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables, a debentures issued and loans taken by the Group.

Derecognition of financial assets
A financial asset is derecognized when the Group's contractual rights to the cash flows from the financial asset expire, or the Group transfers the rights to the cash flows from the finance asset in a transaction that transfers all the risks and rewards from ownership of the financial asset.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset.

The Group classifies financial assets as follows:

Cash and cash equivalents
Cash includes cash balances for immediate use and deposits as required. Cash equivalents include short-term investments (with up to three months between the original deposit and maturity) that are highly liquid and that can be easily converted into known amounts of cash and that are exposed to an insignificant risk of changes in value.

Financial assets at fair value through profit or loss
A financial instrument is classified at fair value through profit or loss (mainly investments in marketable securities) if it is held for trading or is designated as such upon initial recognition. The Group manages such investments and makes purchase and sale decisions based on their fair value, in accordance with the Group's investment strategy.

Available-for-sale financial assets
The Group's investments in shares and certain debt instruments are classified as available-for-sale financial assets. Subsequent to initial recognition, these investments are measured at fair value and changes, other than impairment losses and foreign exchange gains and losses are recognized directly in other comprehensive income and presented in capital reserve for available-for-sale financial assets. A dividend received for available-for-sale financial assets is recognized in profit or loss on the date of payment. When an investment is derecognized, the cumulative gain or loss in equity for available-for-sale financial assets is transferred to profit or loss.

Loans and receivables
Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. These assets are first recognized at fair value with the addition of attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, net of impairment losses.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

C. Financial instruments (contd.)

(1) Non-derivative financial instruments (contd.)

Non-derivative financial liabilities
A financial liability is derecognized when the Group's obligation specified in the contract is discharged, cancelled or expired.

Financial liabilities are initially recognized in fair value with the addition of all the attributable transaction costs. Subsequent to initial recognition, financial liabilities are measured at amortized cost using the effective interest method.

The Group has non-derivative financial liabilities as follows: Debentures, loans and credit from banks, trade and other payables.

Financial assets and liabilities are offset and the net amounts are presented in the statement of financial position. The Group conducts currency legal rights enforceable to offset the recognized amounts and intends to remove the assets and liabilities on a net basis or to exercise the asset and remove the liability at the same time.

(2) Derivative financial instruments

|The Group holds derivative financial instruments to hedge its exposure to foreign currency and the CPI. Embedded derivatives are separated from the host contract and accounted for separately if: (a) the economic characteristics and risks of the host contract and the embedded derivative are not closely related; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of the derivative; (c) the hybrid instrument is not measured at fair value through profit or loss.

Changes in the fair value of separable embedded derivatives are recognized in the income statement as finance income or expense as incurred.

Derivatives are recognized initially at fair value; attributable transaction costs are recognized in profit or loss when incurred. Subsequent to their initial recognition, derivative financial instruments are measured at fair value and the changes in fair value are recognized in the income statement as incurred.

Economic hedging
Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities. Changes in the fair value of such derivatives are recognized in profit or loss as finance revenue or expense.

(3) CPI-linked assets and liabilities not measured at fair value

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is revaluated in each period according to the actual increase in the CPI.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

D. Property, plant and equipment

(1) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. Certain items of property, plant and equipment that were revalued to fair value on the date of transition to IFRSs, are measured on the basis of their deemed cost, which is the revalued amount at the transition date (January 1, 2005), in accordance with the Group's assessments based on an external appraisal.

Cost includes expenditure that is directly attributable to acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labor and financing costs as well as any other cost directly attributable to bringing the asset to the condition for its use intended by the management, and the costs of dismantling and removing the items and restoring the site on which they are located in cases where the Group has an obligation to vacate and restore the site. The cost of purchased software that is integral to the functionality of the related equipment is recognized as part of the cost of the equipment.

Where significant parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment.

Changes necessitated for asset dismantling and site restoration, except for changes caused by the passage of time, are added to or deducted from the cost of the asset in the period in which they occur. The amount deducted from the cost of the asset does not exceed its carrying amount, and the balance, if any, is recognized in profit or loss as incurred.

Profit or loss from disposal of property, plant and equipment is determined by comparing the proceeds from its disposal to the carrying amount of the asset, and is recognized net under "other income" in the income statement.

(2) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognized as part of the carrying amount of the item if it is likely that the future economic benefit embodied in the replaced item will flow to the Group and if the cost of the item can be reliably measured. Ongoing maintenance cost of property, plant and equipment items are recognized in profit or loss as incurred.

(3) Capitalization of borrowing costs

Specific and non-specific borrowing costs are capitalized as qualifying assets during the period required for completion and construction until they are ready for their intended use. Non-specific borrowing costs are capitalized, using a capitalization rate which is the weighted-average cost of those borrowing sources. Other borrowing costs are recognized in the income statement as incurred.

(4) Depreciation

Depreciation is the systematic allocation of the depreciable amount of an asset over the useful life. A depreciable amount is the cost of the asset, or another amount replacing the cost, less the residual value of the asset.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment, since this method is the best reflection of the expected pattern of consumption of the future economic benefits in the asset. Leased assets in finance leases are depreciated over the shorter of the term of the lease and the useful life.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

D. Property, plant and equipment

(4) Depreciation (contd.)

Leasehold improvements are depreciated over the shorter period of the lease, which includes any option for the extension of the lease held by the Group and which it intends to exercise and the period of use of the leasehold improvements.

The estimated useful lives for the current and comparative periods are as follows:

	Year	Main depreciation (%)
NGN equipment	8	12
Digital switching equipment	4-10	10
Transmission and power equipment	5-10	20
Network equipment	5-25	4
Terminal equipment (cellular)	2-3	33
Subscriber equipment	5	20
Vehicles	7	15
Internet equipment	4-7	20
Office equipment	5-16	10
Electronic equipment, computers and internal communication systems	3-7	33
Cellular infrastructure equipment	5-10	10
Buildings	25	4

Depreciation methods, useful lives and residual values are reviewed at minimum at each reporting year and adjusted as required.

E. Non-current assets held for sale

Non-current assets which are expected to be realized by way of sale rather than ongoing use, are classified as assets held for sale. These assets are presented at the lower of carrying amount and fair value, less selling costs. Impairment losses at the time of initial classification of an asset held for sale, and subsequent gains or losses resulting from remeasurement, are recognized in profit or loss. Gains are recognized up to the cumulative amount of impairment loss recorded in the past.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

F. Intangible assets

(1) Goodwill

Goodwill is created as a result of the acquisition of subsidiaries and recorded under intangible assets.

Acquisitions prior to January 1, 2005
For business combinations which occurred prior to January 1, 2005, the transition date to IFRS 3, goodwill reflects the amount recognized by the Group according to accepted accounting principles in Israel. For these acquisitions, accounting treatment was not adjusted to IFRS 3 in preparing the opening balance sheet of the Group.

Acquisitions subsequent to January 1, 2005
For business combinations, the acquisitions of associates and jointly-controlled companies on or after January 1, 2005 (the transition date to IFRS), goodwill reflects the excess cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity.

Subsequent measurement
Goodwill is measured at cost less accumulated impairment losses. In respect of equity-accounted investments, goodwill is included in the carrying amount of the investment. Impairment loss for these investments is attributable to the entire investment and not to assets comprising the investment against goodwill. Therefore, the Group recognizes the reversal of losses recognized for equity-accounted investments when their recoverable amount increases.

(2) Software development costs

Software development costs are recognized as an intangible asset only if the development costs can be measured reliably; the software is technically and commercially applicable; and the Group has sufficient resources to complete the development and intends to use the software. The costs recognized as an intangible asset include the cost of the materials, direct labor and overhead expenses directly attributable to preparation of the asset for its intended use. Other development expenses are recognized in profit or loss as incurred.
Capitalized development costs are measured at cost less amortization and accumulated impairment losses.

(3) Subscriber acquisition

Direct sale commissions paid to dealers and salespersons in respect of sales and upgrades to subscribers who have signed long-term commitments are recognized as an intangible asset. Amortization expenses are recognized in profit or loss over the period of the subscribers' commitments (between 18 and 36 months), on a straight line basis. When the subscriber terminates the agreement period, the balance of the asset is amortized immediately.

(4) Software

The Group's assets include computer systems consisting of hardware and software. Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, licenses for stand-alone software, which adds functionality to the hardware, is classified (mainly) as intangible assets. Software depreciation is recognized in profit or loss using the straight-line method over the estimated useful life of the asset.

(5) Other intangible assets

Other intangible assets acquired by the Group, which have a definite useful life, are measured at cost less amortization and accumulated impairment losses.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

F. Intangible assets (contd.)

(6) Subsequent costs

Subsequent expenses are recognized as an intangible asset only when they increase the future economic benefits embodied in the asset for which they were incurred. All other expenditure, including expenditure relating to generated goodwill and brands, is recognized in profit or loss as incurred.

(7) Amortization

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life. A depreciable amount is the cost of an asset, or another amount instead of the cost, less its residual value.

Amortization, except for goodwill, is recognized in profit or loss on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use. Goodwill is not systematically amortized but is reviewed for impairment.

Estimated useful lives for the current and comparative periods are as follows:

Capitalized development expenses	4-7 years
Other rights	3 - 10 years, depending on the useful life
Subscriber acquisition costs	Depending on the estimated contractual commitment with the subscriber
Frequency usage rights	Over the term of the license for 13.6 years, starting from use of the frequencies
Computer programs and software licenses	Over the term of the license or the estimated time of use of the program

The estimates regarding the amortization method and useful life are reassessed at each reporting date and adjusted as required.

G. Leased properties

Leases in which the Group assumes most of the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased properties are measured at the lower of the fair value and the present value of the minimum future lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Transactions for acquiring an indefeasible right of use (IRU) of seabed cable capacities are accounted for as service transactions. The prepaid expense is amortized on a straight-line basis according to the period in the agreement and no further than the expected estimated useful life of those capacities.

Other leases are classified as operating leases and the leased properties are not recognized on the Group’s balance sheet. Leases of land from Israel Lands Administration ("the Administration") are operating leases. Lease payments made in advance to the Administration are stated in the statement of financial position of the Group and recognized in the income statement over the term of the lease.

The Group applies IFRIC 4 – *Determining Whether an Arrangement Contains a Lease*, which defines criteria for determining, at the start of the arrangement, whether the right to use the property constitutes a lease arrangement. In addition, it defines when the arrangement should be re-examined. The Group applied the relief laid down in IFRS 1, whereby the examination of whether an arrangement contains a lease is based on the facts and circumstances prevailing on January 1, 2005 (the date of transition to IFRSs).

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

H. Inventory

Inventory is measured at the lower of cost and net realizable value. Cost of inventory is determined on the basis of the moving weighted average method. Slow-moving inventory of terminal equipment, accessories and spare parts are stated net of the provision for impairment.

The inventory of a subsidiary includes terminal equipment and accessories intended for sale, as well as spare parts used for repairs in the repair service it provides to its customers. As part of its normal operations, the subsidiary upgrades the terminal equipment for its customers, and therefore inventory also includes used handsets and accessories returned by customers.

I. Impairment

(1) Financial assets

The Group reviews a financial asset for impairment when there is objective evidence that one or more events have had a negative effect on the estimated future cash flows of that asset.

The Group's review of impairment of available-for-sale financial assets that are equity instruments also includes the difference between the fair value of the asset and its original cost, for the period of time at which the fair value of the asset is lower than its original cost, and changes in the technological, economic or legal environment or the market environment in which the company that issued the instrument operates. In addition, material or ongoing decrease in the fair value below the original cost is objective evidence of an impairment.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed for impairment collectively, in groups that share similar credit risk characteristics. The financial statements include specific provisions and specific Group provisions for doubtful debts, which properly reflect, in the estimation of the management, the loss inherent in debts for which collection is in doubt.

All impairment losses are recognized in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in equity is transferred to profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost and available-for-sale financial assets that are debt securities, the reversal is recognized in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognized directly in other comprehensive income.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

(2) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated. On January 1, 2005, the date of transition to IFRSs, the Group reviewed goodwill for impairment. In subsequent periods, the Group assesses annually the recoverable amount of goodwill and of assets which are not available for use, or more frequently if there are indications of impairment.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and the net selling price (fair value less selling costs). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For assessing impairment, the assets are grouped together into the smallest group of assets that generate cash from ongoing use, which are mainly independent of other assets and groups ("cash-generating unit"). To test for impairment of goodwill, cash-generating units to which goodwill is assigned are grouped so that the level in which impairment is tested represents the lowest level within the entity at which goodwill is monitored for internal reporting, but in any event is not larger than an operating segment. Goodwill acquired in a business combination or the purpose of impairment testing, is allocated to cash-generating units which are expected to generate benefits from the synergy of the combination.

An impairment loss is recognized when the carrying amount of the asset or its cash-generating unit exceeds its recoverable amount and is charged to profit or loss. Impairment losses recognized for cash-generating units are allocated initially to reduce the carrying amount of any goodwill allocated to the units, and thereafter, to reduce the carrying amount of the other assets in the unit on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. For other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount after reversal does not exceed the carrying amount, net of depreciation or amortization, that would have been determined if no impairment loss had been recognized.

Goodwill that is part of the investment account in an associate is not recognized separately and therefore is not tested separately for impairment. Alternatively, impairment of an investment is tested when there is objective evidence of impairment.

J. Employee benefits

(1) Severance benefits

The Group has a number of severance benefit plans. The plans are usually financed by contributions to insurance companies, and are classified as defined contribution plans and defined benefit plans.

A. Defined contribution plans

The Group's obligations to make contributions to a defined contribution plan are recognized as an expense in profit or loss on the date on which the obligation to contribute is assumed. (See Note 17A below.)

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

J. Employee benefits (contd.)

(1) Severance benefits (contd.)

B. Defined benefit plans

The Group's net liability for defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is stated at present value less the fair value of the plan's assets and less the cost of past service not yet recognized. The discount rate is the yield at the reporting date on government bonds denominated in the same currency and with similar maturity dates to the terms of the Group's liability. The calculations are made by a qualified actuary (see Note 17B below).

When the calculation results in an asset for the Group, an asset is recognized up to the net present value of economic benefits received in the form of a refund from the plan or a reduction in future contributions to the plan.

Where the minimum contribution requirement includes an obligation to pay additional amounts relating to past services, the Company recognizes an additional obligation.

When the benefits of a plan are improved, the portion of the increased benefits relating to past service of employees is recognized in profit or loss on a straight-line basis over the average period until the benefits mature. If the benefits mature immediately, the expense is recognized in profit or loss as incurred.

The Group has an officers' insurance policy that was issued prior to 2004. Under the terms of the policy, the real retained earnings accumulated on the compensation component will be paid to an employee upon severance.
For these policies, the assets of the plan include the balance of the compensation component and the balance of any real profit accumulated on the contributions for compensation up to the reporting date, and are reported at fair value.
The assets of this plan are used for a defined benefit plan that includes two liability components. The defined benefit plan for compensation, which is calculated actuarially as aforesaid, and liability for payment of any retained earnings accumulated at the date of severance. This component is measured in the amount of the real retained earnings that actually accumulated at the reporting date.

The Group immediately recognizes, through other comprehensive income, all actuarial gains and losses arising from defined benefit plans directly in retained earnings.

(2) Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits other than post-employment benefit plans is the amount of future benefit payable to employees in return for their service in the current and prior periods. The amount of these benefits is discounted to its present value, net of the fair value of the assets related to the obligation. The discount rate is the yield at the reporting date on government bonds denominated in the same currency and with a maturity date similar to the terms of the Group's obligation. The calculation is made using the projected credit unit method. Actuarial gains or losses are recognized in the income statement as incurred (see Note 17C).

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

J. Employee benefits (contd.)

(3) Benefits for early retirement and dismissal

Severance benefits are recognized as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Employee benefits for voluntary retirement are recognized as an expense when the Group proposes a plan encouraging employees to retire voluntarily, the plan is expected to be accepted, and the number of those who will benefit from the plan can be estimated reliably (see Note 17D).

(4) Short-term benefits

Obligations for short-term employee benefits are measured on a non-discounted basis, and the expense is recognized when the relevant service is rendered. A provision for short-term employee benefits in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to pay that amount for a service rendered by the employee in the past, and that amount can be reliably estimated.

(5) Share-based payments

The fair value on the grant date of options granted to employees is recognized as a salary expense with a corresponding increase in equity over the period during which the employee becomes entitled to the options. The amount recognized as an expense is adjusted to reflect the actual number of share options expected to vest.

The Group takes into consideration share-based payments subject to non- vesting terms, when calculating the fair value of the equity instruments that are granted. As such, the Group recognizes an expense for these grants irrespective of whether these terms are fulfilled.

K. Provisions

A provision is recognized if as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. The provisions are measured by discounting future cash flows at a pre-tax interest rate that reflects current market assessments of the time value of the money and the risks specific to the liability.

(1) Lawsuits

Contingent liabilities are accounted for under IAS 37 and its related provisions. Accordingly, the claims are classified according to groups with similar characteristics, by likelihood of realization of the exposure to risk, as follows:

A. More likely than not – more than 50% probability
B. Possible – probability higher than unlikely and less than 50%
C. Unlikely – probability of 10% or less

For claims which the Group has a legal or constructive obligation as a result of a past event, and which are more likely than not to be realized, the financial statements include provisions which, in the opinion of the Group, based, inter alia, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case, despite the claims being denied by the Group companies. There are also a few legal proceedings, received recently, for which the risks cannot be assessed at this stage, therefore no provisions have been made.

Note 18 describes the amount of additional exposure due to contingent liabilities which are likely to be realized.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

K. Provisions (contd.)

(2) Onerous contracts

A provision for onerous contracts is recognized when the benefits expected to be derived by the Group from the contracts are lower than the unavoidable cost of meeting its obligations under the contracts. The provision is measured at the lower of the present value of the expected cost of terminating the contract and the present value of the expected net cost of continuing the contract.

(3) Site dismantling and clearing costs

A provision in respect of an obligation to dismantle and clear sites is accrued in accordance with IAS 37. The provision is accrued for those rental agreements in which the Group has undertaken to restore the rental property to its original state at the end of the rental period, after dismantling and transferring the site, and restoring it as necessary.

(4) Warranty

A subsidiary recognized a provision for warranty in respect of first-year insurances for cellular handsets. The warranty is limited to technical malfunctions defined by the subsidiary, and does not include warranty as a result of customer damages. However, an asset exists in respect of the manufacturer’s warranty for those handsets, which is limited to technical malfunctions defined by the manufacturer.

L. Revenue

The Group's revenues are mainly composed of revenues for fixed-line communication services, cellular services, international communication services, customer center services, communication services for other operators, sales and installation of communication equipment and internet services. Revenue is measured at the fair value of the consideration received or about to be received, less returns, trade discounts and volume rebates.

(1) Equipment sales

Revenue from sales of terminal equipment is recognized in profit or loss when the significant risks and rewards of ownership of the goods transfers to the buyer, receipt of the consideration is probable, the possibility that the goods will be returned and the costs generated in respect of the transaction can be reliably estimated and when the Company has no ongoing involvement with the goods.

Revenue from the sale of terminal equipment to subscribers in long-term credit arrangements is recognized upon delivery to the customer at the present value of the future cash flow expected from them, at the market interest rate for transactions of this kind. Finance income in respect of these transactions is recognized in profit or loss over the period of the installments by the effective interest method.

(2) Revenue from services

Revenue from services rendered is recognized in profit or loss proportionately over the term of the agreement or upon providing the service if the flow of the economic benefits associated with providing the service is certain. Revenue from calls, including revenue from prepaid call cards, is recognized when the call is made by the customer.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

L. Revenue (contd.)

(3) Multi-component sales agreements

The Group recognizes revenue in accordance with IAS 18. For multi-component transactions in which terminal equipment is sold together with the customer's undertaking to receive services, the Group applies the relative fair value method. Allocation of the revenue to a supplied component is limited to the amount of the consideration that is not contingent upon the supply of additional components.

(4) Reporting of gross or net revenues

Where the Group acts as an agent or intermediary without bearing the risks and rewards deriving from the transaction, its revenue is recognized on a net basis. However, where the Group acts as a main supplier and bears the risks and rewards deriving from the transaction, its revenue is recognized on a gross basis.

M. Costs and expenses

Costs and expenses in the income statement are stated and analyzed according to classification based on the nature of the expenses. Classification is compatible with the understanding of the Group's business, which addresses a wide range of services provided using common infrastructure. All of the costs and expenses are used to provide services.

N. Finance income and expense

Finance income includes interest income in respect of amounts invested (including financial assets available for sale), income from dividends, interest income accrued by the effective interest rate method in respect of the sale of terminal equipment in installments, gains from the sale of available-for-sale financial assets, changes in the fair value of financial assets stated at fair value through profit or loss, gains from foreign currency and gains from hedging instruments that are recognized in profit or loss. Interest income is recognized as incurred, using the effective interest method. Dividend income is recognized on the date that the Group's right to receive payment is established which in the case of quoted securities is the ex-dividend date.

Changes in the fair value of financial assets recognized at fair value through profit or loss include revenue from dividends and interest.

Finance expenses comprise interest expense on loans received, debentures issued, commissions paid, changes in the time value in respect of provisions, changes in the fair value of financial assets stated at fair value through profit or loss, impairment losses recognized on financial assets (except for a provision for doubtful debts, which is recognized in operating and general expenses), and losses from hedging instruments recognized in profit or loss. Non-discounted borrowing costs are recognized in profit or loss using the effective interest rate.

Gains and losses from exchange rate differences are reported on a net basis.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

O. Income tax expense

Income tax expense includes current and deferred taxes and is recognized in the income statement unless the tax arises from items recognized directly in capital or other comprehensive income, in which case it is recognized in capital or other comprehensive income.

Current tax is the expected tax payable on the taxable income for the tax year, using tax rates applicable according to laws enacted or substantially enacted at the reporting date, and including changes in the tax payments relating to prior years.

Deferred taxes are recognized in respect of temporarily differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for tax purposes. The Group does not recognize deferred taxes for the following temporary differences: initial recognition of goodwill, initial recognition of assets and liabilities in a transaction which is not a business combination and which does not affect accounting profit or taxable profit, losses carried forward which are not expected to be utilized in the foreseeable future, and differences arising from investment in subsidiaries and associates if they are not expected to be reversed in the foreseeable future and if the Group is in control on the reversal date of the difference. Deferred taxes are measured according to the tax rates that are expected to apply to the temporary differences on the date of their realization, based on the laws enacted or substantively enacted at the balance sheet date. The Group sets off deferred tax assets and liabilities if there is an enforceable legal right to offset current tax assets and liabilities and they are attributed to the same taxable income levied by the same tax authority in the same assessed company or in different companies which intend to settle current tax assets and liabilities on a net basis or the tax assets and liabilities are settled simultaneously.

A deferred tax asset is recognized for transferred losses, tax benefits and temporary deductible differences if it is probable that future taxable profits will be available against which temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced if the related tax benefits are not expected to be realized.

P. Discontinued operations

A discontinued operation is an operation in which the company loses control, however it still has a holding that confers material influence in respect of the operation. For the discontinued operation, comparative information is restated in the income statement, as if the operation was discontinued from the beginning of the prior comparative period.

Q. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which include share options granted to employees.

R. Segment reporting

An operating segment is a part of the Group that meets the three conditions set forth below:

1. The segment engages in business operations that may generate revenue and may incur expenses, including revenue and expenses relating to transactions between the Group companies.
2. The operational results of the segment are regularly reviewed by the chief operating decision maker of the Group, in order to allocate resources to the segment and assess its performance
3. Separate financial information is available.

NOTE 3 – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTD.)

S. Transactions with a controlling shareholder

Assets and liabilities in a transaction with the controlling shareholder are measured at fair value on the transaction date. As this is a capital transaction, the Company charges the difference between the fair value and the proceeds from the transaction to shareholders' equity.

T. Dividend declared subsequent to the balance sheet date

An obligation relating to a dividend proposed or declared after the balance sheet date is recognized only in the period in which the declaration was made.

U. Reclassified amounts

The financial statements include reclassification of certain amounts of the comparative figures for the relevant sections.

V. New standards and interpretations not yet adopted

(1) Below are details of the amendments that are relevant to the operations of the Group, published and approved by IASB and which apply in the periods commencing on or after January 1, 2010, and which are not expected to have a material effect on the financial statements.

A. IAS 17 – *Leases: Classification of Leases of Land and Buildings* (revised) ("the Amendment"). The Amendment eliminates the requirement to classify a lease of land as an operating lease when the title is not expected to pass to the lessee at the end of the lease term. The Amendment is effective for annual financial statements commencing on or after January 1, 2010

B. The appendix to IAS 18 includes an example that lists guidelines for identifying whether an entity is acting as a principle or an agent when selling goods or rendering services. In accordance with the amendment, an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services.

C. Amendment to IAS 39 – *Financial Instruments: Recognition and Measurement* (revised), treating loan prepayment penalties as an embedded derivative. The amendment is to be effective for annual periods commencing on or after January 1, 2010.

(2) Amendments to IFRS 2 – *Share-Based Payment* ("the Amendments") Cash-settled share-based payment transactions in the Group. The Amendment is not expected to have an effect on the financial statements of the Group.

(3) IFRS 9 – *Financial Instruments* ("the Standard") This Standard replaces the requirements in IAS 39 for classifying and measuring financial assets. Under the Standard, there are two main classifications for measuring financial assets: amortized cost and fair value. The basis for classification for debt instruments is based on the entity's business model for measuring financial assets and on the contractual cash flow characteristics of the financial asset.

The Standard will be applied for annual periods commencing on or after January 1, 2013. Early application is permitted, subject to disclosure and subject to parallel adoption of other IFRSs. Application of the Standard will be retrospective, with the exception of specific exemptions. The Group is considering the anticipated effects of the Standard on its financial statements.

NOTE 4 – DETERMINING FAIR VALUE

Accounting policies and disclosure requirements require the Group to determine the fair value of monetary and non-monetary assets and liabilities. Fair values have been determined for measurement and / or disclosure based on the following methods. Further information about the assumptions used in determining the fair values can be found in the Notes relevant to the particular asset or liability.

A. Property, plant and equipment

Certain items of property, plant and equipment were revalued on the date of transition to IFRS (January 1, 2005). Determination of the deemed cost of the items is based on a valuation by an external appraiser using the depreciated replacement cost method.

B. Investments in shares and debentures

The fair value of financial assets measured at fair value through profit or loss and available-for-sale financial asset is based on their proposed selling price quoted at the end of trading, at the reporting date or calculation of most of the observable information in the market (such as use of the interest curve).

C. Trade and other receivables

The fair value of trade and other long-term receivables (determined mainly for disclosure purposes only), is based on the present value of the future cash flows, discounted at the market interest rate at the balance sheet date.

D. Derivatives

The fair value of forward contracts on foreign currency or the CPI and options on foreign currency is based on their quoted market prices, if available, and if unavailable, on the basis of capitalization between the price stated in the forward contact and the price of the present forward contact in respect of the balance of the term of the contract until redemption at an appropriate interest rate.

E. Non-derivative financial liabilities

The fair value, which is determined for disclosure, is calculated at the present value of the future principal and interest cash flows, discounted at the market interest rate at the reporting date.

F. Share-based payment transactions

The fair value of stock options for employees is measured using the Black and Scholes model. The assumptions of the model include the share price at the date of measurement, the exercise price of the instrument, expected volatility (based on the weighted average of historical volatility, adjusted for changes expected from information available to the public), the weighted average of the projected useful life of the instruments (based on past experience and the general behavior of the option-holders), expected dividends, and the risk-free interest rate (based on government bonds). Conditions of service and performance which are not market conditions are not taken into account when determining the fair value. Conditions which are not vesting conditions are taken into account in calculating the fair value. See also Note 27.

G. Investment in investees

The fair value of investments in equity-accounted investees is measured and to record the investment at fair value on deconsolidation of a subsidiary (see Note 5 below).

NOTE 5 – DISCONTINUED OPERATIONS

On August 20, 2009, the Supreme Court accepted the appeal of the Antitrust Commissioner ("the Commissioner") against the merger notice filed by the Company and DBS, regarding exercise of options for DBS shares by the Company, and ruled against the merger. The ruling of the Supreme Court is a peremptory ruling. Until the ruling of the Supreme Court, the Company consolidated the financial statements of DBS in its financial statements (the Company held 49.8% of the share capital of DBS), even though it did not have legal control of DBS, as in view of all the circumstances, including the Company's additional potential voting rights by virtue of the options, in the opinion of the Company, it was able to direct the financial and operational policy of DBS.

The Company estimates that the ruling of the Supreme Court, which is a final and irrevocable external barrier to the Company's ability to obtain more than 50% of the voting rights in DBS, will lead to a material change in the operations between the Company and YES and its shareholders, following which the Company will no longer be able to direct the financial and operational policy of DBS. Therefore, the Company cannot be regarded as controlling DBS (neither legally nor effectively). Accordingly, commencing from August 21, 2009, the Company no longer consolidates the reports of DBS in its financial statements and the investment in DBS shares is stated according to the equity method commencing from that date. The financial statements of DBS are attached to these financial statements.

At the deconsolidation date, the Company presented its investment in shares, share options and loans to DBS according to the equity method based on a valuation by an independent assessor whose opinion is attached to the Hebrew financial statements. According to the opinion, the value of the Company's investment in shares, share options and loans to DBS is estimated at between NIS 1.145 billion and 1.234 billion. The Company stated the investment at NIS 1.175 billion and recognized a profit of NIS 1.538 billion.

At the deconsolidation date, the Company recognized its remaining investment in DBS at fair value. To apply the equity method from the deconsolidation date, the Company measured its share in the identifiable assets of DBS and the liabilities of DBS at the deconsolidation date, through an external appraiser. In this context, the fair value of the tangible assets, intangible assets (other than goodwill), and liabilities of DBS at the deconsolidation date underwent a valuation. The difference between the fair value of the remaining investment in DBS at the deconsolidation date and the Company's share in the identifiable assets of DBS and the liabilities of DBS at that date constitute the goodwill included in the calculation of the Company's investment in DBS at the deconsolidation date.

The fair value is based on an individual estimate of the fair value of the tangible and intangible assets (and liabilities) of DBS. Fair value is defined as the value of the asset (liability) at the date of the transaction between a willing buyer and a willing seller.

NOTE 5 – DISCONTINUED OPERATIONS (CONTD.)

Main points of the valuation:

A. **Customer relations** were estimated at NIS 797 million (according to 100%). The estimate was based on the multi-period excess earning method, which involves the preparation of a future operational profit forecast referring to relations with acquired customers only. A model was chosen that assumes the generation of financial benefit from these customer relations for seven years, inter alia, in view of the estimated churn rate and the uncertainty regarding the survivability of the customer base subsequent to this period given the technological developments in the field (for example, IPTV).

The amortization rate determined according to the expected cash flow from customer relations is 20% for the first three years, 15% for the next two years, and 5% for another two years.

B. **Brand value** is estimated at NIS 174 million (according to 100%). The estimate was made according to the relief from royalty method, according to the remaining balance of the useful life of 12 years.

C. **Value of property, plant and equipment**: The fair value of the property, plant and equipment was estimated according the book value at DBS at the deconsolidation date plus NIS 29 million.

D. **Loans from institutions and debentures**: The surplus value on the cost is estimated at NIS 53 million (according to 100%). The fair value of the loans and debentures was calculated according to the capitalized cash flow from the acquisition date onwards, at a capitalization rate of 8%, representing the weighted price of the debt. The balance of payments was measured according to the known index at the acquisition date.

E. **Shareholder loans and options**: The fair value of the loans and options was set by allocating the value of shareholders' equity and shareholder loans to the various investment instruments (the valuation is attached to the Hebrew financial statements). For the allocation, average useful life was estimated for each of the shareholder loans and effective rate of return.

F. **Goodwill**: A value of NIS 814 million constitutes the difference between the fair value of the Company’s remaining investment in DBS at the deconsolidation date and the Company's share in the identifiable assets of DBS and the liabilities of DBS at the deconsolidation date.

The consolidated statements of income for the year ended December 31, 2009 are stated without consolidation of the statements of DBS. The operational results of DBS for the period up to August 20, 2009 and comparative figures were presented as discontinued operations. The consolidated statements of income for the years ended December 31, 2008 and December 31, 2007 were restated in order to retrospectively reflect the discontinued operations following deconsolidation, separately from continuing operations. The statements of financial position as at December 31, 2008 and 2007 and the statements of cash flow for 2008 and 2007 were not restated.

NOTE 5 – DISCONTINUED OPERATIONS (CONTD.)

(1) Results of discontinued operations

	From January 1 to August 20 2009	Year ended December 31 2008	Year ended December 31 2007
	NIS millions	NIS millions	NIS millions
Revenue	**970**	1,513	1,415
Cost of revenue	**663**	1,091	1,117
Gross profit	**307**	422	298
Selling and marketing expenses	**79**	128	138
General and administrative expenses	**74**	117	104
	153	245	242
Operating profit	**154**	177	56
Finance expenses, net	**313**	441	168
Loss before income tax	**(159)**	(264)	(112)
Income tax	**-**	1	6
Loss after income tax	**(159)**	(265)	(118)
Profit from deconsolidation of a subsidiary	**1,538**	-	-
Profit (loss) for the period from discontinued operations	**1,379**	(265)	(118)

(2) Cash flow from discontinued operations

	From January 1 to August 20 2009	Year ended December 31 2008	Year ended December 31 2007
	NIS millions	NIS millions	NIS millions
Cash flow from operating activities	**260**	347	250
Cash flow used for investment activities	**(176)**	(237)	(254)
Cash flow arising from (used for) finance activities	**(84)**	(110)	4
Cash flow from discontinued operations	**-**	-	-

NOTE 5 – DISCONTINUED OPERATIONS (CONTD.)

(3) Effect of discontinued operations on the financial position of the Group

	August 20 2009
	NIS millions
Working capital	**456**
Property, plant and equipment	**(678)**
Broadcasting rights, net of rights exercised	**(302)**
Intangible assets (except for goodwill)	**(59)**
Goodwill	**(760)**
Debentures	**737**
Loans from banks and institutions	**1,019**
Non-controlling interests	**(551)**
Investments in equity-accounted investees (mainly in loans)	**1,175**
Loans from non-controlling interests	**501**
Profit from deconsolidation of a subsidiary	**(1,538)**
	-

NOTE 6 – CASH AND CASH EQUIVALENTS

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Bank balances	**64**	30
Demand deposits	**516**	756
	580	786

The effective interest rate on the demand deposits in 2009 was 0.74% - 0.8% (2008 – 3.9% - 4.01%). For deposits, the average maturity period was 6-8 days (2008 – 6-7 days). See also Note 32.

NOTE 7 – INVESTMENTS, INCLUDING DERIVATIVES

A. Segmentation by financial assets

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Current investments		
Financial assets held for trade (money market fund)	**141**	-
Derivatives	**13**	24
Other investments	**-**	9
	154	33
Non-current investments		
Bank deposit for providing loans to employees (2)	**83**	130
Available-for-sale financial assets (1)	**37**	57
Derivatives	**10**	-
	130	187
	284	220

(1) Sensitivity analysis – price risk of available-for-sale financial assets (shares and options)
The strengthening of the shekel compared to the dollar by 10% would increase the value of the financial assets available for sale and increase the equity by NIS 2.7 million after tax (in 2008, an increase of NIS 4.1 million after tax). A similar change in the opposite direction would reduce equity by the same amount.

(2) The deposit serves as a security for providing bank loans to Company employees. The deposit is unlinked and the effective interest rate of the deposit at December 31, 2009 is 2.73% (in 2008, 2.85%). The Company is liable for the loans to employees. The deposit is stated at its present value, taking into account the loan repayment schedule, based on a weighted average discount rate of 3.53% (in 2008, 3.87%).

B. Analysis of projected exercise dates

	2010	2012	To be set	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Investments in shares and options	**-**	**-**	**37**	**37**
Bank deposit for providing loans to employees	**-**	**-**	**83**	**83**
Investment in money market fund	**141**	**-**	**-**	**141**
Derivatives	**13**	**10**	**-**	**23**
	154	**10**	**120**	**284**

NOTE 8 – TRADE AND OTHER RECEIVABLES

A. Composition of trade receivables

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Trade receivables		
Outstanding debts	**681**	747
Credit cards and checks receivable	**492**	554
Revenue receivable	**398**	388
Current maturities of long-term receivables	**850**	684
Associate	**70**	-
	2,491	2,373
Receivables		
Prepaid expenses	**88**	90
Other receivables	**83**	121
	171	211
Long-term trade and other receivables		
Long term trade receivables (1)	**831**	576
Other long-term receivables	**56**	-
	887	576
	3,549	3,160

Trade and other receivables include NIS 64 million for trade and other receivables denominated in the US dollar (in 2008, NIS 85 million).

The long-term trade and other receivables are repayable up to 2013.

(1) For discount interest rates, see Note 32.

B. Aging of trade receivables at the reporting date:

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Not in arrears	**2,958**	2,634
Arrears up to one year	**354**	341
Arrears between one and two years	**127**	147
Arrears of over two years	**165**	138
	3,604	3,260
Less provision for doubtful debts	**282**	311
	3,322	2,949

NOTE 8 – TRADE AND OTHER RECEIVABLES (CONTD.)

C. Change in provision for doubtful debts during the year:

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Balance at January 1	**311**	328
Derecognition for discontinued operations	**(9)**	-
Loss recognized from impairment	**55**	38
Change during the year	**(75)**	(55)
Balance at December 31	**282**	311

NOTE 9 – INCOME TAX

A. General

	Year ended December 31		
	2009	2008*	2007*
	NIS millions	NIS millions	NIS millions
Current tax expense			
For the current period	**671**	526	359
Adjustments for prior years, net	**(30)**	(4)	(5)
	641	522	354
Deferred tax expense			
Creation and reversal of temporary differences	**136**	197	312
Effect of change in the tax rate	**30**	-	-
	166	197	312
Income tax expenses	**807**	719	666

* Restatement due to discontinued operations, see Note 5

NOTE 9 – INCOME TAX (CONTD.)

B. Reconciliation between the theoretical tax on income before tax and tax expenses

	Year ended December 31		
	2009	**2008***	**2007***
	NIS millions	**NIS millions**	**NIS millions**
Profit before income tax	**2,969**	2,505	2,145
Statutory tax rate			
Income tax at the statutory tax rate	**772**	676	621
Differences in the tax rate	**60**	13	34
Differences in the definition of capital and assets	**-**	-	(39)
Expenses not recognized for tax purposes	**8**	22	46
Taxes for prior years	**(30)**	(4)	(5)
Others	**(3)**	12	9
	807	719	666

* Restatement due to discontinued operations, see Note 5

C. Unrecognized deferred tax liabilities

The calculation of deferred taxes does not take into account the taxes that would be applicable in the case of investments in subsidiaries and associates, since the Group intends to retain the investment. Deferred taxes in respect of a distribution of profit in subsidiaries and associates were also not taken into account since the dividends are not taxable.

Unrecognized deferred tax assets

Deferred tax assets were not recognized for carryforward capital losses for tax purposes at December 31, 2009, in the amount of NIS 31 million.

Deferred tax assets in respect of losses carried forward and tax benefits carried forward and not yet utilized, were not recognized in cases where future taxable income against which they can be utilized is not foreseen. Under existing tax laws, there is no time limit on utilizing tax losses or on utilizing deductible temporary differences. Deferred tax assets were not recognized in respect of these items since it is not anticipated that there will be taxable income in the future against which the tax benefits can be utilized.

NOTE 9 – INCOME TAX (CONTD.)

D. Recognized tax assets and deferred tax liabilities

Deferred tax assets and tax liabilities are attributed to the following items:

	Assets			**Liabilities**			**Net**		
	2009	**2008**	**2007**	**2009**	**2008**	**2007**	**2009**	**2008**	**2007**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Property, plant and equipment	**-**	25	58	**130**	125	116	**(130)**	(100)	(58)
Doubtful debts	**47**	47	50	**-**	-	-	**47**	47	50
Employee benefit plan	**338**	366	421	**-**	-	-	**338**	366	421
Share-based payments	**33**	122	136	**-**	-	-	**33**	122	136
Provisions	**38**	48	51	**-**	-	-	**38**	48	51
Tax losses carried forward	**2**	4	84	**-**	-	-	**2**	4	84
Other assets and deferred expenses	**6**	11	12	**12**	13	15	**(6)**	(2)	(3)
	464	623	812	**142**	138	131	**322**	485	681

NOTE 9 – INCOME TAX (CONTD.)

E. Changes in temporary differences during the year

	Balance at January 1, 2008	Changes recognized in profit or loss	Changes recognized in equity	Balance at December 31, 2008	Changes recognized in profit or loss	Changes recognized in equity	Balance at December 31, 2009
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Property, plant and equipment	(58)	(42)	-	(100)	**(30)**	**-**	**(130)**
Doubtful debts	50	(3)	-	47	**-**	**-**	**47**
Employee benefit plan	421	(54)	(1)	366	**(31)**	**3**	**338**
Share-based payments	136	(14)	-	122	**(89)**	**-**	**33**
Provisions	51	(3)	-	48	**(10)**	**-**	**38**
Tax losses carried forward	84	(80)	-	4	**(2)**	**-**	**2**
Other	(3)	(1)	2	(2)	**(4)**	**-**	**(6)**
	681	(197)	1	485	**(166)**	**3**	**322**

NOTE 9 – INCOME TAX (CONTD.)

F. Amendments to the Income Tax Ordinance

1. On July 14, 2009, the Knesset passed the Economic Arrangements (Amendments for the Implementation of the 2009 and 2010 Economic Plan) Law, 5759-2009. The Law includes provisions for an additional gradual decrease of corporate tax, for a further gradual decrease in the corporate tax rate to a rate of 18%, commencing from the 2016 tax year. Pursuant to the amendments, corporate tax rates applicable from the 2009 tax year onwards are as follows: 2009 tax year – 26%; 2010 tax year – 25%; 2011 tax year – 24%; 2012 tax year – 23%, 2013 tax year - 22%; 2014 tax year - 21%; 2015 tax year – 20% and from the 2016 tax year onwards – 18%.

   Current and deferred tax balances as at December 31, 2009 are calculated in accordance with the tax rates specified above.

2. On February 4, 2010, the Tax Authority issued a Temporary Order for amendment to the Income Tax Ordinance for the 2007, 2008 and 2009 Tax Years, prescribing that Accounting Standard 29 of the Israel Accounting Standards Board (“Standard 29”) cannot determine taxable income even though this standard applies in financial statements for these tax years. Under Standard 29, companies subject to the Securities Law and which report according to this Law, will prepare their financial statements in accordance with IFRSs.

   The Company is assessing the effect of the amendment to the Income Ordinance for 2006 to 2009.

H. Final tax assessments

1. The Company and Bezeq International have final tax assessments up to and including 2004.

2. Pelephone and Bezeq Online have final tax assessments up to and including 2005.

NOTE 10 – PROPERTY, PLANT AND EQUIPMENT

Composition and movement:

	Land and buildings	Switching, transmission, power, cellular and satellite equipment	Network equipment	Subscriber equipment	Vehicles	Office equipment and computers	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cost or deemed cost							
Balance at January 1, 2008	1,890	4,151	12,283	3,283	80	1,285	22,972
Additions	75	765	168	283	22	87	1,400
Disposals (D, below)	(12)	(146)	(1)	(22)	(18)	(19)	(218)
Transfer to assets held for sale	(53)	-	-	-	-	-	(53)
Balance at December 31, 2008	1,900	4,770	12,450	3,544	84	1,353	24,101
Balance at January 1, 2009	1,900	4,770	12,450	3,544	84	1,353	24,101
Additions	**54**	**558**	**346**	**207**	**37**	**92**	**1,294**
Disposals (D, below)	**(69)**	**(376)**	**(6)**	**(217)**	**(24)**	**(110)**	**(802)**
Transfer to assets held for sale	**(41)**	**-**	**-**	**-**	**-**	**-**	**(41)**
Discontinued operations	**(40)**	**(232)**	**-**	**(2,928)**	**-**	**(74)**	**(3,274)**
Balance at December 31, 2009	**1,804**	**4,720**	**12,790**	**606**	**97**	**1,261**	**21,278**
Depreciation and impairment losses							
Balance at January 1, 2008	1,410	2,056	9,941	2,447	71	983	16,908
Depreciation for the year	85	605	286	310	5	103	1,394
Disposals (D, below)	(11)	(146)	(1)	(5)	(16)	(20)	(199)
Transfer to assets held for sale	(38)	-	-	-	-	-	(38)
Balance at December 31, 2008	1,446	2,515	10,226	2,752	60	1,066	18,065
Balance at January 1, 2009	1,446	2,515	10,226	2,752	60	1,066	18,065
Depreciation for the year	**68**	**631**	**281**	**124**	**8**	**97**	**1,209**
Depreciation from discontinued operations	**2**	**10**	**-**	**109**	**-**	**7**	**128**
Disposals (D, below)	**(55)**	**(376)**	**(3)**	**(206)**	**(24)**	**(110)**	**(774)**
Transfer to assets held for sale	**(57)**	**-**	**-**	**-**	**-**	**-**	**(57)**
Discontinued operations	**(29)**	**(188)**	**-**	**(2,331)**	**-**	**(48)**	**(2,596)**
Balance at December 31, 2009	**1,375**	**2,592**	**10,504**	**448**	**44**	**1,012**	**15,975**
Carrying amount							
January 1, 2008	480	2,095	2,342	836	9	302	6,064
December 31, 2008	454	2,255	2,224	792	24	287	6,036
At December 31, 2009	**429**	**2,128**	**2,286**	**158**	**53**	**249**	**5,303**

NOTE 10 – PROPERTY, PLANT AND EQUIPMENT (CONTD.)

A. Determination of fair value as deemed cost: Certain items of property, plant and equipment from switching, transmission and power equipment, mainly switching equipment, which were revalued to fair value on the date of transition to IFRS, were measured on the basis of their deemed cost, which was based on their fair value on the transition date (January 1, 2005), as assessed by the Group based on the valuation of an external appraiser. The valuation was attached to the consolidated financial statements for the year ended December 31, 2006.

B. Residual value: The residual value of the Group's copper cables was assessed at the end of the reporting year. The residual value is NIS 598 million and NIS 226 million at December 31, 2009 and December 31, 2008, respectively. The increase in residual value will decrease the depreciation expense of the Company by NIS 18 million in 2010.

C. Cost of dismantling and removal of assets: The cost of items of property, plant and equipment includes dismantling and removal costs, as well as site restoration costs where the Group has an obligation. These costs are depreciated according to the expected useful life of the sites. In 2009, the Group recognized, as part of the cost of property, plant and equipment, costs of NIS 5 million for dismantling and removal of assets (in 2008, NIS 4 million).

D. Property, plant and equipment in the Group is derecognized at the year end upon reaching full depreciation, except for land, buildings and vehicles, which are derecognized upon their sale. In 2009, the Group derecognized fully depreciated property at a cost of NIS 661 million (in 2008, NIS 116 million).

E. The cost includes NIS 6 million in the Group, representing finance expenses which were capitalized in the reporting period in respect of loans and credit in the construction period and calculated at an average interest rate of 6.3% per year (in the prior year, 9.1%).

F. In November 2007, the general meeting of Pelephone adopted the resolution of Pelephone's board of directors in September 2007 concerning the installation of an HSPA/UMTS network for one billion shekels. In 2008 and 2009, Pelephone invested NIS 908 million in setting up the network, and the balance of the investment is expected to be spread over the next years. Depreciation commenced in January 2009, as the network was readied and became available for use.

G. In July 2008, the board of directors of the Company resolved to approve Company implementation of the NGN project. At that date, the board approved detailed planning of the project, which consisted of the setting-up of two operational pilot areas and the purchase of software switches. The project will be implemented in a modular form and the Company will conduct regular reviews. After each stage, the Company will reconsider the viability of continuing the project, looking at all the variable factors that could influence its viability and accordingly, the need to revise the project outline. The content, pace of performance and the amounts to be invested in the project, will be determined each year as part of the Company's annual budget. In February 2009, the 2010 budget was approved.

H. The Group companies reviewed the useful life of the property, plant and equipment through the depreciation committee, in order to determine the estimated useful life of their equipment. The findings of the committees do not indicate a need to change the estimated useful life of the property.

I. At the balance sheet date, there are agreements to purchase property, plant and equipment in the Group amounting to NIS 379 million (in 2008, NIS 458 million).

K. See Note 20 for liens.

NOTE 11 – INTANGIBLE ASSETS

	Goodwill	Computer software and licenses and discounted development costs	Subscriber acquisition	Right of use in communi-cation and cellular frequencies	Others	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cost						
Balance at January 1, 2008	1,799	1,360	312	220	61	3,752
Acquisitions or additions from Independent development	-	141	92	202	2	437
Disposals (1)	-	-	(25)	-	-	(25)
Balance at December 31, 2008	1,799	1,501	379	422	63	4,164
Balance at January 1, 2009	**1,799**	**1,501**	**379**	**422**	**63**	**4,164**
Acquisitions or additions from Independent development	**-**	**198**	**95**	**2**	**1**	**296**
Disposals (1)	**-**	**(197)**	**(46)**	**-**	**-**	**(243)**
Discontinued operations	**(760)**	**(135)**	**(197)**		**-**	**(1,092)**
Balance at December 31, 2009	**1,039**	**1,367**	**231**	**424**	**64**	**3,125**
Amortization and impairment losses						
Balance at January 1, 2008	6	949	238	-	33	1,226
Amortization for the year	-	194	87	-	8	289
Disposals (1)	-	-	(25)	-	-	(25)
Balance at December 31, 2008	6	1,143	300	-	41	1,490
Balance at January 1, 2009	**6**	**1,143**	**300**	**-**	**41**	**1,490**
Amortization for the year	**-**	**146**	**65**	**29**	**9**	**249**
Depreciation for discontinued operations	**-**	**5**	**12**		**-**	**17**
Disposals (1)	**-**	**(197)**	**(46)**	**-**	**-**	**(243)**
Discontinued operations	**-**	**(108)**	**(165)**		**-**	**(273)**
Balance at December 31, 2009	**6**	**989**	**166**	**29**	**50**	**1,240**
Carrying amount						
January 1, 2008	1,793	411	74	220	28	2,526
December 31, 2008	1,793	358	79	422	22	2,674
December 31, 2009	**1,033**	**378**	**65**	**395**	**14**	**1,885**

(1) Fully amortized intangible assets

NOTE 11 – INTANGIBLE ASSETS (CONTD.)

Total value of goodwill attributable to each cash-generating unit:

	2009	2008
	NIS millions	NIS millions
Cellular : Pelephone Communications Ltd. (1)	**1,027**	1,027
Multi-channel television: D.B.S. Satellite Services (1998) Ltd. (2)	**-**	760
Others	**6**	6
	1,033	1,793

(1) Impairment of goodwill

The value of the use of cellular telephone – Pelephone, was calculated by the discount cash flow (DCF) method, and was based on the cash flow for the next five years. The cash flow forecast is based on Pelephone's results in 2009, after adding subscribers in the HSPA network, continued acquisition of new subscribers and upgrade of current subscribers to the HSPA network. Migration to the new network contributes to Pelephone's market positioning and improves the customer mix, which leads to increase in ARPU following an increase in revenue from roaming services and content/value added services.

The five-year revenue forecast is based on the forecast of the number of subscribers and average income for each type of income, with reference to the effect of the entry of MVNO and increased competition commencing from 2011 as well as the reduction of interconnect prices commencing from this year. Pelephone is growing slowly in a market that is becoming saturated. An annual increase of up to 0.6% was assumed in 2014 (without Mirs and MVNO). The assumptions regarding call time and call prices lead to an increase in ARPU in 2010 followed by erosion. The operating, sales and marketing expenses were adjusted for Pelephone's volume of operations, with adjustment for operation of the HSPA network. Tax is deducted from the profit at the statutory tax rate each year.

The investments were estimated according to Pelephone's investment plan, which includes completion of the investment in the HSPA network, start of investment in the LTE network (including acquisition of frequencies) in 2011-2013, and investment in IT and other ongoing and forecasted investments as well as the investments in acquisition of subscribers.

Cost of capital based on the WACC model is 10%. In addition, it was assumed that the permanent growth of Pelephone will be 1%.

Valuation of Pelephone was based on the comparative method: comparison of Partner and Cellcom, which operate in the same legal and business environment. Multiples of EV/EBITDA and average P/E and EV/revenue were used for 2009 data (some of which are forecasted) and the market value at December 31, 2009 in relation to Pelephone data. The comparison indicates that the value estimated using the DCF method is within the range of the value calculated using these multiples.

This valuation was made by an external appraiser. Based on these valuations, the Group was not required to record an impairment of the cellular cash-generating unit at Pelephone.

(2) Commencing from August 21, 2009, the Company deconsolidated the statements of DBS and its in investment in DBS is stated at the equity method from that date (see Note 5).

NOTE 12 – DEFERRED AND OTHER EXPENSES

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Land lease rights (1)	**125**	172
Long-term prepaid expenses in respect of use of capacities (2)	**296**	234
Long-term prepaid expenses in respect of lease agreement	**5**	5
	426	411

The deductions recognized in profit or loss are NIS 28 million (in 2008, NIS 20 million and in 2007, NIS 17 million).

(1) Most of the real estate assets used by the Company were transferred to it by the State of Israel pursuant to and at the consideration stated in the asset transfer agreement signed between the Company and the State on January 31, 1984. Some of these assets were leased for 49 years, with an option to extend for another 49 years, and some were rented for two years, renewable each time for another two years.

On May 15, 2003, the Company signed a settlement agreement with the Government of Israel on behalf of the State and Israel Lands Administration, which regulated the dispute between them in the matter of the Company's rights in the various real estate assets which were transferred to the Company when it commenced operation in 1984, under the asset transfer agreement.
The rights are amortized over the course of the lease period.

(2) See Note 3G.

NOTE 13 - INVESTEES

A. Equity-accounted associates

(1) Below is a summary of associates, without adjustment for ownership percentage held by the Group.

(a) Financial position

	Ownership percentage	Current assets	Non-current assets	Total assets	Current liabilities	Non-current liabilities	Total liabilities	Equity
		Year ended December 31						
		NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
2009								
D.B.S. Satellite Services (1998) Ltd.	**49.78%**	**171**	**1,035**	**1,206**	**896**	**3,418**	**4,314**	**(3,108)**
Walla! Communications Ltd.	**34.24%**	**149**	**31**	**180**	**78**	**8**	**86**	**94**
2008								
Walla! Communications Ltd.	34.25%	130	24	154	66	2	68	86

(b) Operating results:

	Rate of ownership	Revenue	Gross profit	Operating profit (loss)	Profit (loss)
		Year ended December 31			
		NIS millions	NIS millions	NIS millions	NIS millions
2009					
D.B.S. Satellite Services (1998) Ltd.	49.78%	**1,530**	**488**	**240**	**(222)**
Walla! Communications Ltd.	34.24%	**132**	**73**	**28**	**20**
2008					
Walla! Communications Ltd.	34.25%	112	63	24	17
2007					
Walla! Communications Ltd.	34.41%	99	52	18	16

NOTE 13 – INVESTEES (CONTD.)

A. Equity-accounted associates (contd.)

(2) Additional details regarding associates held indirectly by the Group:

The investment in associates comprises the investment of Bezeq International in Walla! Communications Ltd. ("Walla"), an Israeli company whose shares are listed on the Tel Aviv Stock Exchange and which provides internet services and operates internet portals, in Bezecom Ltd. and B-Zone partnership. At December 31, 2009, the investments include the Company's investments in shares, share options and loans to DBS.

	Country of incorporation	Group's rights in equity	Amounts provided by the Group to an associate – Loans	Amounts provided by the Group to an associate – Guarantees	Scope of investment in an associate	Market value on the TASE
			NIS millions	NIS millions	NIS millions	NIS millions
2009						
D.B.S. Satellite Services (1998) Ltd. * (1)	Israel	49.78%	**1,166**	**10**	**1,185**	**-**
Walla! Communications Ltd. (2)	Israel	34.24%	**-**	**-**	**34**	**78**
			1,166	**10**	**1,219**	**78**
2008						
Walla! Communications Ltd.	Israel	34.25%	**-**	**-**	**32**	**44**

* The balance of the loans and scope of investment is as stated in the financial statements. In addition, DBS has a current debt to the Group companies. The balance of DBS's current debt to the Company and its subsidiaries amounts to NIS 70 million, of which NIS 52 million is to the Company. The Company and DBS have come to an arrangement for collection of the balance of DBS's debt which as in arrears, NIS 55.6 million. Under the arrangement, the debt is being paid in 60 equal monthly installments plus interest at prime + 1.5%. At the balance sheet date, the balance of the debt covered by the arrangement is NIS 19 million. The balance of the debt to the Company outside the above arrangement, is current debt for which the agreed terms of payment are the usual credit terms between the Company and its customers. At the date of approval of the financial statements, DBS is not in compliance with the terms of the arrangement and the credit terms. The companies defined a new repayment schedule for the entire debt. The arrangement is in the process of being approved.

For the financial position of DBS, see Notes 5 and 29 to the financial statements of DBS for 2009, which are attached to the Company's financial statements.

(1) For details of goodwill arising from deconsolidation of DBS, see Note 5.

(2) The balance of the investment in Walla at December 31, 2009 and 2008 includes goodwill that was not amortized, and its cost at these dates amounted to NIS 4 million.

NOTE 13 – INVESTEES (CONTD.)

B. Subsidiaries

(1) General information

	Country of incorporation	Company's rights in equity	Amounts provided by the Company to subsidiaries: Loans	Amounts provided by the Company to subsidiaries: Guarantees	Investment of equity-accounted subsidiaries
			NIS millions	NIS millions	NIS millions
2009					
Pelephone Communications Ltd.	Israel	100%	**-**	-	**3,570**
Bezeq International Ltd.	Israel	100%	**-**	70	**710**
Bezeq Online Ltd.	Israel	100%	**10**	-	**25**
Bezeq Zahav (Holdings) Ltd.	Israel	100%	**1,006**	-	**1,033**
Stage One Venture Capital Fund	Israel	71.8%	**-**	-	**43**
			1,016	70	**5,381**
2008					
Pelephone Communications Ltd.	Israel	100%	-	-	3,112
Bezeq International Ltd.	Israel	100%	-	70	717
Bezeq Online Ltd.	Israel	100%	12	-	20
Bezeq Zahav (Holdings) Ltd.	Israel	100%	969	-	1,003
Stage One Venture Capital Fund	Israel	71.8%	-	-	39
DBS Satellite Services (1998) Ltd.*	Israel	49.78%	1,232	10	(420)
			2,213	80	4,471

* For the additional guarantees provided by the Company in respect of DBS, see Note 14B(2) and Note 20 H.

(2) Dividends received from subsidiaries or that the Company is eligible to receive

	Year ended December 31: 2009	2008
	NIS millions	NIS millions
From Pelephone Communications Ltd.	**425**	680
From Bezeq International Ltd.	**210**	20
From Stage One Venture Capital Fund	**8**	-
	643	700

NOTE 13 – INVESTEES (CONTD.)

B. Subsidiaries (contd.)

(3) Details of Group entities

(a) Pelephone Communications Ltd.

Pelephone Communications Ltd. ("Pelephone") is a wholly-owned subsidiary of the Company. Pelephone provides cellular communication services and value added services and markets and repairs terminal equipment.

Pelephone operates under an operating license from the Ministry of Communications – a general license for cellular services ("the License"). The License was received on February 7, 1996. After Pelephone won an additional band of frequencies in December 2001, the term of the license was extended to 2022, with an option for extension, subject to the terms of the license, for an additional six years (“the additional period”) and for renewal for one or more additional periods of six years after the additional period.

(b) Bezeq International Ltd.

Bezeq International Ltd. ("Bezeq International") is wholly-owned subsidiary of the Company, and was incorporated on April 5, 1995 to engage in international communications. Since 1999, Bezeq International has also been providing internet access services. Bezeq International has holdings in the Walla! Communications Group Ltd. (see Note 3). Following the merger with BezeqCall Communications Ltd. (BezeqCall), BezeqCall's network end point (NEP) license was assigned to Bezeq International.

On February 8, 2009, the Minister of Communications granted an operation license for domestic telecommunication services to BIP Communication Solutions Limited Partnership (“BIP”), a corporation owned by Bezeq International. The license is for the supply of domestic broadband telephony services (VoB) to private customers through BIP. On August 2, 2009, Bezeq International started to supply domestic broadband telephony services (VoB) to its private customers through BIP.
On December 20, 2009, after the Ministry of Communications determined that Bezeq's market share in domestic telephony in the business sector fell below 85%, the license was amended to permit Bezeq International to supply the services to its business customers as well.

(c) Bezeq On-line Ltd.

Bezeq On-line Ltd. ("Bezeq On-line") is a wholly-owned subsidiary of the Company and was established in December 2000 and commenced operations in 2001, providing call centre outsourcing services.

NOTE 13 – INVESTEES (CONTD.)

B. Subsidiaries (contd.)

(3) Details of Group entities (c0ntd.)

(d) Bezeq Zahav (Holdings) Ltd.

Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") is wholly-owned and controlled by the Company. Bezeq Zahav was established in September 1995 and commenced operations in May 2004. Bezeq Zahav holds debentures issued by the Company.

(e) Stage One Venture Capital Fund (Israel) L.P.

This is a venture capital fund in which the management rights are held by SOCI, and the Company has rights in the profits – see Note 3A(2).

NOTE 14 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS

A. Composition:

	December 31 2009 *	December 31 2008
	NIS millions	NIS millions
Current liabilities		
Short-term credit	**-**	31
Current maturities of debentures	**798**	795
Current maturities of bank loans	**64**	954
	862	1,780
Non-current liabilities		
Debentures	**2,716**	3,943
Bank loans	**558**	214
Loans from institutions	**-**	158**
	3,274	4,315
	4,136	6,095
Loans provided by the non-controlling interest	**-**	449

* From August 21, 2009, the Company no longer consolidates the statements of DBS in its financial statements (see Note 5).

** See Note 3U.

NOTE 14 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

B. Debt terms and repayment schedule

				December 31, 2009*		December 31, 2008	
	Currency	Nominal interest rate %	Redemption year	Par value NIS millions	Carrying amount NIS millions	Par value NIS millions	Carrying amount NIS millions
Short-term credit				**-**	**-**	31	31
Loans from banks and others:							
CPI-linked***	NIS	4.45-5.2	2010-2015	**194**	**222**	391	480**
Unlinked (1)	NIS	Prime + 0.85 Up to prime +1	2010-2013	**400**	**400**	846	846
					622		1,357
Debentures issued to the public							
Linked to the CPI – series 4 and 5 (3)	NIS	4.8-5.3	2010-2016	**2,107**	**2,476**	2,407	2,737
Debentures issued to financial and other institutions:							
CPI-linked (4) ****	NIS	4.4-5.95	2010-2015	**898**	**1,038**	1,829	2,001
Total interest-bearing liabilities					**4,136**		6,095
Loans provided by the non-controlling interest in a subsidiary					**-**	1,012	449

* From August 21, 2009, the Company no longer consolidates the statements of DBS in its financial statements (see Note 5).
** See Note 3U.
*** For long-term loans of DBS from institutional entities, the balance of which at December 31, 2008 is NIS 158 million, see section B(3) below.
**** The balance at December 31, 2008 includes debentures issued by DBS at a total par value of NIS 620 million, with a balance of NIS 655 million at December 31, 2008.

NOTE 14 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

B. Debt terms and repayment schedule (contd.)

(1) In March 2009, the Company raised bank credit amounting to NIS 400 million. Prime interest varies with a margin of between 0.85% and 1%.

(2) DBS's bank loans amounting to NIS 846 million at December 31, 2008, were originally long-term loans, but since at December 31, 2008 DBS failed to meet the financial covenants set by the banks, the loans were stated as short term liabilities.

In respect of the loans of NIS 100 million that DBS received from institutional entities (the balance of which is NIS 182 million, including interest and linkage differences, at December 31, 2009) the Company undertook that if by December 31, 2013 the loans (all or some of them) are not repaid or upon fulfillment of certain other conditions, the lenders could demand that it repay the lower of the balance of the loans (principal, interest and linkage) and an amount computed according to a formula which was determined, which takes into account the value of DBS at that date.

(3) The balance of the par value of the Company's debentures is NIS 2,986,967,000, of which NIS 2,106,867,000 par value was issued to the public.

A. The balance of the par value of the Debentures (Series 4) is 600,000,000 of NIS 1 par value each, repayable in two equal annual installments in each of the years 2010 and 2011. The annual interest rate for these debentures is 4.8%.

B. The balance of the par value of the Debentures (Series 5) is 2,386,967,000 of NIS 1 par value each, of which 1,506,867,000 debentures (some through Bezeq Zahav) were issued to the public and to institutional investors, and the balance of 880,100,000 to Bezeq Zahav. The debentures are payable in six equal annual installments in each of the years 2011-2016. The annual interest rate for these debentures is 5.3%.

(4) Pelephone issued three series of debentures in a private placement to institutional investors. The debentures, which were issued at par value, are linked to the CPI, bear annual interest of 4.4% - 5.2%, and are repayable in 20 equal semi-annual payments. The interest is paid on the unpaid balance of the principal. The balance of the debentures at December 31, 2009, is NIS 713 million.

(5) For the financial covenants of an associate, see Note 5 to the financial statements of DBS for 2009, attached to these financial statements.

C. Charges and collateral

(1) The private debentures of the Company, whose carrying amount at December 31, 2009 is NIS 325 million, are secured by a token charge. In addition, the Company created a negative pledge in favor of the debenture holders and in favor of a bank, which includes exceptions, inter alia, for the matter of a charge on assets that are purchased or expanded by the Company, if the undertakings for which the charge serves as security is created for the purchase or expansion of those assets and for the matter of a token charge.

The lenders have a right to call for immediate payment of the debentures in cases where the Company does not repay the debentures or violates their terms, if a significant attachment is imposed on its assets, if a receiver is appointed for the Company's assets or a liquidation order is given against the Company, if the Company ceases to run its business, or if the holder of another charge realizes the charge it has on the assets of the Company.

NOTE 14 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

C. Charges and collateral

(1) (contd.)
In addition, some of the lenders from whom the balance of the debentures at December 31, 2009 is NIS 94 million, may call for immediate payment of the debentures due to the State's holdings in the share capital of the Company having fallen below 26% (a condition which was met commencing from October 11, 2005). For this reason, the balance in the financial statements is stated as a short-term liability. For this reason, the balance in the financial statements is stated as a short-term liability.

In the Company's opinion, at the reporting date, it is in compliance with all the aforementioned terms, except for the term of the decrease of the State's holdings in the Company.

(2) The Company raised a negative pledge in favor of the creditors for a bank debt of NIS 400 million, as set out in section B(1).

(3) A. The bank loans and debentures of Pelephone, the carrying amount of which at December 31, 2009 is NIS 935 million, are secured by an irrevocable undertaking of Pelephone to the credit providers, not to encumber its assets without their consent (a negative pledge).

The undertaking includes, inter alia:

(1) A declaration that Pelephone will not encumber its assets (as may be from time to time), in whole or in part, in any manner including by means of a floating lien or a fixed lien of any type or rank, in favor of any third party, without the prior written consent of the credit providers.

(2) Compliance with the following financial stipulations:

A. An undertaking that Pelephone's debt will not exceed three times its equity and an undertaking that as long as that ratio exceeds 2.5, dividends will not be distributed and management fees will not be paid to the shareholders.

B. Pelephone undertook that the amount of its debts will not exceed NIS 3.8 billion (linked to the CPI known in January 2002).

C. An undertaking towards a certain bank that its total debt to it will not exceed 40% of its total debts to all the financial entities.

At the date of the financial statements, Pelephone is in compliance with its undertakings to the banks and the financial stipulations. Non-compliance with these undertakings would allow the banks and the debenture holders to call for immediate repayment of the loans it received from the banks and the debentures.

B. Under its general license for cellular services, Pelephone is not permitted to sell, lease or pledge any of its assets used for the implementation of the license, without the consent of the Minister of Communications, except for:

(1) A charge of one of the license assets in favor of a bank operating lawfully in Israel, for receipt of bank credit, provided that it submitted notice to the Ministry of Communications regarding the charge it intends to register, noting that the charge agreement includes a clause ensuring that in any case, exercise of the rights by the bank will not impair in any way the provision of the services pursuant to the license.

(2) Sale of items of equipment when implementing an upgrade, including sale of equipment by the trade-in method.

NOTE 15 – TRADE AND OTHER PAYABLES

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Trade payables		
Outstanding debts	**1,086**	1,262
Notes payable	**5**	119
Total trade payables	**1,091**	1,381
Trade payables consisting of related parties and interested parties	**8**	-
Other payables		
Liabilities to employees and other liabilities for salaries	**297**	296
Institutions	**194**	200
Accrued interest	**99**	185
State of Israel in respect of royalties	**6**	66
Other payables	**101**	103
Total other payables	**697**	850

Amounts payable denominated in a currency other than the functional currency include NIS 258 million for suppliers denominated in US dollars (in 2008, NIS 258 million).

NOTE 16 - PROVISIONS

	Employee claims	Customer claims	Supplier and communication provider claims	Punitive claims	Enterprise and company claims	State and Authorities claims	Dismantling and clearing of sites	Onerous contracts & others	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Balance at January 1, 2009	149	55	11	3	-	123	54	24	419
Provisions created in the period	**39**	**2**	**-**	**-**	**7**	**41**	**7**	**9**	**105**
Provisions utilized in the period	**-**	**-**	**-**	**-**	**-**	**(5)**	**(1)**	**(3)**	**(9)**
Provisions cancelled in the period	**(49)**	**(3)**	**-**	**(2)**	**-**	**-**	**-**	**(1)**	**(55)**
Derecognition for discontinued operations	**-**	**(9)**	**-**	**-**	**-**	**-**	**-**	**-**	**(9)**
Balance at December 31, 2009	**139**	**45**	**11**	**1**	**7**	**159**	**60**	**29**	**451**
Current	**139**	**45**	**11**	**1**	**7**	**159**	**-**	**18**	**380**
Non-current	**-**	**-**	**-**	**-**	**-**	**-**	**60**	**11**	**71**

Claims
For details of claims, see also Note 18.

Dismantling and clearing of sites
The provision is in respect of an obligation of some of the Group's companies to clear sites they lease.

NOTE 17 – EMPLOYEE BENEFITS

A. Defined contribution plans

(1) The pension rights of Company employees for the period of their employment in the civil service through January 31, 1985, are covered by a pension fund ("the Makefet Fund"), which took upon itself the State's obligation following an agreement between the Government of Israel, the Company, the Histadrut and the Makefet Fund.

(2) Liabilities for employee benefits at retirement age in respect of the period of their service in the Company and in investees, are covered in full by regular payments to pension funds and insurance companies.

(3) The severance obligation to employees who leave their employment on terms entitling them to compensation is covered, for the period from February 1, 1985, by regular contributions to such pension funds and insurance companies (in accordance with Section 14 of the Severance Pay Law). Severance pay for the period of employment in the Civil Service through January 31, 1985, is paid by the Company, and the monies accumulated in the Makefet Fund for that period are kept in a fund that will be used for the employees' rights. For a small number of the employees (employed under special contracts), the Company has an obligation to pay severance in excess of the amount accumulated in the compensation fund which is in the employees' names.

B. Defined benefit plan

(1) The severance obligation included in the balance sheet represents the balance of the obligation not covered by contributions and/or insurance policies in accordance with the existing labor agreements, the Severance Pay Law, and the salary components which the managements of the companies believe entitle the employees to receive compensation. For this part of the liability, there are deposits in the name of the Company in a recognized compensation fund. The reserves in compensation funds include accrued linkage differentials and interest deposited in compensation funds, in banks and in insurance companies. Withdrawal of the reserve monies is contingent upon fulfillment of the provisions in the Severance Pay Law.

(2) The collective agreement of December 2006 (see Section D below), provides, among others, that employees who transferred from the civil service to the Company, who will end their employment due to retirement after December 31, 2013, are entitled to a supplement to close the gap between the Civil Service Law and the regulations governing the Makefet Fund. As a result of this clause in the agreement, the benefit to these employees is enhanced. The financial statements of the Company include the liability for this benefit.

(3) Under some personal employment agreements, a number of senior employees are entitled to early retirement terms (pension and retirement grants) which are not dependent on retirement agreements for all employees. Accordingly, a liability is included in the financial statements.

(4) Benefits for notice are paid upon severance. Accordingly, a liability is included in the financial statements in accordance with an employment agreement and an actuarial calculation.

(5) Company retirees receive, in addition to the pension payments, benefits which consist mainly of a holiday gift (linked to the dollar exchange rate), financing the upkeep of retiree clubs, and social activities. The Company's liability for these costs accumulates during the employment period. The Company’s financial statements include the expected costs in the post-employment period, based on an actuarial calculation.

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

C. Other long-term employee benefits

Provision for sick leave
The financial statements include a provision in respect of redemption and use of sick leave. The right to accumulate sick leave was taken into account for all employees in the Group and the right to redemption of sick leave only for employees eligible under the terms of the employment agreement.
The provision was computed on the basis of an actuarial calculation, including the assumption of positive accumulation of days by most of the employees and use of days by the last in, first out (LIFO) method.

D. Benefits for dismissal and early retirement

A number of collective agreements concerning early retirement have been signed in recent years. Below are details of the last agreement that was signed in December 2006:

(1) The collective agreement between the Company and the union and the New Histadrut regulates the labor relations in the Company following the transfer of control in the Company from the State of Israel, and delineates a new organizational structure for the Company. The agreement determines, inter alia, that all the agreements, arrangements and customs existing in the Company prior to execution of the agreement will continue to apply only to the veteran permanent employees in the Company.

(2) The Company may, at its discretion, terminate the employment of 1,225 permanent employees (245 permanent employees in one or more of the years 2009-2013). The retirement terms to be offered to the retirees will be largely the same as the retirement terms prevailing in the Company up to that date. The term of the agreement is from the date of its execution through December 31, 2011. The Company has an option to extend it for two additional years, through December 31, 2013. The term of the retirement section in the agreement, will in any case be through December 31, 2013.

On October 2, 2008 and December 18, 2008, the board of directors of the Company resolved to approve the retirement of 245 employees at a cost of NIS 177 million. In November 2009, the board of directors approved an early retirement plan for 2010. Under the plan, 171 employees will retire from the Company at a total cost of NIS 225 million. On that date, the Board of Directors also resolved to approve an additional cost of NIS 41 million to complete the early retirement plan for 2009. The financial statements include a provision for these resolutions.

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

E. Liabilities for employee benefits

	December 31, 2009	December 31, 2008	December 31, 2007
	NIS millions	NIS millions	NIS millions
Unfunded liabilities	**250**	258	287
Funded liabilities (2)	**203**	171	152
Total present value of liabilities	**453**	429	439
Fair value of plan assets	**(148)**	(140)	(144)
Liability for defined benefit plan	**305**	289	295
Liability for holiday pay	**89**	97*	95*
Liability for sick leave	**122**	81	70
Liability for voluntary early retirement	**283**	210	517
Total employee benefits	**799**	677	977
Stated in the statement of financial position as:			
Short term	**505**	412*	716*
Long term	**294**	265	261
	799	677	977

* Retrospective application by restatement, see Note 2F(3).

(1) Unfunded liabilities are liabilities for which the Company did not deposit a reserve to finance its liabilities and they include a provision for notice, a liability to the Company's pensioners, a liability for early retirement of senior employees in the Company and a liability for employees transferred from the civil service.

(2) Liabilities for which the Company deposited a reserve to finance its liabilities (severance liability).

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

F. Changes

	2009	2008
	NIS millions	NIS millions
Change in an obligation in respect of a defined benefit plan		
Obligation in respect of a defined benefit plan at January 1	**429**	439
Benefits paid according to the plans	**(40)**	(60)
Costs of current service and interest (see section 1 below)	**66**	66
Retirement	**(18)**	(1)
Actuarial gains charged to equity (see section 2 below)	**24**	(15)
Derecognition for discontinued operations	**(8)**	-
Liability in respect of defined benefit plans at December 31	**453**	429
Changes in the plan's assets		
Fair value of plan assets at January 1	**140**	144
Deposits	**11**	21
Withdrawals	**(5)**	(8)
Expected proceeds from the plan assets (see section 1 below)	**6**	4
Actuarial losses charged to equity (see section 2 below)	**11**	(17)
Retirement	**(9)**	(1)
Amortization of cost of past service	**(3)**	(3)
Derecognition for discontinued operations	**(3)**	-
Fair value of plan assets at December 31	**148**	140
1. Expense recognized in profit or loss		
Cost of current service	**37**	42
Interest on the obligation	**29**	24
Other	**(4)**	(1)
	62	65
The expense is included in the following items in the income statement:		
Salary expenses	**38**	39
Other operating expenses	**1**	6
Financing expenses	**23**	20
	62	65
Actual return on plan assets	**15**	(7)
2. Actuarial gains and losses recognized directly in other comprehensive income		
Amount accrued at January 1	**-**	(2)
Amounts recognized in the period	**13**	2
Amount accrued at December 31	**13**	-

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

G. Actuarial assumptions

Main actuarial assumptions at the date of the report:

(1) Mortality rates are based on the rates published in Insurance Circulars 6-3-2007 of the Ministry of Finance, except for early retirement, which was calculated according to the agreement with the insurance company, including future changes in the mortality rate.

(2) Churn rates were determined on the basis of the past experience of the Company and the subsidiaries, distinguishing between different employee populations and taking into account the number of years of employment.

The main assumptions regarding the churn rate were determined with a distinction made between permanent employees (between 3.5% in the first year to 0.5% over 10 years), personal contract employees (5.5% per year), senior employees (20% per year), and temporary employees (between 34% in the first year and 25% for more than 7 years).

(3) The real discounted rate is based on yield on government bonds at a fixed interest rate which have a lifetime equal to that of the gross liability.

	December 31, 2009	December 31, 2008	December 31, 2007
	Average capitalization rate	Average capitalization rate	Average capitalization rate
Sick leave	1.8%	3.4%	3.6%
Severance	1.4%	3.3%	3.4%
Retirement benefit – holiday gift *	4.9%	4.4%	5.3%
Retirement benefit – clubs and activities	2.7%	3.6%	3.6%
Early notice to senior employees	1.4%	3.1%	3.3%

* At a discount rate based on American corporate debentures.

(4) Assumptions regarding salary increases were made on the basis of experience and the management's assessments, distinguishing between the groups of employees. The main assumptions regarding salary increases are as follows:
For permanent employees, the average salary increment is 3% for young employees, with a linear decrease to 1.5% per year up to age 60. For employees in a monthly collective agreement, salary increments average between 6% and 4% depending on the age of the employee. For employees with a personal employment agreement, salary increments average between 4% and 0.5%, depending on the age of the employee, and for senior employees, an average salary increment is 6% per year.

(5) The forecasted growth rate of the assets accumulated in all the companies in the Group is 2% in real terms for old pension funds in the administration. For new, subsidized pension funds, a guarantee of 4.86% is assumed for 30% of the assets. For officer's insurance where the severance interest is not transferred to compensation and their start date is prior to 1989, guaranteed interest is 4.25% in real terms. Growth rates in other plans are the discount interest plus 1% and less 1% for administration fees.

(6) An obligation for voluntary early retirement includes an obligation for pension and grants. The obligation for pension is calculated according to the terms of the agreement of December 2006 (see section D) and in accordance with the agreement with the insurance company. The liability is affected by changes in the interest rates of debentures until the purchase of the policy and payment to the insurance company.

H. The adjustments to liabilities and assets arising from past experience are not material.

I. In 2010, the Group expects pay NIS 17 million as a contribution to a defined benefit plan.

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

J. Other

Under the collective agreements applicable to labor relations in the Company, and in accordance with agreements with the Makefet Fund, an option is reserved for Company employees who are transferred employees, to retire under one of two retirement tracks. The method of calculation of the cost of the early retirement of the transferred employees was laid down in the provisions of a number of agreements and documents drawn up between the Company and the Makefet Fund between 1990 and 1996. The Company contends that the Makafet Fund violated the provisions of the agreements, and therefore, in 2003, Company filed a claim against the Makefet Fund at the district labor court in Tel Aviv, in the amount of NIS 280 million. The Makefet Fund filed defense documents in the court, in which it rejects the allegations of the Company and contends that it acted in accordance with the agreements between it and the Company. The case is in the evidentiary stage.

NOTE 18 – CONTINGENT LIABILITIES

During the normal course of business, legal claims were filed against the companies in the Group and there are pending claims (“hereinafter in this section: “claims”).

In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements (Note 16) include appropriate provisions, where provisions are required to cover the exposure resulting from such claims.

In the opinion of the managements of the Group companies, the additional exposure as at December 31, 2009, due to claims filed against the Group companies on various matters and which are unlikely to be realized, amounts to NIS 10.2 billion. These amounts and all the amounts in this Note are before addition of interest.

For applications for certification as class action of lawsuits to which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see sections 2 and 4 below.

Below are details of the contingent liabilities of the Group at December 31, 2009, classified into groups with similar characteristics.

A. Employee claims

During the normal course of business, employees and former employees filed group and individual claims against the Company. These are mainly claims concerning to recognition of various salary components as pension components, recognition of various components in the determining salary for severance pay, pension rights and overtime. Employees and former employees also filed various individual claims against the other Group companies. At December 31, 2009, the sum of all the additional exposure (beyond the provisions included in these financial statements) for the abovementioned claims amounted to NIS 1.4 billion, referring mainly to claims filed by groups of employees or individual claims with wide ramifications in the Company. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 139 million, where provisions are required to cover the exposure resulting from such claims.

NOTE 18 – CONTINGENT LIABILITIES (CONTD.)

B. Customer claims

During the normal course of business, customers of the Group companies filed claims against the Group companies. These are mainly applications for certification as class actions concerning complaints of collection of payment and impairment of the service provided by the Group companies. On December 31, 2009, the total amount of these claims amounted to NIS 6.1 billion. There are additional claims for which the Group has additional exposure beyond the aforesaid, in view of the fact that the precise amount of the claim is not noted in the claim. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 45 million, where provisions are required to cover the exposure resulting from such claims. Of these claims, there are claims amounting to NIS 738 million, which, at this stage, cannot yet be estimated.

In the second quarter of 2008, four claims were filed against Bezeq International in the Tel Aviv and Central District Courts, concerning the use of international calling cards, together with applications for certification as class actions. The plaintiffs have applied for their claims to be certified as class actions on behalf of group that includes every person who, during the seven years prior to filing the claim and during the claim's proceeding, purchased phone cards of the type referred to in the claims. The plaintiffs estimate the loss sustained by all the members of the group by Bezeq International at NIS 1.1 billion. In the opinion of the management of Bezeq International, based, inter alia, on the opinion of its legal counsel, the maximum amount of the exposure (included in the abovementioned exposure) for these claims is negligible compared to the amount of the claim.

C. Supplier and communication provider claims

During the normal course of business, suppliers of goods and/or services and communications providers that the Group companies supply goods and/or services to or receive goods and/or services from filed various claims against the Group companies. These claims are usually for compensation for alleged damage as a result of the supply of the service and/or the product. On December 31, 2009, the total amount of these claims amounted to NIS 831 million. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 11 million, where provisions are required to cover the exposure resulting from such claims.

D. Claims for punitive damages

During the normal course of business, claims were filed against the Group companies for alleged physical damage or damage to property caused by the Group companies (including environmental quality and radiation). On December 31, 2009, the total amount of these claims amounted to NIS 1.1 billion (this amount does not include claims for which there is no dispute regarding the existence of insurance cover). In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 1.4 million, where provisions are required to cover the exposure resulting from such claims. In addition, of these claims, there are additional claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, in view of the fact that the precise amount of the claim is not noted in the claim.

NOTE 18 – CONTINGENT LIABILITIES (CONTD.)

E. Claims by entrepreneurs and companies

During the normal course of business, claims were filed against some of the Group companies or officers, claiming liability and/or negligence of the Group companies and/or their directors in respect of their activities and/or the investments made in various projects. On December 31, 2009, the total amount of these claims amounted to NIS 315 million. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 7 million, where provisions are required to cover the exposure resulting from such claims.

F. Claims by the State and authorities

During the normal course of business, various claims are pending against the Group companies by the State of Israel, government institutions and authorities ("the Authorities"). These are mainly procedures related to regulations relevant to the Group companies and financial disputes concerning monies paid by the Group companies to the Authorities (including property tax payments) or by the Authorities to the Group companies. On December 31, 2009, the total amount of these claims amounted to NIS 495 million. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 159 million, where provisions are required to cover the exposure resulting from such claims.

For claims against DBS, see Note 22 to the financial statements of DBS for 2009, attached to these financial statements.

NOTE 19 – AGREEMENTS

A. Lease and rental agreements

Contractual rental payments during the next five years, calculated according to the rent in effect at December 31, 2009, are as follows:

Year ended December 31	NIS millions
2010	**188**
2011	**146**
2012	**106**
2013	**69**
2014 onwards	**53**
	562

B. The Group has a number of operating lease agreements for periods of up to three years in respect of vehicles it uses. The contractual annual lease payments, calculated according to the payments in effect at December 31, 2009, are NIS 162 million.

NOTE 19 – AGREEMENTS (CONTD.)

C. Most of the Group companies are required to pay royalties to the Government of Israel. The rate of royalties paid was 2.5% in 2007, 2% in 2008, 1.5% in 2009, and in 2010, the rate of royalties paid will be 1%.

In October 2009, the Finance Committee of the Knesset ratified an amendment to the Communications Regulations (Telecommunications and Broadcasts) (Royalties), 5761-2001.The regulations include clarification of the royalties that a licensee owes the State. The amendment includes an exemption for the payment of royalties for revenue from high-speed communication services which commenced on January 1, 2004. As a result of this exemption, royalties expenses in the fourth quarter and in 2009 decreased by NIS 32 million.

D. Pelephone leases some of the sites from the Israel Lands Administration ("ILA"). Pelephone has an agreement for payments to which the Administration is entitled for the period through December 31, 2009. A further extension until December 31, 2010 was agreed upon.

E. For further information on the HSPA/UMTS network set up by Pelephone, see Note 10F above.

F. Agreement for the purchase and distribution of iPhone handsets
In May 2009, Pelephone signed an agreement with Apple Sales International ("the Manufacturer") for the acquisition and distribution of iPhone handsets in Israel. Under the agreement, Pelephone undertakes to purchase a minimum number of handsets every year for three years. These quantities are a significant part of the number of handsets expected to be sold by Pelephone during the agreement period and the agreement will constitute 5% of the cost of Pelephone's annual services and sales. Under the agreement, the cost of handsets for Pelephone depends on the prices in effect on the actual purchase date.

G. Acquisition of capacities
In June 2009, Bezeq International entered into an agreement with Mediterranean Nautilus Limited for the acquisition of an irrevocable right for use of seabed cable capacity, in a total amount of NIS 84 million. An appendix to this agreement was also signed, for the lease of additional capacities, which will become in the future, for further consideration, a purchase agreement for these capacities.

H. For agreements for the purchase of property, plant and equipment, see Note 10(I) above.

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NOTE 20 – SECURITIES, LIENS AND GUARANTEES

A. In May 2003, the Company provided, at the request of the Ministry of Communications, a bank guarantee of USD 10 million in connection with its general license for implementing telecommunications operations and for providing telecommunication services.

B. The Company provided a guarantee in favor of banks in connection with credit of up to NIS 70 million granted to a subsidiary.

C. The Company has received a demand for the forfeiture of a guarantee in the amount of approximately USD 5.9 million related to a project (HBTL) in a basic telephony tender in 1995 in India, in which the Company participated together with others. An appeal against an order given at the request of the venture and preventing forfeiture of the guarantees, is being heard in the Appeals department of the High Court in Delhi. The Company has applied to the court in India for release of the bank guarantees it provided. The court has not yet heard the application.

D. The Company provided a guarantee of NIS 10 million for DBS in respect of a bank guarantee of NIS 36 million, which DBS had provided in favor of the State of Israel. The guarantee is valid until December 31, 2010.

E. In February 2002 and May 2005, according to Ministry of Communications requirements, Bezeq International provided bank guarantees of NIS 9.4 million and NIS 1.5 million respectively, for fulfillment of all the terms of the license to provide international telecommunication services.
In February 2009, according to Ministry of Communications requirements, Bezeq International provided a bank guarantee of NIS 10 million to fulfill the terms of the special and general license for the provision of domestic operator services through the BIP Limited Partnership At the balance sheet date, Bezeq International had provided additional bank guarantees in a total amount of NIS 9 million.

F. Pelephone has bank guarantees of NIS 81 million in favor of third parties, of which NIS 38 million is in favor of the Ministry of Communications, in connection with a guarantee for fulfillment of the terms of its license.

G. To secure its liabilities, DBS provided guarantees amounting to NIS 39 million (including a bank guarantee of NIS 37 million in favor of the State of Israel).

H. The shareholders in DBS (except for the Company) have pledged their shares in favor of the banks. In view of a negative pledge of the Company, the Company provided the banks with a perpetual guarantee for payment of the debts of DBS. The guarantee is up to a maximum amount equal to the percentage of the Company's holding in DBS, multiplied by the value of DBS as derived from realization of the pledged shares of the other shareholders. If the Company joins the sale in the framework of realization of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the amount of the proceeds the Company will receive from realization of its shares in DBS. The note of guarantee includes numerous restrictions on the Company in realizing the shares it holds, and lists events of violation which, if committed, will enable the banks to call in the guarantee. Furthermore, the Company undertook to put its shares up for sale if the shares pledged to the bank are sold, and agreed that in the event of realization of collateral provided by the other shareholders, the Company would forgo repayment of shareholder loans provided for DBS and that the guarantee would apply, mutatis mutandis, also to stock options which the Company would receive from DBS and to the right to receive them.

Except for one, the shareholders in DBS have made a commitment to the banks not to oppose the sale or other realization of their shares in DBS, which were pledged or for which a guarantee was provided (by the Company), in a way that will enable the banks to accomplish a friendly liquidation.

I. For securities, charges and stipulations given by the Company and subsidiaries in connection with loan covenants and borrowings, see Note 14.

J. In respect of the securities, charges and stipulations recorded by DBS, see Notes 5 and 29 to the financial statements of DBS attached to these financial statements.

NOTE 21 – EQUITY

A. Share capital

	Registered		Issued and paid up	
	December 31 2009	December 31 2008	December 31 2009	December 31 2008
	No. of shares	No. of shares	No. of shares	No. of shares
Ordinary shares of NIS 1 par value each	**2,749,000,000**	2,749,000,000	**2,659,727,630**	2,605,045,611

B. On August 4, 2009, the board of directors resolved to distribute a dividend to the shareholders of 100% of the semi-annual profit ("profit for the period attributable to the shareholders of the Company"), in accordance with the consolidated financial statements of the Company. Application of the policy to distribute a dividend is subject to the provisions of the law, including the distribution criteria prescribed in the Companies Law, and the estimation of the board of directors of the Company regarding the Company's ability to meet its existing and anticipated liabilities, taking into consideration the projected cash flow, the Company's operations and liabilities, the cash balance, its plans and position as will be from time to time and subject to the approval of the general meeting of the Company's shareholders regarding any specific distribution, as set out in the articles of association of the Company.

C. The Company also issued stock options to employees, managers and senior employees in the Group (see Note 27).

D. Description of the funds

Translation fund
A translation fund includes all the foreign currency differences arising from translation of financial statements of a consolidated partnership whose functional currency is a foreign currency.

Capital reserve for activities between the Company and a controlling shareholder
This reserve relates to benefits granted by the State as controlling shareholder in the Company, to employees, in cash and in equity instruments of the Company.

Capital reserve for employee stock options
This reserve relates to a benefit granted to employees by means of share-based payments.

E. Dividends

The Company declared and paid dividends in 2008 and 2009 as follows:

	2009	2008
	NIS millions	NIS millions
In May 2009, a cash dividend was distributed (NIS 0.3 per share)	**792**	-
In October 2009, a cash dividend was distributed (NIS 0.43 per share)	**1,149**	-
In April 2008, a cash dividend was distributed (NIS 0.26 per share)	**-**	679
In October 2008, a cash dividend was distributed (NIS 0.32 per share)	**-**	835
	1,941	1,514

NOTE 21 – EQUITY (CONTD.)

F. On March 2, 2010, the board of directors of the Company resolved to recommend to the general meeting of the shareholders of the Company the distribution of a cash dividend to the shareholders in the amount of NIS 2.453 billion, representing approximately NIS 0.922 per share at the distribution date. The percentage of the dividend actually paid will be determined according to the Company's issued and paid up capital at the end of the business day on April 15, 2010 ("the date of record").

NOTE 22 – REVENUE

	Year ended December 31		
	2009	**2008***	**2007***
	NIS millions	**NIS millions**	**NIS millions**
Domestic fixed-line communications			
Fixed line telephony	**3,247**	3,472	3,804
Internet - infrastructure	**862**	790	711
Transmission, data communication and other	**940**	981	939
	5,049	5,243	5,454
Cellular			
Cellular services and terminal equipment	**4,013**	3,758	3,670
Sale of terminal equipment	**1,119**	692	711
	5,132	4,450	4,381
International communications, internet services and NEP	**1,276**	1,263	1,252
Others	**62**	59	49
	11,519	11,015	11,136

* Restatement due to discontinued operations, see Note 5

NOTE 23 - SALARIES

	Year ended December 31		
	2009	**2008***	**2007***
	NIS millions	**NIS millions**	**NIS millions**
Salaries and incidentals:			
Operating	**1,670**	1,660	1,717
General and administrative	**655**	651	659
Share-based payments	**45**	73	-
Total salaries and incidentals	**2,370**	2,384	2,376
Less – salaries recognized in investments in property, plant and equipment and in intangible assets	**380**	223	184
	1,990	2,161	2,192

* Restatement due to discontinued operations, see Note 5

NOTE 24 – OPERATING AND GENERAL EXPENSES

	Year ended December 31		
	2009	**2008***	**2007***
	NIS millions	**NIS millions**	**NIS millions**
Cellular telephone expenses	**1,750**	1,725	1,828
General expenses	**1,140**	1,008	1,064
Materials and spare parts	**1,003**	831	951
Building maintenance	**295**	204	316
Services and maintenance by sub-contractors	**146**	312	219
International communication expenses	**313**	272	337
Vehicle maintenance expenses	**124**	158	153
Royalties to the State of Israel	**66**	116	173
Collection fees	**34**	34	34
	4,871	4,660	5,075

* Restatement due to discontinued operations, see Note 5

NOTE 25 – OTHER OPERATING EXPENSES, NET

	Year ended December 31		
	2009	**2008**	**2007**
	NIS millions	**NIS millions**	**NIS millions**
Provision for severance pay in early retirement	**267**	165	51
Capital gain from sale of property, plant and equipment (mainly real estate)	**(64)**	(18)	(105)
Capital gain from sale of satellite communication operations	**-**	(50)	-
Provision for contingent liabilities, net	**(2)**	(5)	80
Impairment of long-term loans and others	**-**	4	13
	201	96	39

NOTE 26 - FINANCING INCOME (EXPENSES), NET

	Year ended December 31		
	2009	2008*	2007*
	NIS millions	NIS millions	NIS millions
Interest income from bank deposits, investments and other	**16**	62	115
Net change in fair value of financial assets measured at fair value in profit or loss (mainly for forward transactions)	**61**	-	169
Income in respect of credit in sales, net of discount commission	**83**	69	63
Income from available-for-sale financial assets	**23**	-	6
Net exchange differences	**6**	-	-
Interest and linkage differences from loans to an associate	**198**	189	42
Other finance income	**42**	34	39
Total finance income	**429**	354	434
Interest expenses for financial liabilities	**185**	192	291
Linkage differences, net	**140**	188	133
Net exchange differences	**-**	3	113
Net change in fair value of financial assets measured at fair value through profit or loss	**-**	24	-
Impairment for financial assets available-for-sale	**-**	13	10
Other financing expenses	**73**	74	69
Total financing expenses	**398**	494	616
Financing income (expenses), net (1)	**31**	(140)	(182)
(1) Less amounts capitalized in the amount of	**6**	35	2
Income (expense) recognized directly in other comprehensive income	**-**	(5)	4

* Restatement due to discontinued operations, see Note 5

NOTE 27 – SHARE-BASED PAYMENT

A. (1) Following a public offering under a prospectus of the Company and the State on May 24, 2004, and closing the sale of core control in the Company from the State to Ap.Sb.Ar. on October 11, 2005, Company employees received payment in respect of those sales by means of grant of 4.71% of the shares of the Company held by the State. Allocation of the shares will be by means of a stock options plan as described in the outline published by the Company on November 15, 2005. The final date for exercising the options under the plan was on December 10, 2009 and the plan expired immediately thereafter.

(2) In February 2007, the board of directors of the Company approved an employee stock option plan for 3% of the issued and paid up capital of the Company, under the collective agreement with the employees of December 2006. On March 25, 2007, 78,092,000 options were allocated, and on January 2, 2008 another 59,000 options were allocated to two employee-directors. The value of the grant was determined at February 22, 2007, which is the grant date.

(3) On November 20, 2007, the board of directors of the Company resolved to adopt a new stock option plan for managers and senior employees in the Company and/or in associates, which would allocate up to 65,000,000 non-negotiable options exercisable for up to 65,000,000 shares of the Company and representing 2.5% of the issued capital of the Company, and at full dilution, 2.37% of the share capital.

The stock option plan and the allocation of the options under it, were approved by the general meeting of the Company on January 31, 2008, in accordance with the Company's Articles of Association.

Exercise of the options under the plan was contingent upon obtaining the necessary approvals as prescribed in the provisions of the Telecommunications Order (Telecommunications and Broadcasts) (Determination of Essential Service Provided by Bezeq The Israel Telecommunication Corp. Ltd.), 5757-1997 (the Telecommunications Order) if the holdings of the controlling shareholder of the Company fall below the minimum prescribed in the Telecommunications Order.

The options will vest in three equal annual portions. The vesting dates of each portion will fall at the end of each of the first, second and third years after the grant date, respectively, and the expense for each portion will be spread over its vesting period. In addition, the plan sets terms which, if met, bring forward the vesting date.

Exercise of the options for shares will be by using a cashless exercise mechanism, unless the Board of Directors decides otherwise.

NOTE 27 – SHARE-BASED PAYMENT (CONTD.)

B. Of the options for managers and senior employees, at the date of the financial statements, 64,250,000 options have actually been allocated (which have been partially forfeited and returned to the quantity of options for allotment), as follows:

(1) 55,250,000 options, with a theoretical economic value of NIS 149 million (of which 17,750,000 options, which were allotted in 2008 to the CEO of the Company and to senior officers who are key personnel in the Group with a theoretical economic value of NIS 45 million and 100,000 options, which were allotted in 2009 to an employee director with a theoretical economic value of NIS 303,000), based, inter alia, on the share price on the grant date, a risk-free annual interest rate of between 3.7% and 5.7%, a weighted average life expectancy of between 4.5 and 5.5 years, an exercise price between NIS 5.5 and NIS 8.24, an annual standard deviation between 22.7% and 26.6%. The grant date was set as the later of the date of the general meeting and the date of the notice to the employees. The restriction described above by virtue of the Telecommunications Order was taken into account in calculating the theoretical economic value of the options, assuming that the restriction can be resolved.

The exercise price set for the allotment of 49,950,000 options (out of 55,250,000, as set out above), is NIS 5.5 (adjusted for distribution of a dividend in cash or in kind). On June 26, 2008, the board of directors of the Company resolved that the exercise price for future allotments of options, as will be approved by the board of directors from time to time, will be the same as the average closing price of the Company's share on the stock exchange in the 30 trading days prior to the date of the board's decision to allot options to these offerees.

Following the expected change in control in the Company, on December 31, 2009, the board of directors approved the adoption of a retention plan for senior officers in the Group (CEOs of the Company, Pelephone and Bezeq International). Under the plan, each of the CEOs will receive a retention bonus of nine monthly salaries (subject to certain conditions) and their options agreements will be amended such that in the event of dismissal within one year (compared to six months under the outline) from the date of transfer of control, the vesting period of the balance of the unvested options at the dismissal date will be accelerated. The effect of the amendment on the options agreements is not expected to be material.

(2) On April 17, 2008, the board of directors of the Company resolved to allocate 9,000,000 options to the chairman of the board of directors in accordance with the plan described in section A(3) above, subject to a number of changes relating to the terms of his options. The allocation to the chairman was approved by the general meeting of the shareholders of the Company on June 1, 2008.

The options will vest in 12 equal quarterly portions. The vesting dates of each portion will fall at the end of each quarter from the grant date, and the expense will be spread for each portion in accordance with its vesting period. In addition, the plan sets terms which, if met, bring forward the vesting date.

The exercise price of each option is NIS 6.4405 per share. The price was set according to the share price on the date on which the chairman took up his post – September 4, 2007 (which was NIS 6.649 per share) and after adjustment for distribution of a net dividend in the amount of NIS 0.26 per share, for which the ex-day was April 14, 2008. The closing price of the Company's share on June 1, 2008, the date of approval by the general meeting, was NIS 6.494 per share.

The theoretical economic value of the options granted to the chairman as described above, according to a weighted Black and Scholes model, is NIS 16 million, based, inter alia, on the share price on the grant date, a risk-free annual interest rate of 5.1%, a weighted average life expectancy of 4 years, the exercise price noted above, annual standard deviation of 23.11%, and a solution to the restriction described in section A(3) above imposed by the Telecommunications Order.

NOTE 27 – SHARE-BASED PAYMENTS (CONTD.)

C. The terms of the options

Date of grant / eligible employees	No. of instruments (in thousands)	Vesting terms	Contractual life of the options
A. Grant of options from the State to employees on October 11, 2005	122,698	, Immediate (subject to lock-up, commencing at the end of 2 years for 3 years (one third each year)	4 years
B. Grant of options to employees on February 22, 2007 (1)	78,151	Immediate (subject to lock-up for two years)	5 years
C. Grant to the chairman of the board on April 17, 2008	9,000	12 quarterly portions	4 years
D. Approval and/or grant of options , to managers, senior employees and officers up to December 31, 2009	55,250	Three equal annual portions	8 years
Total stock options granted	265,099		

(1) The expenses in respect of this grant were recorded in 2006, since in that year a promise was made to the employees, with the terms of the grant.

(2) The options referred to sections A and B are settled by way of physical delivery of shares. The options referred to in C and D are settled in a cashless exercise mechanism.

D. Number of options and weighted average of the exercise price

	No. of options Year ended December 31,	
	2009 (in thousands)	2008 (in thousands)
Balance at January 1	**223,399**	200,849
Options granted during the year	**2,700**	61,550
Options forfeited during the year	**(1,267)**	(4,000)
Options exercised during the year	**(142,278)**	(35,000)
Options expired during the year	**(477)**	-
Balance at the end of the year	**82,077**	223,399
Exercisable at the end of the period subject to lock-up	**-**	119,050
Exercisable at the end of the period, not subject to lock-up	**43,777**	48,299

The average share price in 2009 and 2008 was NIS 7.47 per share and 6.409 per share, respectively.

For the balance of the options issued at December 31, 2009, the exercise price is in the range of NIS 1.91 to NIS 8.24, and the weighted average of the remaining contractual life is 4.61 years.

NOTE 27 – SHARE-BASED PAYMENTS (CONTD.)

E. Additional details concerning share-based payments settled in derivatives:

The fair value of services received in consideration of the share options is based on the fair value of the options granted, measured according to the Black and Scholes model on the basis of the following parameters:

	Year ended December 31	
	2009	**2008**
Weighted average of the fair value at the grant date	**NIS 2.27**	NIS 2.65
Share price	**NIS 6.5-8.4**	NIS 6.18-7.049
Exercise price	**NIS 5.97-8.24**	NIS 5.5-6.44
Expected fluctuations	**26% - 24.6%**	22.7% - 24.3%
Contractual life of the option	**4-5.5 years**	4-5.5 years
Risk-free interest rate (based on government bonds)	**4.9% - 3.7%**	5.09% - 5.68%

Due to the method for adjusting exercise increment to distribution of a dividend, an expected dividend percentage of 0% was assumed when calculating fair value.

F. Salary expense for share-based payments

	Year ended December 31		
	2009	**2008**	**2007**
	NIS millions	**NIS millions**	**NIS millions**
Share options granted in 2008 and 2009 (1)	**45**	75	-

(1) Calculation of the salary expense assumed 5% for forfeiture, for each year.

G. Subsequent to the balance sheet date, in January 2010, the board of directors of the Company approved the allotment of 700,000 options to senior employees in the Group under the plan described in section B above. The theoretic economic value of the options that were allotted, calculated at the allotment date, based on the Black and Scholes model, is NIS 1.8 million.

Additionally, subsequent to the balance sheet date, the employees exercised another 936,000 options.

H. For the agreements for options granted to the employees and CEO of DBS, see Note 20 to the financial statements of DBS for 2009, which are attached to the Company's financial statements.

NOTE 28 – EARNINGS PER SHARE

Basic and diluted earnings per share

Calculation of the basic and diluted earnings per share based on the profit relating to the ordinary shareholders, and on a weighted average number of ordinary shares in circulation, is as follows:

	2009	2008*	2007*
	NIS millions	NIS millions	NIS millions
Profit attributable to the ordinary shareholders			
Profit attributable to ordinary shares from continuing operations	**2,157**	1,781	1,398
Profit (loss) attributable to ordinary shares from discontinued operations	**1,446**	(154)	(68)
Basic and diluted Profit for the year	**3,603**	1,627	1,330
Weighted average of the number of regular shares			
Weighted average of the number of ordinary shares (basic)	**2,635**	2,605	2,605
Effect of options on shares	**49**	44	36
Weighted average of the number of ordinary shares (diluted)	**2,684**	2,649	2,641

The average market value of the Company's shares, for calculating the diluting effect of the options on the shares, was based on the market prices in the period during which the options were in circulation.

* Restatement due to discontinued operations, see Note 5

NOTE 29 – SEGMENT REPORTING

The Group operates in various segments in the communications sector, so that every company in the Group operates in one separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and infrastructure it owns. The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly in the matter of the technology and competition in the segment in which it operates.

Accordingly, the separable component in the Group is each company in the Group.

Commencing from August 21, 2009, the Company no longer consolidates the reports of DBS in its financial statements and its investment in DBS is stated according to the equity method commencing from that date (see Note 5). The Group continues to report on multichannel television as a segment.

Based on the above, the business segments of the Group are as follows:

- Bezeq, The Israel Telecommunication Corp. Ltd.: fixed line domestic communications
- Pelephone Communications Ltd.: cellular communications
- Bezeq International Ltd.: international communications, internet services and network end point
- D.B.S. Satellite Services (1998) Ltd.: multi-channel television

The other companies in the Group are presented under the "Others" item. Other operations include Bezeq On-line and StageOne. These operations are not recognized as reporting segments as they do not fulfill the quantitative thresholds.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

The results, assets and liabilities of a segment include items directly attributable to that segment, as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the period for acquisition of property, plant and equipment and intangible assets.

NOTE 29 – SEGMENT REPORTING (contd.)

A. Operating segments

	Year ended December 31, 2009						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external entities	5,039	5,130	1,273	1,529	54	(1,529)	11,496
Inter-segment revenues	264	246	45	1	20	(553)	23
Total revenue	5,303	5,376	1,318	1,530	74	(2,082)	11,519
Depreciation and amortization	794	603	84	234	4	(234)	1,485
Segment results – operating profit	1,523	1,190	261	248	4	(254)	2,972
Finance income	310	90	15	8	23	(17)	429
Finance expenses	(295)	(100)	(12)	(478)	-	487	(398)
Total finance income (expense), net	15	(10)	3	(470)	23	470	31
Segment profit (loss) after finance expenses, net	1,538	1,180	264	(222)	27	216	3,003
Share in earnings of equity-accounted investees	-	-	7	-	-	(41)	(34)
Segment profit (loss) before income tax	1,538	1,180	271	(222)	27	175	2,969
Profit from discontinued operations	-	-	-	-	-	1,379	1,379
Income tax	(431)	(305)	(71)	(1)	(2)	3	(807)
Segment results - net profit (loss)	1,107	875	200	(223)	25	1,557	3,541
Additional information:							
Segment assets	6,368	4,990	1,066	1,206	85	(2,026)	11,689
Goodwill	-	-	6	-	-	1,027	1,033
Investment in associates	-	-	34	-	-	1,185	1,219
Segment liabilities	6,390	2,440	404	4,314	22	(6,167)	7,403
Capital expenditures/contractual investments in property, plant and equipment and intangible assets	838	508	151	270	3	(102)	1,668

NOTE 29 – SEGMENT REPORTING (contd.)

A. Operating segments (contd.)

	Year ended December 31, 2008						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external entities	5,179	4,448	1,243	1,506	31	(1,506)	10,901
Inter-segment revenues	319	265	63	7	44	(584)	114
Total revenue	5,498	4,713	1,306	1,513	75	(2,090)	11,015
Depreciation and amortization	852	523	80	250	3	(250)	1,458
Segment results – operating profit	1,475	933	242	177	-	(187)	2,640
Finance income	236	117	7	52	1	(59)	354
Finance expenses	(361)	(115)	(8)	(493)	(18)	501	(494)
Total finance income (expense), net	(125)	2	(1)	(441)	(17)	442	(140)
Segment profit (loss) after finance expenses, net	1,350	935	241	(264)	(17)	255	2,500
Share in earnings of equity-accounted investees	-	-	5	-	-	-	5
Segment profit (loss) before income tax	1,350	935	246	(264)	(17)	255	2,505
Loss from discontinued operations	-	-	-	-	-	(265)	(265)
Income tax	(400)	(253)	(68)	(1)	-	3	(719)
Segment results - net profit (loss)	950	682	178	(265)	(17)	(7)	1,521
Additional information:							
Segment assets	6,281	4,644	956	1,132	100	(624)	12,489
Goodwill	-	-	6	-	-	1,787	1,793
Investment in associates	-	-	32	-	-	-	32
Segment liabilities	6,037	2,552	284	4,024	29	(2,856)	10,070
Capital expenditures/contractual investments in property, plant and equipment and intangible assets	600	911	120	265	2	-	1,898

NOTE 29 – SEGMENT REPORTING (contd.)

A. Operating segments (contd.)

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external entities	5,373	4,380	1,226	1,403	18	(1,403)	10,997
Inter-segment revenues	340	304	78	12	46	(641)	139
Total revenue	5,713	4,684	1,304	1,415	64	(2,044)	11,136
Depreciation and amortization	941	479	86	273	3	(273)	1,509
Segment results – operating profit	1,319	805	204	56	-	(63)	2,321
Finance income	308	109	12	13	12	(20)	434
Finance expenses	(496)	(114)	(11)	(181)	(2)	188	(616)
Total finance income (expense), net	(188)	(5)	1	(168)	10	168	(182)
Segment profit (loss) after finance expenses, net	1,131	800	205	(112)	10	105	2,139
Share in earnings of equity-accounted investees	-	-	6	-	-	-	6
Segment profit (loss) before income tax	1,131	800	211	(112)	10	105	2,145
Loss from discontinued operations	-	-	-	-	-	(118)	(118)
Income tax	(394)	(215)	(58)	(6)	-	7	(666)
Segment results – net profit (loss)	737	585	153	(118)	10	(6)	1,361

NOTE 29 – SEGMENT REPORTING (CONTD.)

B. Adjustments for segment reporting of revenue, profit or loss, assets and liabilities

	Year ended December 31		
	2009	2008*	2007*
	NIS millions	NIS millions	NIS millions
Revenue			
Revenue from reporting segments	**13,527**	13,030	13,116
Revenue from other segments	**74**	75	64
Cancellation of revenue from inter-segment sales except for revenue from sales to an associate reporting as a segment	**(553)**	(584)	(641)
Cancellation of revenue for an associate reporting as a segment (up to August 20, 2009 – discontinued operations)	**(1,529)**	(1,506)	(1,403)
Consolidated revenue	**11,519**	11,015	11,136

* Restatement due to discontinued operations, see Note 5

	Year ended December 31		
	2009	2008*	2007*
	NIS millions	NIS millions	NIS millions
Profit or loss			
Operating profit or loss for reporting segments	**3,216**	2,817	2,377
Profit or loss for other categories	**4**	-	-
Cancellation of expenses from an associate reporting as a segment (up to August 20, 2009 – discontinued operations)	**(248)**	(177)	(56)
Finance income (expenses), net	**31**	(140)	(182)
Share in the profits (losses) of equity- accounted investees	**(34)**	5	6
Consolidated profit before income tax	**2,969**	2,505	2,145

* Restatement due to discontinued operations, see Note 5

NOTE 29 –SEGMENT REPORTING (CONTD.)

B. Adjustments for segment reporting of revenue, profit or loss, assets and liabilities (contd.)

	December 31	
	2009	2008
	NIS millions	NIS millions
Assets		
Assets from reporting segments	**13,670**	13,051
Assets attributable to operations in other categories	**85**	100
Goodwill not attributable to an operating segment	**1,027**	1,787
Investment in an equity-accounted investee (mainly loans) reported as a segment	**1,185**	-
Cancellation of assets for a segment classified as an associate	**(1,206)**	-
Less inter-segment assets	**(820)**	(624)
Consolidated assets	**13,941**	14,314
Liabilities		
Liabilities from reporting segments	**13,548**	12,897
Liabilities attributable to operations in other categories	**22**	29
Cancellation of liabilities for a segment classified as an associate	**(4,314)**	-
Less inter-segment liabilities	**(1,853)**	(2,856)
Consolidated liabilities	**7,403**	10,070

NOTE 30 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. The Company and its investees provide a range of communication services. Among the entities to which the Company and its subsidiaries provide the services, there are also interested parties in the Company, including Ap.Sb.Ar. which held 30.61% of the Company's shares at December 31, 2009 and Amitim (Pension Funds Under Special Management), which held 7.35% of the Company's shares at December 31, 2009 (the Zeevi Group, which held 17.75% of the Company's shares through a receiver appointed for those shares on behalf of certain banks, ceased being an interested party in the Company on November 9, 2009).

In view of the above, the services provided to them by the Company and its subsidiaries are negligible transactions, and accordingly, in accordance with Article 41(A)(6) of the Securities Regulations (Preparation of Annual Financial Statements), 5770-2010 ("the Regulations"), they are not described in these financial statements.

Following the amendment to the Securities Regulations (Preparation of Annual Financial Statements, Amended, 5765-2005), the Company presented its transactions with the State of Israel, which was an interested party in Bezeq, as transactions with an interested party. Following the exercise of options for purchase of shares at the end of September 2008 by the controlling shareholders of the Company, Ap. Sb. Ar. Holdings Ltd. for the purchase of the balance of the State's holdings in the Company, the State is no longer an interested party in the Company.

Accordingly, at December 31, 2009 and 2008, the balance is not stated in the statement of financial position as a result of transactions with the State as a related party, and the balance of the results of the transactions with the State include the period of January 2008 - September 2008 as a transaction with a related party. For information on royalties to the State, see Note 19(C).

B. On July 29, 2007, an agreement was signed (after being approved by the general meeting of the shareholders of the Company on March 23, 2006) with a corporation owned and controlled by the shareholders of Ap.Sb.Ar., whereby the Company will be granted regular management and consultation services, including by means of currently-serving and future directors of the Company and/or its subsidiaries, all for a consideration of USD 1.2 million per year. The term of the agreement is from October 11, 2005 (the date on which Ap.Sb.Ar. purchased 30% of the shares of the Company), and ends on December 31, 2008. On September 28, 2008, the general meeting of shareholders of the Company approved an extension of the management agreement for an additional period of three years, under the same terms as the original agreement.

C. For the sake of caution, and in view of a possible personal interest for Ap.Sb.Ar. in agreements of Group companies, as a supplier and/or customer, with companies of the 012 Smile Group, on November 4, 2009 the board of directors of the Company approved the agreements between the parties for a period of six months. The transactions are for an annual volume of NIS 745 million, mainly for the acquisition and sale of equipment and services, service agreements and agreements for marketing alliances that were made routinely between the parties before the agreement between Ap.Sb.Ar. and 012 Smile and are continuing and/or renewed after that date as well. There are several agreements, none of which will have a material effect on the Company's profitability, assets or liabilities. In addition, all the transactions are during the regular course of business between the parties and in market conditions. Subsequently in February, 2010, 012 Smile sold its communications operations to a third party.

NOTE 30 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

D. Transactions with interested and related parties

	Year ended December 31		
	2009	2008	2007
	NIS millions	NIS millions	NIS millions
Revenue			
From the State of Israel *	**-**	273	365
Associates	**224**	302	181
Expenses			
To the State of Israel *			
Royalties	**-**	102	194
Frequencies	**-**	21	25
Associates	**3**	7	17
Investments			
Rights to frequencies *	**-**	181	-

* Up to September 25, 2008, when the State ceased to be an interested party in the Company
For other balances with related parties, see the relevant notes.

E. Balances with interested and related parties

	December 31
	2009
	NIS millions
Current assets	
Trade receivables - associate	**70**
Non-current assets	
Trade and other receivables - associate	**8**
Loans to affiliates	**1,165**
Current liabilities	
Trade payables - associates	**(8)**

NOTE 30 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

F. Benefits for key managers

Benefits for employment of key managers, including:

	Year ended December 31			
	2009		2008	
	No. of persons	NIS thousands	No. of persons	NIS thousands
Salary (2)	**4**	**9,544**	5	10,355
Bonus (3)	**4**	**8,713**	5	8,959
Share-based payments (see Note 27)	**4**	**15,712**	5	30,024
		33,969		49,338

(1) Key managerial personnel in the Group in 2009 include the Chairman of the Board and the CEO of the Company, as well as the CEOs of Pelephone and Bezeq International. In 2008, the CEO of DBS was also included among the key managers.

(2) Changes in other provisions (which are included in total salary) are not material. In 2008, the changes in the other provisions were not significant, except for a decrease in the provision for notice for the CEO of the Company, in the amount of NIS 746,000, in accordance with his employment agreement.

(3) The bonus for 2009 to the chairman of the board, NIS 3.444 million, requires the approval of the general meeting of the shareholders of the Company.

	Year ended December 31	
	2007	
	No. of persons	NIS thousands
Total cost of salary (1)(2)	3	10,479

(1) Key managerial personnel in 2007 include the Chairman of the Board and the CEO of the Company.

(2) Including salary and bonuses to former CEO and chairman and to the present CEO in respect of his term of office as former CEO of Bezeq International. The salary of the chairman includes NIS 4.6 million, based on the estimated cost of salary and future payments. The cost does not include this provision, nor the salary and payments to whoever served as Acting CEO in the period from April 1, 2007 to June 26, 2007, nor special compensation to the former CEO of the Company, Amnon Dick.

In 2006, the outgoing CEO of the Company received a bonus of NIS 2.4 million. The Company decided that if this bonus is not returned to the Company, it will institute legal proceedings to collect the debt. However, the outgoing CEO has allegations that are denied by the Company.

NOTE 30 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits for directors

	Year ended December 31		
	2009	2008	2007
	NIS millions	NIS millions	NIS millions
Remuneration for directors who are not employed by the Company (1)	**705**	619	372
Number of directors receiving remuneration	**2**	3	4
Salary of employee-directors (2)	**1,450**	1,120	996
Number of directors receiving the salary	**2**	2	2
Management fees to a controlling company	**4,692**	4,238	5,127

(1) From the date of transfer of control in the Company to Ap.Sb.Ar., the directors serving on the board of directors of the Company, except for the external directors, do not receive compensation from the Company.

(2) Salary paid to employee-directors in respect of their work in the Company; they do not receive any additional pay in respect of their service as directors in the Company. For the matter of stock options allocated to them in 2006 and the resolution of the board of directors of the Company concerning an additional allocation to an employee-director on January 21, 2009, see Note 27.

(1) In December 2003, the general meeting of the shareholders of the Company approved a liability to indemnify officers of the Company in the matter of the framework agreement signed between the Company and the State, including in connection with an allotment of shares to the State pursuant to the framework agreement. The liability was limited to NIS 890 million (the amount of capital raised), linked to the CPI published subsequent to completion of raising the capital for the Company in accordance with the framework agreement.

(4) In May 2004, the general meeting of the shareholders of the Company approved an undertaking to officers for indemnification and insurance, as follows:

A. An undertaking of the Company regarding the provision of a loan to officers to finance reasonable litigation expenses in legal proceedings, and an undertaking of the Company to purchase insurance policies for officers at a reasonable cost.

B. Grant of deeds of indemnity in advance to officers of the Company in the following matters:

(1) A claim of a shareholder who held 15% or more of the share capital of the Company. The total amount of indemnity will not exceed USD 150 million, plus USD 30 million for legal expenses (a claim of this kind was excluded under the officers' insurance policies of the Company).

(2) In all matters relating to a prospectus for an offering of the Company's securities by the State of Israel and an offering by the Company, which was published at the end of May 2004. The total amount of the indemnity (including undertakings to indemnify in advance which were given until publication of the prospectus and for undertakings to indemnify in advance which will be given, if given, immediately prior to the transfer of control in the Company by the State), will not exceed 25% of the equity of the Company (according to the 2003 financial statements, linked to the CPI of November 2003).

NOTE 30 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits for directors (contd.)

(5) In April 2004, the board of directors of the Company resolved that the Company will indemnify the employees of the Group who participated in the preparation of the prospectus published in May 2004, and who are not officers of the Company, for a financial liability which would be imposed upon them and for reasonable litigation expenses they would incur, regarding all matters relating to the prospectus, in the format of the deed of indemnity which was given to the officers.

(6) In April 2005, the general meeting of the shareholders approved an indemnification commitment in respect of a financial liability that would be imposed on officers of the Company and in respect of reasonable litigation expenses which they would incur, relating directly or indirectly to a proceeding for the sale of the State's holdings in the Company.

The indemnification commitment will be provided to officers who served and/or were appointed and/or will be appointed by the Company, commencing from the start of the Company's preparations for the sale and until the date of the closing of the sale proceedings.

The total amount of the indemnification will not exceed 25% of the equity of the Company (according to the 2004 financial statements, linked to the CPI of November 2004), including in respect of undertakings to indemnify in advance which were provided through the date of issuance of the deed of indemnity, together with an undertaking to indemnify in advance in accordance with the letter of the Minister of Finance dated April 21, 2004, which will be given, if given, immediately prior to the transfer of the controlling interest in the Company by the State.

(7) In January 2007, the general meeting of the Company approved a liability to indemnify the officers in the Company in accordance with the deed of indemnity, for any liability or expense imposed on the officer due to his actions in his capacity as an officer in the Company (including his actions in subsidiaries), within the limitations provided in the Companies Law. The total amount of the indemnity was limited to a ceiling of 25% of the equity of the Company as may be at the time of actually paying the indemnity. The deed of indemnity will apply to types of events listed in an addendum to the deed. Subsequently, approval was given for liability to indemnify new officers who joined the Company.

(8) In December 2007, the general meeting of the shareholders of the Company approved a "framework transaction" for the Company's engagement, during the normal course of business, in future insurance policies (after expiry of the policy approved at the same general meeting) to cover the liability of directors and officers as may be from time to time, including directors and officers who are or who are likely to be considered controlling shareholders in the Company, all the officers in companies in which the Company holds 50% or more, officers representing the Company in companies in which the Company holds 20% or more, and senior employees who are not officers, for managerial actions taken by them, and all by way of a "framework transaction" as defined in the Companies Regulations (Reliefs in Transactions with an Interested Party), 5760-2000, at an annual premium of up to USD 510,000 plus a sum constituting up to 20% of that premium in respect of the current insurance cover.

(9) In December 2009, the board of directors of the Company approved the renewal of a liability insurance policy for officers in the Company, under the framework agreement approved by the general meeting of the Company's shareholders in December 2007. This is effective from November 1, 2009 to October 10, 2010 (with an option to extend the policy until October 31, 2010, for no further consideration, subject to due approval). The liability limit is $100 million per claim and in total for all claims in the insurance period. In addition the liability limit, in respect of legal expenses in Israel only, is $20 million per claim and in total for all claims in the insurance period. The liability limit for subsidiaries is $50 million (as part of the aforementioned liability limit). The annual premium for the policy is approximately $313,650.

NOTE 30 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits for the directors (contd.)

(10) In January 2010, the board of directors of the Company entered into an agreement to purchase an officers' insurance policy, under the framework agreement which was approved by the general meeting of the Company's shareholders in December 2007, from the expiry date of the of the ongoing directors' and officers' liability policy (the date of transfer of control from Ap.Sb.Ar. Holdings Ltd. to 012 Smile Communications Ltd., and up to October 10, 2010. The liability limit is up to $50 million for claims and in total for each insurance year. In addition, the liability limit is up to $10 million per claim and in total for the insurance period for legal expenses in Israel only. The liability limit for subsidiaries is half of this amount (as part of the above liability limit). The annual premium for the policy is up to $188,500. This policy replaces the Company's existing insurance policy, which was approved by the board of directors of the Company in December 2009.

(11) In January 2010, the board of directors of the Company approved the conversion of the directors and officers' insurance policy in the Company to a run-off policy, commencing from the date of transfer of control from Ap.Sb.Ar. Holdings Ltd. to 012 Smile Communications Ltd., (insofar as transfer of control is completed), and for a period of seven years from this date (the date of transfer of control from Ap.Sb.Ar. Holdings Ltd. to 012 Smile Communications Ltd. The limit of liability is up to $50 million for claims and in total for the insurance period. In addition, the liability limit is up to $10 million per claim and in total for the insurance period for legal expenses in Israel only. The liability limit for subsidiaries is half of this amount (as part of the above liability limit). The annual premium for the policy is up to $380,500. This insurance is subject to the approval of the general meeting, which is expected to convene on March 8, 2010.

H. For guarantees to related parties, see Note 20.

I. For the retention plan for the CEOs of the Company, Pelephone and Bezeq International, see Note 27.

NOTE 31—FINANCIAL RISK MANAGEMENT

A. General

The Group is exposed to the following risks, arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (which includes currency, interest and other price risks)

This Note provides information about the Group's exposure to each of the above risks, an explanation as to how the risks are managed, and the measurement processes. Other quantitative disclosure is included in the other Notes to the financial statements.

B. Framework for risk management

The board of directors has overall responsibility for the Group's risk management. The purpose of risk management in the Group is to define and monitor those risks constantly, and to minimize their possible effects arising from the exposure on the basis of assessments and expectations for parameters that affect the risks. The Group's policy is to hedge, in part and where required, exposure from fluctuations in foreign exchange rates, the CPI and interest rates.

NOTE 31—FINANCIAL RISK MANAGEMENT (CONTD.)

C. Credit risk

Credit risk is the risk of financial loss to the Group if a customer or the other party to a financial instrument fails to meet its contractual obligations, and it is derived mainly from debit balances of customers and other receivables and from investments in deposits and in securities.

Management monitors the Group's exposure to credit risks on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks and credit assessments are made on material customer balances.

Trade and other receivables
The Group's management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in the management's estimation, the loss inherent in doubtful debts. In addition, the balances of the trade receivables are widely spread.

Investments
Any investments in securities are made in government securities and in investment-grade companies, which are liquid and negotiable. Transactions involving derivatives are made with entities that have a high credit rating.

Guarantees
The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking liabilities of subsidiaries. At December 31, 2009, the Group has the guarantees described in Note 20.

At the reporting date, there is no material concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the balance sheet.

D. Liquidity risk

Liquidity risk is the risk that the Group will be unable to honor its financial liabilities on time. The Group's policy for liquidity management is to ensure, as far as possible, that it will always have sufficient liquidity to honor those liabilities on time, without incurring undesirable losses. In addition, for debentures issued by the Company, see Note 14(B)(3) and for debentures issued by a subsidiary, see Note 14B(4).

E. Market risk

Market risk is the risk that changes in market prices, such as foreign currency exchange rates, interest rates and the prices of securities, raw materials and other items, will influence the Group's results or the value of its holdings in financial instruments. The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters to prevent significant exposures to market risks that will influence the Group's results, liabilities and cash flow in the short term (up to one year).

During the normal course of its business, the Group takes full or partial hedging action and takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in managing its investment portfolio.

<u>CPI risk</u>
Changes in the rate of inflation affect the Group's profitability and its future cash flows, mainly due to its CPI-linked liabilities. The Group has surplus liabilities over assets linked to the CPI. In applying a policy of minimizing the exposure, the Group makes forward transactions against the CPI. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposures. A considerable part of the cash balances is invested in deposits which are exposed to changes in their real value as a result of a change in the rate of the CPI.

NOTE 31—FINANCIAL RISK MANAGEMENT (CONTD.)

E. Market risks

Foreign currency risk

The Group is exposed to foreign currency risks mainly due to dollar-linked and euro-linked payments for purchases of terminal equipment and property, plant and equipment. In addition, it provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the dollar. The Group has surplus liabilities over assets in foreign currency. In applying a policy of minimizing the exposure, the Group makes forward transactions and purchases options against the dollar. The duration of the hedging transactions is the same as or shorter than the duration of the hedged exposures.

Interest risks

The Group is exposed to changes in the fair value of its liabilities as a result of borrowings at fixed interest. The Group is also exposed to changes in its cash flows as a result of borrowings at variable interest.

NOTE 32 – FINANCIAL INSTRUMENTS

A. Credit risk

The carrying amount of the financial assets represents the maximum credit exposure. The maximum exposure to credit loss at the reporting date is described in the table below:

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
	Carrying amount	Carrying amount
Cash and cash equivalents	**580**	786
Financial assets held for trade	**141**	-
Available-for-sale financial assets	**37**	57
Trade and other receivables	**3,461**	3,070
Bank deposit for providing loans to employees	**83**	130
Assets and other investments	**-**	9
Derivatives	**23**	24
	4,325	4,076

See Note 8 for the matter of maximum exposure to credit risk for trade receivables.

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

B. Liquidity risk

Below are the contractual repayment dates of financial liabilities, including estimated interest payments.

	December 31, 2009						
	Carrying amount	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	More than 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Non-derivative financial liabilities							
Trade payables	1,091	1,091	1,091	-	-	-	-
Other payables	695	695	681	14	-	-	-
Bank loans	622	681	32	51	138	441	19
Debentures issued to the public	2,476	2,797	395	-	738	1,044	620
Debentures issued to financial and other institutions (1)	1,038	1,141	286	92	205	490	68
	5,922	6,405	2,485	157	1,081	1,975	707
Financial liabilities - derivatives							
Forward contracts on currencies	1	1	1	-	-	-	-
Exchange rate options	1	1	1	-	-	-	-
		1					
	2	2	2	-	-	-	-

(1) Including debentures of the Company amounting to NIS 94 million, stated in the financial statements as short term due to non-compliance with financial covenants (see Note 14C(1))

It is not expected that the cash flows included in the analysis of the repayment dates will occur materially earlier, or in amounts that are materially different. For guarantees see Notes 14 and 20.

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

B. Liquidity risk (contd.)

	December 31, 2008						
	Carrying amount	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	More than 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Non-derivative financial liabilities							
Trade payables	1,381	1,381	1,381	-	-	-	-
Other payables	658	658	653	5	-	-	-
Short-term credit	31	31	31	-	-	-	-
Bank loans (1)	1,168	1,207	915	52	54	131	55
Debentures issued to the public	2,737	3,229	466	-	450	1,396	917
Debentures issued to financial and other institutions (2)	2,001	2,734	390	123	491	849	881
Loans from institutions	109	266	-	-	-	266	-
	8,085	9,506	3,836	180	995	2,642	1,853
Derivative financial liabilities							
Forward contracts (mainly on the CPI)	17	7	2	7	(2)	-	-
Loans provided by the non-controlling interest in a subsidiary	449	1,329	-	-	-	-	1,329

(1) Including loans of a former subsidiary amounting to NIS 846 million, stated in the financial statements as short term due to non-compliance with financial covenants as set at December 31, 2008. See Note 14B(2).

(2) Including debentures of the Company amounting to NIS 116 million, stated in the financial statements as short term due to non-compliance with financial covenants.

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

C. CPI and foreign currency risks

1. Exposure to CPI and foreign currency risks

The Group's currency risk is based on denominated values, as follows:

	December 31, 2009				
	Unlinked	CPI-linked	Foreign currency linked (mainly dollar)	Non-monetary balance	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Current assets					
Cash and cash equivalents	549	-	31	-	580
Trade receivables	2,396	30	65	-	2,491
Other receivables	72	5	-	94	171
Other investments, including derivatives	140	12	2	-	154
Inventory	-	-	-	263	263
Assets classified as held for sale	-	-	-	40	40
Non-current assets					
Long-term trade and other receivables	788	94	5	-	887
Long-term investments and loans, including derivatives	83	10	31	6	130
Property, plant and equipment	-	-	-	5,303	5,303
Intangible assets	-	-	-	1,885	1,885
Other deferred expenses	-	-	-	426	426
Equity-accounted investments	1	1,166	-	52	1,219
Deferred tax assets	-	-	-	392	392
Total assets	4,029	1,317	134	8,461	13,941
Current liabilities					
Loans and credit	17	845	-	-	862
Employee benefits – not in the scope of IFRS 7	505	-	-	-	505
Trade payables	833	-	258	-	1,091
Other payables, including derivatives	600	94	3	-	697
Current tax liabilities	-	118	-	-	118
Deferred income	5	-	-	31	36
Provisions	30	338	-	12	380
Non-current liabilities					
Debentures	-	2,716	-	-	2,716
Bank loans	383	175	-	-	558
Deferred revenue and other provisions	60	-	-	16	76
Deferred tax liabilities	-	-	-	70	70
Employee benefits – not in the scope of IFRS 7	188	57	49	-	294
Total liabilities	2,621	4,343	310	129	7,403
Total exposure in the statement of financial position	1,408	(3,026)	(176)	8,332	6,538
Currency futures transactions					
Dollar/shekel forward transactions	(32)	-	32	-	-
CPI/shekel-linked forward transactions	(440)	440	-	-	-
Dollar / shekel put options	-	-	(26)	-	(26)
Dollar / shekel call options	-	-	26	-	26
	(472)	440	32	-	-

Note 32 - Financial Instruments (contd.)

C. CPI and foreign currency risks (contd.)

1. Exposure to CPI and foreign currency risks (contd.)

	December 31, 2008				
	Unlinked	CPI-linked	Foreign currency linked (mainly dollar)	Non-monetary balance	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Current assets					
Cash and cash equivalents	771	-	15	-	786
Trade receivables	2,279	24	70	-	2,373
Other receivables	115	-	-	96	211
Other investments, including derivatives	8	18	7	-	33
Inventory	-	-	-	158	158
Assets classified as held for sale	-	-	-	34	34
Non-current assets					
Long-term trade and other receivables	526	35	15	-	576
Long-term investments and loans, including derivatives	131	-	50	6	187
Broadcasting rights, net of rights exercised	-	-	-	253	253
Property, plant and equipment	-	-	-	6,036	6,036
Intangible assets	-	-	-	2,674	2,674
Other deferred expenses	-	-	-	411	411
Equity-accounted investments	1	-	-	31	32
Deferred tax assets	-	-	-	550	550
Total assets	3,831	77	157	10,249	14,314
Current liabilities					
Loans and credit	877	903	-	-	1,780
Employee benefits – not in the scope of IFRS 7	412	-	-	-	412
Trade payables	1,123	-	258	-	1,381
Other payables, including derivatives	619	229	1	1	850
Current tax liabilities	-	45	-	-	45
Deferred income	5	-	-	57	62
Provisions	273	70	-	12	355
Non-current liabilities					
Debentures	-	3,943	-	-	3,943
Bank loans	-	214	-	-	214
Loans from institutions	-	158	-	-	158
Loans provided by the non-controlling interest in a subsidiary	-	449	-	-	449
Deferred revenue and other provisions	60	17	-	14	91
Deferred tax liabilities	-	-	-	65	65
Employee benefits – not in the scope of IFRS 7	159	53	53	-	265
Total liabilities	3,528	6,081	312	149	10,070
Total exposure in the statement of financial position	303	(6,004)	(155)	10,100	4,244
Currency futures transactions					
Dollar/shekel forward transactions	(221)	-	221	-	-
CPI/shekel-linked forward transactions	(1,720)	1,720	-	-	-
Dollar / shekel put options	-	-	(110)	-	(110)
Dollar / shekel call options	-	-	110	-	110
	(1,941)	1,720	221	-	-

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

C. CPI and foreign currency risks (contd.)

1. Exposure to CPI and foreign currency risks (contd.)

The Group's exposure to CPI and foreign currency risks for derivative financial instruments:

	December 31, 2009				
	Currency/ linkage receivable	Currency/ linkage payable	Expiry date	Par value (currency)	Fair value
				Millions	NIS millions
Instruments not used for hedging:					
Forward exchange contracts	USD	NIS	2010-2011	**7**	**(1)**
CPI forward contract	CPI	CPI	2010-2012	**440**	**21**
Foreign currency call options	USD	NIS	2010	**7**	**-**
Foreign currency put options	USD	NIS	2010	**7**	**(1)**
					19

	December 31, 2008				
	Currency/ linkage receivable	Currency/ linkage payable	Expiry date	Par value (currency)	Fair value
				Millions	NIS millions
Instruments not used for hedging:					
Forward exchange contracts	USD	NIS	2009-2011	57	3
Forward exchange contract	Euro	NIS	2009	1	-
CPI forward contract	CPI	CPI	2009-2012	1,720	2
Foreign currency call options	USD	NIS	2009	29	2
Foreign currency put options	USD	NIS	2009	29	(3)
					4

Data in shekels for exchange rates and CPI

				Change (%)	Change (%)	Change (%)
	December 31	December 31	December 31	December 31	December 31	December 31
	2009	2008	2007	2009	2008	2007
CPI in points (*)	**130.42**	125.5	120.9	**3.91**	3.8	3.4
1 US dollar	**3.775**	3.802	3.846	**(0.71)**	(1.14)	(8.97)
1 euro	**5.44**	5.297	5.659	**2.73**	(6.39)	1.71

(*) CPI for the month at average base of 100=1998

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

C. CPI and foreign currency risks (contd.)

2. Sensitivity analysis for changes in the CPI and foreign currency

A strengthening of the shekel against the following currencies at December 31, 2009 and 2008 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on the assumption that all the other variables, in particular the interest rates, will remain fixed. The analysis is performed on the same basis for 2008.

	Shareholders' equity	Profit or loss
	NIS millions	NIS millions
December 31, 2009		
1 US dollar – 10% strengthening of the shekel against the dollar	**2**	**(9)**
CPI – 10% strengthening beyond the inflation forecast (*) (inflation forecast of 2% per year)	**(4)**	**(4)**
December 31, 2008		
1 US dollar – 10% strengthening of the shekel against the dollar	4	5
CPI – 10% strengthening beyond the inflation forecast (*) (inflation forecast of 2% per year)	(6)	(6)

* Sensitivity rates are determined according to assessments based on variable conditions in the economy.

Weakening of the shekel against the above currencies and a similar in the CPI at December 31 would have had the same effect in the opposite direction, and in the same amounts, assuming all other variables remain fixed.

D. Interest rate risk

1. Type of interest

Type of interest of the Group's interest-bearing financial instruments at the reporting date:

	Carrying amount	Carrying amount
	2009	2008
	NIS millions	NIS millions
Fixed-interest instruments		
Financial assets	**2,341**	2,162
Financial liabilities	**(3,736)**	(6,015)
Loans from non-controlling interests	**-**	(449)
	(1,395)	(4,302)
Variable-interest instruments		
Financial assets	**(400)**	(31)

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

D. Interest rate risk (contd.)

2. Sensitivity analysis of the fair value for instruments at fixed interest

The Group's assets and liabilities at fixed interest are not measured at fair value through profit or loss, nor does the Group designate derivatives (interest swap contracts) as hedging instruments according to a hedge accounting model of fair value. Therefore, a change in interest rates at the reporting date not affect profit or loss.

3. Sensitivity analysis of cash flow for instruments at variable interest

An increase of 100 basis points in the interest rate at the reporting date would decrease shareholders' equity and profit or loss by NIS 2.96 million (in 2008, NIS 0.23 million). This analysis assumes that all other variables, especially foreign currency rates, remain stable.

E. Fair value

1. Fair value compared to carrying amounts

The table below shows the differences between the carrying amount and the fair value of groups of financial instruments, where material differences exist among them. The carrying amount of financial assets does not differ significantly from their fair value.

	December 31, 2009		December 31, 2008	
	Carrying amount	Fair value	Carrying amount	Fair value
	NIS millions	NIS millions	NIS millions	NIS millions
Short-term credit	**-**	**-**	31	31
Secured loans from banks and others				
CPI-inked	**223**	**235**	481	473
Unlinked	**403**	**403**	846	808
Debentures issued to the public				
CPI-inked	**2,548**	**2,707**	2,816	2,841
Debentures issued to financial institutions and others				
CPI-inked	**1,058**	**1,079**	2,106	2,098
	4,232	**4,424**	6,280	6,251

The methods used to estimate the fair values of financial instruments are described in Note 4.

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

E. Fair value (contd.)

(2) Interest rates used to determine fair value

	2009	2008
	%	%
Long-term trade receivables	**5**	7.4
Loans	**3.5**	7.5
Debentures	**3.4**	6.2

(3). Fair value hierarchy

The table below presents an analysis of the financial instruments measured at fair value, using the evaluation method.

The levels are defined as follows:

A. Level 1: Quoted prices (unadjusted) in an active market for identical instruments
B. Level 2: Observable market inputs, direct or indirect, other than Level 1 inputs
C. Level 3: Inputs not based on observable market data

	December 31, 2009			
	Level 1	Level 2	Level 3	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Financial assets held for trade:				
Money market fund	**141**	**-**	**-**	**141**
Derivatives not used for hedging				
Options	**-**	**(1)**	**-**	**(1)**
Forward contracts	**-**	**20**	**-**	**20**
Available-for-sale financial assets:				
Non-marketable shares	**-**	**-**	**31**	**31**
	141	**19**	**31**	**191**

NOTE 32 - FINANCIAL INSTRUMENTS (CONTD.)

E. Fair value (contd.)

4. Financial instruments measured at fair value on level 3

The table below reconciles the opening balance and the closing balance in respect of financial instruments measured at fair value on level 3 in the fair-value hierarchy:

	2009
	Available-for-sale financial assets
	Non-marketable shares
	NIS millions
Balance at January 1, 2009	**50**
Total profits recognized in profit or loss (*)	**23**
Acquisitions	**4**
Proceeds from disposal	**(45)**
Capital reserve	**(1)**
Balance at December 31, 2009	**31**
Total profits (losses) for the period included in profit or loss for assets held at December 31, 2009 (*)	**9**

(*) Finance income and expense

NOTE 33 - SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Statement of financial position

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Current assets	**2,102**	1,898
Non-current assets	**2,888**	2,746
	4,990	4,644
Current liabilities	**1,519**	1,502
Long term liabilities	**921**	1,050
Total liabilities	**2,440**	2,552
Shareholders' equity	**2,550**	2,092
	4,990	4,644

B. Statement of income

	Year ended December 31,		
	2009	2008	2007
	NIS millions	NIS millions	NIS millions
Revenue from services	**4,256**	4,020	3,972
Revenue from terminal equipment sales	**1,120**	693	712
Revenue from services and sales	**5,376**	4,713	4,684
Cost of services and sales	**3,592**	3,235*	3,347
Gross profit	**1,784**	1,478	1,337
Selling and marketing expenses	**461**	405*	430
General and administrative expenses	**133**	140	102
	594	545	532
Operating profit	**1,190**	933	805
Finance expenses	**100**	115	114
Finance income	**(90)**	(117)	(109)
Net finance expenses (income)	**10**	(2)	5
Profit before income tax	**1,180**	935	800
Income tax	**305**	253	215
Profit for the year	**875**	682	585

* See Note 3U.

NOTE 33 - SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD. (CONTD.)

2. Bezeq International Ltd.

A. Statement of financial position

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Current assets	**547**	496
Non-current assets	**559**	498
	1,106	994
Current liabilities	**367**	254
Long term liabilities	**37**	30
Total liabilities	**404**	284
Shareholders' equity	**702**	710
	1,106	994

B. Statement of income

	Year ended December 31,		
	2009	2008	2007
	NIS millions	NIS millions	NIS millions
Revenue	**1,318**	1,306	1,304
Operating expenses	**777**	780	859
Gross profit	**541**	526	445
Selling and marketing expenses	**175**	181	147
General and administrative expenses	**105**	103	94
Operating profit	**261**	242	204
Finance expenses	**(12)**	(8)	(11)
Finance income	**15**	7	12
Financing income (expenses), net	**3**	(1)	1
Share in earnings of an equity-accounted associate	**7**	5	6
Profit before income tax	**271**	246	211
Income tax expense	**71**	68	58
Profit for the year	**200**	178	153

D.B.S. Satellite Services (1998) Ltd.

Financial Statements
Year ended
December 31, 2009

Financial Statements as of 31 December, 2009

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Auditors Report for the Shareholders of
D.B.S. Satellite Services (1998) Ltd.

We have audited the accompanying statements of financial position of D.B.S. Satellite Services (1998) Ltd ("the Company") as at December 31, 2009 and 2008, and the related income statements, the statements of comprehensive income, the statements of changes in equity and the statements of cash flows for each of the three years, the last of which ended December 31, 2009. These financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing principles in Israel, including standards prescribed by the Auditors' Regulations (Manner of Auditor's Performance) – 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion these financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2009 and 2008, and its results of operations, changes in equity and cash flows for each of the three years, the last of which ended December 31, 2009, in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Securities Regulations (Annual Financial Statements) - 2010.

Without qualifying our opinion, we draw attention to Note 5 with respect to the financial position of the Company. The continuation of the Company's activities depends, inter alia, on its compliance with the stipulations determined for 2010 and/or further reliefs that will be received.

Furthermore, we draw attention to Note 22B to the financial statements with respect to a class action filed against the Company with respect to disruptions to the Company's broadcasts. Based on the assessment of the Company's management, which is based on the opinion of its legal counsel, the Company has included appropriate provisions in its financial statements.

Somekh Chaikin
Certified Public Accountants

February 25, 2010

Statement of Financial Position as at December 31

	Note	2009 NIS thousands	2008 NIS thousands
Assets			
Short-term deposits	6	**3,020**	3,000
Trade receivables	7	**160,152**	152,876
Other receivables	7	**8,177**	8,261
Total current assets		**171,349**	164,137
Property, plant and equipment, net	8	**682,473**	671,663
Other intangible assets, net	9	**67,043**	42,970
Broadcasting rights, net of rights exercised	10	**284,766**	253,333
Total non-current assets		**1,034,282**	967,966
Total assets		**1,205,631**	1,132,103

Statement of Financial Position as at December 31

	Note	2009 NIS thousands	2008 NIS thousands
Liabilities			
Credit from banks	11	**283,698**	877,202
Current debenture maturities	15	**54,812**	-
Trade payables	12	**406,389**	400,280
Other payables	13	**143,343**	207,962*
Provisions	14	**8,079**	8,980
Total current liabilities		**896,321**	1,494,424
Debentures	15	**625,741**	654,780
Loans from institutions	16	**181,729**	157,700
Bank loans	11	**607,036**	-
Loans from shareholders	17	**1,981,887**	1,681,515
Other liabilities	18	**14,288**	27,812
Employee benefits	19	**7,389**	8,010*
Total non-current liabilities		**3,418,070**	2,529,817
Total liabilities		**4,314,391**	4,024,241
Equity deficit			
Share capital		**29**	29
Share premium		**85,557**	85,557
Option warrants		**48,219**	48,219
Capital reserves		**1,537,271**	1,537,271
Capital reserve for share-based payments		**6,931**	1,636
Accumulated deficit		**(4,786,767)**	(4,564,850)
Total equity deficit	23	**(3,108,760)**	(2,892,138)
Total liabilities and equity		**1,205,631**	1,132,103

Rimon Ben Shaul **Authorized to sign on behalf of chairman of the board** **(See Note 34)**	**Ron Eilon** **CEO**	**Katriel Moriah** **CFO**

* Reclassified
Date of approval of the financial statements: February 25, 2010

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

Statements of Income for the year ended December 31

	Note	2009 NIS thousands	2008 NIS thousands	2007 NIS thousands
Revenue		**1,530,435**	1,512,632	1,414,823
Cost of revenue	24	**1,042,101**	1,091,171	1,117,098
Gross profit		**488,334**	421,461	297,725
Selling and marketing expenses	25	**122,312**	128,162	137,679
General and administrative expenses	26	**117,805**	116,151	104,047
		240,117	244,313	241,726
Operating profit		**248,217**	177,148	55,999
Finance expenses		**177,900**	229,650*	166,523*
Finance income		**(8,347)**	(51,805)*	(13,392)*
Shareholders' finance expenses		**300,373**	262,961*	14,227*
Financing expenses, net	27	**469,926**	440,806	167,358
Loss before taxes on income		**(221,709)**	(263,658)	(111,359)
Income tax	28	**745**	1,048	6,251
Loss for the period		**(222,454)**	(264,706)	(117,610)
Basic and diluted losses per share (in NIS)		**7,441**	8,919	3,934

* Reclassified

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

Statements of Comprehensive Income for the year ended December 31

	Note	2009 NIS thousands	2008 NIS thousands	2007 NIS thousands
Loss for the period		**(222,454)**	(264,706)	(117,610)
Other items of comprehensive income				
Actuarial gains from a defined benefit plan	19	**537**	127	655
Other comprehensive income for the period		**537**	127	655
Total comprehensive loss for the period		**(221,917)**	(264,579)	(116,955)

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of comprehensive income was changed. See also Note 2E (1) pertaining to changes in accounting policy.

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

Statement of Changes in Shareholders Equity for the year ended December 31, 2009

	Note	Share capital	Premium Shares	Option warrants	Capital reserve	Share-based payments	Accrued deficit	Total
		NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance at January 1, 2009 (audited)		29	85,557	48,219	1,537,271	1,636	(4,564,850)	(2,892,138)
Comprehensive loss for the period		**-**	**-**	**-**	**-**	**-**	**(221,917)**	**(221,917)**
Share-based payments	20	**-**	**-**	**-**	**-**	**5,295**	**-**	**5,295**
Balance at December 31, 2009 (audited)		**29**	**85,557**	**48,219**	**1,537,271**	**6,931**	**(4,786,767)**	**(3,108,760)**
Balance at January 1, 2008 (audited)		29	85,557	48,219	1,537,271	-	(4,300,271)	(2,629,195)
Comprehensive loss for the period		-	-	-	-	-	(264,579)	(264,579)
Share-based payments	20	-	-	-	-	1,636	-	1,636
Balance at December 31, 2008 (audited)		29	85,557	48,219	1,537,271	1,636	(4,564,850)	(2,892,138)
Balance at January 1, 2007 (audited)		29	85,557	48,219	1,188,855	-	(4,183,316)	(2,860,656)
Comprehensive loss for the period		-	-	-	-	-	(116,955)	(116,955)
Changes in repayment dates of shareholders' loans	17	-	-	-	348,416	-	-	348,416
Balance as at December 31, 2007 (audited)		29	85,557	48,219	1,537,271	-	(4,300,271)	(2,629,195)

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of changes in shareholders equity was changed. See also Note 2E (1) pertaining to changes in accounting policy.

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

Statements of Cash Flows for the year ended December 31

	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities			
Loss for the period	**(222,454)**	(264,706)	(117,610)
Adjustments:			
Depreciation and amortization	**234,203**	249,880	273,202
Finance expenses, net	**455,232**	426,258	156,757
Loss (profit) from the sale of property, plant and equipment	**(236)**	(124)	23
Share-based payments	**5,295**	1,636	-
Income tax benefit expenses	**745**	1,048	6,251
Change in trade receivables	**(7,277)**	(7,352)	3,657
Change in other receivables	**84**	5	8,956
Change in trade payables	**5,466**	(61,394)	(4,060)
Change in other payables and provisions	**(15,231)**	21,585*	12,978
Changes in broadcasting rights, net of rights exercised	**(31,433)**	(10,585)	(73,731)
Change in employee benefits	**(82)**	3,871*	(488)
Change in other liabilities	**(13,524)**	(8,022)	(14,810)
	410,788	352,100	251,125
Income tax paid	**(1,060)**	(5,073)	(1,250)
Net cash flows from operating activities	**409,728**	347,027	249,875
Cash flow from investing activities			
Interest received	**-**	76	211
Proceeds from sale of property, plant and equipment	**949**	-	60
Acquisition of property, plant and equipment	**(214,368)**	(198,208)	(223,607)
Acquisition of intangible assets	**(9,262)**	(12,643)	(11,995)
Payments for subscriber acquisition	**(37,931)**	(26,690)	(18,948)
Net cash used for investing activities	**(260,612)**	(237,465)	(254,279)

* Reclassified

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

Statements of Cash Flows for the year ended December 31 (contd.)

	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Cash flow from financing activities			
Loans received from institutions	**-**	-	50,000
Repayment of loans from institutions	**-**	-	(100,000)
Repayment of bank loans	**-**	-	(465,490)
Short-term credit from banks, net	**13,532**	(50,471)	(16,459)
Interest paid	**(162,648)**	(59,091)	(77,885)
Issue of debentures, net	**-**	-	614,238
Net cash flows deriving from (used for) financing activities	**(149,116)**	(109,562)	4,404
Increase in cash and cash equivalents	**-**	-	-
Cash and cash equivalents at the beginning of the period	**-**	-	-
Cash and cash equivalents at the end of the period	**-**	-	-

The accompanying notes are an integral part of the financial statements

NOTE 1 – GENERAL

A. Reporting Entity

DBS Satellite Services (1998) Ltd. (“the Company”) was incorporated in Israel on December 2, 1998. The Company’s head office is at 6 Hayozma St., Kfar Saba, Israel.
In January 1999, the Company received a license from the Ministry of Communications to broadcast television via satellite (“the License”). The broadcasting license was granted to the Company until January 2017 and may be extended for a further six years under certain conditions. The Company is subject to, inter alia, the Communications (Telecommunications and Broadcasts) Law 5742-1982 (“the Communications Law”) and its subsequent regulations and rules and to the license terms.
Under the license of Bezeq The Israel Telecommunication Corporation Limited (“Bezeq”), Bezeq is required to maintain full structural separation between it and its subsidiaries, including between it and the Company. Additionally, on March 31, 2004, the Minister of Communications published a document banning certain business alliances between Bezeq and its subsidiaries, including the Company, unless, inter alia, there is a material deterioration in the competitive status of the Company. The Ministry is considering the approval of certain exemptions regarding the restrictions relating to the alliances by amending the license. This process has not yet been completed.
In August 2009, the Supreme Court accepted the Antitrust Commissioner’s appeal of the ruling of the Antitrust Tribunal, which approved the merger (as defined in the Antitrust Law, 5748-1988) between the Company and Bezeq by exercising the options held by Bezeq into Company shares, subject to certain conditions, and decided not to consent to the merger.

B. Definitions

In these financial statements -

(1) International Financial Reporting Standards - ("IFRS") – standards and interpretations that were adopted by the International Accounting Standards Board (IASB) and which include international financial reporting standards and international accounting standards (IAS) along with the interpretations to these standards of the International Financial Reporting Interpretations Committee (IFRIC) or interpretations of the Standing Interpretations Committee (SIC), respectively.

(2) The Company – D.B.S. Satellite Services (1998) Ltd.

(3) Related party – Within its meaning in IAS 24, Related Party Disclosures

(4) Interested parties – Within their meaning in Paragraph (1) of the definition of an “interested party” in Section 1 of the Securities Law - 1968

(5) Index – The consumer price index as published by the Israeli Central Bureau of Statistics

NOTE 2 - BASIS FOR DRAFTING THE FINANCIAL STATEMENTS

A. Statement of compliance with IFRS

The financial statements have been prepared in accordance with the Securities Regulations (Annual Financial Statements) 5770 - 2010.

The Company first adopted IFRS in 2006, therefore the transition date to IFRS was set as January 1, 2005 ("the date of transition to IFRS").

The financial statements were approved by the board of directors on February 25, 2010.

B. Functional and presentation currency

These financial statements are presented in the new Israeli shekel, which is the Company’s functional currency, and are rounded to the nearest thousand. The shekel is the currency that represents the Company’s main financial environment

NOTE 2 - BASIS FOR DRAFTING THE FINANCIAL STATEMENTS (CONTD.)

C. Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following assets and liabilities that are stated at fair value: Derivative financial instruments.
The amount recognized as liability for a defined benefit is the current value of the liability for a defined benefit at the end of the reporting period less costs for any past service that has as yet not been recognized and less the fair value at the end of the reporting period of plan assets from which the liability should be paid, directly.
The value of non-monetary assets and equity items that were measured on the historical cost basis was adjusted to changes in the CPI until December 31, 2003, since until that date Israel was considered a hyperinflationary economy.

D. Use of estimates and judgments

The preparation of the financial statements in compliance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The preparation of accounting estimates used in the preparation of the Company's financial statements requires management to make assumptions regarding circumstances and events that involve considerable uncertainty. The Company's Management prepares the estimates on the basis of past experience, various facts, external circumstances, and reasonable assumptions according to the pertinent circumstances of each estimate.
Estimates and underlying assumptions are reviewed on an ongoing basis. Adjustments in the accounting estimates are recognized in the period in which they are made and in any other affected period in the future.

Presented hereunder is information about critical estimates, made while implementing accounting policies and which have a significant effect on the financial statements:

- Contingent liabilities – When assessing the possible outcomes of legal claims that were filed against the Company and its investees, the Company relied on the opinions of its legal counsel. The opinions of the legal counsel are based on the best of their professional judgment, and take into consideration the current stage of the proceedings and the legal experience accumulated with respect to the various matters. As the results of the claims may ultimately be determined by the courts, they may be different from such estimates.

- Impairment of assets – The Company examines on every balance sheet date whether there have been any events or changes in circumstances which would indicate impairment of one or more non-monetary assets. In the event of signs of impairment, the Company assesses whether the amount in which the investment in the asset is presented can be recovered from the projected future discounted cash flows from that asset, and if necessary, a provision for impairment is recorded up to the recoverable amount. The cash flows are discounted using a pre-tax discount rate that reflects current market assessments pertaining to the time value of the money and the risks specific to the asset. The estimates regarding cash flows are based on past experience with respect to this asset or similar assets, and on the best possible assessments of the Company regarding the economic conditions that will exist during the remaining useful life of the asset.

- Useful life –The Company's fixed assets, intangible assets and broadcasting rights are amortized using the straight line method over their estimated useful life. The estimated useful life of these items is fixed based on their estimated technical life and the condition of the equipment. Changes in these factors, which affect the estimated useful life of the asset, have a material impact on the Company's financial position and the results of its operations. The estimated useful life of the fixed assets and tangible assets are presented in Note 3(C) and in Note 3(D) below.

NOTE 2 - BASIS FOR DRAFTING THE FINANCIAL STATEMENTS (CONTD.)

E. Changes in accounting policies

(1) Presentation of financial statements

As of January 1, 2009, the Company applies IAS 1 – Presentation of Financial Statements, revised ("the Standard"). The Standard permits the presentation of two statements – a statement of income and a separate statement of comprehensive income.

(2) Employee benefits

As of January 1, 2009, the Company applies IAS 19 – Employee Benefits, revised ("the Amendment"), in accordance with the IFRS Improvements to International Financial Reporting Standards 2008 (Improvements to IFRSs). The amendment addresses the definition of "short-term employee benefits" and "other long-term employee benefits" to refer to when the benefits are due to be settled. Based on the foregoing, specific benefits are classified as short-term benefits. The Amendment is applied retrospectively. The effect of the change on the financial statements was not material.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared on the basis of International Financial Reporting Standards and their related interpretations ("IFRS").
The accounting policy applied in the financial statements has been applied consistently to all the periods presented.

A. Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Group at the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are translated to the functional currency at the exchange rate at that date.

B. Broadcasting rights

Broadcasting rights are presented by cost, net of rights exercised.
The cost of broadcasting rights that are acquired for movies and television programs to be broadcast include the amounts paid to the rights' vendors. According to the terms of their acquisition agreements, the broadcasting rights are depreciated, based on actual broadcasts, from the total number of expected broadcasts based on management's projection, or permitted under the agreement (while the part that is not depreciated by the end of the agreement period is depreciated in full upon termination of the agreement) or according to the rights' agreement period. The net adjustment of the broadcasting rights is presented as an adjustment of earnings as part of the ongoing operations in the statements of cash flows.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

C. Property, plant and equipment

(1) Recognition and measurement

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed properties includes the cost of materials, direct labor and financing costs as well as any additional cost that can attributed directly to bringing the property to the status and condition required so that it can operate as intended by the management, and the costs of dismantling and removing the items and restoring the site on which they are located. The cost of purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When parts of an item of property, plant and equipment are material (including material costs of periodic tests) have a different useful life, these components are accounted for as separate items (material components) of property, plant and equipment.

(2) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognized when that cost is incurred if it is probable that the future economic benefits embodied within the item will flow to the Company and the cost of the item can be measured reliably. The book value of the replaced part is derecognized. Ongoing maintenance costs are charged to profit or loss as incurred.

(3) Depreciation

Depreciation is recognized in the statement of income on a straight-line basis over the estimated useful lives of each part of a fixed asset item.

	Years
Broadcasting and receiving equipment	6.67
Installation costs*	1,2,3,15
Digital satellite decoders	4,6,8
Office equipment and furniture	6.67-14.2
Computers	3

* The costs of installation in apartments are depreciated based on the duration of the contract with the subscribers.

Leasehold improvements are depreciated over the rental period or the expected useful life of the improvements, whichever is shorter.

D. Intangible assets

(1) Acquisition of subscribers

The Company capitalizes the direct selling costs paid to the marketers and sales staff for selling and upgrading subscribers who sign commitments to remain customers of the Company for the duration of the contractual period, and records these costs as an intangible asset.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

D. Intangible assets (contd.)

(2) Software

Stand-alone software which adds additional functionality to the hardware is classified as intangible assets.

(3) Research & Development

The developments are linked to the plan for creating products or new processes or for substantial improvements of the existing products or processes. Development costs are only recognized as intangible assets if the development costs can be measured reliably, the technical and economic feasibility of the project can be demonstrated, there is future financial reward from the product and the Company has the intention and ability to complete the development and use or sell the asset. The costs recognized as intangible assets include the cost of materials, direct salaries and overheads that are directly attributable to preparation of the asset for its intended use and capitalized credit costs. Other costs for software development are charged to profit or loss as incurred.

Capitalized software development costs are measured at cost less accumulated amortization and impairment losses.

(4) Amortization

Amortization of intangible assets is recognized in the statements of income on a straight-line basis over the estimated useful lives of the intangible assets, from the date that they are available for use.

The estimated useful lives for the current and comparative periods are as follows:

	Years
Software	3,5
Costs of acquisition of subscribers*	1,2,3
Capitalized development costs	3,5

* Pursuant to the terms and conditions of contracts with the subscribers, since this method best reflects the projected consumption pattern of the future financial benefits inherent in the asset.

E. Financial instruments

(1) Non-derivative financial instruments

Non-derivative financial instruments comprise debt instruments, trade and other receivables, loans and credit received, and trade and other payables.

Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

A financial instrument is recognized when the Company accepts the contractual conditions of the instrument. A financial asset is derecognized when the Company's contractual rights to receive the cash flows deriving from the financial asset expires, or when the Company transfers the financial asset to others without maintaining control of the asset or transfers all the risks and rewards deriving from the asset. Regular way purchase and sale of financial assets are recognized on the trade date, meaning on the date on which the Company undertook to purchase or sell the asset. A financial liability is derecognized when the Company's obligation specified in the contract is discharged, cancelled or expired.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

E. Financial instruments (contd.)

(2) Derivative financial instruments

The Company holds derivative financial instruments to hedge its foreign currency risks. The financial instruments primarily comprise forward transactions.

Derivative financial instruments are recognized initially at fair value; attributable transaction costs are included in statements of income when incurred. Subsequent to initial recognition, the financial derivatives are measured at fair value. Hedge accounting is not applied to derivative instruments serving as an economic hedge against financial obligations in foreign currency. The changes in the fair value of these derivative financial instruments are attributed to the statements of income as part of the profits or losses from foreign currency.

(3) Index-linked assets and liabilities that are not measured at fair value

The value of the index-linked financial assets and liabilities, which are not measured at fair value, is revaluated in each period according to the actual increase in the index.

F. Impairment

(1) Financial assets

A financial asset is tested for impairment when objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its book value and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are attributed to the statement of income.

(2) Non-financial assets

The book value of the Company's non-financial assets is reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset’s recoverable amount is estimated. The Company assesses annually the recoverable amount if indications of impairment exist.
The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its net selling price (fair value less selling costs). In assessing value in use, the Company discounts the estimated future cash flows to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the “cash-generating unit”).
An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

G. Employee benefits

(1) Post-employment benefits

The Company has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies or with pension funds and they are classified as defined contribution plans and defined benefit plans.

(a) Defined contribution plans

The Company's obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss when they are created.

(b) Defined benefit plans

The Company's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service during the current and prior periods. That benefit is recognized at its present value and the fair value of any plan assets is deducted. The discount rate is fixed according to the proceeds on the reporting date for government debentures denominated in the same currency and having similar maturity dates as the terms of the Company's obligations. The calculation is carried out by a qualified actuary using the projected unit credit method.

When the calculation results in an asset for the Company, an asset is recognized up to the net present value of economic benefits available in the form of a refund from the plan or a reduction in future contributions to the plan. Economic benefit in the form of refunds or reduction in future payments will be considered to be available when it can be exercised during the life of the plan or after removal of the liability.

If there is an obligation, as part of a minimal deposit requirement, for payment of additional amounts for past services, the Company recognizes the additional liability (increase of the net liability or reduction of the net asset) if such amounts are not available as a financial benefit in the form of a refund from the plan or reduction in future payments.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized as an expense in profit or loss on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately, the expense is recognized immediately in profit or loss.

The Company immediately recognizes, through other comprehensive income, all actuarial gains and losses arising from defined benefit plans directly in retained earnings.

(2) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

Provision for a short-term employee benefit meant for a cash bonus or profit-sharing plan is recognized if the Company has a current legal or constructive obligation to pay said amount for past service provided by the employee and the obligation can be estimated reliably.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

G. Employee benefits (contd.)

(3) Other long-term employee benefits

The Company's net obligation in respect of long-term employee benefits other than post-employment plans is the amount of future benefit that employees have earned in return for services rendered during the current and prior periods. The amount of these benefits is discounted to their current value. The discount rate is fixed based on the yield at the reporting date for government bonds that are denominated in the same currency and have maturity dates similar to the terms of the Company's obligation. The calculation is carried out using the projected unit credit method. Any actuarial gains or losses are recognized in profit or loss in the period in which they arise.

(4) Share-based payments

The fair value at grant date of share-based payments granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the grants. The amount recognized as an expense for share-based payment grants contingent upon vesting terms which are service or performance terms and which are not market terms, are adjusted to reflect the actual number of share options that are expected to vest

For transactions in which Bezeq grants the Company's employees rights in its equity financial instruments, the Company handles the grant as an equity-settled share-based payment. In other words, the fair value of the grant is recognized directly in equity, as aforesaid.

H. Provisions

A provision is recognized if, as a result of a past event, the Company has a current legal or constructive obligation that can be reliably estimated, and if it is probable that an outflow of economic benefits will be required to settle the obligation.

(1) Onerous contracts

A provision for an onerous contract is recognized when the economic benefits that the Company expects to gain from the contract are lower than the unavoidable costs as a result of compliance with contractual commitments. The provision is measured based on the lower of the current value of the contractual cost of cancellation of the contract and the current value of the net contractual cost that will be incurred as a result of continuing the contract.

(2) Lawsuits

A provision for claims is recognized if, as a result of a past event, the Company has a current legal or constructive obligation and it is more likely than not that an outflow of financial resources will be required to settle the obligation and the amount of obligation can be estimated reliably.

I. Revenue

1) Revenues from services provided are attributed to profit or loss, proportionately throughout the agreement period or on providing the service.

2) Revenues from rental of digital satellite decoders are attributed proportionately throughout the agreement period.

3) The Company charges a deposit for the digital satellite decoders rented by its customers, part of which the customers are eligible to be refunded for, proportionately, upon termination of their contract, in accordance with the contract signed with them. The revenue from deposit deductions is attributed to the statements of income, according to the terms of the contract signed with the customer.

4) Commissions – when the Company acts in a transaction as an agent and not as owner, the revenue is recognized in the amount of the net commission.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

J. Income tax benefit expenses

Income tax expense comprises current and deferred tax. Current and deferred income tax is attributed to profit or loss unless the tax derives from the inclusion of transactions or items that were recognized directly in shareholders’ equity or in other comprehensive income. Current and deferred taxes for a transaction or event that is recognized directly in shareholders' equity or other comprehensive income, is recognized directly in shareholders' equity or other comprehensive income. Current tax is the expected amount of tax payable (or receivable) on the taxable income for the year, using tax rates in force or substantively in force at the reporting date.

K. Operating lease

The Company classifies lease agreements, under which the Lessor substantially assumes all risks and rewards of ownership, as operating leases. Payments made under operating leases are recognized in statements of income on a straight-line basis over the term of the lease.

L. Loss per share

Basic loss per share is calculated by dividing the loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during said period.

M. Finance income and expenses

Financing income comprises income from interest on invested funds, profits from exchange rate differentials and profits from derivative instruments recognized in profit or loss. Income on interest is recognized as it accrues, using the effective interest method.
Financing expenses comprise interest expense on loans received, impairment losses on financial assets and losses on derivative instruments recognized in profit or loss. All borrowing costs are recognized in statements of income using the effective interest method.
Gains and losses from exchange rate differentials are reported on a net basis.

N. Transactions with the controlling shareholder

Assets and liabilities in a transaction with the controlling shareholder are measured at fair value on the transaction date.
As this is a capital transaction, the differences between the fair value and the proceeds from the transaction are attributed to shareholders’ equity.

O. New standards and interpretations yet to be adopted

As part of its annual improvements program, Improvements to IFRSs 2009, the IASB published and confirmed on April 15, 2009, IFRS amendments on diverse accounting issues and specific conditions for each amendment. Presented hereunder are the amendments that may be relevant to the Company and which are expected to have an impact on the financial statements:

* Items that qualify for hedging, amendment to IAS -39 Financial Instruments: Recognition and measurement ("the Amendment"). The Amendment clarifies that changes in cash flows or changes in the fair value of a one-sided risk can de designated as a hedged item, in other words, a risk defined as a risk exposed to fluctuations above or below a certain price or a defined variable. The Amendment also clarifies that an inflation component can also be designated as a separate risk provided it is contractually specified in the cash flows of an index-linked debenture, so that it can be identified separately and measured reliably, if the other cash flows of the instrument are not affected by the inflation component. The Amendment is effective retrospectively for annual periods beginning on or after January 1, 2010 and thereafter. The Company is examining the effect of application of the new Standard on its financial statements.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES – (CONTD.)

O. New standards and interpretations yet to be adopted (contd.)

* IFRIC 19 – *Extinguishing Financial Liabilities with Equity Instruments* (“the Interpretation”). The Interpretation provides guidance on accounting for debt for equity swaps. Equity instruments issued at the date of settlement and extinguishing of all or part of a financial liability would be deemed "consideration paid" for calculating profit or loss from extinguishing of the financial liability. Equity instruments will be measured initially at fair value, unless that fair value cannot be measured reliably, in which case the equity instruments should be measured to reflect the fair value of the extinguished financial liability. Any difference between the carrying amount of the financial liability and the initially measurement of the equity instruments would be recognized in profit or loss. The Interpretation is effective retroactively for annual periods beginning on or after July 1, 2010 or thereafter. Early adoption is permitted. The Company is examining the effect of application of the new Standard on its financial statements.

NOTE 4 - DETERMINATION OF FAIR VALUES

Under the accounting and disclosure policies the Company is required to determine the fair value of both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. Further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

A. Derivatives

The fair value of forward contracts on foreign currencies is based on references from financial institutions.

B. Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

C. Share-based payment expenses

The fair value of employee share options and of share appreciation rights is measured using the Black-Scholes model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends, and the risk-free interest rate (based on government debentures). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

NOTE 5 – THE FINANCIAL POSITION OF THE COMPANY

A. Since the beginning of its operations, the Company has accumulated substantial losses. The Company's losses in 2009 and 2008 amounted to NIS 222 million and NIS 265 million, respectively. As a result of these losses, the Company's capital deficit and working capital deficit at December 31, 2009 amounted to NIS 3,109 million and NIS 725 million, respectively.

B. The terms of the loans and the credit facility that the Company received from the banks, the balance of which at December 31, 2009 is NIS 960 million, impose various restrictions on the Company that include, inter alia restrictions on providing a lien on or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction concerning repayment of shareholders' loans, and a requirement for compliance with financial covenants ("the Conditions").

As of the date of this report, DBS ("the Company"?) has reached a basic agreement with the banks, which has not as yet been formulated into a binding contract, according to which:

a. An additional bank will join the consortium of banks that finance DBS ("the Company"?), under the terms of the financing contract.

b. The loan that the additional bank will extend will, for the most part, be used to repay the existing bank credit and other financing needs of the Company.

c. The period for repaying the bank credit will be extended until the end of 2015.

d. The financial covenants that the Company is required to comply with under the financing contract will be amended and replaced by others which will be adjusted to the Company's business plan.

C. At December 31, 2009, the Company is in compliance with the financial covenants set for it.

In the opinion of the Company's Management and subject the signing of the foregoing financing contract in section B, the sources of financing available to it will be sufficient for its operating requirements for the forthcoming year, based on the cash flow forecast approved by the Company's board of directors. If additional sources are required, or if the basic agreement does not mature into a contract, the Company will adapt its operations to preclude the need for additional sources other than those available to it.

D. Subsequent to decisions of the Ministers of Communications in 2004 and 2005, restricting the injection of funds to the Company from the shareholder, Bezeq, holding the largest share in the Company, the Company and Bezeq filed a petition to the High Court of Justice for issue of an order nisi against the Minister of Communications as of then, according to which the aforesaid decisions of the Ministry of Communications are null and void. In September 2008, the Company and Bezeq's petition was struck out *in limine* due to unclean hands.

NOTE 6 – SHORT-TERM DEPOSITS

The deposits are deposited in banks and bear average interest at 0.8%. Withdrawal of the deposits is restricted until a settlement is reached in the matter of the satellite insurance due to the demand from the banks to insure loss of revenue resulting from satellite failure.

NOTE 7 – TRADE AND OTHER RECEIVABLES

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Trade receivables (1)		
Open accounts	**46,143**	45,602
Credit companies	**123,022**	116,004
Net of provision for doubtful debts	**(9,013)**	(8,730)
	160,152	152,876
Other Receivables (1)		
Prepaid expenses	**1,520**	1,846
Others	**6,657**	6,415
	8,177	8,261
(1) Including Trade and other receivables who are related parties and interested parties	**52**	784

For further information pertaining to trade and other receivables who are related parties and interested parties, see Note 32 pertaining to Related Parties and Interested Parties.
For the Company's exposure to currency and liquidity risks, see Note 31 – Financial Instruments.

NOTE 8 – PROPERTY, PLANT AND EQUIPMENT

A. Composition

	Equipment, broadcasting & reception	Discounted installation costs	Digital satellite decoders	Office furniture and equipment (Including computers)	Improvements to leases	Total
	NIS thousands					
Cost						
Balance at January 1, 2008	200,111	1,321,831*	1,304,532	59,592	35,413	2,921,479
Additions during the year:	10,396	83,632	109,049	15,736	2,729	221,542
Disposals during the year:	(70)	-	(4,367)	(4)	-	(4,441)
Balance at December 31, 2008	210,437	1,405,463*	1,409,214	75,324	38,142	3,138,580
Additions during the year:	22,045	76,964	103,588	10,335	3,144	216,076
Disposals during the year:	-	(5,608)	(1,793)	(1,526)	-	(8,927)
Balance at December 31, 2009	**232,482**	**1,476,819**	**1,511,009**	**84,133**	**41,286**	**3,345,729**
Accumulated depreciation						
Balance at January 1, 2008	151,495	1,066,691*	974,072	35,377	24,324	2,251,959
Additions during the year:	15,228	75,628	116,317	8,843	2,845	218,861
Deductions during the year:	(70)	-	(3,832)	(1)	-	(3,903)
Balance at December 31, 2008	166,653	1,142,319*	1,086,557	44,219	27,169	2,466,917
Additions during the year:	16,415	67,532	106,200	10,841	3,111	204,099
Deductions during the year:	-	(5,608)	(636)	(1,516)	-	(7,760)
Balance at December 31, 2009	**183,068**	**1,204,243**	**1,192,121**	**53,544**	**30,280**	**2,663,256**
Book value						
As at January 1, 2008	48,616	255,140	330,460	24,215	11,089	669,520
As at January 1, 2009	43,784	263,144	322,657	31,105	10,973	671,663
As at December 31, 2009	49,414	272,576	318,888	30,589	11,006	682,473

* Reclassified

B. Collateral

To secure its collateral and liabilities, the Company created liens on all its assets, including share capital (subject to the provisions of the Communications Law).

C. Credit acquisitions of fixed assets

In the year ended December 31, 2009, credit, due to fixed asset acquisitions increased by an amount of NIS 1,708 thousand.

NOTE 9 – INTANGIBLE ASSETS, NET

	Costs of acquisition of subscribers	Software & Licenses	Total
		NIS thousands	
Cost			
Balance at January 1, 2008	157,814	120,743	278,557
Additions during the year:	31,504	11,637	43,141
Balance at December 31, 2008	189,318	132,380	321,698
Additions during the year:	33,812	20,365	54,177
Balance at December 31, 2009	**223,130**	**152,745**	**375,875**
Accumulated depreciation			
Balance at January 1, 2008	142,472	105,237	247,709
Additions during the year:	23,233	7,786	31,019
Balance at December 31, 2008	165,705	113,023	278,728
Additions during the year:	21,461	8,643	30,104
Balance at December 31, 2009	**187,166**	**121,666**	**308,832**
Book value			
As at January 1, 2008	15,342	15,506	30,848
As at January 1, 2009	23,613	19,357	42,970
As at December 31, 2009	**35,964**	**31,079**	**67,043**

During the year ended December 31, 2009, credit, due to intangible asset acquisition, increased by an amount of NIS 6,984 thousand.

NOTE 10 –BROADCASTING RIGHTS, NET OF RIGHTS EXERCISED

	December 31 2009	December 31 2008
	NIS thousands	NIS thousands
Cost	**511,027**	500,678
Less- rights exercised	**226,261**	247,345
	284,766	253,333

NOTE 11 - BANK CREDIT

This Note includes information of the contractual conditions of the Company's bank loans and credit bearing interest.

Additional information about the Company's exposure to interest, currency and liquidity risks appears in Note 31 – Financial Instruments.

With respect to collateral and restrictions pertaining to credit and to financial covenants, see Note 29.

	December 31	December 31
	2009	2008
	NIS thousands	NIS thousands
Short-term credit	**44,504**	30,972
Current maturities of bank loans	**239,194**	-
Bank loans*	**-**	846,230
	283,698	877,202

* The loans were originally received as long-term, since as at December 31, 2008 the Company had not complied with the financial covenants set by the banks and the loans were presented as short-term liabilities.
In March 2009, the Company received relief with regard to the financial covenants, and subsequent to this relief the Company was in compliance with the financial covenants set for it.

Hereunder, particulars relating to the loans:

The loans are repayable according to settlement schedules over a period of 8 years as of December 31, 2005. According to the loan agreements, the Company may change the loan tracks every year or two years, as of December 31, 2005.
On December 31, 2008 the Company switched the loan tracks to fixed interest loans bearing interest rate of 5.52% for a period of two years.

The loans are to be settled in the forthcoming years based on the following settlement schedules:

	December 31
	2009
	NIS thousands
2010	239,194
2011	262,740
2012	289,093
2013	55,203
	846,230

With respect to changes in the terms of the financing contract and expected repayment dates see Note 5B.
With respect to liens, see Note 29.

NOTE 12 – TRADE PAYABLES

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Open accounts	**293,411**	285,438
Notes and checks for repayment	**112,978**	114,842
	406,389	400,280
Of which- related parties and interested parties	**86,242**	118,109

For further information pertaining to suppliers that are related parties and interested parties, see Note 32 – Related Parties and Interested Parties.
For the Company's exposure to currency and liquidity risks for part of the trade balances, see Note 31 – Financial Instruments.

NOTE 13 – OTHER PAYABLES

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Employees and Institutions with respect to wages	**26,005**	27,791
Provisions for vacation leave and convalescence pay	**10,161**	10,576
Interest to be paid on debentures	**28,225**	78,199
Deposits from customers	**2,740**	3,036
Institutions	**39,835**	36,114
Deferred income	**17,941**	16,673
Others	**18,436**	35,573*
	143,343	207,962

For the Company's exposure to currency and liquidity risks for part of the payables balances, see Note 31 – Financial Instruments.

* Reclassified

NOTE 14 - PROVISIONS

	Legal Claims
	NIS thousands
Balance at January 1, 2009	8,980
Provisions during the period	599
Provisions realized during the period	(1,000)
Provisions cancelled during the period	(500)
Balance at December 31, 2009	8,079

During the normal course of business various lawsuits were filed against the Company.

In the opinion of the Company's Management based, inter alia, on professional opinions of its legal counsel, the financial statements include appropriate provisions in the amount of NIS 8,079 thousand , where required, to cover exposure resulting from such lawsuits.

For details pertaining to lawsuits and amounts of such exposure, see Note 22.

NOTE 15 – DEBENTURES

On July 31, 2007 the Company issued debentures at nominal value totaling NIS 620 million by private placement to institutional investors. The debentures were listed on the TACT-institutional system of the Tel Aviv Stock Exchange. The debentures were rated for the issuance, by S&P Maalot Ltd. ("the Rating Agency") at BBB-/stable. In August 2008, the Rating Agency validated the said rating. The issue raised capital, net costs, in the amount of NIS 614 million.

The debentures are repayable in 8 annual principal and interest payments every 5th of July in each of the years 2010 through 2017. The principal payments in each of the years 2010 through 2013 will be at a rate of 8% of the nominal value of the debentures, and the principal payments in each of the years 2014 through 2017 will be at a rate of 17% of the nominal value of the debentures. The debentures are linked to the consumer price index commencing June 2008, and bear linked annual interest at the annual rate of 7.9% (subject to various possible adjustments according to the debenture terms), that will be repaid in semi-annual installments in January and July of each of the years 2009 through 2017.

The Company did not undertake to list the debentures on the stock exchange, but if they will be listed, the linked annual interest paid on them commencing on the listing date will be reduced to 7.4%. Under the terms set at the issue date of the debentures, as the debentures were not listed for trading by July 31, 2008, the annual interest that they bear increased to 8.4%, as of said date. If, in the future, the Company will list the debentures for trading, then the annual interest rate on them will decrease to 7.4% from the same date.

In addition, if the Company fails to comply with the terms set in the financing agreement it had entered into with the banks, and as a condition for the banks ceding the said breach, the Company will undertake to pay to the banks additional interest to that of the bank interest margin, and if the debentures are not listed at the time, then as long as the said margin supplement is paid to the banks and the debentures are not listed, the Company will pay the holders of the debentures an annual interest supplement at the same rate.

The debentures are secured by a first floating lien on all of the Company's assets (other than exceptions as dictated by the provisions of the Communications Law), unlimited in amount. They are further secured by a first fixed charge, unlimited in amount, on the Company's rights and assets that were attached by it in favor of banks (other than exceptions as dictated by the provisions of the Communications Law). The said securities are first level and pari pasu to the floating liens and the fixed charge created by the Company in favor of the banks, in order to secure the bank credit.

NOTE 15 – DEBENTURES (CONTD.)

	December 31, 2009			
	Nominal interest	Repayment year	Par value	Book value
			NIS thousands	NIS thousands
Debentures	8.4%	2010-2017	**620,300**	**680,553**

Repayment dates

	December 31, 2009
	NIS thousands
2010	54,812
2011	54,812
2012	54,812
2013	54,812
2014	116,476
2015 onwards	349,427
	685,151

Regarding attachments with respect to the debentures, also see Note 29.

NOTE 16 – LONG-TERM LOANS FROM INSTITUTIONAL ENTITIES

1) During March and April 2005, the Company signed agreements with three institutional entities according to which the institutional entities would grant the Company loans in the total amount of NIS 100 million.

   These loans are linked to the CPI and bear interest at a rate of 11% per annum. The loans are repayable, with the addition of interest and linkage differentials, on December 31, 2013, but are repayable at an earlier date, subject to partial repayment of the loans received from the banks, under the terms fixed in this contract.

   Bezeq undertook that if, by December 31, 2013, the loans have not been settled (in full or in part) or under certain other conditions, the lenders will be entitled to demand that Bezeq repay the lower of the loan balances (principal, interest and linkage), and the amount calculated based on a fixed formula, taking into account the Company's worth at said date.

2) The balance of the loans from institutional entities as at December 31, 2009, including accrued interest amount to NIS 68,157 thousand (as at December 31, 2008 – NIS 48,304 thousand).

NOTE 17 – LOANS FROM SHAREHOLDERS

A.

	Interest rate as at December 31, 2009	December 31 2009	December 31 2008
	%	NIS thousands	
Balance of the loans, based on their nominal terms:			
Old Shareholders loans (1)	Without interest	**2,200,008**	2,119,032
New Shareholders loans:			
Loans received prior to August 2003 (2)	5.5	**351,598**	321,562
Loans received from September 2003 and thereafter (2)	11	**1,113,108**	965,937
		3,664,714	3,406,531
Net – received loan amounts in excess of the fair value upon receipt, after cumulative reduction (at effective interest rate) (3)		**(1,682,827)**	(1,725,016)
		1,981,887	1,681,515

(1) The loans extended to the Company by its shareholders until July 20, 2002 ("Old Shareholders Loans") in the amount of NIS 2,200 million, are linked to the known index increase, do not have a repayment date and do not bear interest. These loans were received in accordance with their pro-rata holdings in the Company upon receipt of the loans.

(2) Pursuant to the agreement between the shareholders and the Company as of December 30, 2002, it was decided that the loans extended by some of the Company's shareholders as of July 10, 2002 ("the New Shareholders Loans"), will have preference over the Old Shareholders Loans. In accordance with the agreement, the New Shareholders Loans will be eligible for full settlement by the Company before any dividend is distributed by the Company and/or the repayment of the Old Shareholders Loans extended to the Company by the shareholders, and subject to the Company's cash flows and liabilities under the agreements with the banks.

The New Shareholders Loans which were received until April 2003, are linked to the known CPI and bear annual interest of 5.5%, while the New Shareholders Loans which were received after this date, based on an amendment to the aforesaid agreement, are linked to the known CPI with the addition of annual interest of 11%. No repayment dates were set for the new loans as well.

(3) The shareholders loans were included in the financial statements at their fair value at the time received. The fair value of the loans was set based on the current value of the expected cash flows for repayment of the loans, taking into consideration the dates on which the shareholders may make an initial request for repayment of the loans (in accordance with the restrictions that the shareholders consented to in the agreements with the banks and financial institutions) and at the interest rates applicable to loans with similar risks upon receipt of the loans. The interest rate taken into account as aforesaid, which constitutes the effective interest rate for the loans, is 12%.

When changes in the loan terms cause differences of over 10% in the discounted cash flows, the difference between the expected cash flows prior to the changes which are discounted at the interest rate at the time the loans were granted and their discounted value at the interest rate at the time of the changes, is attributed to financing income.

NOTE 17 – LOANS FROM SHAREHOLDERS (CONTD.)

A. (contd.)

(3) (contd.)
The difference between the current value of the monthly cash flows which are discounted in accordance with the interest rate at the time of the change to the old cash flows which are discounted at the interest rate at the time of the change, is attributed to capital reserves in shareholders equity.

During the course of 2007, in the framework of rating the debentures with the Rating Agency, the Company committed to the Rating Agency (and to it alone) that it shall not make payment on account of the shareholders loan prior to the end of the life of the debentures.

The interest rate at the time of change was set in accordance with a professional opinion received from an external consulting firm, according to which the interest rate for discounting the shareholders loans that do not bear interest is 15.63% and the interest rate for discounting the shareholders loans bearing interest of 5.5% is 15.58%.

Based on these rates, the difference between the expected cash flows prior to the change which are discounted according to the 12% interest rate at the time the loans were received and their discounted value of 15.63% or 15.58% at the time of the change, accordingly, which amounted to NIS 213 million, was attributed to the financing income.

The difference between the current value of the expected cash flows based on the new repayment dates and the current value of the cash flows which were expected based on the repayment dates prior to any change is discounted according to the interest rate at the time of the change, 15.63% or 15.58%, which amounted to NIS 348 million, was attributed to capital reserves.
The foregoing differences affect the Company's financing expenses in the future.

B. In accordance with the agreement aforementioned in section 2 above, the shareholders that injected the New Shareholders Loans into the Company were awarded rights to receive additional shares in the Company or options exercisable to shares, derived from their injection.

Accordingly, the shareholders were allocated additional shares in the Company or options exercisable to the Company's shares. The options are exercisable at any time and without additional consideration, and they are negotiable as though they were shares, subject to the approval of the banks, according to the financing agreements.

Exercise of the options allocated and changes in certain holdings in the Company are contingent to various regulatory approvals.
As at the date of the approval of these financial statements, said approvals have not been received. For further details, see Note 33.

NOTE 18 - OTHER NON-CURRENT LIABILITIES

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Open accounts with related parties	**8,340**	19,459
Deposits from customers	**5,287**	5,955
Notes and checks for repayment	**661**	2,398
	14,288	27,812

NOTE 19 – EMPLOYEE BENEFITS

Employee benefits include post-employment benefits, termination benefits, short-term benefits and share-based payments.

The Company has defined benefit plans for post-employment benefits and it makes contributions to central severance pay funds and appropriate insurance policies.
The Company also has a defined contribution plan for some of its employees who are subject to Section 14 of the Severance Pay Law – 1963.

Regarding share-based payments see Note 20 – Share-based Payments.

	December 31	
	2009	2008
	NIS thousands	NIS thousands
Current value of obligations	**13,400**	13,255
Fair value of plan assets	**(6,011)**	(5,245)
Liability recognized for defined benefit plan	**7,389**	8,010
Other liabilities	**10,161**	10,576
Total employee benefits	**17,550**	18,586
Presented under the following items:		
Other payables	**10,161**	10,576
Long-term employees benefits	**7,389**	8,010*
	17,550	18,586

* Reclassified

Post-employment benefit plans – defined contribution plan

A. Change in the current value of the defined benefit obligations

	December 31	December 31
	2009	2008
	NIS thousands	NIS thousands
Balance of obligations pertaining to defined benefit plan at January 1	**13,255**	12,049
Current service cost	**1,015**	2,192
Finance expenses with respect to obligations	**503**	559
Actuarial gains recognized in other comprehensive income	**(834)**	(864)
Benefits paid based on benefit plan	**(539)**	(681)
Balance of obligations as of end of year	**13,400**	13,255

B. Change in plan assets

	December 31	December 31
	2009	2008
	NIS thousands	NIS thousands
Fair value of plan assets as at January 1	**5,246**	4,284
Contributions paid into the plan	**785**	1,284
Expected return on plan assets	**318**	225
Actuarial (losses) recognized in other comprehensive income	**(297)**	(737)
Benefits paid based on benefit plan	**(41)**	(351)
Fair value of plan assets as at end of year	**6,011**	5,245

NOTE 19 - EMPLOYEE BENEFITS (CONTD.)

C. Expense recognized in profit or loss

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Current service cost	**1,015**	2,192
Interest for obligations	**503**	559
Expected return on plan assets	**(318)**	(225)
	1,200	2,526

The expense is recognized in the following line items in the income statement:

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Cost of sales	**558**	1,206
Selling and marketing expenses	**345**	745
General and administrative expenses	**112**	241
	1,015	2,192

D. Actuarial gains and losses recognized directly in other comprehensive income

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Amount accrued at December 1	**1,971**	1,844
Amounts recognized in the period	**537**	127
Amount accrued at December 31	**2,508**	1,971

E. Actuarial assumptions

	2009 %	2008 %
Discount rate as of December 31	2.9	3.7
Future salary increases	3	3-5

Assumptions regarding future mortality are based on published statistics and mortality tables.
The expected long-term yield rate on the assets is 2.93%. This rate is based on the whole asset portfolio and on the yield of the separate asset groups. The yield is based exclusively on historical returns, without adjustments.

NOTE 19 - EMPLOYEE BENEFITS (CONTD.)

F. Historical information

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Present value of the defined benefit obligation		
Defined benefit	**13,400**	13,255
Fair value of plan assets	**(6,011)**	(5,245)
Deficit in the plan	**7,389**	8,010

G. Post-employment benefit plans – defined contribution plan

	For the year ended December 31	
	2009 NIS thousands	2008 NIS thousands
Present value of the defined benefit obligation	**9,381**	8,302

NOTE 20 – SHARE-BASED PAYMENTS

On September 4, 2008, the Company's general meeting allocated 4,250,000 options of Bezeq to the Company's CEO, following approval by the board of directors of Bezeq.
The options, exercisable to Bezeq shares, will vest in three equal annual tranches, and the vested options will be exercisable for up to 5 years from the vesting date of the third tranche.

A. Number of Bezeq options

	Number of Options 2009 in thousands
Balance at 1 January	4,250
Awarded during the period	-
Balance as of December 31	**4,250**
Exercisable on December 31	1,417

NOTE 20 – SHARE-BASED PAYMENTS (CONTD.)

B. Additional details

The fair value of the services received in consideration of the stock options awarded is based on the fair value of the awarded options, measured on the Black-Scholes model, based on the following parameters:

Fair value at the time of grant	10,280
Parameters taken into account in calculating fair value:	
Price of Bezeq shares	6.18
Exercise price	5.24
Anticipated fluctuations (weighted average)	23.1% - 23.8%
Useful life of the options (projected weighted average)	5
Risk-free interest rate	5.1% - 5.3%
Additional information (not taken into account in calculation):	
Share price shortly prior to board of directors' decision	6.37
Share price shortly prior to allocation	5.92

The anticipated fluctuations were based on historical fluctuations of Bezeq's share prices. The life of the options was fixed based on the management's assessment with respect to the holding period, taking into consideration the position and past experience. The risk-free interest rate was determined on the basis of shekel government bonds, with the time to maturity being equal to the expected lifespan of the option warrants.
The total expense recorded with respect to the options during the three month period ended December 31, 2009, and attributed to administrative and general expenses in the statements of income, amounted to NIS 5,295 thousand.

Benefits

1) In July 2009, the Company's board of directors approved the revised employment contract for the Company's CEO, so that it cancelled his right to the allocation of options and awarded him a bonus, part of which was paid and part of which will be paid in 2010.

2) In January 2010, the general meeting of the Company's shareholders approved the CEO's revised employment contract according to which he will be eligible to a bonus under certain terms and conditions, inter alia, that he remains with the Company at least until December 31, 2010 when the controlling shares in Bezeq will be sold and Eurocom's holding in the Company will be sold. The bonus was awarded in the form of a loan extended to the CEO, which will be offset against the bonus in so far as the CEO will be eligible for.

NOTE 21 - CONTRACTS

1. At December 31, 2009, the Company is engaged in contracts for the acquisition of broadcasting rights. In the year ended December 31, 2009, the acquisition of such rights amounted to NIS 106 million.

2. At December 31, 2009, the Company is engaged in contracts for the acquisition of owned channels. In the year ended December 31, 2009, the acquisition of such rights amounted to NIS 255 million.

3. The Company is engaged in a primary operational leasing contract for the building it occupies. The lease expires in 2014, with an option to extend for a further 5 years. The rent is linked to the consumer price index (CPI). Furthermore, the Company is engaged in several additional operational leasing contracts for various periods.

   The contractual rentals for the forthcoming years calculated on the valid rentals at December 31, 2009, are as follows:

	NIS thousands
2010	9,280
2011 through 2014	24,208

4. Leasing of space segments:

   A. On May 16, 2001, the Company engaged in a contract for leasing space segments in the Amos 2 satellite, with a related party. The lease period ends after 12 years from the date the satellite was positioned in space or at the end of the satellite's life, the earlier of the two. The satellite was positioned in space in April 2004.

   B. On July 15, 2008, the Company engaged in a contract according to which it will lease 13 space segments in the Amos 2 and in Amos 3 satellites, while up until December 31, 2009, only 12 space segments were leased and the lease of the 13^{th} segment is contingent upon notification of either of the parties, in accordance with the provisions of the contract. In 2010 the Company will continue to lease 12 segments.

   C. Contractual leasing fees for the forthcoming years, based on the foregoing contracts, are as follows:

	NIS thousands
2010	98,150
2011 through 2014	392,600
2015 onwards	122,688

5. Leasing operations

   a) The Company engaged in several operational leasing contracts for a period of up to 36 months for vehicles it uses. The annual contractual leasing fees, based on the valid leasing fees at December 31, 2009, are NIS 24.8 million.

   b) During the course of the year, the Company purchased several components from a components importer. This transaction is handled in the Company's books as operational leasing. The expected annual payments, which will be spread over three years, are in the amount of NIS 10.8 million.

6. Licensing fees – pursuant to licensing terms, the Company undertook to pay royalties to the State of Israel, based on the income from broadcasting services as set forth in the license.

   In 2006, the rate of royalties was amended and pursuant to the Communications Regulations 5766-2006. As a result of the said amendment, the rates of royalties applicable were as follows: 2007 – 2.5%; 2008 – 2%; 2009 – 1.5%, 2010 and thereafter – 1%.

NOTE 21 – CONTRACTS (CONTD.)

7. In accordance with the licensing requirements and the regulations set forth by the Cable and Satellite Broadcasts Council ("the Council"), in each of the years 2006 through 2010, the Company will invest no less than 8% of its income from subscription fees in local production content broadcasts in said year. Furthermore, the Council required that the Company settle during 2010-2011 past debts for investment in content broadcasts in an amount totalling NIS 27,539 thousand.

8. Contracts with NDS Limited ("NDS") - The Company engaged in several agreements with NDS to acquire services pertaining to the Company's encoding, broadcasting and receiving systems and hardware pertaining to these services.
   In 2009 and 2008 the Company's payments to NDS amounted to NIS 31,283 thousand and NIS 26,392 thousand, respectively.

9. In August 2000 the Company engaged in a three-way contract to acquire decoders from Eurocom Marketing (1986) Ltd. ("Eurocom") and Advanced Digital Broadcast Ltd ("ADB"). Eurocom is an interested party of the Company. The contract included, inter alia, providing ongoing maintenance and repair services (following the warrantee period) by ADB.

   In 2009 and 2008 the Company's payments to Eurocom for the acquisition of decoders amounted to NIS 57 million and NIS 37 million, respectively.

NOTE 22 – CONTINGENT LIABILITIES

1. Guarantees

To assure its obligations the Company placed collateral in the amount of NIS 39 million (including State of Israel government guarantees in the amount of NIS 37 million).

2. Litigations

Various lawsuits were filed against the Company and it faces various pending proceedings (in this section: "Litigations").

In the opinion of the Company's management, which is based, inter alia, on the opinions of its legal counsel as to the likelihood of the success of these litigations, the financial statements (Note 14) include appropriate provisions for covering the exposure generated by such claims.

The management believes that the additional exposure as at December 31, 2009 due to claims filed against the Company on various matters and for which success is considered probable or unlikely, amounts to NIS 255,864 thousand. The foregoing amounts and all the amounts noted in this Note are prior to the addition of interest.

Below is a description of the status of the Company's material pending lawsuits as at December 31, 2009, classified by groups with similar characteristics.

A. Employee claims

During normal ongoing business, collective and individual lawsuits were filed against the Company by current and former employees of the Company. In particular, these lawsuits deal mainly with claims of non-payment of salary components and delay of pay. Various individual litigations were filed against the Company by its current and former employees. As at December 2009, the total amount of all the foregoing litigations amounted to a total of NIS 1,604 thousand. In the opinion of the Company's management, which is based, inter alia, on the opinions of its legal counsel as to the likelihood of the success of said litigations, the financial statements include appropriate provisions in the amount of NIS 699 thousand , where required, for covering the exposure generated by said litigations..

NOTE 22 – CONTINGENT LIABILITIES (CONTD.)

2. Litigations (contd.)

B. Customers litigation

During normal ongoing business, various litigations were filed against the Company by customers. In particular, these litigations are class action suits dealing with claims of unlawful charges and impaired services provided by the Company. As at December 2009, the total amount of all the foregoing litigations amounted to a total of NIS 209,271 thousand. In the opinion of the Company's management, which is based, inter alia, on the opinions of its legal counsel as to the likelihood of the success of said litigations, the financial statements include appropriate provisions in the amount of NIS 7,380 thousand , where required, for covering the exposure generated by said litigations..
Of the foregoing litigations, there are litigations that total NIS 4,000 thousand, which at this time cannot be estimated.

The foregoing legal proceedings include the following lawsuits - on October 3, 2007, a petition was filed against the Company with the Tel Aviv - Jaffa District Court on behalf of Mr. Yigal Grindler to approve a class action with respect to reception disturbances to DBS broadcasts and problems with the proper functioning of DBS service system during these disturbances in September 2007. The Applicant claims that during September 2007, DBS subscribers suffered daily disturbances and long breaks in television broadcasts, which were manifested, inter alia, as severe picture and sound disruptions and that DBS's service center did not function and it was not possible to receive service or assistance from them.
On January 16, 2008 the applicant filed a petition with the Court, according to which he had reached an understanding with the plaintiff in TA 2466/07, Ms Maya Ofek, in which she filed a suit and petition for approval as a class action against DBS on the same topic as this case, he claims that only this suit will proceed, and that the TA 2466/07 suit would be erased. On April 27, 2008 lawsuit TA 2466/70 was erased.
The applicants assessed the claim to be in the amount of NIS 121 million.
On April 13, 2008, DBS filed its response, in which it rejected the applicant's claims and noted that in light of DBS's actions to locate the disturbances and to grant its customers with benefits with respect to the disturbances and in light of the source of the disturbances, which was an external source outside of DBS's control, the purpose and rationale on which the instrument of class action by consumers against service providers is based do not exist.
On November 20, 2008, the applicants filed a rejoinder in which they claimed that in light of the fact that the frequencies used by DBS are secondary allocations, it should have anticipated such disturbances and been prepared for them.
On October 29, 2009, the Court ruled in favor of DBS's motion to erase sections in the applicant's rejoinder since they included new grounds, new claims and new evidence that have nothing to do with the petition for approval.
On December 7, 2009 the applicant filed an amended response and motion to add evidence.
On February 2, 2010, the Court accepted the motion, permitting the applicant to add a copy of Bezeq's report dated November 14, 2007 to the motion to approve class action and permitting DBS to complete its response to the motion to approve class action within 21 days.
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C. Litigations of suppliers and communication providers

During normal ongoing business, various litigations were filed against the Company by suppliers who provide the Company with goods and/or services. The primary litigation was filed for damages caused to a supplier as a result of DBS's negligence. As at December 31, 2009, the sum of these litigations amount to a total of NIS 44,990 thousand. No provisions were made in the financial statements for these claims.

NOTE 23 – SHAREHOLDERS EQUITY

A. Share capital

The shareholders equity consists of shares of NIS 1 par value each, as follows:

	December 31 2009	December 31 2008
	Number of shares and amount in NIS	
Issued and paid up share capital	**29,896**	29,896
Registered capital	**39,000**	39,000

B. Option warrants for shareholders

See Note 17(3)B.

NOTE 24 – COST OF REVENUES

	For the year ended December 31		
	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**132,172**	117,294	108,507
Content costs	**295,608**	278,285	269,614
Utilized broadcasting rights	**180,826**	168,478	156,384
Consumption of space segments:	**94,228**	89,997	105,564
Depreciation and amortization	**200,679**	217,873	247,231
Royalties	**13,581**	17,555	20,566
Others	**125,007**	201,689	209,232
	1,042,101	1,091,171	1,117,098

NOTE 25 – SALES AND MARKETING EXPENSES

	For the year ended December 31		
	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**27,913**	28,919	27,957
Advertising	**60,897**	62,862	75,124
Marketing consultation	**1,603**	1,791	1,595
Vehicle maintenance	**7,921**	8,739	9,081
Depreciation	**20,862**	21,510	18,352
Others	**3,116**	4,341	5,570
	122,312	128,162	137,679

NOTE 26 – ADMINISTRATIVE AND GENERAL EXPENSES

	For the year ended December 31		
	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**45,490**	49,119	43,655
Share-based payment	**5,295**	1,636	-
Professional consultation and fees	**7,738**	8,966	9,267
Rental and maintenance fees	**12,727**	12,706	11,465
Depreciation	**12,662**	10,497	7,619
Provision for doubtful and bad debts	**1,764**	2,352	3,554
Subcontractors (mainly for system maintenance)	**19,648**	18,726	17,277
Others	**12,481**	12,149	11,210
	117,805	116,151	104,047

NOTE 27 – FINANCE EXPENSES, NET

Recognized in profit or loss

	For the year ended December 31		
	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Income from interest on bank deposits	**(77)**	(178)	(353)
Changes in the fair value of financial assets at fair value through profit or loss	**(5,518)**	(35,883)	(212,949)
Income from linkage and other differentials	**(2,752)**	(15,744)	(13,039)
Finance income recognized in profit or loss	**(8,347)**	(51,805)	(226,341)
Expenses pertaining to shareholder loans	**258,183**	255,164	181,412
Expenses for discounting of shareholder loans	**42,190**	7,797	45,764
Changes in the fair value of financial assets at fair value through profit or loss	**4,558**	43,579	-
Interest expenses pertaining to financial liabilities measured at reduced cost:	**124,189**	127,392	115,485
Expenses pertaining to linkage and other differentials	**29,343**	34,163	29,978
Expenses from exchange rate changes	**3,253**	12,825	15,744
Other finance expenses	**16,557**	11,691	5,316
Finance expenses recognized in profit or loss	**478,273**	492,611	393,699
Finance expenses recognized in profit or loss, net	**469,926**	440,806	167,358

NOTE 28 – INCOME TAX

A. Income tax expense components

	For the year ended December 31		
	2009	2008	2007
	NIS thousands	NIS thousands	NIS thousands
Current tax expenses			
For the current period	**972***	1,048	1,251
In respect of preceding years	**(227)**	-	5,000
	745	1,048	6,251

* Expenses for surplus payment.

B. Deferred tax assets and liabilities

The Company has losses for tax purposes and deductions for inflation carried forward to the next year and recognized in the statements of financial position in the amount of NIS 4.4 billion (in 2008: NIS 4.2 billion)
Loss balances and deductions carried forward to the next year are CPI linked to the end of 2007.

Pursuant to the current Income Tax Law, there are no time restrictions on the utilization of losses for income tax purposes and on the utilization of deductable temporary provisions. The Company does not generate deferred taxes since it is not expected that it will have positive income in the foreseeable future, against which the tax benefit can be exploited.

C. Tax assessments

The Company has been issued final assessments up to and including 2004 and assessments considered final up to 2005.

D. Tax authority hearing

In February 2010 the Company reported to the tax authorities concerning a payment deficit for value added tax for 2006 and thereafter, in an amount of NIS 2,850 thousand (tax principal), which was discovered due to an internal audit conducted by the Company for the yes-WOW venture (offering a service bundle including DBS television services, infrastructure connection to the internet provided by the Company and internet access services provided by Bezeq International Ltd.). The foregoing is not expected to have a material impact on the financial statements.

NOTE 29 – TOTAL LIABILITIES ASSURED BY LIENS AND RESTRICTIONS IMPOSED WITH RESPECT TO LIABILITIES

A. The Company's liabilities balance and secured collateral are as follows:

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Debentures	**680,553**	654,780
Credit from banks	**890,734**	877,202
Guarantees	**39,460**	38,275

B. To secure the foregoing liabilities and collateral, the Company recorded a lien on all its assets, including share capital.

C. The terms of the loans and the credit facility that the Company received from the banks, the balance of which as at December 31, 2009 is NIS 960 million, impose certain restrictions the encumbrance or sale of certain Company assets, a restriction on receipt of credit from banks and others (without prior approval of the loaning banks), a restriction on distribution of dividends, a restriction concerning repayment of shareholders' loans and on transactions with interested parties, a restriction regarding the shareholding ratio of shareholders, a restriction concerning the Company's compliance with the various licenses issued to it, a restriction regarding the Company purchasing securities and establishment of a subsidiary, and a restrictions concerning the ratio for allocation of the Company's shares or other securities.

In addition, the imposition of various restricting loan terms, including the requirement to comply with financial covenants, as follows:

1) Minimum overall income.
2) Minimum operational surplus (as set in the financing agreement)
3) Minimum operational surplus net of investment in decoders (as set in the financing agreement)
4) Maximum churn rate
5) Overall financing needs (as set in the financing agreement)
6) Maximum supplier credit
7) Minimum bank debt cover ratio and balance-debt ratio (as defined in the agreement)

The values for compliance with the financial covenants vary and are measured quarterly. Noncompliance with the financial covenants awards the banks the right to demand early settlement of the loans that the Company received.

At December 31, 2009, the Company is in compliance with the financial covenants set for it subsequent to the relief granted in March 2009. For further information pertaining to the changes and updates in expected conditions subsequent to the balance sheet date, see Note 5.

NOTE 30—FINANCIAL RISK MANAGEMENT

A. General

The company is exposed to the following risks that derive from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risks (including currency and interest risks)

This Note presents information about the Company's exposure to each of the above risks, and the Company's objectives, policies and processes for measuring and managing risk.

B. Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the receivables from customers.
The management has a credit policy and it monitors the Company's credit risk exposure continuously.
The Company's management constantly monitors customer debts and financial reports including specific deductions for uncertain debts which properly reflect, as per the management's assessment, the latent loss in debts for which collection is uncertain

C. Liquidity risk

Liquidity risk is the risk of the Company being unable to meet its financial liabilities repayable by cash or other financial asset. The Company’s approach to managing liquidity risk is to ensure, as far as possible, the degree of liquidity that is sufficient to meet its liabilities on time, under normal conditions and stressful conditions, without causing it unexpected losses or harming its goodwill.
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D. Market risk

Market risk is the risk that changes to market prices such as foreign currency exchange rates and interest rates will impact the Company's income or the value of its holdings in financial instruments. The objective of market risk management is to manage and supervise the exposure to market risks under restricting parameters, by maximizing the risk yield.

NOTE 31 - FINANCIAL INSTRUMENTS

A. Credit risk

(1) Exposure to credit risk

The book value of the financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	December 31	December 31
	2009	2008
	NIS thousands	NIS thousands
Short-term deposits	**3,020**	3,000
Trade receivables	**160,152**	152,876
Other receivables	**6,657**	6,106
	169,829	161,982

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

A. Credit risk (contd.)

(2) Aging of debts and impairment losses

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Not in arrears	**156,061**	151,320
Past due up to 1 year	**8,152**	7,167
Past due 6 months to 1 year	**7,693**	4,494
Past due over two years	**3,917**	4,731
	175,823	167,712
Net of provision for doubtful debts	**(9,013)**	(8,730)
Total	**166,180**	158,982

(3) Changes in provision for doubtful and bad debts:

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Balance as of 1 January	**8,730**	8,350
Other provision	**283**	380
Balance as of December 31	**9,013**	8,730

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

B. Liquidity risk

Hereunder contractual repayment dates of financial liabilities, including interest payments. This aging does not include the impact of netting agreements.

	As at December 31, 2009						
	Book value	Cash flows	6 months or less	6-12 months	1-2 years	2-5 years	More than five years
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Non-derivative financial liabilities							
Credit from banks at variable interest	44,504	44,504	44,504	-	-	-	-
Credit from banks at fixed interest	846,230	976,660	186,350	141,301	290,841	358,168	-
Debentures, including accrued interest	708,778	985,762	29,013	83,352	107,761	357,452	408,184
Loans from institutions	181,729	275,956	-	-	-	275,956	-
Loans from shareholders	1,982,166	5,164,460	-	-	-	-	5,164,460
	3,763,407	7,447,342	259,867	224,653	398,602	991,576	5,572,644
Derivative Financial liabilities							
Forward exchange contracts, net	989	989	989	-	-	-	-

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

B. Liquidity risks (contd.)

	As at December 31, 2008						
	Book value	Cash flows	6 months or less	6-12 months	1-2 years	2-5 years	More than five years
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Non-derivative financial liabilities							
Credit from banks at variable interest	30,972	30,972	30,972	-	-	-	-
Credit from banks at fixed interest	846,230	846,230	846,230	-	-	-	-
Debentures, including accrued interest	732,979	1,210,272	78,984	27,492	108,237	324,864	670,695
Loans from institutions	157,700	265,810	-	-	-	265,810	-
Loans from shareholders	1,681,515	4,974,578	-	-	-	-	4,974,578
	3,449,396	7,327,862	956,186	27,492	108,237	590,674	5,645,273
Derivative Financial liabilities							
Forward exchange contracts, net	3,569	3,517	3,517	-	-	-	-

* Credit from banks at variable interest was presented for immediate settlement as the Company did not comply with the financial covenants set for it as at December 31, 2008. The repayment dates of this liability, according to the agreement, not taking into account the non compliance with the financial covenants are as follows:

	As at December 31, 2008						
	Book value	Cash flows	6 months or less	6-12 months	1-2 years	2-5 years	More than five years
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Credit from banks at fixed interest	846,230	976,660	23,339	23,339	280,973	649,009	-

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

C. Foreign currency and index risks

(1) Foreign currency and index risks for the Company's financial instruments are as follows

	December 31, 2009				
	Unlinked	Index linked	In foreign currency or foreign currency linked (Primarily USD)	Non financial items	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets					
Short-term deposits	3,020	-	-	-	3,020
Trade receivables	155,111	-	5,041	-	160,152
Other receivables	6,614	2	41	1,520	8,177
Total assets	164,745	2	5,082	1,520	171,349
Liabilities					
Credit from banks	283,698	-	-	-	283,698
Trade payables	322,688	-	83,701	-	406,389
Other payables	54,602	70,800	-	17,941	143,343
Debentures	-	625,741	-	-	625,741
Contingent liabilities in debentures	-	54,812	-	-	54,812
Loans from shareholders	-	1,981,887	-	-	1,981,887
Loans from institutions	-	181,729	-	-	181,729
Bank loans	607,036	-	-	-	607,036
Other liabilities	9,001	5,287	-	-	14,288
Total liabilities	1,277,025	2,920,256	83,701	17,941	4,298,923
Surplus liabilities over assets	1,112,280	2,920,254	78,619	16,421	4,127,574

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

C. Foreign currency and index risks

(1) Foreign currency and index risks for the Company's financial instruments based on nominal values are as follows (contd.)

	December 31, 2008				
	Unlinked	Index linked	In foreign currency or foreign currency linked (Primarily USD)	Non financial items	Total
	NIS thousands	NIS thousands	NIS thousands		NIS thousands
Assets					
Short-term deposits	3,000	-	-	-	3,000
Trade receivables	147,719	-	5,157	-	152,876
Other receivables	1,356	112	4,638	2,155	8,261
Total assets	152,075	112	9,795	2,155	164,137
Liabilities					
Credit from banks	877,202	-	-	-	877,202
Trade payables	283,293	-	116,987	-	400,280
Other payables	73,940	117,349	-	16,673	207,962
Debentures	-	654,780	-	-	654,780
Loans from shareholders	-	1,681,515	-	-	1,681,515
Loans from institutions	-	157,700	-	-	157,700
Other liabilities	21,857	5,955	-	-	27,812
Total liabilities	1,256,292	2,617,299	116,987	16,673	4,007,251
Surplus liabilities over assets	1,104,217	2,617,187	107,192	14,518	3,843,114

(2) Hereunder figures pertaining to the CPI and exchange rates of material currencies:

	December 31 2009	December 31 2008	% Change 2009	% Change 2008
Consumer price index (in points)	**110.57**	106.4	**3.9**	3.8
US dollar exchange rate	**3.775**	3.802	**(0.01)**	(1.14)
Euro exchange rate	**5.442**	5.297	**2.7**	(6.39)

D. Interest rate risk

Hereunder details of the types of interest on the Company's interest bearing financial instruments:

	Book value 2009	Book value 2008
	NIS thousands	NIS thousands
Instruments at fixed interest		
Bank deposits	**3,020**	3,000
Financial liabilities	**3,690,679**	3,340,225
Instruments at variable interest		
Financial liabilities	**43,816**	30,972

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

E. Fair value compared to book value

The book value of assets and liabilities correspond with or are close to their fair values.
The fair value of assets and financial liabilities, which are not presented in the books at their fair value, are as follows:

	2009		2008	
	Book value	Fair value	Book value	Fair value
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Bank loans	**846,230**	**841,671**	846,230	808,490
Institutional loans	**181,729**	**192,263**	157,700	155,647
Debentures, including accrued interest	**708,778**	**714,603**	732,979	724,165
	1,736,737	**1,748,537**	1,736,909	1,688,302

See Note 4 for the basis for determining fair value.

The interest rates used to discount estimated cash flows, when applicable, are based on the government yield curve at the reporting date plus an adequate credit spread, and in 2009 ranged between 8.42% - 9.22% (in 2008 – 9.1% - 11.3%).:

F. Derivative financial instruments

The Company has limited involvement in derivative financial instruments ("Derivatives"). The Company contracts such transactions with the objective of protecting its cash flows. See details in Note 31B.

G. Sensitivity test

Below are sensitivity tests for changes in the main market risks which changes will change the values of assets and liabilities and will impact the Company's net profit and equity.

(1) Sensitivity to changes in the CPI

The Company has financial instruments that are sensitive to changes in the CPI such as loans, debentures and customer deposits. The sensitivity analysis of 5% and 10% refers to the rate of deviation from an inflation assessment of 2% per year, based on the Inflation Target Center at the Bank of Israel.

Sensitivity analysis as at December 31, 2009

Deviation rate from inflationary goal	10%	5%	(5%)	(10%)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Impact on equity and net profit	**(5,930)**	**(2,965)**	**2,965**	**5,930**

Sensitivity analysis as at December 31, 2008

Deviation rate from inflationary goal	10%	5%	(5%)	(10%)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Impact on equity and net profit	(5,162)	(2,581)	2,581	5,162

NOTE 31 - FINANCIAL INSTRUMENTS (CONTD.)

G. Sensitivity test (contd.)

(2) Sensitivity analysis of changes in the US dollar exchange rate

The Company has financial instruments that are sensitive to changes in the US dollar exchange rate, such as trade payables and forward transactions. The sensitivity analysis of 5% and 10% refers to the rate of changes in the exchange rate.

Sensitivity analysis as at December 31, 2009

Change rate in NIS in the Shekel/dollar exchange rate	10%	5%	(5%)	(10%)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Impact on equity and net profit	**(7,704)**	**(3,852)**	**3,852**	**7,704**

Sensitivity analysis as at December 31, 2008

Change rate in NIS in the Shekel/dollar exchange rate	10%	5%	(5%)	(10%)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Impact on equity and net profit	1,534	767	(767)	(1,534)

(3) Sensitivity to changes in the interest rates

The Company has financial instruments that are sensitive to changes in interest rates such as financial liabilities to banks. The sensitivity analysis of 5% and 10% refers to the rate of changes in the interest rate.

Sensitivity analysis as at December 31, 2009

Change rates in interest rate	10%	5%	(5%)	(10%)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Impact on equity and net profit	**(176)**	**(88)**	**88**	**176**

Sensitivity analysis as at December 31, 2008

Change rates in interest rate	10%	5%	(5%)	(10%)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Impact on equity and net profit	(3,097)	(1,549)	1,549	3,097

NOTE 32 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. Transactions with interested and related parties

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Revenue (3)	**12,196**	9,629
Cost of income (1)	**112,576**	203,380
Administrative and general expenses	**1,855**	2,337
Financing expenses	**302,303**	262,192
Salary and benefits to interested parties employed by the Company (2)	**8,367**	4,805

(1) The expenses primarily include costs of leasing space segments from an interested party and operating costs of Bezeq Online call center (see Note 21).

(2) The Company's CEO participates in an options plan for shares in the parent company (see Note 20). In addition, on August 11, 2008, the Company's board of directors approved a two year options plan for the Company's CEO for 2009 and 2010, based on compliance with certain goals defined in the plan.

(3) Includes revenues from the sale of content to interested parties.

B. Balances with related parties

	December 31 2009 NIS thousands	December 31 2008 NIS thousands
Loans from Shareholders (see Note 17)	**1,981,887**	1,681,515
Current liabilities	**77,902**	118,109
Non-current liabilities	**8,340***	19,459
Other receivables	**52**	784

* Constitutes the balance of the settlement agreement signed in 2006 for past debts

C. Additional details

(1) The Company is engaged in a contract for the import and maintenance of digital satellite decoders from a company that is an interested party (see Note 21). The cost of acquisition and maintenance of decoders amounted to NIS 57 million (in 2008 – NIS 37 million).

(2) The Company is engaged in an agreement with an interested party for the installation of broadcasting and receiving equipment. The cost of installations in 2009 amounted to NIS 1.9 million (2008 – NIS 21 million).

(3) With respect to options awarded to the Company's shareholders - see Note 17(3)B

(4) The Company has a disputed debt with Bezeq. The parties have agreed to a settlement which was approved by the Company's administration, but is yet to be approved by Bezeq's administration.

NOTE 33 – MATERIAL EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

For information pertaining to update to the employment terms of the CEO, see Note 20C(2).

NOTE 34 – APPOINTMENT OF THE CHAIRMAN OF THE BOARD FOR THE FINANCIAL STATEMENTS APPROVAL MEETING

On the date of the meeting to approve the financial statements the Company does not have a serving chairperson of the board of directors. As a result, on February 25, 2009 the Company's board of directors certified Mr Rimon Ben Shaul to serve as a Company director, to act as chairman of the board of directors meeting in which the financial statements are approved and by virtue of such to sign on the Company's financial statements as at December 31, 2009.

“BEZEQ” THE ISRAEL TELECOMMUNICATION CORP. LIMITED

FINANCIAL DATA FROM THE CONSOLIDATED FINANCIAL STATEMENTS ATTRIBUTED TO THE PARENT COMPANY FOR THE YEAR ENDED DECEMBER 31, 2009

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To:
The shareholders of "Bezeq" The Israeli Telecommunication Corp. Limited

Dear Sirs,

Subject: Special auditors' report on separate financial data according to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) – 1970

We have audited the separate financial data presented in accordance with Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) – 1970 of "Bezeq" The Israeli Telecommunication Corp. Limited (hereinafter – the Company) as at December 31, 2009 and 2008 and for each of the three years, the last of which ended December 31, 2009. The separate financial data are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on the separate financial data based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Israel. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial data are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the separate financial data. An audit also includes assessing the accounting principles that were used in preparing the separate financial data and the significant estimates made by the Board of Directors and by Management, as well as evaluating the separate financial data presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the separate financial data has been prepared, in all material respects, in accordance with Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) - 1970.

Without qualifying our opinion, we draw attention to claims made against the Company of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Note 9.

Somekh Chaikin
Certified Public Accountants (Isr.)

March 2, 2010

Data on financial condition at December 31

	Note	2009 NIS millions	2008 NIS millions
Assets			
Cash and cash equivalents	2	**360**	93
Investments, including derivatives	3A	**10**	23
Trade receivables		**845**	902
Other receivables		**555**	531
Inventory		**9**	11
Assets classified as held for sale		**40**	34
Total current assets		**1,819**	1,594
Investments including derivatives	3A	**100**	137
Trade & other receivables		**102**	54
Property, plant and equipment	5	**3,646**	3,647
Intangible assets		**193**	138
Deferred and other expenses		**125**	171
Investments in associates		**6,566**	4,471
Deferred tax assets	4	**383**	540
Total non-current assets		**11,115**	9,158
Total assets		**12,934**	10,752

	Note	2009 NIS millions	2008 NIS millions
Liabilities			
Debentures, loans and borrowings	3C	**685**	671
Trade payables	3B	**263**	330
Other payables, including derivatives	3B	**537**	530
Loans from subsidiaries	3, 8	**250**	-
Current tax liabilities		**86**	19
Deferred income		**19**	25
Provisions	9	**279**	253
Employee benefits		**469**	366
Total current liabilities		**2,588**	2,194
Debentures	3C	**3,166**	3,605
Obligations to banks	3C	**383**	-
Employee benefits		**247**	219
Deferred income and others		**6**	19
Total non-current liabilities		**3,802**	3,843
Total liabilities		**6,390**	6,037
Equity			
Share capital		**6,187**	6,132
Premium on share capital		**275**	-
Reserves		**595**	748
Deficit balance		**(513)**	(2,165)
Total equity		**6,544**	4,715
Total equity and liabilities		**12,934**	10,752

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Shlomo Rodav	**Avraham Gabbay**	**Alan Gelman**
Chairman of the Board	CEO	Deputy CEO and CFO

Date of approval of the financial statements: March 2, 2010

The attached Notes are an integral part of the separate financial data.

Income data for the year ended December 31

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Revenue	6	**5,303**	5,498	5,713
Costs and expenses				
Depreciation and amortization		**794**	852	941
Salaries		**1,094**	1,202	1,293
Operating and general expenses	7	**1,690**	1,873	2,121
Other operating expenses, net		**202**	96	39
		3,780	4,023	4,394
Operating income		**1,523**	1,475	1,319
Finance expenses				
Finance expenses		**295**	361	496
Finance income		**(310)**	(236)	(308)
Finance expenses (income), net		**(15)**	125	188
Profit after finance expenses, net		**1,538**	1,350	1,131
Equity in profits of associates		**958**	677	593
Profit from loss of control in a company consolidated in the past		**1,538**	-	-
Profit before income tax		**4,034**	2,027	1,724
Income tax	4	**431**	400	394
Profit for the year		**3,603**	1,627	1,330

The attached Notes are an integral part of the separate financial data.

Profit data for the year ended December 31

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Profit for the year		**3,603**	1,627	1,330
Items of other comprehensive income				
Actuarial profits (losses) from a defined benefit plan		**(13)**	(2)	14
Miscellaneous		**(1)**	(9)	4
Taxes for items of other comprehensive income	4	**3**	1	(4)
Other comprehensive income for the year, net of tax		**(11)**	(10)	14
Total comprehensive income for the year		**3,592**	1,617	1,344

The attached Notes are an integral part of the separate financial data.

Cash flow data for the year ended December 31

	Note	2009	2008	2007
		NIS millions	NIS millions	NIS millions
Cash flows from operating activities				
Profit for the year		**3,603**	1,627	1,330
Adjustments:				
Depreciation	5	**709**	709	789
Amortization of intangible assets		**79**	114	146
Amortization of deferred and other expenses		**6**	29	6
Profit from loss of control in a company consolidated in the past		**(1,538)**	-	-
Equity in profits of affiliates accounted by the equity method		**(958)**	(677)	(593)
Finance expenses, net		**(44)**	86	148
Payments to former senior officer		**-**	-	6
Capital gain, net		**(64)**	(68)	(87)
Share-based payment transactions		**25**	38	-
Income tax expenses	4	**431**	400	394
Change in inventory		**1**	9	(6)
Change in trade receivables		**(18)**	106	(216)
Change in other receivables		**46**	(17)	33
Change in other payables	3	**20**	49	(56)
Change in trade payables	3	**(19)**	(56)	22
Change in provisions		**25**	(34)	79
Change in employee benefits		**118**	(306)	(304)
Change in deferred income and others		**(3)**	1	(8)
Net cash from current operations in respect of transactions with affiliates	8	**2**	16	20
Income tax paid, net		**(202)**	(335)	(324)
Net cash from operating activities		**2,219**	1,691	1,379
Cash flows from investment activities				
Investment in intangible assets and deferred expenses		**(133)**	(98)	(93)
Proceeds from sale of property, plant and equipment and deferred expenses		**86**	144	169
Change in current investments, net		**6**	319	647
Purchase of property, plant and equipment	5	**(720)**	(518)	(412)
Proceeds from realization of non-current investments and loans		**47**	19	54
Purchase of investments and long-term loans		**(1)**	(2)	-
Dividend received		**-**	-	4
Interest received		**25**	34	91
Net cash from investment activities in respect of transactions with affiliates		**578**	302	-
Net cash from (used for) investment activities		**(112)**	200	460

The attached Notes are an integral part of the separate financial data.

Cash flow data for the year ended December 31 (contd.)

	Note	2009 NIS millions	2008 NIS millions	2007 NIS millions
Cash flows from financing activities				
Receipt of bank loans	3	**400**	-	-
Repayment of debentures	3	**(556)**	(593)	(1,811)
Issuance of debentures		**-**	-	1,200
Dividend paid		**(1,941)**	(1,514)	(2,860)
Interest paid		**(167)**	(183)	(238)
Receipt in respect of derivatives, net		**44**	52	77
Proceeds from exercise of option warrants for shares		**129**	-	-
Net cash from financing activities in respect of transactions with affiliates	8	**250**	-	-
Net cash used for financing activities		**(1,841)**	(2,238)	(3,632)
Increase (decrease), net, in cash and cash equivalents		**266**	(347)	(1,793)
Cash and cash equivalents at January 1		**93**	451	2,262
Exchange rate differences		**1**	(11)	(18)
Cash and cash equivalents at the end of the year	2	**360**	93	451

The attached Notes are an integral part of the separate financial data.

NOTE 1 – MANNER OF PREPARING THE FINANCIAL STATEMENTS

A. Definitions

"Company" – Bezeq The Israel Telecommunication Corp., Limited.

"Affiliate", "the Group", "Associate", "Interested Party" – as these terms are defined in the consolidated financial statements of the Group for 2009 ("the Consolidated Financial Statements").

B. Main points in the manner of preparing the financial data

The financial data from the Consolidated Financial Statements which are attributed to the Parent Company ("the Financial Data") were prepared in accordance with the provisions of Article 9C in the Securities (Periodic and immediate reports) Regulations, 5730-1970, including the details referred to in the Tenth Schedule to those Regulations("the Tenth Schedule").

In addition, the Notes presented below include disclosures relating to additional material information, in accordance with the disclosure requirements of the aforementioned Article and as described in the Tenth Schedule, to the extent that such information was not included in the Consolidated Financial Statements in a way that relates expressly to the Company itself as parent.

NOTE 2 – CASH AND CASH EQUIVALENTS

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Denominated in shekels	**357**	90
Linked to a foreign currency	**3**	3
Total cash and cash equivalents	**360**	93

NOTE 3 – FINANCIAL INSTRUMENTS

A. Investments, including derivatives

(1) Segmentation by investment classification

	December 31, 2009	December 31, 2008
	NIS millions	NIS millions
Current investments		
Government and corporate bonds	**-**	6
Derivatives	**10**	17
	10	23
Non-current investments		
Bank deposit for grant of loans to employees	**83**	130
Investments in mutual funds	**7**	7
Derivatives	**10**	-
	100	137
	110	160

NOTE 3 – FINANCIAL INSTRUMENTS (CONTD.)

A. Investments including derivatives (contd.)

(2) Analysis of projected realization dates

	2010	2012	To be set	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Investments in shares and options	**-**	**-**	**7**	**7**
Bank deposit for grant of loans to employees	**-**	**-**	**83**	**83**
Derivatives	**10**	**10**	**-**	**20**
	10	**10**	**90**	**110**

B. Trade payables and other payables

	December 31, 2009			
	Unlinked	CPI-linked	In dollars or dollar-linked	Total
	NIS millions			
Trade payables	**236**	**-**	**27**	**263**
Other payables	**426**	**111**	**-**	**537**
	662	**111**	**27**	**800**

	December 31, 2008			
	Unlinked	CPI-linked	In dollars or dollar-linked	Total
	NIS millions			
Trade payables	310	-	20	330
Other payables	407	123	-	530
	717	123	20	860

C. Debentures and loans

(1) Composition

	December 31 2009	December 31 2008
	NIS millions	NIS millions
Current liabilities		
Current maturities of debentures	**668**	671
Current maturities of bank loans	**17**	-
Loans from affiliates	**250**	-
	935	671
Non-current liabilities		
Debentures	**3,166**	3,605
Bank loans	**383**	-
	3,549	3,605
	4,484	4,276

NOTE 3 – FINANCIAL INSTRUMENTS (CONTD.)

C. Debentures (contd.)

(2) Debt repayment terms and schedule

	Currency	Nominal interest rate %	Redemption year	December 31, 2009 Par value NIS millions	December 31, 2009 Carrying value NIS millions	December 31, 2008 Par value NIS millions	December 31, 2008 Carrying value NIS millions
Bank loans:							
Unlinked	NIS	Prime + 0.85 to Prime + 1	2010-2013	**400**	**400**	-	-
Loans from affiliates:							
Linked	NIS	4	2010	**250**	**250**	-	-
					650		
Debentures issued to the public:							
Linked to the CPI	NIS	4.8-5.3	2010-2016	**2,987**	**3,510**	3,287	3,740
Debentures issued to financial institutions and other							
Linked to the CPI	NIS	4.8-5.95	2010-2014	**273**	**324**	471	536
					3,834		4,276
Total interest-bearing liabilities					**4,484**		4,276

NOTE 3 – FINANCIAL INSTRUMENTS (CONTD.)

D. Liquidity risk

Below are the contractual repayment dates of financial liabilities, including interest payments:

	As at December 31, 2009						
	Carrying value	**Contractual cash flow**	**6 months or less**	**6-12 months**	**1-2 years**	**3-5 years**	**Over 5 years**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Financial liabilities that are not derivatives							
Trade payables	**263**	**263**	**263**	**-**	**-**	**-**	**-**
Other payables	**537**	**537**	**528**	**9**	**-**	**-**	**-**
Loans from subsidiaries	**250**	**250**	**250**	**-**	**-**	**-**	**-**
Bank loans	**400**	**432**	**4**	**24**	**84**	**320**	**-**
Debentures issued to the public	**3,510**	**4,011**	**417**	**-**	**959**	**1,653**	**982**
Debentures issued to financial entities and others[(1)]	**324**	**342**	**219**	**12**	**50**	**61**	**-**
	5,284	**5,835**	**1,681**	**45**	**1,093**	**2,034**	**982**

(1) Including approximately NIS 94 million of Company debentures stated in the financial statements at short term due to non-compliance with financial covenants.

NOTE 3 – FINANCIAL INSTRUMENTS (CONTD.)

D. Liquidity risk (contd.)

	As at December 31, 2008						
	Book value	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	Over 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives							
Trade payables	330	330	330	-	-	-	-
Other payables	526	526	526	-	-	-	-
Debentures issued to the public	3,740	4,480	517	-	501	2,009	1,453
Debentures issued to financial entities and others[1]	536	571	12	12	12	535	-
	5,132	5,907	1,385	12	513	2,544	1,453
Derivative financial liabilities	16	4	-	7	(3)	-	-

(1) Including approximately NIS 116 million of Company debentures stated in the financial statements at short term due to non-compliance with financial covenants.

NOTE 3 – FINANCIAL INSTRUMENTS (CONTD.)

E. Currency and index risks

The Company's exposure to index and currency risks in respect of derivative financial instruments is as follows:

	December 31, 2009				
	Currency/ linkage receivable	Currency/ linkage payable	Expiration date	Par value (currency)	Fair value
				Millions	NIS millions
Instruments not used for hedging					
Forward contract on CPI	CPI	CPI	2010-2012	**400**	**19**

	December 31, 2008				
	Currency/ linkage receivable	Currency/ linkage payable	Expiration date	Par value (currency)	Fair value
				Millions	NIS millions
Instruments not used for hedging					
Forward contract on exchange rates	Dollar	NIS	2009	8	-
Forward contract on CPI	CPI	CPI	2009-2012	1,700	2
					2

NOTE 4 – INCOME TAX

A. General

	For the year ended December 31		
	2009	**2008**	**2007**
	NIS millions	**NIS millions**	**NIS millions**
Current tax expense			
In respect of the current period	**301**	292	299
Adjustments in respect of prior years, net	**(30)**	-	-
	271	292	299
Deferred tax expense			
Creation and reversal of temporary differences	**120**	108	95
Effect of change of tax rates	**40**	-	-
	160	108	95
Income tax expense	**431**	400	394

B. Deferred tax assets and liabilities recognized

Deferred tax assets and liabilities are attributed to the following items

	Assets	
	2009	**2008**
	NIS millions	**NIS millions**
Property, plant and equipment	**-***	22
Employee benefit plans	**318**	345
Share-based payments	**27**	118
Provisions	**30**	43
Others	**8**	12
	383	540

* Less than NIS 500,000.

NOTE 4 – INCOME TAX (CONTD.)

C. Changes in temporary differences during the year

	Balance at January 1, 2008	Charged to profit and loss	Charged to equity	Balance at December 31, 2008	Charged to profit and loss	Charged to equity	Balance at December 31, 2009
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Property, plant and equipment	54	(32)	-	22	**(22)**	**-**	**-**
Employee benefits	399	(54)	-	345	**(30)**	**3**	**318**
Share-based payments	136	(18)	-	118	**(91)**	**-**	**27**
Provisions	47	(4)	-	43	**(13)**	**-**	**30**
Others	11	-	1	12	**(4)**	**-**	**8**
	647	(108)	1	540	**(160)**	**3**	**383**

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT

A. Property, Plant and Equipment

	2009 NIS millions	2008 NIS millions	2007 NIS millions
Cost or deemed cost			
Balance at January 1	**16,652**	**16,385**	16,448
Additions	**710**	**504**	442
Disposals	**(732)**	**(184)**	(451)
Transfer to assets held for sale	**(41)**	**(53)**	(54)
Balance at December 31	**16,589**	**16,652**	16,385
Depreciation and loss from impairment of assets			
Balance at January 1	**13,005**	**12,512**	12,203
Depreciation for the year	**709**	**709**	789
Disposals	**(714)**	**(178)**	(440)
Transfer to assets held for sale	**(57)**	**(38)**	(40)
Balance at December 31	**12,943**	**13,005**	12,512
Carrying value			
At January 1	**3,647**	**3,873**	4,245
At December 31	**3,646**	**3,647**	3,873

NOTE 6 – REVENUE

	For the year ended December 31,		
	2009 NIS millions	2008 NIS millions	2007 NIS millions
Telephony	**3,333**	3,572	3,905
Internet	**863**	790	712
Data transmission and communication	**851**	811	754
Other services	**256**	325	342
	5,303	5,498	5,713

NOTE 7 – OPERATING AND GENERAL EXPENSES

	For the year ended December 31,		
	2009	**2008**	**2007**
	NIS millions	**NIS millions**	**NIS millions**
Cellular telephone expenses	**823**	894	1,033
General expenses	**266**	259	268
Materials and spare parts	**80**	99	83
Building maintenance	**278**	293	297
Services and maintenance by sub-contractors	**96**	113	156
Vehicle maintenance expenses	**96**	126	127
Royalties to the State of Israel	**18**	57	98
Collection fees and miscellaneous	**33**	32	59
	1,690	1,873	2,121

NOTE 8 – MATERIAL ENGAGEMENTS AND TRANSACTIONS WITH AFFILIATES

List of the entities held by the Company:

- Pelephone Communications Ltd. – ("Pelephone").
- Bezeq International Ltd. ("Bezeq International").
- Bezeq On Line Ltd. ("Bezeq On Line").
- Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav").
- Stage One Venture Capital Fund (Israel), LP ("Stage One").
- D.B.S. Satellite Services (1998) Ltd. ("DBS").

A. Financial guarantees

(1) The Company provided Bezeq International with guarantees of up to NIS 70 million: a guarantee provided in 1996 for NIS 60 million, and another two guarantees from 1997 for a total of NIS 10 million, which were provided in favour of Bezeq-Call Communications, which merged into Bezeq International.

(2) The Company provided a guarantee for DBS of approximately NIS 10 million in respect of a bank guarantee of approximately NIS 36 million that DBS provided in favour of the State of Israel. The guarantee is valid to December 31, 2010.

(3) Bank loans taken by DBS at December 31, 2008 of approximately NIS 846 million, were originally received for the long term, but since at December 31, 2008 DBS was not in compliance with the financial covenants set by the banks, the loans were stated as short-term liabilities.

The Company undertook, in connection with loans of approximately NIS 100 million (the balance of which, including interest and linkage differentials at December 31, 2009 is approximately NIS 182 million) received by DBS from institutional bodies, that if by December 31, 2013 the loans (all or some of them) are not repaid, or if certain other terms are fulfilled, the lenders can demand that DBS repay the lower of the balance of the loans (principal, interest and linkage) and a sum calculated according to a preset formula that takes into account the value of DBS as at that date.

NOTE 8 – MATERIAL ENGAGEMENTS AND TRANSACTIONS WITH AFFILIATES (CONTD.)

A. Financial guarantees (contd.)

(4) The shareholders in DBS (other than the Company) pledged their shares in favour of the banks. In view of a negative pledge of the Company, the Company guaranteed towards the banks in a perpetual guarantee for payments of the debts of DBS. The guarantee is for up to a maximum sum equal to the percentage of the Company's holding in DBS multiplied by the value of DBS as derived from sale of the pledged shares of the other shareholders. If the Company joins the sale in a realization of the shares in DBS, the deed of guarantee includes numerous limitations on the Company in realization of the shares it holds, and lists violation events which, if they take place, will entitle the banks to implement the guarantee. In addition, the Company undertook to put it shares up for sale in the event of sale of the pledged shares by the banks, and agreed that in the event of realization of the collateral given by the other shareholders, the Company would waive repayment of the shareholder loans extended to DBS and that its guarantee would apply, *mutatis mutandis*, also to options for shares that the Company would receive from DBS and to the right to receive them.

The shareholders in DBS, except for one of them, undertook towards the banks not to oppose sale or other realization of their shares in DBS that were pledged or for which a guarantee was provided (by the Company), in a way that will enable the banks to make the sale as a friendly liquidation.

B. Loans

Loans from affiliates

(1) On October 4, 2009, the Company took a loan of NIS 280 million from Pelephone (in accordance with the framework agreement between the two companies).

The loan was linked to the CPI and bore 4% annual interest, repayable by January 4, 2010. At December 31, 2009 the balance of the unpaid principal was NIS 180 million, which was subsequently repaid on its due date.

(2) On October 4, 2009, the Company took a loan of NIS 70 million from Bezeq International (in accordance with the framework agreement between the two companies). The loan was linked to the CPI and bore 4% annual interest, repayable by January 4, 2010. At December 31, 2009 the balance of the unpaid principal was NIS 70 million, which was subsequently repaid on its due date.

(3) In 2004, Bezeq Zahav purchased Series 5 debentures of the Company. The balance of the par value held by Bezeq Zahav at December 31, 2009 was NIS 880,100,000. The debentures are repayable in six equal annual instalments in each of the years 2011 to 2016. The interest rate set for these debentures is 5.3% p.a. The purchase was made by taking a loan from the Company on the same terms as those of the debentures.

Loans to affiliates

(1) Commencing December 9, 2001, an agreement between the Company and Bezeq On-line provides that from time to time, the Company will provide funds to Bezeq On-line for short terms. The loan is at Bank of Israel current interest rate plus 0.5%. The balance of the loan principal at December 31, 2009 is NIS 10.5 million.

(2) Most of the Company's investment in DBS is shareholder loans. At the balance sheet date, the nominal balance of these loans (excluding interest and linkage) is NIS 1,562 million.

On August 20, 2009, the Company ceased consolidation of DBS and the balance of the shareholder loans was stated at fair value at that date.

The shareholder loans stated at fair value after revaluation to the balance sheet date:

NOTE 8 – MATERIAL ENGAGEMENTS AND TRANSACTIONS WITH AFFILIATES (CONTD.)

B. Loans (contd.)

(2) (contd.)

a. CPI-linked interest-free loans. The balance of these loans at December 31, 2009 is NIS 44 million.

b. CPI-linked loans at 5.5% interest. The balance of these loans at December 31, 2009 is NIS 47 million.

c. CPI-linked loans at 11% interest. The balance of these loans at December 31, 2009 is NIS 1,074 million.

(3) Concerning a loan provided by the Company to Bezeq Zahav in connection with debentures series 5, see Section 3B above.

C. Agreements to provide services

The Company and its affiliates, as communications providers, are parties to agreements and arrangements for providing and receiving various communications services:

Pelephone
Transmission agreement, interconnect arrangements, agreements regulating communications services provided by the two companies jointly, and rental agreements (mainly of communications installations).

Bezeq International
Transmission agreement, interconnect agreements, billing agreements, regulation of international and domestic communications, ADSL agreement (for regulating the connection between the Company's infrastructure and Bezeq International's servers), agreements regulating communications services provided by the two companies jointly, maintenance of communications equipment, marketing agreements and rental agreements (mainly of communications installations).

Bezeq On-line
Equipment maintenance agreements, telephone answering service agreements.

DBS
Dealer agreements and communications equipment maintenance agreements.

D. Others

In addition to such service provision agreements, there are outstanding debt balances of Pelephone and Bezeq International in respect of their share in a manager compensation plan (described in Note 27 to the Consolidated Financial Statements – Share-Based Payments). Under that plan, the Company reached an agreement with Pelephone and Bezeq International whereby in the event of actual exercise of stock options, the Company would receive from the two companies, immediately after the exercise, a sum equal to the value of the benefit charged to the employees for tax purposes ("the yield part").

NOTE 8 – MATERIAL ENGAGEMENTS AND TRANSACTIONS WITH AFFILIATES (CONTD.)

E. Details of transaction amounts and balances in the Company's books in respect of those transactions (excluding loans described in section B above):

	For the year ended December 31,		
	2009	**2008**	**2007**
	NIS millions	**NIS millions**	**NIS millions**
Transactions			
Pelephone	**149**	138	142
Bezeq International	**103**	116	117
Bezeq On-line	**2**	1	1
DBS	**10**	64	80
Total	**264**	319	340
Expenses			
Pelephone	**233**	254	290
Bezeq International	**3**	17	28
Bezeq On-line	**-**	5	4
DBS	**1**	4	10
Total	**237**	280	332

	December 31, 2009	December 31, 2008
	NIS millions	**NIS millions**
Balances		
Pelephone	**(1)**	(16)
Bezeq International	**(3)**	(14)
Bezeq On-line	**(1)**	5
DBS	**52**	73
Total	**47**	48

The terms of the agreements to provide services were set at accepted market rates for such services.

F. Dividend

(1) On January 4, 2009, Pelephone paid the Company a dividend of NIS 400 million in respect of a declaration in 2008 (of NIS 680 million).

(2) During 2009, Pelephone announced the distribution of a dividend of NIS 425 million, of which NIS 50 million was paid to the Company on September 30, 2009. The balance of NIS 375 million was paid on January 4, 2010.

(3) During 2009 Bezeq International announced the distribution of a dividend of NIS 210 million, of which the Company received NIS 30 million on May 10, 2009, NIS 90 million on September 30, 2009 and the balance of NIS 90 million on January 4, 2010.

(4) In December 2009 the Company received its share of the distribution of profits of Stage One in the amount of NIS 8 million.

For additional information about affiliates, see Note 13 to the Consolidated Financial Statements – Affiliates.

NOTE 9 – CONTINGENT LIABILITIES

In the course of regular business, legal claims were filed against the Company or various legal proceedings are pending against it (hereinafter "Legal Claims").

The financial statements of the Company include provisions of NIS 279 million in respect of Legal Claims. The additional exposure beyond those provisions in respect of Legal Claims amounts to NIS 3.2 billion. In addition, there are claims in a total amount of approximately NIS 188 million which at this stage cannot be assessed, as well as other claims in respect of which the Company's additional exposure exceeds the aforesaid in view of the fact that the claims do not state a precise amount of claim.

For more information about contingent liabilities, see Note 18 to the Consolidated Financial Statements – Contingent Liabilities.

Chapter D – Additional Details About the Corporation

1. Summary of the Quarterly Statements of Operations for the Year Ended December 31, 2009 (In NIS millions)

The quarterly financial statements were prepared to comply with the International Financial Reporting Standards (IFRS).

	Q1 2009	Q2 2009	Q3 2009	Q4 2009	FY 2009	FY 2008
Revenues	2,791	2,872	2,924	2,932	11,519	11,015
Costs and expenses	1,992	2,054	2,049	2,452	8,547	8,375
Operating profit	799	818	875	480	2,972	2,640
Finance income (expenses), net	30	(1)	(16)	18	31	(140)
Earnings before Group equity in affiliates	829	817	859	498	3,003	2,500
Profit (loss) in affiliates	2	2	(12)	(26)	(34)	5
Earnings before income tax	831	819	847	472	2,969	2,505
Income tax	221	222	259	105	807	719
Earnings for period from ongoing activities	610	597	588	367	2,162	1,786
Earnings (loss) for the period for discontinued activities	(1)	(95)	1,475	-	1,379	(265)
Net earnings	609	502	2,063	367	3,541	1,521
Attributed to:						
Shareholders of the Company	608	541	2,088	366	3,603	1,627
Non-controlling interests	1	(39)	(25)	1	(62)	(106)
Profit for the period	609	502	2,063	367	3,541	1,521

2. Use of Proceeds from Securities with Reference to the Application of the Proceeds According to a Prospectus

No issue has been made on the basis of a Prospectus.

3. List of Investments in Subsidiaries and Related Companies as at the Balance Sheet Date*

Company name	Name of holder	Class of Share	Number of shares	Total par value	Rate of holding in %	Adjusted balance sheet value in NIS millions*
Pelephone Communications Ltd.	The Company	Ordinary NIS 1	302,460,000	302,460,000	100%	3,571
Bezeq International Ltd.	The Company	Ordinary NIS 0.1	1,136,990,000	113,699,000	100%	709
DBS Satellite Services (1998) Ltd.[1]	The Company	Ordinary NIS 1	14,881	14,881	49.80%	1,185
Bezeq Online Ltd.	The Company	Ordinary NIS 1	1,070,000	1,070,000	100%	25
Bezeq Zahav (Holdings) Ltd.[2]	The Company	Ordinary NIS 1	999,999	999,999	100%	1,033
Walla! Communications Ltd.[3]	Bezeq International	Ordinary NIS 1	15,562,759	15,562,759	34.24%[4]	0[5]

* Stated in accordance with IFRS.

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1 D.B.S. Satellite Services (1998) Ltd. includes an investment of NIS 1,165 million which was made by means of loans. Of this, NIS 44 million is in loans linked to the known CPI, NIS 47 million in loans linked to the known CPI and bearing 5.5% interest, and NIS 1,074 million is in loans linked to the known CPI and bearing 11% interest.

2 A loan was extended to the subsidiary Bezeq Zahav (Holdings) Ltd. for financing the purchase of Company debentures Series 4 and 5.

3 On the Tel Aviv Stock Exchange, the share price of Walla! on December 31, 2009 was 501 agorot. Walla! has 2,568,039 employee options that can be exercised for up to 2,568,039 shares in Walla! Communications, Ltd. according to the financial statements of Walla! Communications, Ltd. dated February 24, 2010.

4 32.41% with full dilution.

5 Using the equity method, the value is NIS 34 million and is included in the financial statements of Bezeq International and not in the separate financial statement of the Company.

4. Changes in Investments in Subsidiaries and Related Companies during the Reporting Period

Date of the change	Type of change	Company name	Reported amounts NIS millions
Jan-Dec 2009	Employee options	Pelephone Communications, Ltd.	8
Jan-Dec 2009	Employee options	Bezeq International, Ltd.	2
Jan-Dec 2009	Employee options	D. B. S.	5
Jan-Dec 2009	Declared dividend	Pelephone Communications, Ltd.	(425)
Jan-Dec 2009	Declared dividend	Bezeq International, Ltd.	(210)
Jan-Dec 2009	Reduce premium	Bezeq Zahav (Holdings), Ltd.	(7)
Jan-Dec 2009	Revaluation	Bezeq Zahav (Holdings), Ltd.	37
Jan-Dec 2009	Linkage differentials and interest	D. B. S.	198

5. Revenues of Subsidiaries and Related Companies and Revenues of the Corporation from them as at the Report Date (In NIS millions)

Company name	Earnings (loss) before tax	Earnings (loss) after tax	Dividend	Management Fees	Interest
	NIS millions				
Pelephone Communications Ltd.	1,180	875	425	0	2
Bezeq International Ltd.	271	200	210	0	0
DBS Satellite Services (1998) Ltd.	(222)	(222)	0	0	127
Bezeq On-line Ltd.	6.4	5	0	0	0.5
Bezeq Zahav (Holdings) Ltd.	0	0	0	0	46
Walla! Communications Ltd.*	29	20	5	0	0

* Walla! declared a dividend of NIS 15 million on June 29, 2009. NIS 5 million was received by Bezeq International.

6. Stock Exchange Trading – Listed Securities – Dates and Reasons for Termination of Trading

In 2009, 54,682,019 Company shares were listed for trading due to options exercised from the option plan for employees in accordance with the outline dated March 25, 2007 and exercising of options from the option plan for senior employees dated December 25, 2007.

Below are dates and reasons for interruption of trading:

October 10, 2009 between 9:41 and 10:27, due to the Company's notification that Ze'evi Communications Holdings, Ltd. had made an agreement to sell some of its shares.

August 10, 2009, between 11:29 and 12:15, because of the Company's notification that Ze'evi Communications Holdings, Ltd. had made an agreement to sell some of its shares.

August 10, 2009, between 9:44 and 11:29, waiting for the Company's notification that Ze'evi Communications Holdings, Ltd. had made an agreement to sell some of its shares.

August 9, 2009, between 10:39 and 11:25, because of the Company's notification that the controlling shareholder had made an agreement with Citigroup Global to distribute some of its shares.

7. A. Remuneration to interested parties and executive officers

Following are details of the remuneration paid in 2009, as recorded in the financial statements for the reporting year, to each of the five highest-paid senior officers in the Company or in a corporation under its control, paid in connection to his service in the Company or a corporation under its control (cost to the employer on an annual basis):

Recipient					Remuneration for services (in NIS 000)							Other remuneration (in NIS 000)			Total (in NIS 000)
Name	Position	Employment basis	% holdings in the Company's capital - shares	% holdings in the Company's capital - options[6]	Salary	Bonus[7]	Share-based payment[8]	Management fee	Consultancy fee	Commission	Other	Interest	Rent	Other	Total
Shlomo Rodav	Chairman of Bezeq board of directors	Fulltime	-	0.33%	3,073	3,444	5,222	-	-						11,740
Abraham Gabbay	CEO Bezeq	Fulltime	0.001%	0.19%	2,484	2,179[9]	4,237	-	-						8,900
Gil Sharon	CEO Pelephone Communication, Ltd	Fulltime	-	0.19%	2,474	2,130[10]	4,237	-	-						8,841
Alan Gelman	Bezeq Deputy CEO and CFO	Fulltime	-	0.13%	2,284	1,142	3,551	-	-						6,978
Yitzhak Benvenisti	CEO Bezeq International Ltd	Fulltime	-	0.09%	1,513	960[11]	2,016	-	-						4,489

6 Options allotted in accordance with an option plan for senior managers and employees (2007) of the Company. The calculation assumes full exercise and does not consider the cashless exercise mechanism included in the plan.

7 The bonus is for 2009 and not yet been paid to the senior officers. Furthermore, the bonus for 2009 for the chairman of the board of directors requires approval from the Company's general meeting of shareholders. In addition, as a result of the changes expected in control of the Company, on December 31. 2009, the Board of Directors, approved adoption of the retention plan for the senior executives in the Company as reported in an immediate notification of the Company on that day. Accordingly, the CEO of the Company, CEO of Pelephone and the CEO of Bezeq International were granted a retention grant equivalent to nine monthly salaries, according to their value in December 2009. The cost of the salaries stated here includes the retention grant, which was paid to the CEOs as a loan in January 2010.

8 According to Black and Scholes value on the allocation day. This amount is the relative value for share-based remuneration for options that were recognized in the financial statements for the reporting year (including amortization of 5% for possibility of forfeiture of the options if conditions of the vesting period are not met, for the CEO of the Company, CEO of Pelephone, Deputy CEO and CFO, and the CEO of Bezeq International).

9 As a result of the changes expected in control of the Company, on December 31, 2009, the Board of Directors, approved adoption of the retention plan for the senior executives in the Company as reported in an immediate notification of the Company on that day. Accordingly, the CEO of the Company, CEO of Pelephone and the CEO of Bezeq International were granted a retention grant equivalent to nine monthly salaries, according to their value in December 2009. The bonus listed here does not include the retention grant, which was paid to the CEOs as a loan in January 2010.

10 See note 9, above.

11 See note 9, above

A. Shlomo Rodav is employed by the Company as active chairman of the Board of Directors under a personal employment agreement dated April 29, 2008. The agreement has been valid since September 4, 2007 which is the date on which he started working as chairman of the Company's board of directors. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 12 months' notice (from the Company) and 6 months' notice (from Chairman). The Chairman's salary is linked to the CPI. On June 1, 2008, 9,000,000 option warrants were allotted to the Chairman at an exercise price of NIS 6.4405 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to the Chairman is NIS 16.807 million. The options were divided into 12 (twelve) equal portions; the first portion vested after three months from the grant date, and another portion vests every three months thereafter, so that all the option warrants vest gradually over a period of three years from the grant date. As of this report date, 6,750,000 of the options have vested[12].

Changes in remuneration instituted in the reporting year: On May 3, 2009, The General Meeting of the Company's shareholders approved a bonus for 2008 for the Chairman of the Board pursuant to his employment agreement, dated June 1, 2008, equivalent to 18 monthly salaries, for a total of NIS 3,244,935.

In accordance with the Chairman's employment agreement, as approved by the General Meeting of the Company's shareholders on June 1, 2008 and as reported in the Company's immediate report dated April 18, 2008, the amount of the annual bonus to which the Chairman is entitled, if it is decided to grant it, will amount to between six and eighteen monthly salaries.

On March 2, 2010 the Company's Board of Directors decided (after the matter was approved by the Compensation Committee and the Audit Committee of the Company) to approve the maximum bonus pursuant to his employment agreement, which is equivalent to eighteen monthly salaries according to their value in December 2009, for a total of NIS 3,444,480. This bonus was approved as a sign of great appreciation for the Chairman's achievements in 2009. During 2009, the Chairman continued to work in a professional and thorough manner while leading the Group to impressive achievements during a period in which the Israeli and international economies suffered from difficult economic crises. This is expressed by the Group's excellent financial results for 2009, even in comparison to last year's financial results. The Chairman led important processes in the Group, including creation of a group strategy, stabilizing and improving the working interface with the management of the Company and its subsidiaries, as well as constant improvement in the effectiveness of the Board of Directors in both the company and its subsidiaries. The Audit Committee and the Board of Directors examined comparative data the accepted level of bonuses for chairmen of companies of similar size, with the assistance of the survey prepared by Professor Moshe Zviran. The bonus approved for the Chairman is within the range of bonus amounts presented in the survey, at the upper level of the range. In the opinion of the Audit Committee and the Board of Directors, this amount is reasonable considering the circumstances.

The bonus is subject to approval of the General Meeting of the Company's shareholders

B. Abraham Gabbay is employed by the Company as CEO, under a personal employment agreement dated July 19, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 6 months' notice. Mr. Gabbay's salary is linked to the CPI.

On February 4, 2008, 5,250,000 option warrants[13] were allotted to the CEO at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to the CEO is NIS 14.25 million.

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[12] The option warrants are exercisable from the end of the vesting period of each portion of option warrants until four years have elapsed from the grant date of the option warrants. In the event that the Company initiates the termination of the Chairman's service on any date after one year from the grant date has elapsed, the vesting of all the option warrants will be accelerated and they will be exercisable on the date of termination of his service. In this case, the exercise period of the options will end 90 days from termination of his service or at the end of the exercise period, whichever is the earlier, and they will expire at the end of mentioned period. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) as reported in the Company's immediate report dated December 25, 2007 (in accordance with the plan 65,000,000 option warrants may be granted which are exercisable in up to 65,000,000 Company shares) and in accordance with a material private placement report to the chairman of the board of directors as approved by the General Meeting of the Company's shareholders on June 1, 2008 and as reported in the Company's immediate report dated April 18, 2008.

[13] One-third of the option warrants vest after one calendar year elapses after the grant date, another third of the option warrants vest after two calendar years elapse from the grant date and the final third of the option warrants vest after three calendar years elapse from the grant date. The option warrants are exercisable from the end of the vesting period of all the option warrants until five years elapse from the vesting date of the third portion. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) (in accordance with the plan 65,000,000 option warrants may be granted which are exercisable into up to 65,000,000

Considering the transfer expected in control of the Company[14], on December 31, 2009, the Board of Directors, approved adoption of the retention plan for the CEO, as reported in an immediate notification of the Company on that day. Accordingly, the CEO of the Company was granted a retention grant equivalent to nine monthly salaries, which was given to the CEO as a loan in January 2010. Entitlement to the grant will vest if the CEO does not give notice of his resignation prior to December 31, 2010. Similarly, the options agreement was amended so that in the event of termination (but not resignation) within one year (instead of six months) after the change in control, the vesting of options that have not vested yet at the time of his termination will be accelerated.

On March 2, 2010 the Company's Board of Directors decided (after the matter was approved by the Compensation Committee and the Audit Committee of the Company) to approve a bonus for the Company's CEO for 2009, which is 116.6% of the CEO's annual salary, equal to NIS 2,178,596. Approval of the bonus is based on (1) percentage of the CEO's compliance with the target set for him by the Board in 2009 (EBITDA target according to unconsolidated financial statements and NGN target), and (2) an additional bonus (that brings the total to the aforementioned amount) above the formula that was determined by the compensation plan, which was set at the discretion of the Board of Directors. The bonus was approved as a sign of appreciation for the CEO's achievements during 2009, when he successfully led the Company to very good operating and financial results, while improving the organizational culture and continuing the streamlining process, all despite working in a competitive market with difficult regulatory constraints. The Audit Committee and the Board of Directors did not find it appropriate to examine comparative figures, beyond the limited number that were available to the public at the time that the bonuses for 2009 were discussed, which were presented to the Audit Committee and the Board of Directors and from which it emerges that the bonus is in the upper range of bonuses that were presented (although not the highest). In the opinion of the Board, the amount is reasonable under the circumstances.

C. Gil Sharon is employed by the subsidiary Pelephone Communication Ltd. (hereinafter, "Pelephone") as CEO, under a personal employment agreement dated January 19, 2006. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 12 months' notice (from Pelephone) and 6 months' notice (from the CEO of Pelephone). The CEO of Pelephone's salary is linked to the CPI.

On February 4, 2008, 5,250,000 option warrants[15] were allotted to the CEO of Pelephone at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to the CEO of Pelephone is NIS 14.25 million.

Considering the transfer expected in control of the Company[16], on December 31. 2009, the Board of Directors, approved adoption of the retention plan for the senior executives in the Company including the CEO of Pelephone, as reported in an immediate notification of the Company on that day. Accordingly, the CEO of Pelephone was granted a retention grant equivalent to nine monthly salaries, which was given to the CEO of Pelephone as a loan in January 2010. Entitlement to the grant will invest if the CEO of Pelephone does not give notice of his resignation prior to December 31, 2010. Similarly, options agreement was amended so that in the event of termination (but not resignation) within one year (instead of six months) after the change in control, the vesting of options that have not vested yet at the time of his termination will be accelerated.

On March 2, 2010 the Company's Board of Directors decided (after the matter was approved by the Compensation Committee and the Audit Committee of the Company) to approve a bonus for the CEO of Pelephone for 2009, which is 114% of annual salary for 2009, equal to NIS 2,130,017. Approval of the bonus is based on (1) percentage of the CEO of Pelephone's compliance for the target set for him by the Board in 2009 (EBITDA target for Pelephone and other managerial targets). (2) An additional bonus (that brings the total to the aforementioned amount) above the formula that was determined by the compensation plan,

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Company shares) and in accordance with a material private placement report for the company's CEO as reported in the Company's immediate report dated December 25, 2007.

[14] On October 25, 2009, Ap. Sb. Ar., the controlling shareholder in the Company notified the Company that it entered into an agreement with 012 Smile Communications, Ltd. (hereinafter, "012 Smile") to sell, outside the Stock Exchange, approximately 30.6% of the issued and paid share capital of the Company. Completion of the transaction is dependent on receiving the legally required regulatory permits no later that April 26, 2010, including the following permits: agreement of the Ministry of Communications to the transaction (including permits for control); permit of the Restraint of Trade Commissioner for the transaction; approval of the Prime Minister and Minister of Communications according to the Communications Law (Telecommunications and Broadcast) 5742-1982 and provisions of the Communications Order (Telecommunications and Broadcast) (Determination of Essential Service Provided by Bezeq: The Israel. Telecommunication Corp., Limited) 5757-1997; and any other permit or approval required by law.

[15] See Note 13, above.

[16] See Note 14, above.

which was set at the discretion of the Board of Directors. The bonus was approved as a sign of appreciation for the achievements of Pelephone's CEO during 2009, primarily leading Pelephone to very good operating and financial results, launching the HSPA network and strengthening the company's status in the cellular market. The Audit Committee and the Board of Directors did not find it appropriate to examine comparative figures, beyond those the limited number that were available to the public at the time of the discussion, which were presented to them and from which it emerges that the bonus is in the upper range of bonuses that were presented (although not the highest). In the opinion of the Board, the amount is reasonable under the circumstances.

D. **Alan Gelman** is employed by the Company as the deputy CEO and CFO under a personal employment agreement dated November 29, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 6 months' notice. The salary of the deputy CEO and CFO is linked to the CPI.

On March 7, 2008, 3,500,000 option warrants[17] were allotted to the deputy CEO and CFO at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr.Gelman is NIS 10.518 million.

On March 2, 2010 the Company's Board of Directors decided (after the matter was approved by the Compensation Committee and the Audit Committee of the Company) to approve a bonus for the deputy CEO and CFO for 2009, equal to 68.8% of his annual salary, equal to NIS 1,165,343. Approval of the bonus is based on compliance with the following targets: net earnings of Bezeq Fixed line, investor relations targets, and various administrative targets.

E. Yitzhak Benvenisti is employed as CEO of the subsidiary Bezeq International Ltd. (hereinafter, "Bezeq International") under a personal employment agreement dated July 1, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 3 months' notice. The salary of the CEO of Bezeq International is linked to the CPI.

On February 4, 2008, 2,500,000 option warrants[18] were allotted to the CEO of Bezeq International at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to the CEO of Bezeq International is NIS 6.786 million.

Considering the changes expected in control of the Company[19], on December 31, 2009, the Board of Directors, approved adoption of the retention plan for the senior executives in the Company including the CEO of Bezeq International, as reported in an immediate notification of the Company on that day. Accordingly, the CEO of Bezeq International was granted a retention grant equivalent to nine monthly salaries, which was given to the CEO of Bezeq International as a loan in January 2010. Entitlement to the grant will vest if the CEO of Bezeq International does not give notice of his resignation prior to December 31, 2010. Similarly, options agreement was amended so that in the event of termination (but not resignation) within one year (instead of six months) after the change in control, the vesting of options that have not vested yet at the time of his termination will be accelerated.

On March 2, 2010 the Company's Board of Directors decided (after the matter was approved by the Compensation Committee and the Audit Committee of the Company) to approve a bonus for the CEO of Bezeq for 2009, which is 80% of his annual salary, equal to NIS 960,000. Approval of the bonus is based on compliance with the EBITDA target, pursuant to Bezeq International's financial statements for 2009.

Interested parties who receive remuneration from the Company

Rami Nomkin, an employee director, who serves as manager of the sales department, has been employed by the Company as a permanent employee since 1966 when he transferred from the Ministry of Communications. All the remuneration paid to Mr. Nomkin is on account of his being a Company employee and not for his service as a Company director. Mr. Nomkin's total salary is NIS 571 thousand for 2009 and is linked to the professional salary tables. This salary includes a bonus for 2009 of NIS 19 thousand, which has

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[17] One-third of the option warrants vest after one calendar year elapses after the grant date, another third of the option warrants vest after two calendar years elapse from the grant date and the final third of the option warrants vest after three calendar years elapse from the grant date. As of the date of this report, one-third of the deputy CEO and CFO's options has vested. The option warrants are exercisable from the end of the vesting period of all the option warrants until five years elapse from the vesting date of the third portion. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) (in accordance with the plan 65,000,000 option warrants will be granted which are exercisable into up to 65,000,000 Company shares) and in accordance with a material private placement report to the Company's CEO as reported in the Company's immediate report dated December 25, 2007.

[18] See Note 13, above.

[19] See Note 14, above.

not yet been paid, and which was determined in accordance with the criteria for all the Company's employees which are based on the Company's EBITDA results.

Yehuda Porat, an employee director, serves as manager of the Company's security and safety department and is employed by the Company under a personal employment agreement dated October 29, 2007 (which was updated in May 2009). The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 3 months' notice. All the remuneration (including options as set forth below) paid to Mr. Porat is on account of his being a Company employee and not for his service as a Company director. Mr. Porat's salary is linked to the CPI. Mr. Porat's total salary for 2009 is NIS 879 thousand. This salary includes a bonus for 2009 (which has not yet been paid) of NIS 90 thousand, which is subject to approval from the General Meeting of Company shareholders which has not yet been convened. The bonus is determined in accordance with compliance with targets and the opinion of a manager.

On the basis of the material private placement report to a director, 100,000 options were an allotted to Mr. Porat, at an exercise price of NIS 5.9703 (adjusted for distribution of a dividend), as approved by the General Meeting of the Company's shareholders on May 3, 2009 and as reported in an immediate notification on January 21, 2009. The Black and Scholes value of all the options allotted to Mr. Porat is NIS 297,000.[20]

Remuneration of two external directors is in accordance with the maximum tariffs (for an external director with expertise) determined in the Companies Regulations (Rules Concerning Remuneration and Expenses for an External Director), 2000, linked to the CPI as determined in mentioned regulations and which was updated in accordance with an amendment which took effect on March 6, 2008 and which was approved by the General Meeting on June 1, 2008. The remuneration for 2009 for Dr. Eyal Yaniv (who completed his term on January 31, 2010) is NIS 349,122 and for Mr. Yitzhak Edelman (who was appointed for three years from January 31, 2008) is NIS 355,757 (including the reimbursement of travel expenses as approved by the General Meeting of the Company's shareholders on September 28, 2008 and which was reported in the Company's immediate report on that date).

On February 4, 2010, the General Meeting of the Company's shareholders approved the appointment of Mr. Mordechai Keret as an external director to replace Mr. Yaniv. Mr. Keret will be entitled to the same conditions that Mr. Yaniv received prior to his departure and are received by the other external director, Mr. Yitzhak Edelman.

Management fees for Ap. Sb. Ar. - For 2009 – NIS 4,692 thousand. On September 28, 2008, the General Meeting of the Company's shareholders approved an extension of the agreement to provide management and consultancy services with Ap. Sb. Ar. Cayman L.P a corporation connected with Ap. Sb. Ar. Holding Ltd., a controlling shareholder in the Company, for an additional three-year period from January 1, 2009 until December 31, 2011, in consideration of US$ 1.2 million per annum, under the same conditions as the original agreement, as set forth in the immediate report published by the Company on August 13, 2008 pursuant to the securities regulations. In respect of this matter, see also Note 30(G) to the financial statements.

[20] One third of the option warrants vests one calendar year after the grant date, another third of the option warrants vests two calendar years after the grant date, and another third of the option warrants vests three calendar years after the grant date. The option warrants are exercisable commencing form the end of the vesting period of each portion until five years after the vesting date of the third portion.

8. Shares and Convertible Securities Held by Interested Parties in the Corporation, a Subsidiary or a Related Company, as Close as Possible to the Report Date [update]

	Name of holder	Type of security	Number of convertible securities ratio 1:1	Number of Shares NIS1 n.v. each	Percentage of holding of control and equity	Number of NIS 1 n.v. shares fully diluted	Rate of holdings fully diluted
1.	Ap. Sb. Ar. Holdings Ltd. through Romema Investments Co. Ltd.	Ordinary		814,211,545	30.60%	814,211,545	29.70%
2.	Amitim (senior pension funds under special management)	Ordinary		190,251,407	7.15%	190,251,407	6.94%
3.	Shlomo Rodav (chairman of the board of directors)[21]	Ordinary	9,000,000		0.00%	9,000,000	0.33%
5.	Ran Gottfried (director)	Ordinary		12,000	0.00%	12,000	0.00%
6.	Avi Gabbay[22](CEO)	Ordinary	5,250,000	20,600	0.001%	5,270,600	0.19%
7.	Rami Nomkin[23] (director)	Ordinary	39,862		0.00%	39,862	0.00%
8.	Yehuda Porat[24] (director)	Ordinary	119,712		0.00%	119,712	0.00%

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[21] Options allotted to the Chairman of the Board of Directors in accordance with a material private placement report of April 18, 2008 with the approval of the General Meeting which was convened on June 1, 2008.

[22] On February 4, 2008, 5,250,000 options were allotted to the CEO in accordance with the private placement report of December 25, 2007.

[23] Options allotted to the employee director according to an outline dated November 15, 2005 and under an outline for employees dated February 22, 2007, subject to the approval of the General Meeting which took place on December 26, 2007.

[24] Options allotted to the employee director according to an outline for employees dated February 22, 2007, approved by the General Meeting which took place on December 26, 2007. In addition on January 21, 2009 the Company's board of directors approved an allotment of 100,000 additional options which were approved by from the General Meeting of the Company's shareholders on May 3, 2009.

9. Registered Capital, Issued Capital and Convertible Securities

- Registered capital 2,749,000,000 shares of NIS 1 par value each.
- Issued and paid capital, as of this report date, 2,660,705,053 shares of NIS 1 par value each, having equal rights.
- 78,151,368 exercisable options to employees for Company shares of NIS 1 par value each, in accordance with an outline dated February 22, 2007, were allotted on March 25, 2007 (including 59,574 options to two directors from the employees, which were allotted on January 2, 2008 in accordance with a private placement report dated October 29, 2007). As of this report date, 55,314,391 of the employees' options had been exercised for shares of NIS 1 n.v. each.
- In accordance with the option plans for senior managers and employees (2007) (on the basis of which 65,000,000 option warrants were allotted which the Company earmarked for exercise into up to 65,000,000 Company shares), as at the date of this report 59,383,333 options were allotted to employees for Company shares of NIS 1 par value each, of which 733,331 were exercised as of this report date.
- There are no dormant shares.

10. Registered Address of the Corporation

Address: 132 Menahem Begin Street, Azrieli Center (The Triangular Tower), Tel Aviv.

Telephone 1: 03-626-2200; Telephone 2: 03-626-2201; Fax: 03-626-2209

Email: linoryo@bezeq.co.il (Company Secretary)

11. Directors of the Corporation

A. (1) Name**: Shlomo Rodav** ID no. 030596860

(2) Date of Birth: October 27, 1949

(3) Address: 5 Kerem Hazeitim St., Savion

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Chairman of the Security Committee.

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Yes
The director is Chairman of the Board of Directors (as of September 4, 2007).

(8) Date of start of tenure as a director: September 4, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA (Economics), Tel Aviv University.

MBA, Columbia University.

2003-2005 – chairman of the board of directors and CEO (2004-2005) of Gilat Satellite Networks Ltd.

1990-2007 – CEO and/or director and/or chairman of the board of directors of Kror Holdings Ltd. / Yafaora-Tavori Ltd. / Yafaora Ltd. / Tefogen Industries Ltd. / Whist Management Israel Ltd. / InirU Israel Ltd. / InirU Wireless Inc. / the Israel Shipping & Supply Corporation Ltd. / Nimphaea A.A. Ltd. / Turel Investments Ltd. Since August 2007, not acting as CEO and/or chairman of the board of directors of any of the above companies.

Chairman of the board of:

Bezeq International Ltd.

Pelephone Communications Ltd.

DBS Satellite Services (1998) Ltd.

Bezeq Online Ltd.

Walla! Communications Ltd.

Bezeq Zahav (Holdings) Ltd.

Member of the board of DBS Satellite Services (1998) Ltd.

(10) Related to an interested party in the Corporation: No
(11) The Company considers the director to have accounting and financial expertise.

B. (1) Name: **Yitzhak Edelman** ID no. 50066174.
(2) Date of Birth: July 1, 1950
(3) Address: 4 Duchifat St., Tel Mond.
(4) Citizenship: Israeli
(5) Membership of Board of Directors Committees: Audit Committee, Balance Sheet Committee
(6) External Director: Yes.
(7) Employee of the corporation, a subsidiary, related company or interested party: No
(8) Date of start of tenure as director: February 1, 2008
(9) Education and employment during the past five years and details of the corporations in which he serves as director:
BA (Accounting and Economics), Tel Aviv University.
2005-2007 – Deputy CEO and VP Finances at Ness Technologies Ltd.
1996-2005 – Director of Finance Division at Cellcom.
Director of:
(10) Related to an interested party in the Corporation: No
(11) The Company views the director as having accounting and finance expertise

C. (1) Name: **Ran Gottfried** ID no. 006357206.
(2) Date of Birth: August 20, 1944
(3) Address: 64 Pinkas Street, Tel Aviv
(4) Citizenship: Israeli
(5) Membership of Board of Directors Committees: Audit Committee, Security Committee
(6) External Director: No
(7) Employee of the corporation, a subsidiary, related company or interested party: No
(8) Date of start of tenure as director: November 24, 2005
(9) Education and employment during the past five years and details of the corporations in which he serves as director:
Completed two years undergraduate degree studies in Economics and Social Sciences at Tel Aviv University.
From 2006 – 2009 – chairman of Power Paper Ltd.
From 2004 - 2006 – chairman of Careline-Neca
2003 – November 2005 CEO and partner, Magnolia Export Logistics Ltd.
2001 - November 2005 Chairman of the Board of Magnolia Silver Jewelry Ltd.
2000 - 2002 – Strategic adviser to cosmetic companies abroad.
1998 - 2000 – CEO and partner of NewPharm.
1995 - 2000 – CEO and partner of April Ltd.
Director of:
2003-2005 Director of Agis
Since 2006 Director of Frigo
(10) Related to an interested party in the Corporation: No

D. (1) Name: **David Gilboa** ID no. 51212587.
(2) Date of Birth: May 2, 1952
(3) Address: 9 Nahar Yarden St., Kiryat Ono
(4) Citizenship: Israeli
(5) Membership of Board of Directors Committees: Balance Sheet Committee
(6) External Director: No
(7) Employee of the corporation, a subsidiary, related company or interested party: No
Accountant and Adviser of Moshe Arkin???????????
(8) Date of start of tenure as a director: September 19, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA (Economics & Accounting), Tel Aviv University.

May 2008 – partner and senior manager in David Gilboa and Co., Accountants

2000 -2008: senior partner / manager – Chaikin, Cohen, Rubin and Gilboa, Certified Public Accountants.

Director of:

Bezeq International Ltd.

Bezeq Online Ltd.

David Gilboa & Co., Accountants

Gadad Consultancy and Investments (2006) Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

E. (1) Name: **Michael Grabiner** Passport No.: 099096227

(2) Date of Birth: August 21, 1950

(3) Address: 35 Uphill Rd., London NW7 4RA, UK

(4) Citizenship: British

(5) Membership of Board of Directors Committees: No

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Business consultant to Apax Partners LLP.

(8) Date of start of tenure as a director: June 21, 2006

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

MA Economics and Politics, Cambridge University.

Partner, Apax Partners LLP (2002-2009)

Director of:

Partnerships for Schools Ltd

Pelephone Communications Ltd

Bezeq International Ltd

Ap. Sab. Ar. Cayman Ltd.

(10) Related to an interested party in the Corporation: Brother of director Steven Grabiner

F. (1) Name: **Steven Grabiner** Passport No.: 024558479

(2) Date of Birth: September 30, 1958

(3) Address: 33 Jermyn St., London SW1Y 6DN, UK

(4) Citizenship: British

(5) Membership of Board of Directors Committees: No

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party:

Partner of Apax Partners LLP, and head of Media Sector at Apax.

Acted as a director of the Company in the past, between October 11, 2005 and March 8, 2006, and acted several times as an alternate director.

(8) Date of start of tenure as a director: September 4, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

MBA, Manchester University.

Director of: Apax Partners Europe Managers Ltd

Apax Partners LLP

Cloverhawk Ltd

ISC (International Sportsworld Communicators

Ap. Sab. Ar. Holdings Ltd

Yellow Green Finance & Investment Ltd

Purple Green Project & Investment Ltd

(10) Related to an interested party in the Corporation: Brother of director Michael Grabiner

H. (1) Name: **Zehavit Cohen** ID no. 058344797.

(2) Date of Birth: November 16, 1963

(3) Address: 4 Berkowitz St., Museum Tower, Tel-Aviv.

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Member of Audit Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: CEO of Apax Partners Israel Ltd.

(8) Date of start of tenure as a director: June 21, 2006

(9) Education and employment during the past five years and details of the corporations in which she serves as director:

BA Accounting, Duquesne University

MBA Finance – Wharton School of Business, University of Pittsburgh

MA ABD Accounting, Wharton School of Management, University of Pennsylvania

From 1998 – Lecturer in Finance and Accounting, Wharton School of Management, University of Pennsylvania

From 1998 – Deputy CEO and Chief Financial Officer, IDB Development Company Ltd.

From 2003 - Chief Financial Officer, IDB Holdings Company Ltd.

From 1998 – Deputy CEO and Chief Financial Officer, IDB Holdings Company Ltd.

From 2006 – CEO, Apax Partners Israel, Ltd.

Director of:

Tnuva Food Industries - Agricultural Cooperative Association in Israel Ltd.

Tnuva Cooperative Center for the Marketing of Agricultural Produce in Israel Ltd.

Yellow Green Finance & Investment Ltd.

Purple Green Project & Investment Ltd.

Ap. Ms. Tn. Holdings Ltd.

Am. Tn. Ap. P. Ltd.

Ap. Tn. Ltd.

Genetrix

Mabat – Fresh Meat Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

I. (1) Name: **Rami Nomkin** ID no. 042642306.

(2) Date of Birth: January 14, 1949

(3) Address: 126 Mohliver Street, Yahud

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Balance Sheet Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: The director is manager of the sales department.

(8) Date of start of tenure as director: January 17, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

High School Education

From 2009 - manager of Bezeq's sales department.

From 2001 **-** Business Center Manager at Bezeq Business

Until October 11, 2005 served as employee director.

Director of other corporation: No

(10) Related to an interested party in the Corporation: No

J. (1) Name: **Arieh Saban** ID no. 064902083.

(2) Date of Birth: May 2, 1947

(3) Address: 59 Kaplan Street, Herzliya

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: No

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: No

(8) Date of start of tenure as director: October 11, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

From 2001 – partner in the Fox Kids Channel. He sold all his holdings in December 2002.

For 15 years distributed and marketed children's television programs through Israel Audio Visual Corp.

Director of:

Bezeq International Ltd.

D.B.S. Satellite Services, Ltd.

Keshet Broadcasting Ltd.

(10) Related to an interested party in the Corporation: Yes

Brother of Haim Saban. Haim Saban is the controlling shareholder of SCG Israel Ventures LLC, which holds 45% of the capital and 40.5% of the voting rights in Ap. Sab. Ar. Holdings Ltd. Ap. Sab. Ar. Holdings Ltd. holds 30% of the Company's share capital (which is held in trust by Romema Investment Company Ltd.).

K. (1) Name: **Menahem Inbar*** ID no. 000483982

(2) Date of Birth: September 3, 1948

(3) Address: 5 Hagilad St., Ramat Gan

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Remuneration, Organization and Administration Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party:

The Director assists Moshe Arkin, an interested party in the Company, with management of his investments.

(8) Date of start of tenure as director: October 11, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Social Sciences, Bar Ilan University.

MA Law, Bar Ilan University.

Since 2000 – managing partner at Schifman-Inbar Ltd.

Director of:

DBS Satellite Services (1998) Ltd.

Pelephone Communications Ltd.

Arkin Communications Ltd.

Schifman-Inbar Ltd.

Carmel Investment Group Ltd.

MCS Medical Corporation Ltd.

OIS Ophthalmic Imaging

U.M. Accelmed

Exalenz Bioscience Ltd.

Sphera Global Healthcare

Poalei Agudat Israel Bank Ltd.

HealOr Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

* The director holds 3% of the shares of Arkin Communications Ltd. which owns 10% of the equity and 19.5% of the voting rights in Ap. Sab. Ar. Holdings Ltd.

L. (1) Name: **Yehuda Porat** ID no. 059769455

(2) Date of Birth: February 18, 1968

(3) Address: 2 Mevo Haro'im, Har Adar 90836

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: (Observer on Security Committee pending amendment of articles of association and license).

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Manager of the Security, Safety and Emergency Department of the Company.

(8) Date of start of tenure as director: January 17, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

LL.B., Kiryat Ono Academic College.

Practical Electronic Engineer, Bezeq College, Jerusalem

Member of the Israel Bar Association

Bugging Location and Detection course given by an external advisor to the Security Services
Bugging Detection course – R.E.I., USA
Basic Data Protection for Security Officers course – Israel Security Agency (ISA)
Interrogation course – ISA
IT Systems Security – ISA
Critical computer systems security course – ISA
Advanced course in protecting computerized systems from information warfare – ISA
Directors in Private and Public Companies course - The Israeli Center for Management
Advanced Directors course - The Israeli Center for Management
Analysis of Financial Reports and Corporate Value Assessment course - The Israeli Center for Management
Qualified Mediator course – Israel Bar Association
1999-2007 Manager of Bezeq's Bugging Detection and Special Jobs Department
2007-present Manager of Bezeq's Security, Safety and Emergency Department
Until October 11, 2005 served as employee director

(10) Director of other corporation: No

(11) Related to an interested party in the Corporation: No

M. (1) Name: **Adam Chesnoff*** ID no. 022113597.

(2) Date of Birth: November 15, 1965

(3) Address: 10100 Santa Monica Blvd. Los Angeles, California 90067, U.S.A

(4) Citizenship: Israeli and American

(5) Membership of Board of Directors Committees:

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party:
Is a director of SCG Israel Ventures LLC, which holds 45% of the capital and 40.5% of the voting rights in Ap. Sab. Ar. Holdings Ltd. Ap. Sab. Ar. Holdings Ltd. holds 30.61% of the share capital of the Company (which is held in trust by Romema Investment Company Ltd.). The director holds 2% of SCG Israel Ventures LLC.

(8) Date of start of tenure as director: September 19, 2007
Acted in the past as director of the company between October 11, 2005 and September 4, 2007.

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Economics and Management, Tel Aviv University
MBA, School of Business, UCLA
Since 2001, President of Saban Capital Group.
Director of:
Saban Capital Group (f/k/a KSF Corporation.) (Inc. in Delaware, USA).
Broadcast Media Partners, Inc. (inc. in Delaware, USA).
Broadcast Media Partners Holdings (inc. in Delaware, USA).

Univision Communications (inc. in Delaware, USA).
Saban Music Group Inc. (inc. in California, USA).
SCG Investment Holdings (inc. in Delaware, USA).
Far East Innovative Investment B.V. (inc. in the Netherlands).

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

* Adam Chesnoff holds 2.025% of SCG Israel Ventures LLC.

SCG Israel Ventures LLC holds 45% of the capital and 40.5% of the voting rights in Ap. Sab. Ar. Holdings Ltd. Ap. Sab. Ar. Holdings Ltd. holds 30.61% of the share capital of the Company (which is held in trust by Romema Investment Company Ltd.).

N. (1) Name: **Kihara R. Kiarie** Passport number: 039101782

(2) Date of Birth: May 16, 1974

(3) Address: 10100 Santa Monica Blvd. Los Angeles, California 90067, U.S.A

(4) Citizenship: American

(5) Membership of Board of Directors Committees: Balance Sheet Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Is an officer (director) of Saban Capital Group, a company which has indirect holdings in Ap. Sab. Ar. Holdings Ltd.

(8) Date of start of tenure as director: November 24, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:
B.A. in economics, Dartmouth College.
MBA, Harvard Business School.
1999-2001 – Associate at AEA Investors.
Director of:
2003-2006 – Saban Capital Group

(10) Related to an interested party in the Corporation: No

O. (1) Name: **Yoav Rubinstein** ID no. 16447153

(2) Date of Birth: May 17, 1973

(3) Address: Apartment 28, 2 Kehilat Venezia Street, Tel Aviv

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Chairman of Remuneration and Organization Committee, Balance Sheet Committee, Committee to Negotiate with Former CEO.

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: The director is a consultant for Apax Partners.

(8) Date of start of tenure as a director: June 21, 2006

(9) Education and employment during the past five years and details of the corporations in which he serves as director:
BA Business Administration, Interdisciplinary Center
From 2009 – consultant for Apax Partners
From 2000 - Investment Manager, Apax Partners
Director of:
DBS Satellite Services (1998) Ltd.
Walla! Communications Ltd.
Yellow Green Finance & Investment Ltd
Purple Green Project & Investment Ltd
Ap. Sab. Ar. Holdings Ltd.
Ap. Sab. Ar. Cayman Ltd.
Genetrix

(10) Related to an interested party in the Corporation: No

(11) The Company considers the director to have accounting and financial expertise.

P. (1) Name: **Elon Shalev** ID no. 050705276.

(2) Date of Birth: July 26, 1951

(3) Address: 70 Yehoshua Bin Nun Street, Tel Aviv.

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Audit Committee, Remunerations Organization & Administration Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: No

The director provides services to SCG Israel Ventures LLC which is a company indirectly controlled by Haim Saban.

Acted as a director of the Company in the past, between October 11, 2005 and March 8, 2006, and acted several times as an alternate director.

(8) Date of start of tenure as a director: September 4, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Political Science, Tel Aviv University.

Entrepreneur and Consultant

Director of:

Bezeq International Ltd.

DBS Satellite Services (1998) Ltd.

Shachal Medical Services Ltd. and its subsidiaries.

Logia Group Ltd. and its subsidiaries.

(10) Related to an interested party in the Corporation: No

P. (1) Name: **Mordechai Keret**[25] ID no. 054759915.

(2) Date of Birth: May 7, 1957

(3) Address: 12 Hanurit Street, Tel Mond.

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Audit Committee, Security Committee

(6) External Director: Yes

(7) Employee of the corporation, a subsidiary, related company or interested party: No

(8) Date of start of tenure as a director: February 4, 2010

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

B.A. in Accounting and Finance, Tel Aviv University

From 2002, CEO and owner of consulting and investment firm, Keret Management and Holdings.

7/2008-9/2009, Chairman, Board of Directors, Gmul Investment Company.

12/2007-7/2009, Director, Gmul Investment Company.

2007-2/2008, Chairman, Board of Directors, Multimatrix, Ltd.

2000-7/2007, Director, Shikun & Binui, Ltd.

1998-9/2007, Director, Gain Holdings, Ltd.

1993-2006, Senior Vice President CFO, Arison Investments, Ltd.

12/2007-7/2009, Director, Gmul Real Estate, Ltd.

Director of TIA Investments – external director, Priortech Ltd., ISSTA Lines, Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company considers the director to have accounting and financial expertise and an external director.

* Dr. Yaniv – completed his tenure as a director on January 31, 2010.

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[25] The appointment of Mr. Keret was approved by the General Meeting of Shareholders on February 2, 2010, for a period of three years.

12. Senior Officers of the Corporation

A. (1) Name: **Abraham Gabbay** ID no. 59777920

(2) Date of Birth: February 22, 1967

(3) Date of Commencement of Office: November 14, 2007

(4) Position in the Company: CEO

(5) Is he an interested party or related to a senior officer or to any interested party: Yes Interested party in the Corporation by virtue of his service as Company CEO.

Education and business experience over the past five years:

MBA, Hebrew University

6/07-11/07 – Acting CEO of Bezeq, The Israel Telecommunications Corp. Ltd.

7/03-6/07 – CEO Bezeq International

11/00-6/03 – VP Economics and Strategy

B. (1) Name: **Ran Guron** ID no. 024113268

(2) Date of Birth: December 25, 1968

(3) Date of Commencement of Office: January 9, 2006

(4) Position in the Company: VP Marketing

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics and Business Administration, Hebrew University

MBA, Hebrew University

2003-2005 VP Marketing, Barak

1997-2002 VP Marketing Business Sector, Cellcom

C. (1) Name: **Alan Gelman** ID no. 015704307

(2) Date of Birth: November 5,1955

(3) Date of Commencement of Office: February 15, 2008

(4) Position in the Company: CFO and Deputy CEO

Position in a subsidiary of the Company, in a related company or in an interested party of the Company:

Director of:

Pelephone Communications Ltd.

Walla! Communications Ltd.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

B A., Queens College, NY

MBA, Hofstra University, NY

Certified Public Accountant in Israel.

CPA in the State of NY

2006-2007 – CFO and Deputy CEO of Delek Group.

2001-2006 – CFO at Partner Communications Ltd.

D. (1) Name **Malka Dror** ID no. 056524358

(2) Date of Birth: July 7, 1960

(3) Date of Commencement of Office: June 28, 2007

(4) Position in the Company: Chief Internal Auditor

(5) Is she an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics, Hebrew University

CISA qualification for the position of Controller of Computer Systems

Course in auditing and information systems security

Course in information systems analysis

6/07-8/06 acting internal auditor

12/04-8/06 - Manager, Audit Department and Deputy Internal Auditor – Bezeq.

E. (1) Name **Guy Hadas** ID no. 029654472
(2) Date of Birth: September 8, 1972
(3) Date of Commencement of Office: December 9, 2007
(4) Position in the Company: Company spokesperson
(5) Is he an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years
BA Economics and Media, Hebrew University
MBA Tel Aviv University
2002 – 2007 – Globes [Israeli financial newspaper] journalist

F. (1) Name: **Itamar Harel** ID no. 028054666
(2) Date of Birth: October 18, 1970
(3) Date of Commencement of Office: October 25, 2007
(4) Position in the Company: VP, Manager of Private Division
(5) Is he an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years
BA Economics and Business Administration, Hebrew University
2002-2007 – Manager of Private Marketing Department and Manager of Private and Medium and Small Business Sales and Services Department at Bezeq

G. (1) Name: **Linor Yochelman** ID no. 032037939
(2) Date of Birth: February 11, 1975
(3) Date of Commencement of Office: August 19, 2007
(4) Position in the Company: Company Secretary
Position in a subsidiary of the Company, in a related company or in an interested party of the Company:
Company secretary of subsidiaries: Bezeq International Ltd.; Bezeq Online Ltd.; Bezeq Zahav Holdings Ltd.
(5) Is she an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years
BA Business Administration, Interdisciplinary Center, Herzliya
LLB, Interdisciplinary Center, Herzliya.
2005-2007 Company secretary of The Phoenix Holdings Ltd.
2002-2005 – Assistant to Chief Judge of the Local Court, Tel Aviv.

H. (1) Name: **Ehud Mezuman** ID no. 052176336
(2) Date of Birth: February 17, 1954
(3) Date of Commencement of Office: October 25, 2007
(4) Position in the Company: VP Human Resources
(5) Is he an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years:
3 years studies at Tel Aviv University – Social Sciences (no degree)
2005-2007 – Deputy VP Human Resources and Director of Management Development Department
2001-2005 – Director of Management Development & Training Department, Bezeq.

I. (1) Name**: Dudu Mizrachi** ID no. 024810368
(2) Date of Birth: January 28, 1970
(3) Date of Commencement of Office: June 28, 2007
(4) Position in the Company: VP Economics & Budgets
(5) Is he an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years
BA Economics, Hebrew University
2000-2007 – Director of Regulations Department at Bezeq

J. (1) Name**: Amir Nachlieli** ID no. 23012313

(2) Date of Birth: May 30, 1967

(3) Date of Commencement of Office: January 1, 2009

(4) Position in the Company: VP Legal Advice

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

2007 – 2008 – Legal adviser to Colmobil Ltd.

2005 – 2006 – YaGusa Technology business development

2002 – 2004 – Legal adviser to Bezeq International (on behalf of Yossi Levi and Co. Law Office)

1995 – 2004 – Partner and lawyer in Yossi Levi and Co. Law Office

MBA (expanded major in Finance), Tel Aviv University

BA Economics, Hebrew University

LLB, Hebrew University

K. (1) Name: **Danny Oz** ID no. 054299953

(2) Date of Birth: June 16, 1956

(3) Date of Commencement of Office: September 1, 1998

(4) Position in the Company: Accountant and Deputy CFO.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

BA Economics & Accounting, Hebrew University, Certified Public Accountant's License.

EMBA – Integrative Administration, Hebrew University

Since September 1998 – Company Accountant

L. (1) Name: **Yaakov Paz** ID no. 058610999

(2) Date of Birth: October 21, 1963

(3) Date of Commencement of Office: November 1, 2007

(4) Position in the Company: VP, Manager of Business Division

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

Since 2006 – Chairman of board of directors of Alcatel Telecom Israel Ltd.

2006 – CEO, DoubleU Advanced Mobile Solutions

2002-2006 – CEO and Chairman of Alcatel Telecom Israel Ltd.

M. (1) Name: **Sharon Fleischer Ben Yehuda** ID no. 028531648

(2) Date of Birth: April 25, 1971

(3) Date of Commencement of Office: June 1, 2006

(4) Position in the Company: VP Regulation

(5) Is she an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Political Science, Hebrew University

MA Public Policy and Administration, Hebrew University

Until May 31, 2006 – VP Regulation at Pelephone Communications Ltd.

2001-2005 – Manager, Regulation and Government Relations Department, Pelephone Communications Ltd.

1995-2001 – Senior Adviser to Director General at Ministry of Communications.

N. (1) Name: **Eli Frank** ID no. 053337739

(2) Date of Birth: July 6, 1955

(3) Date of Commencement of Office: September 19, 2006

(4) Position in the Company: VP Information Systems

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

MBA, Tel Aviv University

BA Mathematics and Computer Science, Bar Ilan University.

Professional qualifications (Programming, Systems Analysis, etc.) Mamram [IDF Central Computing Facility]

Since 2004, information strategy and management consultant (freelance)

12/03-6/04 – VP and Department Manager Ness Information Technology Services Group

1999-2003 –VP CRM Systems Supply and Billing Division, Amdocs

O. (1) Name: **Yuval Keinan** ID no. 032089245

(2) Date of Birth: February 23, 1975

(3) Date of Commencement of Office: August 1, 2007

(4) Position in the Company: VP Engineering and Networks Division

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

BA Computer Science, Merci College

2005-2007 – VP Information Technologies (Engineering and Information Systems) at Bezeq International Ltd.

2003-2005 – Director, Engineering Operations, Bezeq International Ltd.

P. (1) Name: **Eyal Kamil** ID no. 057248999

(2) Date of Birth: August 30, 1961

(3) Date of Commencement of Office: December 05, 2006

(4) Position in the Company: VP Operations & Logistics

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA, Industrial Engineering & Management, Tel Aviv University

MBA, Tel Aviv University

2005 – December 4, 2006 – Manager, Change Administration, Bezeq.

2001-2005 – Manager, Organization and Methods Department, Pelephone Communications Ltd.

Pelephone Communications Ltd.

Q. (1) Name: **Gil Sharon** ID no. 058381351

(2) Date of Birth: September 12, 1963

(3) Date of Commencement of Office: October 11, 2005

(4) Position in the Company: CEO of the subsidiary Pelephone Communication Ltd.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

BA Economics and Business Management, Hebrew University

MBA Tel Aviv University

2001 – 2005 Deputy CEO Pelephone Communication Ltd.

Bezeq International Ltd.

R. (1) Name: **Yitzhak Benvenisti** ID no. 059146415

(2) Date of Birth: January 21, 1965

(3) Date of Commencement of Office: November 11, 2007

(4) Position in the Company: CEO of the subsidiary Bezeq International Ltd.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

BA, Economics, Hebrew University

MBA, Finance and Marketing, Hebrew University

May – November 2007 – acting CEO Bezeq International Ltd.

2003 – 2006 – Hewlett – Packard Israel – director and CEO of the personal computer and distribution channel division

* Following the decision of the Supreme Court on August 20, 2009, prohibiting the Company from exercising options that would increase its holdings to more than 50% of the shares in DBS Satellite Services (1998) Ltd. (hereinafter, "Yes"). As result of the ruling Yes is, therefore, no longer included in the Company's financial statements and the Company no longer reports on Ron Eilon, the CEO of Yes, as an officer in the Company.

The Corporation has no independent signatories.

Following are the names of the senior officers who completed their term of service during the course of 2009 and by the date of publication of the periodic report for 2009:

Director:

Eyal Yaniv's tenure as an External Director ended on January 31, 2009.

13. The Auditors of the Corporation

Someck Chaikin – Certified Public Accountants (Isr.)

Address: 17 Ha'Arba'a Street

Millennium Tower KPMG

Tel Aviv 64739

Tel: 03-684-8000

14. Change in the Memorandum or Articles of Association

On February 4, 2010 articles 85.1, 88 and 103.1 were amended as set forth in section 16.4 below. The amendment of article 103.1 is yet to take effect.

15. Recommendations and Resolutions of the Directors Before the General Meeting and their Resolutions which are not Subject to the Approval of the General Meeting

15.1 March 23, 2009 – (a) to recommend to the General Meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 792 million; (b) to recommend that the General Meeting of shareholders of the Company approve the employment conditions of Mr. Yehuda Porat, in accordance with the employment agreement dated October 29, 2007 and up dated on March 17, 2008 and to approve a bonus for Mr. Porat for 2008 totaling NIS 85,000, for compliance with targets and the manager's recommendation; (c) to recommend that the General Meeting of shareholders of the Company to approve the a bonus totaling NIS 3,244,935 (which is approximately 150% of his annual salary) for Mr. Shlomo Rodav, Chairman of the Board of Directors, which was approved by the General Meeting of the Company on June 1, 2008.

15.2 August 4, 2009 – to recommend to the General Meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 1,149 million.

15.3 Regarding extraordinary transactions, see section 17, below.

16. Resolutions of a Special General Meeting

16.1 Approval for paying a cash dividend in the total sum of NIS 792 million. (Resolution of May 3, 2009).

16.2 Approval for paying a cash dividend in the total sum of NIS 1,149 million. (Resolution of September 2, 2009).

16.3 Approval of appointment and conditions of office of Mr. Mordechai Keret as external director for a period of three years (Resolution of February 4, 2010).

16.4 On February 4, 2010 articles 85.1, 88 and 103.1 were amended as follows:

16.4.1 At the end of Regulation 85.1, the following words will be added: “Despite the abovementioned, the directors currently serving may, at any time, appoint as a director any person who is suitable to be appointed a director in accordance with Section 224A of the Companies Law, in order to fill a place that becomes vacant for any reason and in order to add members to the Board of Directors, as long as the number of directors at one time does not exceed the number stated above. A director appointed according to this section will serve for a period of no more than 90 days from his appointment or until the next regular General Meeting when he can be elected.”

16.4.2 Regulation 88 will be changed and replaced by the following text: “The Board of Directors of the Company may continue working even if there is a vacancy on the board as long as the number of directors does not drop below the minimum. The remaining directors may act in order to appoint additional directors as stated in the last section of Regulation 85.1 and/or in order to convene at the earliest possible time a General Assembly for the purpose of appointing additional directors. During the interim period, until additional directors are appointed as stated, the Board of Directors may act for any purpose that is critical in urgent for the company’s benefit but not for other purposes.”

16.4.3 Regulation 103.1 of the regulations will be changed. Instead of the words “three classified Directors” it will now read, “up to four classified Directors.”

* In accordance with Regulation 148 of the company’s regulations, amendment to this regulation requires prior written approval of the Minister of Communications and it will become valid after his approval is received.

17. Transactions Requiring Special Approval

17.1 On March 23, 2009 –

The Board of Directors approved the grant of bonuses for 2008 to the chairman of the Board of Directors and the CEO of Pelephone Communication Ltd. and the CEO of Bezeq International Ltd. as set forth in section 7A above and also the grant of bonuses to VP Marketing, VP Economics, and VP Engineering and Network.

17.2 On December 31, 2009 –

The Board of Directors approved adoption of the Executive Retention plan for senior manages of the Group (the CEO of the Company, CEO of Pelephone and CEO of Bezeq International) as described in the immediate report of the Company on that date. According to this plan, each one the aforementioned CEOs will be given a retention grant equal to nine month’s salary and their option plans were amended so that in event of termination (but not resignation) within one year (instead of six months) after the change in control, the vesting of options that have not vested yet at the time of his termination will be accelerated.

17.3 On March 2, 2010 –

The board of directors approved the grant of bonuses for 2009 to the chairman of the board of directors and the CEO of Pelephone Communication Ltd. and the CEO of Bezeq International Ltd. as set forth in section 7A above and also the grant of bonuses to VP Private Division (NIS 410,000), VP Economics (NIS 410,000), VP Human Resources (NIS 370,000) and VP Engineering and Network (NIS 370,000).

18. Liability Insurance for Directors and Officers and Indemnities Obligation for Officers

Insurance

A resolution from May 16, 2005 regarding approval of the exercise of an option for the purchase of a run-off policy covering the liability of Company officers by virtue of which a run-off insurance policy was issued covering the liability of officers who served in the Company until the date of transfer of control, October 11, 2005, for a period of seven years from said date.

Resolution of August 3, 2005 regarding the extension of an officers' insurance policy including the run off option, for a period of up to four months.

Resolution of December 26, 2007 regarding approval of the "framework agreement" for the company's contracting in the ordinary course of its business in future insurance policies to cover the liability of directors and officers, as may be applicable from time to time, including directors and officers of companies in which the Company holds 50% or more, officers acting for the Company in companies in which the Company less than 50% and senior employees who are not officers regarding administrative acts done by them all via a "framework transaction" as defined in the Companies (Relief in Transactions with Interested Parties) Regulations, 5760-2000, at an annual premium in the sum of up to $510,000 plus a sum of up to 20% of the aforesaid premium for the sum of the current insurance premium.

Resolution of December 10, 2009, regarding the extension of a liability insurance policy for Company officers as part of a "framework agreement" which was approved by the General Meeting of Company shareholders on December 26, 2007, all from November 1, 2009 through October 10, 2010 (with the option of extending the policy until October 31, 2010 at no extra cost as required by law) . The liability ceiling of $100 million per claim and total for the entire insurance year. In addition, a liability ceiling of $20 million per claim and total claims for the insurance period for legal expenses in Israel alone. Liability ceiling for subsidiaries – up to $50 million (as part of the aforesaid liability ceiling). Total annual premium for the policy $313,650.

Resolution on January 28, 2010 regarding approval of purchase of insurance policies to cover liability of officers of the Company, as part of the "framework agreement" which was approved by the General Meeting of Company shareholders on December 26, 2007, from the date on which the regular directors and officers liability ends (the date on which control is transferred from Ap. Sb. Ar. Holdings, Ltd. to Smile 012 Communications, Ltd. as described in the immediate notification that the Company issued on January 31, 2010 on convening of the General Meeting) until October 10, 2010. The limit of liability up to $50 million per claim and total for the insurance year. In addition, limitation of liability to $10 million per claim and for the entire period of the insurance for legal costs in Israel only. Liability ceiling for subsidiaries – half of the aforementioned amounts (as part of the aforementioned annual limitation). The total annual premium for the policy $188,500. It is clarified that **this policy will replace the existing insurance policy which was approved by the Board of Directors on December 12, 2009.**

Resolution on January 28, 2010 regarding conversion of the insurance policies that covered liability of officers of the Company into a run-off policy, as of the date on which control is transferred from Ap. Sb. Ar. Holdings, Ltd. to Smile 012 Communications, Ltd. (if the transfer of control is completed) and for a period of seven years from that date (the date on which control is transferred from Ap. Sb. Ar. Holdings, Ltd. to Smile 012 Communications, Ltd. as described in the immediate notification that the Company issued on January 31, 2010 on convening of the General Meeting). The limit of liability up to $50 million per claim and total for the insurance period. In addition, limitation of liability to $10 million per claim and for the entire period of the insurance for legal costs in Israel only. Liability ceiling for subsidiaries – half of the aforementioned amounts (as part of the aforementioned annual limitation). The total annual premium for the policy $380,500. This insurance is **conditional on approval of the General Meeting that is expected to be convened on March 8, 2010.**

Indemnification Obligation

A resolution of January 17, 2007 concerning approval of the granting of an undertaking to indemnify in accordance with the Note to an undertaking to indemnify for each Company officer in respect of any liability or expense imposed on him by actions taken in his capacity as a Company officer (including his actions in subsidiaries), is within the limits laid down by the Companies Law. The amount of indemnification is capped at 25% of the Company's share capital as it shall be when the indemnification is granted. The undertaking to indemnify shall apply to a list of types of occurrences which is attached to the Note to an undertaking to indemnify which is attached to the immediate report concerning the convening of a General Meeting to approve the granting of an indemnification commitment. During 2007 – 2008 and until the date of publication of this report, grant of indemnification was also approved for new officers who joined the Company.

It should be noted that in the past, the Company granted indemnity to officers in the following areas:

A. An advance undertaking to indemnify for any expense or financial liability which is imposed on an officer following a proceeding filed against him in respect of the Company's prospectus from May 2004.

B. An advance undertaking to indemnify Company officers who served in the Company at the time the undertaking to indemnify was made or who were in office during the seven years preceding that date, for any expense or financial liability imposed on an officer due to a claim by a shareholder who held, at any time during the fours years preceding the date on which the undertaking to indemnify was given, 15% and more of the issued share capital of the Company.

C. An undertaking to indemnify to Company officers who served in the Company at the time an undertaking to indemnify was made or who were in office during the seven years preceding that date, to grant a loan for financing reasonable litigation expenses in a proceeding in which an officer is sued by another person, including a derivative action. The loan will become a grant if a competent court does not impose liability on the officer in a rule absolute.

D. The grant of an undertaking to officers that the insurance cover for events covered by an officers' insurance policy, which the Company purchased in July 2003, will be maintained for seven years, provided that the cost of the insurance premium is reasonable.

E. An undertaking to indemnify from April 6, 2005 for financial liability imposed on Company officers for reasonable litigation expenses incurred by them in all matters pertaining directly or indirectly to a sale of State holdings in the Company.

F. An undertaking from May 16, 2005 to indemnify Company offers who were in office during the seven years preceding the date of completion of the sale of the controlling core of the Company to Ap. Sb. Ar.

Date	Bezeq The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shlomo Rodav – Chairman of the Board

Abraham Gabbay, CEO