

Translation from Hebrew

**DBS SATELLITE SERVICES (1998) LTD.**

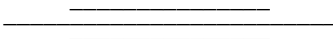
2001 ANNUAL REPORT

**DBS SATELLITE SERVICES (1998) LTD.**

2001 ANNUAL REPORT

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## AUDITORS' REPORT

To the shareholders of

### **DBS SATELLITE SERVICES (1998) LTD.**

We have audited the balance sheets of DBS Satellite Services (1998) Ltd. (hereafter - the Company) as of December 31, 2001 and 2000 and the related statements of operations, changes in capital deficiency and cash flows for each of the two years in the period ended December 31, 2001 and for the period from the date of incorporation (December 2, 1998; see note 1a(1)) to December 31, 1999. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Israel, including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 1973. Those standards require that we plan and perform the audit to obtain reasonable assurances about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the board of directors and management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2001 and 2000 and the results of its operations, the changes in its capital deficiency and its cash flows for each of the two years in the period ended December 31, 2001 and for the period from the date of incorporation (December 2, 1998) to December 31, 1999, in conformity with accounting principles generally accepted in Israel. Furthermore, in our opinion, the financial statements referred to above are prepared in accordance with the Israeli Securities (Preparation of Annual Financial Statements) Regulations, 1993.

As explained in note 1b, the financial statements referred to above are presented in values adjusted for the changes in the general purchasing power of Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Without qualifying our opinion, we draw attention to note 1a(2) regarding the financial position of the Company, the non-compliance with certain terms specified in the financing agreement between the Company and banks. As explained in the abovementioned note, the Company's activity depends on the continued execution of the financing agreement, increase of the credit facilities provided by banks and the receipt of additional loans from shareholders. Management's opinion as to the chances of achieving the required financing arrangements is presented in note 1a2d.

Tel Aviv

March 25, 2002

Translation from Hebrew

**DBS SATELLITE SERVICES (1998) LTD.**  
BALANCE SHEETS  
IN ADJUSTED NIS

	<u>Note</u>	<b>December 31</b>	
		<b>2001</b>	<b>2000</b>
		<b>In thousands</b>	
<b>A s s e t s</b>	10		
<b>CURRENT ASSETS:</b>	9		
Cash and cash equivalents		21	428
Accounts receivable:	11a		
Trade		56,967	4,016
Other		29,831	43,454
<b>T o t a l current assets</b>		<b>86,819</b>	<b>47,898</b>
<b>BROADCASTING RIGHTS:</b>	1d;11e		
Cost		286,574	218,780
Less - utilized rights		64,300	32,869
		<b>222,274</b>	<b>185,911</b>
<b>FIXED ASSETS:</b>	2		
Cost		1,494,063	952,604
Less - accumulated depreciation		256,659	56,508
		<b>1,237,404</b>	<b>896,096</b>
<b>LICENSE FEES - ADVANCE ON ACCOUNT OF ROYALTIES</b>	3	26,192	30,192
		<b>1,572,689</b>	<b>1,160,097</b>
<b>Liabilities, net of capital deficiency</b>			
<b>CURRENT LIABILITIES:</b>	9		
Bank credit	11b	882,510	499,504
Accounts payable and accruals:	11c		
Trade		519,551	485,131
Other		29,977	36,612
<b>T o t a l current liabilities</b>		<b>1,432,038</b>	<b>1,021,247</b>
<b>LONG-TERM LIABILITIES:</b>			
Shareholders' loans	5	1,568,546	774,435
Liability for employee rights upon retirement - net	4	1,151	
Customer deposits	1h	19,241	189
Other liabilities	11d	27,110	
<b>T o t a l long-term liabilities</b>		<b>1,616,048</b>	<b>774,624</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>	6		
<b>T o t a l liabilities</b>		<b>3,048,086</b>	<b>1,795,871</b>
<b>CAPITAL DEFICIENCY</b>		<b>(1,475,397)</b>	<b>(635,774)</b>
		<b>1,572,689</b>	<b>1,160,097</b>

Date of approval of the financial statements: March 25, 2002

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**Oren Lider**  
Member of the  
Board of Directors

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**Shlomo Liran**  
Chief Executive Officer

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**David Brodet**  
Chairman of the  
Board of Directors

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

**DBS SATELLITE SERVICES (1998) LTD.**  
**STATEMENTS OF OPERATIONS**  
**IN ADJUSTED NIS**

	<u>Note</u>	<u>2001</u>	<u>2000</u>	<u>Period from December 2, 1998 (see note 1a(1)), to December 31, 1999</u>
<u>I n t h o u s a n d s</u>				
<b>REVENUES</b>		305,717	26,651	
<b>OPERATING EXPENSES</b>	11f	<u>707,644</u>	<u>*262,945</u>	
<b>GROSS LOSS</b>		401,927	236,294	
<b>SELLING, MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES:</b>	11g			
Selling and marketing		189,048	*166,249	19,144
General and administrative		<u>153,757</u>	<u>*125,644</u>	<u>61,295</u>
<b>LOSS FROM ORDINARY OPERATIONS</b>		744,732	528,187	80,439
<b>FINANCIAL EXPENSES, net</b>	11h	<u>94,891</u>	<u>23,278</u>	<u>3,880</u>
<b>LOSS FOR THE PERIOD</b>		<u>839,623</u>	<u>551,465</u>	<u>84,319</u>

\* Reclassified.

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

**DBS SATELLITE SERVICES (1998) LTD.**  
**STATEMENTS OF CHANGES IN CAPITAL DEFICIENCY**  
**IN ADJUSTED NIS**

	<u>Share capital</u>	<u>Receipts on account of shares</u>	<u>Accumulat ed deficit</u>	<u>Total</u>
	<u>In thousands</u>			
<b>CHANGES DURING THE PERIOD</b>				
<b>FROM DECEMBER 2, 1998 (see</b>				
<b>note 1a(1)) TO DECEMBER 31, 1999:</b>				
Issue of share capital	*			*
Receipts on account of shares to be allotted		1		1
Loss			(84,319)	(84,319)
<b>BALANCE AT DECEMBER 31, 1999</b>	*	1	(84,319)	(84,318)
<b>CHANGES DURING 2000:</b>				
Issue of share capital	10	(1)		9
Loss			(551,465)	(551,465)
<b>BALANCE AT DECEMBER 31, 2000</b>	10	-,	(635,784)	(635,774)
<b>CHANGES DURING 2001 - loss</b>			(839,623)	(839,623)
<b>BALANCE AT DECEMBER 31, 2001</b>	<u>10</u>	<u>-,</u>	<u>(1,475,407)</u>	<u>(1,475,397)</u>

\* Represents an amount of less than adjusted NIS 1,000.

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

**DBS SATELLITE SERVICES (1998) LTD.**

## STATEMENTS OF CASH FLOWS

## IN ADJUSTED NIS

**Period from  
December 2, 1998  
(see note 1a(1)), to  
December 31,  
1999**

	<u>2001</u>	<u>2000</u>	<u>1999</u>
	<u>In thousands</u>		
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Loss for the period	(839,623)	(551,465)	(84,319)
Adjustments required to reflect the cash flows from operating Activities (a)	<u>243,450</u>	<u>274,467</u>	<u>56,803</u>
Net cash used in operating activities	<u>(596,173)</u>	<u>(276,998)</u>	<u>(27,516)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of fixed assets	(510,512)	*(667,123)	(99,207)
Purchase of broadcasting rights	(69,810)	*(126,502)	(45,498)
Advance on account of license fees	<u>                    </u>	<u>                    </u>	<u>(30,668)</u>
Net cash used in investing activities	<u>(580,322)</u>	<u>(793,625)</u>	<u>(175,373)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Receipt of long-term loans from shareholders	793,082	638,297	136,139
Short-term credit from banks - net	<u>383,006</u>	<u>387,267</u>	<u>112,237</u>
Net cash provided by financing activities	<u>1,176,088</u>	<u>1,025,564</u>	<u>248,376</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(407)	(45,059)	45,487
<b>BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<u>428</u>	<u>45,487</u>	<u>                    </u>
<b>BALANCE OF CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<u>21</u>	<u>428</u>	<u>45,487</u>

\* Reclassified.

**DBS SATELLITE SERVICES (1998) LTD.**  
**STATEMENTS OF CASH FLOWS**  
**IN ADJUSTED NIS**

	<b>2001</b>	<b>2000</b>	<b>Period from December 2, 1998 (see note 1a(1)), to December 31, 1999</b>
	<b>In thousands</b>		
<b>(a) Adjustments required to reflect the cash flows from operating activities:</b>			
Expenses not involving cash flows:			
Depreciation and amortization	279,034	87,663	2,048
Liability for employee rights upon retirement - net	1,151		
Linkage differences on principal of long-term shareholders' loans	1,029		
	281,214	87,663	2,048
Changes in operating asset and liability items:			
Increase in accounts receivable	(39,328)	(39,413)	(7,907)
Increase in accounts payables and accruals (including customer deposits)	1,564	*226,217	62,662
	(37,764)	186,804	54,755
	243,450	274,467	56,803
<b>(b) Supplementary information on investing activities not involving cash flows:</b>			
Purchase of fixed assets with suppliers' credit	30,947	136,598	49,663
Purchase of broadcasting rights with suppliers' credit	41,436	30,331	16,448

\* Reclassified.

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

**DBS SATELLITE SERVICES (1998) LTD.**

**NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies, applies on a consistent basis, are as follows:

**a. General:**

1) Activities

DBS Satellite Services (1998) Ltd. (hereafter - the Company) was incorporated in Israel on December 2, 1998. In January 1999, the Company received a license from the Ministry of Communications to broadcast, in Israel, television broadcasts by means of satellite (hereafter - the License). The License is for a period of ten years from the day of its receipt and can be extended for a period of six additional years on certain conditions. The Company paid an advance on account of license fees (royalties) in the amount of approximately adjusted NIS 30 million, and presented a bank guarantee in the same amount in favor of the State of Israel. The Company is subject to the Telecommunications Law, 1982 (hereafter - the Telecommunications Law), the regulations and rules promulgated thereunder and the terms of the License.

In July 2000, the Company completed the development stage and began to provide its customers with multi-channel television broadcasts in accordance with the License granted it under the Telecommunications Law.

2) The Company's financial position

- a) The Company expects significant losses and a negative cash flow from ordinary operations during the first years of its activities. The loss for 2001 amounts to approximately adjusted NIS 840 million and the negative cash flow from ordinary operations aggregated approximately adjusted NIS 596 million. As a result of these losses, the working capital deficiency increased to adjusted NIS 1,345 million (including approximately adjusted NIS 883 million in short-term credit from banks).
- b) On August 1, 2000, the Company signed a memorandum of terms with banks, which indicates the terms and stipulations likely to be included in a financing agreement between them.

On May 23, 2001, the financing agreement between the Company and the banks was signed (hereafter - the financing agreement). The financing agreement specifies, inter alia, prerequisite conditions for the utilization of credit lines within the facility, including undertakings by the Company to meet certain suspending conditions as well as specified cumulative milestones and financial stipulations (hereafter - the terms).

To date of the approval of these financial statements, not all of the said terms had been fulfilled. The Company and the banks are continuing to discuss the steps necessary to achieve the fulfillment of the terms. In addition, discussions are underway regarding the increase of the credit facilities provided to the Company.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES** (continued):

- c) The Company's activities are financed by shareholders' loans and credit from banks. The receipt of additional loans from a principal shareholder is, inter alia, conditional upon the approval of the Ministerial Committee for Privatization (hereafter - the Committee). To date of the approval of the financial statements, the Committee has allowed the shareholder to increase his exposure up to the sum of the multiplication of the percentage of his shareholding of the Company's share capital by U.S. dollar 480 million.
- d) The Company's activity depends on the continued execution of the financing agreement, increase of the credit facilities provided by banks and the receipt of additional loans from shareholders. It is the opinion of the Company's management that the agreements between the shareholders and the existing credit facilities should suffice for most of the finance that would be required for the Company's operations in 2002, and that there are good chances that the ongoing deliberations between the Company, the shareholders and the banks will yield an arrangement for the remaining financing required.
- 3) Interested parties - as defined in the Israeli Securities (Preparation of Annual Financial Statements) Regulations, 1993.
- 4) Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of expenses during the reporting periods. Actual results could differ from those estimates.

**b. Adjusted financial statements:**

- 1) The financial statements have been prepared on the basis of historical cost adjusted for the changes in the general purchasing power of Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel (hereafter - the Israeli Institute). All figures in the financial statements are presented in adjusted new Israeli shekels (NIS) which have a uniform purchasing power (December 2001 adjusted NIS) - based upon the changes in the consumer price index (hereafter - the CPI) see also note 9b).

The adjustment of the financial statements is based on the accounts of the Company, maintained in nominal NIS. Condensed nominal Israeli currency data of the Company, on the basis of which its adjusted financial statements were prepared, are presented in note 14.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES** (continued):

The components of the statements of operations were, for the most part, adjusted as follows: the components relating to transactions carried out during the year were adjusted on the basis of the index for the month in which the transaction was carried out, while those relating to non-monetary balance sheet items (mainly depreciation and amortization) were adjusted on the same basis as the related balance sheet item. The financing component represents financial income and expenses in real terms and the erosion of balances of monetary items during the period.

- 2) The adjusted amounts of non-monetary assets do not necessarily represent realization value or current economic value, but only the original historical values, adjusted to reflect the changes in the general purchasing power of Israeli currency. In these financial statements, the term "cost" signifies cost in adjusted Israeli currency.
- 3) In October 2001, the IASB issued Israel Accounting Standard No. 12 - Discontinuance of Adjusting Financial Statements for Inflation. Standard 12 provides for the discontinuance of inflation-adjusted financial statements and the return to the nominal-historical financial reporting as is generally practiced in the world, due to the significant decrease in recent years in the inflation rates, and the less common usage of linkage in the Israeli economy.

According to this Standard, the adjustment of financial statements for inflation will be discontinued commencing January 1, 2003. Through December 31, 2002, the Company will continue to draw up financial statements, adjusted to inflation in accordance with Opinion No. 36 of the Israeli Institute. The inflation-adjusted amounts as of December 31, 2002, will be the base for the nominal-historical financial reporting in the following periods.

The implementation of Standard No. 12 will mainly affect the financing expenses item.

**c. Cash equivalents**

The Company considers all highly liquid investments, which include short-term bank deposits (up to three months from the date of deposit) that are not restricted as to withdrawal or use, to be cash equivalents.

**d. Broadcasting rights**

The rights are presented at cost, which includes commitments to suppliers of rights for the screening of movies and television programs, plus direct costs incurred for adapting such movies and programs for screening in Israel. The broadcasting rights are partially depreciated on the basis of actual screenings and partially according to the term of the rights agreement.

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES** (continued):

**e. Fixed assets**

Fixed assets are stated at cost and depreciated by the straight-line method, based on their estimated useful life. The costs of installation of broadcasting and receiving equipment were allocated to the cost of this equipment.

Annual rates of depreciation are as follows:

	<u>%</u>
Broadcasting and receiving equipment	10-15
Digital satellite decoders	25
Office furniture and equipment	7-15
Computers	33

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

**f. License fees - advance on account of royalties**

The license fees, which reflect royalty amounts as stipulated in the terms of the License (see note 1a(1)), are depreciated from the beginning the commercial utilization of the License, in accordance with the Company's obligation to pay royalties and throughout a period not exceeding ten years.

**g. Loss per NIS 1 of par value of shares**

The financial statements do not include data regarding the loss per NIS 1 of par value of shares, as it would not add any significant information to that already included in the financial statements.

**h. Revenue recognition:**

- 1) Revenues from subscribers are recognized as services to the subscribers are performed.
- 2) The Company leases digital satellite decoders to its customers, on an operational lease basis. Revenues from the lease fees are recognized ratably over the lease period.
- 3) The Company receives deposits from its subscribers for the digital satellite decoders, in an amount that does not exceed the cost of the decoders. Revenues from the depreciation of the deposits are carried to income over 5 or 10 years, based on the terms of the contract with the subscriber.

**i. Advertising expenses**

The expenses are carried to the statement of operations as incurred.

**j. Concentration of credit risks - allowance for doubtful accounts**

The allowance is determined in accordance with delays in collecting debts.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 2 - FIXED ASSETS:**

**a. Composition of assets and accumulated depreciation, grouped by major classifications and changes therein in 2001 are as follows:**

	Cost			Accumulated depreciation			Depreciated balance	
	Balance at beginning of year	Additions during the year	Balance at end of year	Balance at beginning of year	Additions during the year	Balance at end of year	December 31	
	Adjusted NIS			in thousands			2001	2000
Adjusted NIS in thousands								
Broadcasting and receiving equipment	*141,608	764	142,372	*12,902	19,468	32,370	110,002	128,706
Capitalized installation costs	411,363	273,377	684,740	21,697	47,667	69,364	615,376	389,666
Digital satellite decoders	295,349	236,616	531,965	7,382	102,056	109,438	422,527	287,967
Office furniture and equipment (including computers)	*83,474	25,545	109,019	*12,928	28,693	41,621	67,398	70,546
Leasehold improvements	20,810	5,157	25,967	1,599	2,267	3,866	22,101	19,211
	<u>952,604</u>	<u>541,459</u>	<u>1,494,063</u>	<u>56,508</u>	<u>200,151</u>	<u>256,659</u>	<u>1,237,404</u>	<u>896,096</u>

\* Reclassified.

**b. As to liens on the assets - see note 10.**

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 3 - PAYMENTS ON ACCOUNT OF LICENSE FEES**

Payments on account of license fees (royalties) are linked to the index known on balance sheet date (see note 1a(1)). The accumulated amortization as of December 31, 2001 is adjusted NIS 4,361,000.

In accordance with the terms of the License, the Company has undertaken to pay royalties to the Government of Israel which are calculated on the basis of revenues from the provision of broadcasting services as defined in the License. The rate of the royalties was set at 1.5% of the Company's revenues for the first five years starting on January 1, 1999 or until the accumulation of 250,000 subscribers, whichever is the earlier. Thereafter, royalties will be computed at the following rates:

<u>Year</u>	<u>Percentage of the Company's revenue</u>
2001	5%
2002	4%
2003 and thereafter	3.5%

In November and December 2001, the number of subscribers exceeded 250,000. The license fees - approximately NIS 30 million - are considered as a non-refundable advance on account of the abovementioned royalties.

**NOTE 4 - EMPLOYEE RIGHTS UPON RETIREMENT**

- a. Labor laws and agreements require the Company to pay severance pay to employees dismissed or retiring from its employ in certain other circumstances. The Company's severance pay liability to its employees (which is based on the number of years worked and the latest monthly salary) is covered mainly by purchase of insurance policies. The amounts funded as above are not reflected in the balance sheets since they are not under the control and management of the Company.
- b. The amount of liability for severance pay presented in the balance sheets reflects that part of the liability not covered as above, in accordance with labor agreements in force.

**NOTE 5 - SHAREHOLDERS' LOANS**

At the general meeting of the shareholders of the Company on December 24, 2000, it was decided that the various loans which had been extended by the shareholders to the Company would be linked to the CPI and bear interest at the annual rate of 7%, from the date of their grant to the date of their repayment, or the repayment of any part thereof, as the case may be, or other interest and linkage differences if so decided by a meeting of the shareholders of the Company. These terms will apply also to loans which will be extended to the Company by the shareholders in the future, as long as no decision to the contrary is made by the shareholders' meeting.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 5 - SHAREHOLDERS' LOANS** (continued):

In addition, it was resolved that the abovementioned decision would take effect on January 24, 2001 unless, by that date objections had been registered by a particular shareholder. In the event of such objections by the particular shareholder, the decision would take effect on the date the particular shareholder ceases to be a member of the enterprise. As at the date of signing of these financial statements, the shareholder has registered his objections as aforesaid, and the decision, therefore, has not taken effect. Accordingly, no interest has been charged on the shareholders' loans.

The loans, as included in the financial statements, bear interest at the rate of the increase in the known CPI.

The total amount of interest accrued until December 31, 2001, which would have been added to the amount of the loans had the decision taken effect, aggregates approximately adjusted NIS 128 million.

The date of repayment of the loans has not yet been determined, and is subject to the limitations specified in the memorandum of terms which was signed between the Company and the banks (see note 1a(2)).

**NOTE 6 - COMMITMENTS AND CONTINGENT LIABILITIES:**

**a. Commitments:**

- 1) The Company has entered into agreements for the purchase of fixed assets (mainly digital satellite decoders) and broadcasting rights, as follows:

	<b>December 31, 2001</b>
	<b>Adjusted NIS in thousands</b>
Fixed assets:	
Digital satellite decoders*	213,443
Other assets	10,177
Broadcasting rights	371,096

\* See note 13b.

- 2) The Company has entered into two main operating lease agreements for buildings it uses. One agreement expires in 2003 with an option to renew for three additional years, and the second agreement expires in 2009 with an option to renew for an additional 10 years. The lease fees are linked to the U.S. dollar (hereafter - the dollar). Furthermore, the Company has entered into numerous additional operating lease agreements for various periods.

The projected annual lease fees for the next five years, calculated according to the rate in effect on December 31, 2001, are approximately adjusted NIS 13 million.

- 3) As to the Company's undertaking to pay royalties to the Government of Israel, see note 3.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 6 - COMMITMENTS AND CONTINGENT LIABILITIES** (continued):

- 4) The Company has entered into an agreement for the lease of space segments on the Amos 1 satellite. The agreement is for a period of 8.5 years commencing April 14, 1999, with options to renew for additional six month periods each time. The lease is linked to the dollar.

The projected annual lease fees for the next five years, calculated according to the rate in effect on December 31, 2001, are approximately adjusted NIS 98 million.

In addition, on May 16, 2000, the Company has entered into an agreement for the lease of space segments on the Amos 2 satellite. The agreement expires after 10 years or at the end of the useful life of the satellite, whichever is earlier. The projected annual lease fees are approximately adjusted NIS 18 million, linked to the dollar. The satellite is expected to be launched in the first quarter of 2003.

- 5) The Company has entered into subcontracting agreements for the establishing, management and operation of the installation array. The installation array includes installing equipment in the homes of subscribers' and instructing them as to the operation of the equipment, end equipment maintenance services and other related services. The costs incurred by the Company in respect of these agreements during the period from September 2001 through December 2001 aggregate approximately adjusted NIS 83 million.

**b. Contingent liabilities:**

- 1) To secure its liabilities, the Company has provided documentary credits and guarantees in the amount of approximately NIS 52 million.

Claims which were filed against the Company are described below.

In the opinion of the Company's management, based on its legal counsel, the outcome of the claims pending against the Company, which are described below, cannot be estimated at this stage. Therefore, no provision was made in the financial statements in respect thereof.

- 2) On November 27, 2001, Reuveni Pridan Advertisers (hereafter - Pridan) filed a claim for NIS 3 million against the Company.

Pridan alleges that the Company has unlawfully cancelled the advertising services agreement between them, thereby, inter alia, preventing Pridan from receiving additional commissions under the agreement and damaging Pridan's reputation.

On February 12, 2002, the parties have reached an agreement, according to which the Company is to make monthly deposits of NIS 100,000, up to an amount of NIS 1 million, with a trust account that would be opened for this purpose by the representatives of the parties and the dispute is to be referred to an arbitrator.

In the opinion of the Company's legal counsel, the outcome of the claim cannot be estimated at this stage.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 6 - COMMITMENTS AND CONTINGENT LIABILITIES** (continued):

- 3) In November and December 2001, the Company received demands (including a claim) for damages in an aggregate amount of approximately NIS 1 million in respect of alleged breach of rights. On March 12, 2002, during a pretrial proceeding, the parties have reached a settlement, according to which the Company is to pay the claimant an insignificant amount. The settlement agreement is in its final stages and is expected to be submitted to the Court in the next few days, with an application to give the agreement the force of a judgment.

In the opinion of the Company's legal counsel, it cannot be estimated at this stage whether the applicant would file a claim, nor can the measures that may be required under such claim or the chances thereof be determined at this stage.

- 4) On May 10, 2001, a claim was filed against the Company, alleging that, in its advertisements, the Company misleads consumers as to the possibility of purchasing only specific channels as well as with respect to the number of channels offered to the consumer. In addition, according to the claim, the Company has charged its subscribers for a maximum channel package, although they have not chosen such package.

The claimant has filed the claim as the representative of the Company's subscribers and has concurrently submitted an application to approve the claim as a class action under the Consumer Protection Law.

The claimant's alleged damages are in an insignificant amount. The aggregate amount of damages claimed for all the members in the represented group is approximately NIS 177 million.

On March 18, 2002, the parties signed a compromise agreement, under which a request to reject the claim and the application for the approval thereof as a class action would be submitted to the Court. In return, the Company shall pay the claimant damages of an insignificant amount.

- 5) On September 3, 2001, the general manager of the Consumer Council notified the Company in writing that the delivery fees (NIS 2.90 per month) that the Company charges its subscribers, without their expressed consent, for the delivery of the Yes magazine, is against the law and required that the Company reimburse all the subscribers whose expressed consent had not been received and, that in the future, the Company would avoid charging any amounts without receiving the expressed consent of consumers.

The general manager of the Consumer Council has also filed a complaint in this respect with the Cable and Satellite Broadcast Council. Consequently, on September 30, 2001 the chairwoman of the latter Council notified the Company that the way in which the delivery fees were charged is also contrary to the terms of the license and of the subscriber agreements. the chairwoman demanded that the Company receive the positive consent of all subscribers before charging them for the delivery of the magazine, reimburse all those who does not express their consent thereto and cease immediately charging delivery fees from those who did not give their expressed consent thereto.

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 6 - COMMITMENTS AND CONTINGENT LIABILITIES** (continued):

On November 7, 2001, the Head of the Supervising and Control Department in the Ministry of Communications notified the Company that the charging of the delivery fees constitutes an alleged breach and required the Company to submit its response, in accordance with the breach procedure set forth by the Cable and Satellite Broadcast Council. In addition, in his letter he requires the Company to cease immediately any breaches, correct them without delay and report these actions upon their completion.

On November 22, 2001, the Company submitted its response to the Head of the Supervising and Control Department, in which it specified all the measures already taken by the Company as well as those that the Company intends to take in order to make certain that each and every one of the subscribers is aware of his option to cancel the delivery of the magazine and the charge of the delivery fees.

On February 24, 2002, the chairwoman of the Cable and Satellite Broadcast Council notified the Company that, according to the Council's policy, the Company continues to act in violation of the terms of the license and the subscriber agreements. On this basis, the chairwoman of the Council determined that the Company's conduct constitutes a breach and notified the Company that she intends to exercise her authority and require the Company to pay a penalty in respect of such breach.

On February 26, 2002, the Company replied that, to the best of its understanding, it acted in accordance with the expressed instructions of the Council regarding this matter and therefore requests that the claim for breach be cancelled.

In the opinion of the Company's legal counsel, whether a claim would be filed, what measures may be required under such claim or the chances thereof cannot be estimated at this stage, nor can it be determined whether the chairwoman of the Council would require the Company to pay a penalty.

- 6) A dispute arose between the Company and its distributor in the Arab sector (hereafter - the distributor) with respect to the termination of the agreement between the parties.

On March 22, 2001, the Company received a liquidation notice from the distributor, in which he requires a payment of approximately NIS 4.8 million in respect of commissions that he alleges are due to him from the Company. The Company rejects the claims of the distributor and claims that the distributor owes the Company approximately NIS 100,000, before taking into account damages caused to the Company by his breach of the agreement, that have not yet been fully estimated by the Company. The Company and the distributor are currently reviewing various drafts of an agreement regarding the type of proceedings by which their disputes are to be deliberated.

In the opinion of the Company's legal counsel, it cannot be determined at this stage whether a claim would be filed, what measures may be required under such claim or what the chances of such claim may be.

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 7 - SHARE CAPITAL:**

- a. The share capital as of December 31, 2001 and 2000 is composed of ordinary shares of NIS 1 par value, as follows:

	<b>Number of shares</b>
Authorized	<u>36,000</u>
Issued and paid	<u>10,000</u>

**b. Stock options to employees**

The employment agreements with certain employees entitle them to participate in an employee stock option plan, should the Company choose to adopt one, under which options would be granted for the purchase of Company shares. The exact number of options to be granted to each employee under such plan will be determined at the sole discretion of the Company's management.

In accordance with the Company's employment agreements with some of its senior employees, each of these employees is to be granted options for the purchase of Company shares, by way of allotment of shares, of NIS 1 par value, at par, so that after the options are exercised, the number of shares held by each of said employees would range between 0.2% and 0.8% of the Company's issued share capital as on the date of the signing of each agreement.

Each employee would be entitled to exercise the options in purchase of the number of shares stipulated in the agreement with such employee. To date of the approval of the financial statements, the Company has not adopted an employee stock option plan.

See also note 13a(3).

**NOTE 8 - TAXES ON INCOME:**

**a. Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985 (hereafter - the inflationary adjustments law)**

Under the inflationary adjustments law, results for tax purposes are measured in real terms, having regard to the changes in the CPI. The Company is taxed under this law.

**b. Tax rates applicable to the Company**

The income of the Company will be taxed at the regular rate of 36%.

**c. Losses for tax purposes carried forward to future years**

Carryforward losses as of December 31, 2001, amount to adjusted NIS 1,471 million. Due to the uncertainty of their utilization in the foreseeable future, the Company has not created deferred taxes in its accounts in respect of these losses. Under the inflationary adjustments law, carryforward losses linked to the CPI and can be utilized indefinitely.

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 8 - TAXES ON INCOME** (continued):

**d. Tax assessments**

The Company has not been assessed for tax purposes since incorporation.

**NOTE 9 - LINKAGE TERMS OF MONETARY BALANCES:**

**a. As follows:**

	<b>December 31, 2001</b>		
	<b>In dollars or linked thereto</b>	<b>CPI linked</b>	<b>Unlinked</b>
	<b>Adjusted NIS in thousands</b>		
<b>Assets - current:</b>			
Cash and cash equivalents	6		15
Accounts receivable:			
Trade			56,967
Other	10,351	738	18,742
	10,357	738	75,724
<b>Liabilities:</b>			
Current liabilities:			
Bank credit			882,510
Accounts payable and accruals:			
Trade	195,347		324,204
Other	29,977		
Long-term liabilities:			
Shareholders' loans		1,568,546	
Other liabilities, including the current portion		46,351	1,151
	225,324	1,614,897	1,207,865

**b. Data regarding the exchange rate and the CPI:**

	<b>Exchange rate of one U.S. dollar</b>	<b>CPI*</b>
At end of year:		
2001	NIS 4.416	170.9 points
2000	NIS 4.041	168.5 points
1999	NIS 4.153	168.5 points
Increase (decrease) during the year:		
2001	9.3%	1.4%
2000	(2.7)%	0.0%
1999	(0.2)%	1.3%

\* Based on the index for the month ending on each balance sheet date, on the basis of 1993 average = 100.

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 10 - LIABILITIES SECURED BY LIENS AND RESTRICTIONS IMPOSED IN CONNECTION WITH LIABILITIES:**

- a. Following is the balance of secured liabilities and guarantees of the Company:

	<b>December 31</b>	
	<b>2001</b>	<b>2000</b>
	<b>Adjusted NIS in thousands</b>	
Liabilities - short-term bank credit	882,510	499,504
Guarantees	52,315	46,482

- b. To secure the abovementioned liabilities and guarantees, the Company registered a lien on all its assets, including share capital and goodwill.
- c. See note 1a(2)(b) as to the financing agreement that the Company signed with banks which, inter alia, stipulates prerequisite conditions for the utilization of credit lines within the facility, including undertakings by the Company to meet certain suspending conditions as well as specified cumulative milestones and financial stipulations.

**NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:**

**Balance sheets:**

- a. **Accounts receivable:**

- 1) Trade

This item net of an allowance for doubtful accounts of adjusted NIS 5,333,000 (December 31, 2000 - approximately adjusted NIS 230,000).

- 2) Other:

	<b>December 31</b>	
	<b>2001</b>	<b>2000</b>
	<b>Adjusted NIS in thousands</b>	
Institutions (mainly VAT)	18,720	28,607
Advances to suppliers of purchased channels	8,197	14,807
Other	2,914	40
	29,831	43,454

**DBS SATELLITE SERVICES (1998) LTD.**

## NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):**b. Short-term bank credit:**

- 1) Classified by currency, linkage basis and interest rates, the short-term credit is as follows:

	<b>D e c e m b e r 3 1</b>		
	<b>2001</b>	<b>2001</b>	<b>2000</b>
	<b>Interest rates</b>	<b>Amount</b>	
	<b>%</b>	<b>Adjusted NIS in thousands</b>	
In dollars or linked thereto			136,323
Unlinked	7.9	882,510	363,181
		<u>882,510</u>	<u>499,504</u>

- 2) As to securities - see note 10.

**c. Accounts payable and accruals:**

	<b>December 31</b>	
	<b>2001</b>	<b>2000</b>
	<b>Adjusted NIS in thousands</b>	
1) Trade:		
Open accounts*	484,649	347,553
Checks and notes payable	34,902	137,578
	<u>519,551</u>	<u>485,131</u>
* Including content suppliers	<u>88,215</u>	<u>46,779</u>
2) Other:		
Employees and employee institutions	16,872	9,105
Provision for vacation pay	6,334	3,025
Customer deposits	6,365	21
Sundries	406	24,461
	<u>29,977</u>	<u>36,612</u>

- d. On January 3, 2002, the Company filed a claim against Baran Raviv Telecom Ltd. (hereafter - "Baran Raviv"). The Company claims, inter alia, that Baran Raviv has failed to fulfill its duties according to the agreement between the two, in which Baran Raviv undertakes to establish, manage and operate an array for the installation of user end equipment for the reception of the Company's broadcasts, as an independent contractor, on behalf of the Company.

The balance of the Company's liabilities to Baran Raviv, according to the settlement reached on February 2002, is NIS 55.5 million, linked to the CPI for January 2002. The balance is payable until 2004.

**DBS SATELLITE SERVICES (1998) LTD.**  
 NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):

The Company's liabilities to Baran Raviv under the settlement are presented in the balance sheets as follows:

	<b>Adjusted NIS in thousands</b>
Among current liabilities	28,390
As a long-term liability	27,110
	55,500

**e. Broadcasting rights:**

	<b>December 31</b>	
	<b>2001</b>	<b>2000</b>
	<b>Adjusted NIS in thousands</b>	
Advances to content suppliers	47,946	68,439
Broadcasting rights	282,080	150,341
	330,026	218,780
L e s s - fully utilized rights	43,452	
	286,574	218,780

**DBS SATELLITE SERVICES (1998) LTD.**

## NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):**Statements of operations:**

	<u>2001</u>	<u>*2000</u>	<u>Period from December 2, 1998, to December 31, 1999</u>
	<u>Adjusted NIS in thousands</u>		
<b>f. Operating expenses:</b>			
Salaries and employee related expenses	77,136	14,022	
External customer service center	36,652	15,564	
Depreciation and amortization	182,613	50,702	
Amortization of broadcasting rights utilized	75,711	32,870	
Content costs	220,933	107,315	
Consumption of space segments	66,885	35,320	
Rent	4,621	3,309	
Other	43,093	3,843	
	<u>707,644</u>	<u>**262,945</u>	
<b>g. Selling, marketing, general and administrative expenses:</b>			
Selling and marketing:			
Salaries and employee related expenses	81,323	58,601	2,941
Advertising	65,650	77,030	3,574
Marketing consultation	6,067	16,054	11,406
Rent and maintenance	4,100	3,510	
Depreciation	483	43	
Other	31,425	11,011	1,223
	<u>189,048</u>	<u>166,249</u>	<u>19,144</u>
General and administrative:			
Salaries and employee related expenses	66,531	37,876	14,351
Consultation and professional fees	9,711	42,115	28,245
Office expenses	14,264	9,696	
Rent and maintenance	15,763	8,702	
Depreciation	20,694	11,508	
Allowance for doubtful accounts	5,103	230	
Other	21,691	15,517	18,699
	<u>153,757</u>	<u>125,644</u>	<u>61,295</u>
<b>h. Financial expenses, net:</b>			
In respect of short-term bank credit	71,971	23,978	2,422
Credit agreement stamping fees	20,207		
Other - net	2,713	(700)	1,458
	<u>94,891</u>	<u>23,278</u>	<u>3,880</u>

\* Reclassified.

\*\* For the period from July 1, 2000 to December 31, 2000 (see note 1a(1)).

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 12 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:**

**a. Concentration of credit risks**

The cash and cash equivalents as of December 31, 2001 and 2000 are deposited with Israeli banks. The Company is of the opinion that the credit risk in respect of these balances is remote.

The Company's sales are made in Israel to a large number of customers. Consequently, the balance of the Company's trade receivables does not represent a significant concentration of credit risk as of December 31, 2001.

**b. Fair value of financial instruments**

The Company's financial instruments as of December 31, 2001 and 2000 are composed mainly of non-derivative assets and liabilities (which include working capital and the current portion of long-term liabilities). In view of their nature, the fair value of the financial instruments included in working capital is usually close or identical to their carrying value. As to shareholders' loans, see note 5.

**NOTE 13 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES:**

**a. Transactions with interested parties:**

	<u>2001</u>	<u>2000</u>	<u>Period from December 2, 1998, to December 31, 1999</u>
<u>Adjusted NIS in thousands</u>			
1) Operating expenses	<u>94,508</u>	<u>47,633</u>	
Consultancy	<u>644</u>	<u>578</u>	<u>752</u>
Selling, marketing, general and administrative and expenses	<u>19,544</u>	<u>11,716</u>	
2) Benefits to interested parties - salary to an interested party employed by the Company and a director's fees	<u>3,138</u>	<u>2,782</u>	<u>750</u>

**DBS SATELLITE SERVICES (1998) LTD.**

NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 13 - TRANSACTIONS AND BALANCES WITH INTERESTED PARTIES** (continued):

- 3) Under the employment agreement with the CEO of the Company, the Company is to allot him options exercisable in purchase of ordinary shares of NIS 1 par value of the Company, subject to the adoption of a stock option plan by the Company's board of directors. The options will be granted at no consideration and will be exercisable in purchase of a number of shares representing 0.8% of the Company's issued and paid share capital as of the date of the agreement.

The options shall be granted to the CEO in three annual batches, commencing November 2002. The exercise price of each option shall be the par value of one share.

To date of the approval of the financial statements, the Company has not adopted an employee stock option plan.

- 4) Under the employment agreement with a former CEO of the Company, he will be entitled to require the Company to purchase from him the shares underlying exercise of the options to which he is entitled on the date he ended his office - 0.25% of the Company's share capital - at a price which will be set according to an estimated Company valuation which will be made within 60 days of the date on which the CEO gave written notice to the Company of his wish to require the Company to purchase the aforesaid shares from him. The CEO's right to require the Company to purchase the shares from him will be valid for a period of two years from the date of his severance, and so long as the Company's shares have not been listed on the stock exchange.

To the date of the approval of the financial statements, former CEO has not notified the Company on his intention to require the Company to purchase the shares from him.

**b. Balances with interested parties:**

	<b>December 31</b>	
	<b>2001</b>	<b>2000</b>
	<b>Adjusted NIS in thousands</b>	
1) Long-term liabilities - shareholders' loans (see note 5)	<u>(1,568,546)</u>	<u>(774,435)</u>
2) Current liabilities - presented in the balance sheets under "accounts payable and accruals - other"	<u>(67,083)</u>	<u>(79,835)</u>

- c. The Company has entered into an agreement with a third party and with an interested party for the import of digital satellite decoders. In the year ended December 31, 2001, the Company purchased decoders in a total amount of adjusted NIS 237 million.
- d. The Company has entered into an agreement for the lease of space segments on the Amos 1 satellite with a third party who is an interested party. See note 6.

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 14 - NOMINAL DATA OF THE COMPANY:****a. Balance sheet data**

	<b>Nominal NIS in thousands</b>	
	<b>December 31</b>	
	<b>2001</b>	<b>2000</b>
<b>A s s e t s</b>		
Current assets:		
Cash and cash equivalents	21	422
Accounts receivable:		
Trade	56,967	3,960
Other	29,831	42,851
	86,819	47,233
Broadcasting rights:		
Cost	286,574	215,740
L e s s - utilized rights	64,300	32,413
	222,274	183,327
Fixed assets:		
Cost	1,484,682	938,678
L e s s - accumulated depreciation	254,135	55,631
	1,230,547	883,047
License fees - advance on account of royalties	26,192	29,772
	1,565,832	1,143,379
<b>Liabilities, net of capital deficiency</b>		
Current liabilities:		
Bank credit	882,510	492,562
Accounts payable and accruals:		
Trade	519,551	478,389
Other	29,977	36,103
	1,432,038	1,007,054
Long-term liabilities:		
Shareholders' loans	1,568,546	763,672
Liability for employee rights upon retirement, net	1,151	
Customer deposits	19,241	186
Another liability, net of the current portion	27,110	
	1,616,048	763,858
T o t a l liabilities	3,048,086	1,770,912
Capital deficiency, see c. below	(1,482,254)	(627,533)
	1,565,832	1,143,379

**DBS SATELLITE SERVICES (1998) LTD.**  
NOTES TO FINANCIAL STATEMENTS (continued)

**NOTE 14 - NOMINAL DATA OF THE COMPANY (CONTINUED):****b. Operating results data**

	Nominal NIS in thousands		
	2001	2000	Period from December 2, 1998, to December 31, 1999
Revenues	305,011	26,281	
Operating expenses	703,458	*245,786	
Gross loss	398,447	219,505	
Selling, marketing, general and administrative expenses:			
Selling and marketing	188,146	*183,729	18,788
General and administrative	152,780	*117,553	60,030
Loss from ordinary operations	739,373	520,787	78,818
Financial expenses, net	115,348	23,151	4,787
Loss for the period - nominal	854,721	543,938	83,605

\* Reclassified.

**c. Changes in capital deficiency:**

	Nominal NIS in thousands			
	Share capital	Receipts on account of shares	Accumulated deficit	Total
Changes during the period from December 2, 1998 to December 31, 1999:				
Issuance of share capital	*			*
Receipts on account of shares to be allotted		1		1
Loss			(83,605)	(83,605)
Balance at December 31, 1999	*	1	(83,605)	(83,604)
Changes during 2000:				
Issuance of share capital	10	(1)		9
Loss			(543,938)	(543,938)
Balance at December 31, 2000	10	-,-	(627,543)	(627,533)
Changes during 2001 - loss			(854,721)	(854,721)
Balance at December 31, 2001	10	-,-	(1,482,264)	(1,482,254)

\* Represents an amount of less than NIS 1,000.