May 19, 2009

# "Bezeq" The Israel Telecommunication Corp. Limited

# Quarterly Report for the period ending 31.3.09

## Update of Chapter A (Description of Company Operations) of the Periodic Report for 2008

## Directors' Report on the State of the Company's Affairs for the period ended March 31, 2009

## Condensed Interim Consolidated Financial Statements as at March 31, 2009

**UPDATE OF CHAPTER A (DESCRIPTION OF COMPANY OPERATIONS)[1]**

**OF THE PERIODIC REPORT FOR 2008 ("THE PERIODIC REPORT")**

**OF "BEZEQ" – THE ISRAEL TELECOMMUNICATIONS CORP. LTD. ("the Company")**

**In this report, which contains an update of the chapter regarding the description of the Company's business from the periodic report for 2008, the Company has included forward-looking information, as defined in the Securities Law 5728-1968 ("the Securities Law") with respect to both itself and the market. 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 Company's control. 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.**

**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 Company does not independently check their correctness. The Company's assessments vary from time to time in accordance with the circumstances.**

**In addition, the realization and/or otherwise of the forward-looking information will be affected by factors that cannot be assessed in advance, and which are beyond the Company's control, including the risk factors that are characteristic of its operations as set out in this report, developments in the general environment, and external factors and the regulation that affects the Company's operations, as set out in this report.**

## 1. Description of General Development of Group Operations

### Section 1.1 – Group activity and description of its business development

### Section 1.1.4 - Holdings of the Company

The following are details of the current rate of the Company's holdings, fully diluted, assuming exercise of all of the options actually allotted to employees of the Company at March 31, 2009 and May 18, 2009 (as set out in the Periodic Report for 2008 and in the update to section 1.3.2 below):

| Shareholders | Percentage of holdings | | |
|---|---|---|---|
| | At March 31, 2009 | At May 18, 2009 | Fully diluted at March 31, 2009 |
| Ap.Sb.Ar. | 40.44% | 40.29% | 38.62% |
| State of Israel | 3.80% | 3.62% | 0.96% |
| Zeevi Group | 17.66% | 17.59% | 16.86% |
| The public | 38.10% | 38.50% | 43.56% |

### Section 1.1.5 – Mergers and Acquisitions – DBS

On April 30, 2009, the board of directors of the Company resolved to effect the merger of the Company and DBS Satellite Services (1998) Ltd. ("DBS") on the terms prescribed in the ruling of the Antitrust Tribunal, to give notice to the Antitrust Tribunal and the Supreme Court of such resolution, all without derogating from the Company's claims in the counter-appeal that it filed against the amount of the bank guarantee prescribed as part of the terms of the merger. Exercise of the merger is subject to the ruling of the Supreme Court on the appeal filed against approval of the merger.

[1] The update is pursuant to Article 39A of the Securities (Periodic and Immediate Reports) Regulations, 5730-1970, and includes material changes or innovations that have occurred in the Company in any matter which must be described in the Periodic Report. The update relates to the Company's periodic report for 2008 and relates to the section numbers in Chapter A (Description of Company Operations) in that periodic report.

The following are the main conditions set out in the ruling of the Antitrust Tribunal, for approval of the merger: Provision of a public fixed-line broadband public telecommunications network that permits provision of television services (including VOD) at an assured level of quality; a permit to DBS to provide only bi-directional services not available for satellite broadcast via the Company's infrastructure so long as there is not at least one competitor with at least 100,000 subscribers or a monthly revenue of at least NIS 10 million transmitting television broadcasts over the Company's infrastructure, preservation of the structural separation between the Company and DBS, approval of the provision of services or products from the Company to DBS by a majority of at least 75% of the members of the board of directors of DBS and preservation of the satellite infrastructure in the event that DBS moves over to broadcast over IPTV infrastructure. Likewise, the conditions include deposit of a bank guarantee in the sum of NIS 200 million for assurance of performance of the above conditions such that for a fundamental breach of the conditions, the Commissioner may render forfeit the entire amount of the guarantee and for any other breach the Commissioner may render forfeit the sum of NIS 10 million for each breach, and in addition, an identical sum for each additional month during which the breach continues. The Company submitted a counter appeal against the amount of this guarantee, as noted above.

**<u>Section 1.3 – Investments in equity and stock transactions</u>**

**<u>Section 1.3.2 - Employee option schemes</u>**

As part of an option scheme for managers and senior employees of the Group of November 2007, to allot up to 65,000,000 options, since the date of publication of the Periodic Report for 2008 and until May 18, 2009, 100,000 additional options were allotted and 400,000 options expired, so that at the date of publication of this Report, 59,250,000 options, net, have been allotted (after set-off of the options that have expired) under the scheme (59,550,000 options up to March 31, 2009).

**<u>Section 1.4 – Distribution of dividends</u>**

On May 3, 2009, the general meeting of the shareholders of the Company, following the recommendation of the board of directors of the Company of March 23, 2009, approved the distribution of a cash dividend to the shareholders of the Company in the amount of NIS 792 million, constituting, at the effective date for the distribution (May 11, 2009), the sum of NIS 0.3013025 per share and 30.13025% of the issued and paid up share capital of the Company. The dividend will be paid to the shareholders of the Company on May 24, 2009. Tax will be withheld from the dividend as required by law.

**Section 1.5 - Financial information regarding the Group's areas of operation**

**Section 1.5.3 Principal results and operational data**

## A. Bezeq Landline (the Company's activity as domestic operator)

(NIS millions except where stated otherwise)

| | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|
| Revenue | 1,326 | 1,348 | 1,388 | 1,354 | 1,408 |
| Operating profit | 437 | 257 | 422 | 428 | 368 |
| Depreciation and amortization | 211 | 209 | 214 | 211 | 218 |
| Operating profit before depreciation and amortization (EBITDA) | 648 | 466 | 636 | 639 | 586 |
| Payments for investment in property, plant and equipment and intangible assets | 238 | 170 | 156 | 132 | 158 |
| Proceeds from sale of property, plant and equipment | 48 | 20 | 12 | 25 | 60 |
| No. of active subscriber lines at end of period (in thousands) | 2,579 | 2,615 | 2,645 | 2,681 | 2,711 |
| Average monthly revenue per line (NIS) * | 81 | 82 | 85 | 82 | 84 |
| No. of outgoing minutes (in millions) | 3,123 | 3,154 | 3,428 | 3,346 | 3,511 |
| No. of incoming minutes (in millions) | 1,654 | 1,648 | 1,719 | 1,651 | 1,673 |
| No. of ADSL subscribers at end of period (in thousands) | 1,011 | 1,005 | 994 | 982 | 970 |
| Average monthly revenue per ADSL subscriber (NIS) | 68 | 67 | 68 | 66 | 68 |

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

## B. Pelephone

(NIS millions except where stated otherwise)

| | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|
| Revenue | 1,265 | 1,138 | 1,214 | 1,188 | 1,173 |
| Operating profit | 302 | 159 | 293 | 266 | 215 |
| Depreciation and amortization | 139 | 135 | 129 | 130 | 129 |
| Operating profit before depreciation and amortization (EBITDA) | 441 | 294 | 422 | 396 | 344 |
| Net profit | 230 | 128 | 211 | 180 | 163 |
| Cash flow from current operations | 375 | 298 | 379 | 344 | 256 |
| Investment in property, plant and equipment and intangible assets | 149 | 163 | 350 | 182 | 103 |
| Proceeds from sale of property, plant and equipment | - | 1 | - | 1 | 1 |
| No. of subscribers at end of period (in thousands) | 2,669 | 2,649 | 2,698 | 2,636 | 2,595 |
| Average monthly minutes of use (MOU) per subscriber* | 323 | 335 | 359 | 358 | 355 |
| Average monthly revenue per subscriber (ARPU) (in NIS)* | 128 | 122 | 129 | 128 | 126 |
| No. of subscribers at end of period (in thousands) | 1,217 | 1,151 | 1,068 | 977 | 867 |
| Revenue from value added services and content, of revenues from cellular services (%) | 18.5% | 18.4% | 16.2% | 15.5% | 15.0% |

* MOU and ARPU data for Q1 2009 include deduction of 92,000 dormant subscribers from the number of active subscribers at December 31, 2008. Inclusion of the impact of this deduction in the comparison period would have increased the above indices in the comparison period by 1 – 3%.

## C. Bezeq International

(NIS millions except where stated otherwise)

| | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|
| Revenue | 324 | 337 | 329 | 326 | 314 |
| Operating profit | 60 | 65 | 59 | 63 | 55 |
| Depreciation and amortization | 20 | 20 | 20 | 20 | 20 |
| Operating profit before depreciation and amortization (EBITDA) | 80 | 85 | 79 | 83 | 75 |
| Net profit | 44 | 46 | 44 | 47 | 42 |
| Cash flow from operating activities | 84 | 72 | 32 | 51 | 8 |
| Payments for investment in property, plant and equipment and intangible assets* | 21 | 26 | 33 | 31 | 28 |
| Proceeds from sale of property, plant & equipment | - | 1 | - | - | - |

* This item also includes long-term investments in assets.

D. **DBS**

(NIS millions except where stated otherwise)

| | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|
| Revenue | 384 | 377 | 375 | 380 | 381 |
| Operating profit | 66 | 55 | 52 | 43 | 27 |
| Depreciation and amortization | 57 | 66 | 59 | 60 | 65 |
| Operating profit before depreciation and amortization (EBITDA) | 122 | 122 | 111 | 103 | 92 |
| Net profit (loss) | (1) | (18) | (82) | (99) | (66) |
| Cash flow from operating activities | 91 | 134 | 97 | 32 | 84 |
| Payments for investment in property, plant and equipment and intangible assets* | 61 | 63 | 56 | 40 | 79 |
| Proceeds from sale of property, plant and equipment | - | - | - | - | - |
| No. of subscribers at end of period (in thousands) | 560 | 560 | 556 | 551 | 549 |
| Average monthly revenue per subscriber (NIS) | 228 | 225 | 226 | 230 | 231 |

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

**Section 1.6 - Group forecast**

Building on the incremental visibility following the close of the first quarter of 2009, which included materially stronger financial performance as compared to the corresponding quarter in 2008, and taking into consideration the current economic environment, Bezeq Group is raising its outlook for 2009 and currently anticipates achieving revenues, net profit, EBITDA, and operating cash flows in line with those of the Group's full-year 2008 performance levels. The Bezeq Group is not changing its outlook for gross capital expenditures, which will still be close to the 2008 level.

**The information in this section contains forward-looking information, based on the Company's assessments. Actual results might be substantially different from these assessments, taking into account the changes that might occur in commercial conditions, and the possible impact of regulatory decisions.**

## 2. Fixed-line Domestic Services – Bezeq, The Israel Telecommunication Corp. Ltd. ("the Company")

**Section 2.3 - Breakdown of revenues and profitability of products and services**

For updates of data regarding the breakdown of the Company's revenues based on products and services, see Note 9B to the financial statements of the Company for the period ended on March 31, 2009.

**Section 2.6 – Competition**

On May 10, 2009, HOT announced the establishment of a UFI (Ultra Fast Internet) network using Docsis3 technology. According to its announcement, the network will offer speeds of up to 100 mega. In accordance with its announcement, HOT expects to launch the network in several cities in Israel this year and to deploy nationally within three years.

**Section 2.7 – Property, plant and equipment**

**Section 2.7.4 – Real estate**

During the course of the first three months of 2009, the Company sold two real estate assets in a total area of approximately 7,100 $m^2$ in land and approximately 3,700 $m^2$ built-up, for a total sum of NIS 23 million.

**Section 2.9 – Human resources**

Pursuant to a resolution of the board of directors of the Company of 2008 to approve the retirement of 245 employees during 2009 in accordance with the conditions of the Collective Agreement of December 2006, 99 employees retired from the Company in this context at the date of publication of this Report (of whom 83 retired prior to March 31, 2009).

**Section 2.16 – Limitation and regulation of Company activities**

**Section 2.16.1 – Control of the Company's tariffs**

Sub-section (a), regarding update of the Company's tariffs – According to the draft regulations sent to the Company on May 17, 2009 by the Ministry of Communications, the Company's tariffs are scheduled for updating on June 1, 2009, based on the regular update formula in the Communications (Telecommunications and Broadcasts) (Calculation of Payments and Linkage for Telecommunications Services) (Amendment) Regulations 5767-2007, so that the monthly payment for a telephone line will rise by 3.8% and the other controlled services provided by the Company will be reduced by 0.3183%.

Furthermore, on May 7, 2009, the Company received a letter from the Ministry of Communications, enclosing a draft amendment to the Communications (Telecommunications and Broadcasting) (Payments for Interconnect) (Amendment) Regulations, 5769-2009, which was submitted to the Company for review. According to this draft, if the regulations are indeed amended, the interconnect fee paid by cellular and domestic operators in respect of termination of a call on the domestic operator's network, and the interconnect fee the international operators pay in respect of an international call that begins or ends on the domestic operator's network, will be reduced, commencing June 1, 2009, by 0.3183%.

**Section 2.16.2 – The Company's general license**

Concerning the letter of the Director General of the Ministry of Communications of March 9, 2009, in which he gave notice that he was considering imposing a monetary sanction on the Company for alleged breach of the provisions of its license with respect to structural separation, on April 26, 2009, the Company submitted its detailed remarks to the effect that the Company had not breached the provisions of its license with respect to structural separation, and no such breach can be attributed to it, and that in these circumstances and those described in the Company's document, a monetary sanction cannot be imposed on the Company. The Company also requested a hearing.

Concerning baskets of common services – According to the notice of the Ministry of Communications on May 17, 2009, the market share of the Company has fallen, in terms of normative revenue for February 2009, to 80.7% in fixed-line telephony in the private sector and to 86.6% in the business sector. In addition, the Ministry is employing another method of measurement intended for determining the discount brackets permitted to the Company with approvals of alternative tariff baskets as prescribed in the Gronau Report. By this measurement, the Company's market share in February 2009, in terms of regular (individual) lines based on normative revenue, fell to 79.2%, and in terms of access lines based on normative revenue, fell to 81.2%.

**Section 2.18 – Legal proceedings**

For updates on the subject of legal proceedings, see Note 5 to the financial statements of the Company for the period ended March 31, 2009.

## 3. Cellular – Pelephone Communications Ltd. ("Pelephone")

**Section 3.7 – Competition**

**Section 3.7.1**

In March 2009, upon the recommendation of the Gronau Committee, the Ministry of Communications published a hearing on the issue of a change in the tariff structure and the method of billing for international calls via a cellular network. In May 2009, Pelephone submitted its response to the hearing and its objection to the proposed change.

**Section 3.18.3.1 C – Main changes in Pelephone's license**

The changes in terms of the invoice structure will take effect in December 2009.

## 4. International Communications, Internet Services and NEP – Bezeq International Ltd. ("Bezeq International")

**Section 4.1.2.5 – Gronau Committee Report.**

In March 2009, the Ministry of Communications, upon the recommendation of the Gronau Committee, published a hearing regarding a change in the tariff structure and method of billing for international calls via cellular networks. In Bezeq International's response to the Ministry of Communications in the aforesaid hearing, Bezeq International expressed its objection to the proposed format for changing the tariff structure in overseas calls by cellular subscribers, pointed to possible faults as a result of its implementation, proposed reservations and limitations on its application and again warned the Ministry of Communications of the problems existing in the market for international telephony and internet access services provided by cellular operators.

**Section 4.19 – Legal proceedings**

For updates on the subject of legal proceedings, see Note 5 to the financial statements of the Company for the period ended March 31, 2009.

## 5. Multi-channel television – D.B.S. Satellite Services (1998) Ltd. ("DBS")

**Section 5.1.3 – Developments in markets in the area of operation**

To the best of the Company's knowledge, in May 2009 the Government made a decision in which it determined, inter alia, that some of the provisions included in the Arrangements in the State Economy (Legislative amendments for attaining budget targets and economic policy for the 2009 fiscal year) Bill, 5769-2008, published in October 2008 ("the Arrangements Bill") would be amended. The decision determined, among other things, that the date on which license-holders for broadcasting would be able to broadcast advertising will be postponed to January 1, 2012 (with an option to postpone the date of the permit for a period not exceeding three years); that the date on which the broadcasting licenses would be required to offer the basic package to their subscribers will be postponed to August 1, 2012 (with an option to postpone that date for no more than one year); that the broadcasting licensees will distribute to all their subscribers the broadcasts of a special license-holder for cable broadcasts without collecting payment from the subscriber beyond the access fee. The Government also decided that if the Communications Law is amended as proposed in the relevant sections of the Arrangements Bill, to direct the Minister of Communications and the Minister of Finance to request approval from the Knesset Finance Committee for regulations granting exemption from payment of royalties to broadcasting licensees commencing on the date on which the broadcasting licensees are required to offer the basic package. The decision also states that the date for completing set-up of the DTT array will be postponed to August 2009. In addition, the Government decision adopted the recommendations of the Mordechai Committee in everything relating to the transition of the Second Authority franchisees from a regimen of franchises to one of licenses for the establishment of a National Communications Authority.

**Section 5.1.3.7** – For the merger of the Company and DBS, see section 1.1.5 above.

**Section 5.1.3.8** – In March 2009, the Ministry of Communications and the Council published a hearing on the question of the regulation of broadcasts over new broadcasting platforms and technologies. The hearing sought comments, inter alia, on the question of the characterization of the new services in respect of which the need for arrangement is being examined, including the nature and purpose of content, the method of distribution of such content, the handset that will enable its viewing, the need to distinguish linear broadcasts from VOD broadcasts, the method of offering services, the identity of the offerors, the extent to which the service providers are to be involved in various aspects of the service and the expectations of the reasonable consumer for regulatory protection. Comments were also requested regarding the scope of regulation necessary, including restrictions on adult broadcasts, protection of minors, classification and marking of broadcasts, original production obligations, a prohibition against broadcasting advertisements, and ethics in broadcasts. In addition, comments were also called for on the question of the need to protect new competitors and the impact that the regulation would have on the currently existing regulation. DBS has not yet presented its position in this hearing.

**Section 5.2 – Products and Services**

In April 2009, DBS began marketing PVR decoders capable of receiving HDTV broadcasts (as well as the other services that PVR decoders permit), at the same time as it expanded the supply of channels that it broadcasts using HD technology.

**Section 5.8 – Intangible assets**

Section 5.8.1.2 – On May 4, 2009, a representative of the Civil Administration gave notice to DBS that the Civil Administration intended to extend the broadcast license in Judea and Samaria until 2014, overlapping the license in Israel, although the extension still requires a final resolution by the head of the Civil Administration.

**Section 5.15.1 – Specific legal restrictions on operations**

In March 2009, the Ministry of Communications gave notice to DBS that in the opinion of the general counsel, and in the opinion of the Legal Department of the Ministry of Communications, the split of the deeds of pledge of shares of DBS charged to the consortium of banks into individual charges for each bank will not, in and of itself, affect Bank Leumi's status as a "holder" of DBS with respect to the qualification restriction set out in the License Regulations, in the absence of an amendment of the financing agreement. The Ministry of Communications gave further notice that it intends to take the necessary steps to ensure compliance with the conditions of the Regulations. Although DBS is of the opinion that the current state of affairs does not amount to a breach of the aforesaid qualification restriction, it is negotiating with the Ministry of Communications to arrive at an arrangement that will satisfy the Ministry in order to resolve the issue within such fixed period of time as may be agreed upon.

**Section 5.15.3 – Principal restrictions by virtue of the law and broadcasting license**

With respect to transfer fees – In March 2009, the Ministry of Communications published a hearing regarding the setting of transfer fees that the producer of an independent channel, including the broadcaster of a designated channel, must pay DBS for use of its channels, noting that the outcome would constitute the basis for a resolution of the dispute between DBS and the designated channels, the sum of the payment set in the hearing being applicable as of 2007 and until the end of 2013 and the method of its calculation serving the parties as an outline for calculating the amount of the payment until 2006. The Ministry of Communications noted that the economic opinion that it attached to the hearing may be used as a basis for ruling in other disputes, if such arise between DBS and other independent channel operators. Under the aforesaid economic opinion, the usage fee will include a fixed component of an annual payment of approximately NIS 1.2 million, plus variable payment components amounting to approximately NIS 1 million with respect to an independent channel producer not financed by way of subscription fees.

**Section 5.18 – Legal proceedings**

In April 2009, two claims were filed against DBS in the Regional Labor Court on behalf of 21 technicians (20 of whom are former employees of the Company previously and the other is still employed by the Company) in a total sum of NIS 1.3 million. The claim alleges that DBS owes the technicians for various salary components that the plaintiffs claim were not paid to them, and that DBS held over some of their salaries. No statement of defense has yet been filed.

19.5.09

| 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 three-month period ended March 31, 2009

We respectfully present the Directors' Report on the state of affairs of Bezeq - The Israel Telecommunication Corp. Limited (hereinafter: "the Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter referred to as “the Group"), for the three-month period ended March 31, 2009 (hereinafter:” the Directors' Report").

The Directors' Report contains a condensed review of its contents and it assumes that the Directors' Report for December 31, 2008 is also available to the reader.

The Group operates in four main areas which are reported as business segments in the Company's consolidated reports as set forth below:

1) **Fixed-line domestic communications**

2) **Cellular**

3) **International communications, internet services and NEP**

4) **Multi-channel television**

The Company has an additional area of operations which is not material to the Group's operations, and which has been included in the Company’s financial statements at March 31, 2009 as a business segment which mainly includes customer call center services and investment in a venture capital fund.

Profit in the reporting period amounted to NIS 609 million compared with NIS 385 million in the corresponding quarter, an increase of NIS 224 million (58%). The increase in profit stemmed primarily from a decrease in costs and expenses from NIS 2,436 million to NIS 2,296 million, an increase in revenues from NIS 3,100 million to NIS 3,162 million and a decrease in financing costs from NIS 100 million to NIS 37 million. The profit attributable to the Company's owners amounted to NIS 608 million compared with NIS 411 million in the corresponding quarter. The increase in profit for the period stemmed from an increase in profit in all the principal segments. See below for further details.

## 1. Financial position

A. The financial statements are drafted in accordance with International Financial Reporting Standards (IFRS)

B. The Group's assets at March 31, 2009 amounted to NIS 15.38 billion, compared with NIS 15.19 billion on March 31, 2008, of which NIS 6.07 billion (39%) is property, plant and equipment, compared with NIS 5.98 billion (39%) on March 31, 2008.

The increase in the Group’s assets stemmed mainly from the cellular segment and the international communications, internet services and NEP segment.

In the fixed-line domestic communications segment there was a decrease of NIS 95 million in assets, excluding investment in investee companies, compared with the corresponding quarter. The decrease stemmed from the realization of financial assets held for trading, a decrease in the accounts receivable balance mainly because of the delay in the process of sending customer invoices caused by the transition to a new billing system which had to be overcome. In addition there was a decrease in the depreciated cost of property, plant and equipment resulting from the gap between the depreciation expenses and the investment made in the reporting period as well as from a decrease in the balance of deferred taxes. The decrease in assets was offset by an increase in cash and cash equivalents.

In the cellular segment, assets increased from NIS 4.42 billion on March 31, 2008 to NIS 4.54 billion on March 31, 2009. Most of the increase was due to an investment in frequency rights and property, plant and equipment for the operation of the new network (using UMTS/HSPA technology). Moreover, there was an increase in the accounts receivable balance which stemmed primarily from an increase in sales of end-user equipment in installments. In contrast, there was a decrease in cash balances caused by dividend distributions.

In the international communications, internet and NEP services segment, assets increased from NIS 905 million on March 31, 2008 to NIS 1,051 million on March 31, 2009. The increase stemmed primarily from a rise in cash balances. Moreover, the rise stemmed from additional acquisitions of capacity usage rights.

In the multi-channel television segment there was a moderate rise in total assets from NIS 1.15 billion at March 31, 2008 to NIS 1.17 million at March 31, 2009 which stemmed mainly from an increase in broadcasting rights and a rise in net investment balances in property, plant and equipment.

C. The shareholders' equity attributed to the Company’s owners on March 31, 2009 amounted to NIS 5.38 billion, comprising 35% of the total balance sheet, compared with NIS 4.96 billion on March 31, 2008, which comprised 33% of the total balance sheet. The increase in shareholders’ equity stemmed primarily from the Group’s revenues which were offset by the distribution of a dividend in the amount of NIS 1.51 billion in 2008.

D. The Group's debt to financial institutions and debenture holders on March 31, 2009 amounted to NIS 6.28 billion, compared with NIS 6.54 billion on March 31, 2008. The decrease stemmed primarily from the mobile segment where there was a repayment of loans and debentures. In the fixed-line domestic communications segment there were loan repayments amounting to NIS 568 million. The repayment was offset by the receipt of loans totaling NIS 400 million. The decrease in the Group’s debt was partially offset by a revaluation of CPI-linked loans and debentures caused by a rise in the CPI.

## 2. Results of operations

### A. Operating segments

Below is a summary of data from consolidated income statements:

| | For three-month period ended March 31, 2009 | | | |
|---|---|---|---|---|
| | 2009 | 2008 | Increase | % |
| | NIS millions | NIS millions | (decrease) | Change |
| Revenues | 3,162 | 3,100 | 62 | 2% |
| Costs and expenses | 2,296 | 2,436 | (140) | (6%) |
| Operating profit | 866 | 664 | 202 | 30% |
| Financing expenses, net | 37 | 100 | (63) | (63%) |
| **Profit after financing costs** | **829** | **564** | **265** | **47%** |
| Equity in profits of investees accounted by the equity method | **2** | **1** | **1** | **100%** |
| **Profit before taxes** | **831** | **565** | **266** | **47%** |
| Income tax | 222 | 180 | 42 | 23% |
| **Profit for the period** | **609** | **385** | **224** | **58%** |
| **Attributed to:** | | | | |
| **The Company's owners** | **608** | **411** | **197** | **48%** |
| **Non-controlling interests** | **1** | **(26)** | **27** | **-** |
| **Profit for the period** | **609** | **385** | **224** | **58%** |
| **Earnings per share** | | | | |
| **Basic earnings per share (in NIS)** | **0.23** | **0.15** | **0.08** | **53%** |
| **Diluted earnings per share (in NIS)** | **0.23** | **0.15** | **0.08** | **53%** |

Group revenue in the first quarter of 2009 amounted to NIS 3.16 billion compared with NIS 3.1 billion in the corresponding quarter, an increase of 2%. Most of the growth stemmed from the cellular segment which was partially offset by a decrease in the Fixed-line domestic communications segment.

The Group's depreciation and amortization expenses in the first quarter of 2009 amounted to NIS 424 million compared with NIS 429 million in the corresponding quarter, a decrease of 1%. Most of the decrease stemmed from the multi-channel television segment and the fixed-line domestic communications segment which was offset partially by an increase in expenses in the cellular segment.

The Group's salary expenses in the first quarter of 2009 amounted to NIS 557 million compared with NIS 616 million in the corresponding quarter, a decrease of 9.6%. The decrease stemmed primarily from a decrease in salary expenses in the fixed-line domestic communications segment and in the cellular segment.

The Group's operating and general expenses in the first quarter of 2009 amounted to NIS 1,335 million compared with NIS 1,370 million in the corresponding quarter, a decrease of 2.6%. The decrease stemmed primarily from a decrease in expenses in the fixed-line domestic communications segment and in the multi-channel television segment.

B. **Operating segments**

Below are details of operations by segments presented in accordance with the Group's operating segments:

| Revenues by operating segment | 1-3/2009 NIS millions | 1-3/2009 % of total revenues | 1-3/2008 NIS millions | 1-3/2008 % of total revenues |
|---|---|---|---|---|
| Fixed-line domestic communications | 1,326 | 42% | 1,408 | 45% |
| Cellular | 1,265 | 40% | 1,173 | 38% |
| International communications internet services and NEP | 324 | 10% | 314 | 10% |
| Multi-channel television | 384 | 12% | 381 | 12% |
| Other and offsets | (137) | (4%) | (176) | (5)% |
| Total | 3,162 | 100% | 3,100 | 100% |

| Operating profit by operating segment | 1-3/2009 NIS millions | 1-3/2009 % of segment's revenues | 1-3/2008 NIS millions | 1-3/2008 % of segment's revenues |
|---|---|---|---|---|
| Fixed-line domestic communications | 437 | 33% | 368 | 26% |
| Cellular | 302 | 24% | 215 | 18% |
| International communications internet services and NEP | 60 | 19% | 56 | 18% |
| Multi-channel television | 66 | 17% | 27 | 7% |
| Other and offsets | 1 | - | (2) | - |
| Consolidated operating profit / % of Group's revenues | 866 | 27% | 664 | 21% |

**Fixed-line domestic communications segment**

Revenues:

Segment revenues in the first quarter of 2009 totaled NIS 1.33 billion compared with NIS 1.41 billion in the corresponding quarter, a decrease of 6%.

The decrease in segment revenues stemmed primarily from a decrease in the number of lines as well as in call traffic and a decrease in interconnect fees to the cellular networks (there was a parallel decrease in expenditure). In contrast there was an increase in revenues from high speed internet, data and transmission communications.

Costs and expenses:

Depreciation expenses in the first quarter of 2009 amounted to NIS 211 million compared with NIS 218 million in the corresponding quarter, a decrease of 3%. This decrease was caused by the end of depreciation of property, plant and equipment, a decrease in investments in new assets and a change in the useful life and scrap value estimate of property, plant and equipment.

Salary expenses in the first quarter of 2009 amounted to NIS 278 million compared with NIS 316 million in the corresponding quarter, a decrease of 12%. The decrease in salary expenses stemmed primarily from the attribution of salary expenses to property, plant and equipment. This was caused mainly by the deployment of the NGN network.

Operating and general expenses in the first quarter of 2009 amounted to NIS 420 million compared with NIS 485 million in the corresponding quarter, a decrease of 13%. The decrease stemmed primarily from a decrease in interconnect fees to the cellular networks together with a decrease in revenue from interconnect fees, and from the implementation of efficiency measures which led to a decrease in operating expenses.

Other net operating income in the first quarter of 2009 amounted to NIS 20 million, compared with expenses of NIS 21 million in the corresponding quarter.

This was caused mainly by capital gains in the reporting quarter compared with an increase in provision expenses for early retirement severance pay and the recording of provisions for claims in the corresponding quarter.

Operating profit:

Operating profit in the segment in the reporting quarter of 2009 amounted to NIS 437 million compared with NIS 368 million in the corresponding quarter, an increase of 19%. The increase in operating profit stems from the changes described above in the expenses and revenue items.

**Cellular segment**

Revenues:

Segment revenues in the first quarter of 2009 amounted to NIS 1.26 billion compared with NIS 1.17 billion in the corresponding quarter, an increase of 7.7%.

The increase in revenues stems from an increase in revenues from services, primarily from value-added services and from a rise in sales and upgrade prices of terminal equipment which was offset by a decline in the number of sales and upgrades.

Costs and expenses:

Depreciation and amortization expenses in the first quarter of 2009 amounted to NIS 139 million compared with NIS 129 million in the corresponding quarter, an increase of 7.8%. The increase in depreciation expenses stemmed primarily from the launch of the HSPA/UMTS network in January 2009.

Salary expenses in the first quarter of 2009 amounted to NIS 151 million compared with NIS 169 million in the corresponding quarter, a decrease of 10.7%. The decrease in salary expenses stemmed primarily from a decrease in the number of employee positions.

Operating and general expenses in the first quarter of 2009 amounted to NIS 672 million compared with NIS 660 million in the corresponding quarter, an increase of 1.8%. The increase stemmed primarily from an increase in network maintenance expenses resulting from the operation of the additional network alongside the existing network and from an increase in advertising expenses as part of the launch of the new network. The increase was partially offset by a decrease in interconnect fees resulting from the reduction in interconnect fees instituted in March 2008.

Operating profit:

Operating profit in the segment in the first quarter of 2009 amounted to NIS 302 million compared with NIS 215 million in the corresponding quarter, an increase of 40.5%. The improvement in operating profit stemmed from the changes described above in the revenues and expenses items.

**International communication, internet and NEP segment**

Revenues:

In the first quarter of 2009, revenues in the segment amounted to NIS 324 million compared with NIS 314 million in the corresponding quarter, an increase of 3.4%. The increase stemmed primarily from operations in the internet area in which there was an increase in the number of broadband customers. In contrast there was a decrease in revenues from outbound traffic caused by a decrease in traffic and by average-per-minute price erosion. Furthermore there was also a decline in PBX sales activity.

Costs and expenses:

Depreciation expenses in the first quarter of 2009 amounted to NIS 20 million which remains unchanged from the corresponding quarter.

Salary expenses in the first quarter of 2009 amounted to NIS 64 million compared with NIS 65 million in the corresponding quarter, a decrease of 2%.

Operating and general expenses in the first quarter of 2009 amounted to NIS 181 million compared with NIS 174 million in the corresponding quarter, an increase of 4%. Most of the increase in expenses parallels the increase in segment revenues in internet activities.

Operating profit:

Operating profit in the segment in the first quarter of 2009 amounted to NIS 60 million compared with NIS 56 million in the corresponding quarter, an increase of 7%. The improvement in operating profit stems from the changes described above in the revenues and expenses items.

**Multi-channel television segment**

Revenues:

Revenues in the segment in the first quarter of 2009 amounted to NIS 384 million compared with NIS 381 million in the corresponding quarter, an increase of 0.8%. The increase stemmed primarily from revenues from advanced services resulting from an increase in the number of subscribers. In contrast there was a decrease in internet revenues caused by an update of the Company's internet agreement.

Costs and expenses:

Depreciation and amortization expenses in the first quarter of 2009 amounted to NIS 57 million compared with NIS 65 million in the corresponding quarter, a decrease of 12%. The decrease was caused by an extension of the customer commitment period in offers which in turn affected the installation depreciation rate.

Salary expenses in the first quarter of 2009 amounted to NIS 53 million compared with NIS 51 million in the corresponding quarter, an increase of 2.4%.

Operating and general expenses in the first quarter of 2009 amounted to NIS 208 million compared with NIS 239 million in the corresponding quarter, a decrease of 13%. Most of the decrease stems from the reduction in internet activity following the new agreement with the Company, a decrease in customer service costs and a reduction in advertising.

Operating profit:

Operating profit in the segment in the first quarter of 2009 amounted to NIS 66 million compared with NIS 27 million in the corresponding quarter, an increase of 144%. The increase in operating profit stemmed primarily from the above-mentioned changes in the revenues and expenses items.

C. **Financing expenses, net**

The Group's net financing expenses in the first quarter of 2009 amounted to NIS 37 million compared with NIS 100 million in the corresponding quarter, a decrease of 63%. The Group's debt to financial institutions and debenture holders is mainly linked to the CPI and the financing expenses are affected by changes in the CPI. In the reporting period there was a decline in the index to which the debt balances are linked, compared with a rise in the corresponding quarter. A revaluation of liabilities in the reporting quarter led to the decline in the Group's financing expenses.

In the fixed line domestic communications segment in the first quarter of 2009, net financing income amounted to NIS 21 million compared with net financing expenses of NIS 20 million in the corresponding quarter. The change stemmed primarily from the above-mentioned decline in the index in the first quarter of 2009.

In the cellular segment net financing income amounted to NIS 11 million compared with NIS 9 million in the corresponding quarter, an increase of 22%.

In the multi-channel television segment net financing expenses in the first quarter of 2009 amounted to NIS 67 million compared with NIS 92 million in the corresponding quarter, a decrease of 27%. Most of the decrease was caused by the above-mentioned decline in the index in the first quarter of 2009.

D. **Income tax**

The Group's tax expenses in the reporting period amounted to NIS 222 million, representing approximately 27% of pre-tax profit, compared with NIS 180 million in the corresponding quarter which represented 32% of pre-tax profit. Most of the decrease in the rate of tax on profits before income tax was due to a tax rate reduction as well as a decrease in DBS's losses that are not deductible for tax purposes.

## 3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in the first quarter of 2009 amounted to NIS 1,224 million, compared with NIS 618 million in the corresponding quarter, an increase of NIS 606 million. The increase in cash flows generated by operating activities is mainly due to the increase in operating profit in all the Group's segments and a change in trade payables and other balances.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reporting quarter included, inter alia, NIS 408 million invested in development of communications infrastructures, compared with an investment of NIS 307 million in the corresponding quarter.

In the reporting period, the Group repaid net debts and paid interest of NIS 347 million, of which NIS 206 million was for debentures, NIS 31 million for loans, and NIS 110 million for interest payments. In contrast the Company received loans amounting to NIS 400 million and a consideration from the realization of option warrants for employees in the amount of NIS 36 million. This compares with the repayment of a net debt and interest payments amounting to NIS 313 million in the corresponding quarter.

The monthly average short-term credit balance from banks in the first quarter of 2009 amounted to NIS 62 million. The monthly average of long-term liabilities to financial institutions and debenture holders in the first quarter of 2009 amounted to NIS 6,102 million.

Working capital at March 31, 2009 amounted to NIS 280 million, compared with NIS 291 million in the corresponding quarter. Most of the decrease in working capital is in the mobile segment and it was offset by an increase in the fixed-line domestic communications segment and in the international, internet and NEP segment.

## 4. Exposure to and management of market risks

**Market risks and the Company's risk management policy**

A. Further to the description in the 2008 Directors' Report, hedging transactions against market risks of exposure to changes in exchange rates and in the CPI have partially reduced this exposure.

B. Sensitivity analyses of the fair value and the effect of the change in market prices on the fair value of balance sheet balances and off-balance sheet balances in respect of which there is a firm agreement at March 31, 2009 are not materially different from those of December 31, 2008.

C. The linkage base report for March 31, 2009 is not materially different from the report of December 31, 2008.

## 5. Critical accounting estimates

The preparation of the financial statements according to IFRS requires the management to make estimates and assessments that influence the reported values of assets and liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on additional factors, value appraisals and opinions which it believes are relevant, taking into account the circumstances. The actual results can differ from those assessments based on various assumptions and conditions. Information on the principal matters of uncertainty in critical assessments and judgments in the application of the accounting policy is provided in the annual financial statements. We believe that these assessments and estimates are critical because every change in them and in the assumptions has the potential to materially affect the financial statements.

## 6. Disclosure regarding the proceeding for approving the Company's financial statements

The board of directors is responsible for oversight. The board of directors appointed a balance sheet committee whose tasks and composition are described in the Directors' Report for 2008.

The financial statements were discussed at the balance sheet committee and submitted to the board of directors for approval. The following officers attended the board discussion: board members – Shlomo Rodav, Eyal Yaniv, Menachem Inbar, Michael Grabiner, Stephen Grabiner, Ran Gottfried, Yoav Rubinstein, Elon Shalev, Kihara R. Kiarie, David Gilboa, Rami Nomkin, Yitzhak Idelman, Yehuda Porat, Arieh Saban, Adam Chesnoff and Zehavit Cohen. In addition, the following officers attended: Abraham Gabbay – CEO, Alan Gelman – CFO and Deputy CEO and Amir Nachlieli, the General Counsel.

Representatives of Somekh Chaikin, the Company's auditing accountants, also participated in the discussion.

## 7. Details of debenture series

Following are the updated details for March 31, 2009.

| | | Series 4 debentures | Series 5 debentures |
|---|---|---|---|
| **A.** | Par value reassessed for reporting date (linked to the CPI) | NIS 983,800,065 | NIS 2,609,220,322 (1) |
| **B.** | Accumulated interest | NIS 39,352,003 | NIS 115,240,564 |
| **C.** | Fair value | NIS 1,062,720,000 | NIS 2,990,869,651 |
| **D.** | Stock exchange value | NIS 1,062,720,000 | NIS 2,990,869,651 |

* (1) Of which NIS 962 million held by a wholly-owned subsidiary.

## 8. Miscellaneous and events subsequent to the date of the financial statements

A. On May 3, 2009, further to the board's recommendation of March 23, 2009, the general meeting approved the distribution of a cash dividend of NIS 792 million to the Company's shareholders. The dividend will be paid on May 24, 2009.

B. As a result of the ramifications of the global financial crisis on the Israeli market, the Group conducts regular reviews of the possible effects on its businesses. Building on the incremental visibility following the close of the first quarter of 2009, which included materially stronger financial performance as compared to the corresponding quarter in 2008, and taking into consideration the current economic environment, Bezeq Group is raising its outlook for 2009 and currently anticipates achieving revenues, net profit, EBITDA, and operating cash flows in line with those of the Group's full-year 2008 performance levels. The Bezeq Group is not changing its outlook for gross capital expenditures, which will still be close to the 2008 level.

**The information contained in this section includes forward-looking information which is based on the Company's assessments. The actual results are likely to be materially different from the above assessments, bearing in mind the changes that will occur in business conditions and in the effects of regulatory decisions.**

C. As at March 31, 2009, the scope of the Group's net contractual liabilities (including off balance sheet) which are linked to the dollar amounted to NIS 916 million and the Group's net liabilities (including off balance sheet) which are linked to the CPI amounted to NIS 4,816 million. The dollar exchange rate declined by 1.6% between March 31, 2009 and the date of signing the financial statements and the known CPI rose by 1.5% in March and April 2009.

We thank the managers, employees and shareholders of the Group's companies.

| | |
|---|---|
| Shlomo Rodav<br>Chairman of the Board of Directors | Abraham Gabbay<br>CEO |

# "BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

## CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
## MARCH 31, 2009
## (UNAUDITED)

## Contents

**Somekh Chaikin**
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## Review Report to the Shareholders of "Bezeq" The Israel Telecommunication Corp. Limited

Introduction

We have reviewed the accompanying financial information of "Bezeq" The Israel Telecommunication Corp. Limited and its subsidiaries (hereinafter - "the Group") comprising of the condensed consolidated interim statement of financial position as of March 31, 2009 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the three-month period then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 "*Interim Financial Reporting*", and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

We did not review the condensed interim financial information of equity accounted investees the investment in which amounted to NIS 34 million as at March 31, 2009, and the Group's share in their profits amounted to NIS 2 million for the three month period then ended. The condensed interim financial information of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of such companies, is based solely on the said review reports of the other auditors.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements 1, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" of the Institute of Certified Public Accountants in Israel. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review and the review reports of other auditors, nothing has come to our attention that causes us to believe that the accompanying financial information was not prepared, in all material respects, in accordance with IAS 34.

In addition to that mentioned in the previous paragraph, based on our review and the review reports of other auditors, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not comply, in all material respects, with the disclosure requirements of Section D of the Securities Regulations (Periodic and Immediate Reports), 1970.

Without qualifying our conclusion, we draw attention to the contingent claims made against the Group of which the exposure yet be assessed or calculated, and other contingencies as described in Notes 5B and 5C.

Somekh Chaikin
Certified Public Accountants

May 19, 2009

## Condensed Consolidated Interim Statements of Financial Position

| | March 31, 2009 (Unaudited) NIS millions | March 31, 2008 (Unaudited) NIS millions | December 31, 2008 (Audited) NIS millions |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | **1,702** | 1,283 | 786 |
| Investments, including derivatives | **37** | 317 | 33 |
| Trade receivables | **2,390** | 2,480 | 2,373 |
| Other receivables | **234** | 245 | 211 |
| Inventory | **188** | 238 | 158 |
| Current tax assets | **-** | 28 | - |
| Assets classified as held for sale | **43** | 20 | 34 |
| **Total current assets** | **4,594** | 4,611 | 3,595 |
| Investments, including derivatives | **192** | 227 | 187 |
| Trade receivables | **637** | 562 | 576 |
| Broadcasting rights, net of rights exercised | **288** | 271 | 253 |
| Property, plant and equipment | **6,066** | 5,981 | 6,036 |
| Intangible assets | **2,664** | 2,495 | 2,674 |
| Deferred and other expenses | **398** | 376 | 411 |
| Investments in equity-accounted investees | **34** | 39 | 32 |
| Deferred tax assets | **503** | 626* | 550* |
| **Total non-current assets** | **10,782** | 10,577 | 10,719 |
| | **15,376** | 15,188 | 14,314 |

| | March 31, 2009 (Unaudited) NIS millions | March 31, 2008 (Unaudited) NIS millions | December 31, 2008 (Audited) NIS millions |
|---|---|---|---|
| **Liabilities** | | | |
| Debentures, loans and borrowings | **1,018** | 1,032 | 1,780 |
| Trade payables | **1,471** | 1,350 | 1,381 |
| Other payables, including derivatives | **962** | 866 | 850 |
| Current tax liabilities | **88** | 33 | 45 |
| Deferred income | **58** | 19 | 62 |
| Provisions | **358** | 388 | 355 |
| Employee benefits | **359** | 632* | 412* |
| **Total current liabilities** | **4,314** | 4,320 | 4,885 |
| Debentures | **3,711** | 4,242 | 3,943 |
| Bank loans | **1,391** | 1,125 | 214 |
| Loans from institutions | **161** | 140 | 109 |
| Loans provided by non-controlling interest in a subsidiary | **462** | 389 | 449 |
| Employee benefits | **267** | 262 | 265 |
| Deferred income and others | **25** | 52 | 76 |
| Provisions | **70** | 58 | 64 |
| Deferred tax liabilities | **63** | 42 | 65 |
| **Total non-current liabilities** | **6,150** | 6,310 | 5,185 |
| **Total liabilities** | **10,464** | 10,630 | 10,070 |
| **Equity** | | | |
| Share capital | **6,146** | 6,132 | 6,132 |
| Share premium | **26** | - | - |
| Reserves | **762** | 690 | 748 |
| Deficit balance | **(1,557)** | (1,865)* | (2,165)* |
| **Total equity attributable to owners of the Company** | **5,377** | 4,957 | 4,715 |
| **Non-controlling interest** | **(465)** | (399)* | (471) |
| **Total equity** | **4,912** | 4,558 | 4,244 |
| **Total equity and liabilities** | **15,376** | 15,188 | 14,314 |

* Retrospective application, see Note 3C.

**Shlomo Rodav**
Chairman of the Board

**Avi Gabbay**
CEO

**Alan Gelman**
Deputy CEO and CFO

Date of approval of the financial statements: May 19, 2009

The attached notes are an integral part of the condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statements of Income

| | For the three months ended March 31, | | For the year ended December 31, |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| **Revenue (Note 7)** | **3,162** | 3,100 | 12,407 |
| **Costs and expenses** | | | |
| Depreciation and amortization | **424** | 429 | 1,703 |
| Salary | **557** | 616 | 2,354 |
| Operating and general expenses (Note 8) | **1,335** | 1,370 | 5,437 |
| Other operating expenses (income), net | **(20)** | 21 | 96 |
| | **2,296** | 2,436 | 9,590 |
| Operating income | **866** | 664 | 2,817 |
| **Finance expenses** | | | |
| Finance expenses | **115** | 161 | 747 |
| Finance income | **(78)** | (61) | (166) |
| Finance costs, net | **37** | 100 | 581 |
| Profit after finance expenses | **829** | 564 | 2,236 |
| **Share in profits of equity-accounted investees** | **2** | 1 | 5 |
| Profit before income tax | **831** | 565 | 2,241 |
| **Income tax** | **222** | 180 | 720 |
| Profit for the period | **609** | 385 | 1,521 |
| **Attributable to:** | | | |
| The Shareholders of the Company | **608** | 411* | 1,627 |
| Non-controlling interest | **1** | (26)* | (106) |
| Profit for the period | **609** | 385 | 1,521 |
| **Earnings per share** | | | |
| Basic earnings per share (in NIS) | **0.23** | 0.15 | 0.62 |
| Diluted earnings per share (in NIS) | **0.23** | 0.15 | 0.61 |

* Retrospective application, see Note 3C.

The attached notes are an integral part of the condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statements of Comprehensive Income

| | For the three months ended March 31 | | For the year ended December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| Profit for the period | **609** | 385 | 1,521 |
| Other items of comprehensive income | | | |
| Net change in fair value of available-for-sale financial assets transferred to profit or loss | **-** | (5) | (5) |
| Actuarial losses from a defined benefit plan (1) | **-** | - | (2) |
| Foreign currency translation differences | **3** | - | (4) |
| Taxes in respect of other items of comprehensive income | **-** | 1 | 1 |
| **Other total comprehensive income for the period, net of tax** | **3** | (4) | (10) |
| **Total comprehensive income for the period** | **612** | 381 | 1,511 |
| **Attributable to:** | | | |
| The shareholders of the Company | **611** | 407 * | 1,617 |
| Non-controlling interest | **1** | (26) * | (106) |
| **Total comprehensive income for the period** | **612** | 381 | 1,511 |

(1) The Group does not re-examine its assessments, assumptions and estimates in each interim reporting period to calculate its employee liabilities, unless there are significant changes during the interim period. As a result, actuarial gains or losses in the reporting period are not recognized.

* Retrospective application, see Note 3C.

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 3A(1) for a description of first-time adoption of the new standard.

The attached notes are an integral part of the condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statements of Changes in Equity

| | Attributable to the shareholders of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Translation reserve | Capital reserve for a transaction between a corporation and a controlling shareholder | Capital reserve for available-for-sale assets | Capital reserve for options for employees | Deficit | Total | Non-controlling interests | Total equity |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Three months ended March 31, 2009** | | | | | | | | | | |
| **Balance at January 1, 2009 (audited)** | **6,132** | **-** | **(4)** | **390** | **-** | **362** | **(2,165)*** | **4,715** | **(471)** | **4,244** |
| Comprehensive income for the period (unaudited) | **-** | **-** | **3** | **-** | **-** | **-** | **608** | **611** | **1** | **612** |
| Share-based payments (unaudited) | **-** | **-** | **-** | **-** | **-** | **15** | **-** | **15** | | **15** |
| Exercise of options into shares (unaudited) | **14** | **26** | **-** | **-** | **-** | **(4)** | **-** | **36** | **-** | **36** |
| Transfers by non-controlling interest (unaudited) | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **5** | **5** |
| Balance at March 31, 2009 (unaudited) | **6,146** | **26** | **(1)** | **390** | **-** | **373** | **(1,557)** | **5,377** | **(465)** | **4,912** |
| **Three months ended March 31, 2008** | | | | | | | | | | |
| **Balance at January 1, 2008 (audited)** | 6,132 | - | - | 390 | 4 | 287 | (2,276)* | 4,537 | (373) | 4,164 |
| Comprehensive income for the period (unaudited) | - | - | - | - | (4) | - | 411* | 407 | (26)* | 381 |
| Share-based payments (unaudited) | - | - | - | - | - | 13 | - | 13 | - | 13 |
| **Balance at March 31, 2008 (unaudited)** | 6,132 | - | - | 390 | - | 300 | (1,865)* | 4,957 | (399)* | 4,558 |

* Retrospective application through restatement, see Note 3C.
For distribution of a cash dividend, see Note 12D.

## Condensed Consolidated Interim Statements of Changes in Equity (cont)

| | Attributable to the shareholders of the Company | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Translation reserve | Capital reserve for a transaction between a corporation and a controlling shareholder | Capital reserve for available-for-sale assets | Capital reserve for options for employees | Deficit | Total | Non-controlling interests | Total equity |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Year ended December 31, 2008 (audited):** | | | | | | | | | |
| **Balance at January 1, 2008** | 6,132 | - | 390 | 4 | 287 | (2,276)* | 4,537 | (373) | 4,164 |
| Comprehensive income for the year (audited) | - | (4) | - | (4) | - | 1,625 | 1,617 | (106) | 1,511 |
| Dividends to Company shareholders (audited) | - | - | - | - | - | (1,514) | (1,514) | - | (1,514) |
| Share-based payments (audited) | - | - | - | - | 75 | - | 75 | - | 75 |
| Transfers by non-controlling interests (audited) | - | - | - | - | - | - | - | 8 | 8 |
| **Balance at December 31, 2008 (audited)** | 6,132 | (4) | 390 | - | 362 | (2,165)* | 4,715 | (471) | 4,244 |

* Retrospective application through restatement, see Note 3C.

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

## Condensed Consolidated Interim Statements of Cash Flows

| | For the three months ended March 31 | | For the year ended December 31 |
|---|---|---|---|
| | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| **Cash flows from operating activities** | | | |
| Net profit for the period | **609** | 385 | 1,521 |
| Adjustments: | | | |
| Depreciation | **346** | 351 | 1,394 |
| Amortization of intangible assets | **72** | 68 | 289 |
| Amortization of deferred and other expenses | **6** | 10 | 20 |
| Equity in profits of equity-accounted investees | **(2)** | (1) | (5) |
| Finance costs, net | **77** | 129 | 561 |
| Capital gain, net | **(20)** | (1) | (68) |
| Share-based payment transactions | **15** | 13 | 75 |
| Income tax expenses | **222** | 180 | 720 |
| Receipt (payment) for disposal of derivative financial instruments, net | **9** | (10) | (38) |
| Change in: | | | |
| Inventory | **(33)** | (37) | 42 |
| Trade receivables | **(78)** | (104) | (10) |
| Other receivables | **(51)** | (53) | (44) |
| Other payables | **197** | 73 | 15 |
| Trade payables | **116** | (143) | (225) |
| Provisions | **7** | (4) | (34) |
| Broadcasting rights, net of rights exercised | **(34)** | (28) | (11) |
| Employee benefits | **(50)** | (83) | (302) |
| Deferred income and others | **(46)** | 1 | 50 |
| Income tax paid | **(138)** | (128) | (535) |
| Net cash flows from operating activities | **1,224** | 618 * | 3,415 |
| Cash flows for investment activities | | | |
| Investment in intangible assets and deferred expenses | **(63)** | (59) | (469) |
| Proceeds from the sale of property, plant and equipment and deferred expenses | **51** | 61 | 147 |
| Realization of current investments, net | **6** | 57 | 321 |
| Purchase of property, plant and equipment | **(408)** | (307) | (1,300) |
| Proceeds from realization of investments and long-term loans | **7** | 6 | 19 |
| Purchase of investments and long-term loans | **(1)** | - | (8) |
| Investment in an affiliate | **-** | (1) | - |
| Dividend received | **-** | - | 13 |
| Interest received | **5** | 19* | 64 |
| Net cash used for investment activities | **(403)** | (224) | (1,213) |

* See Note 3D

The attached notes are an integral part of the condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statements of Cash Flows (contd.)

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| **Cash flows from financing activities** | | | |
| Receipt of loans | **400** | - | - |
| Repayment of debentures | **(206)** | (229) | (714) |
| Repayment of loans | **(31)** | (40) | (148) |
| Short-term borrowing, net | **-** | 12 | (50) |
| Dividend paid | **-** | - | (1,514) |
| Interest paid | **(110)** | (56) | (243) |
| Receipt for settlement of derivative financial instruments, net | - | 4 | 52 |
| Transfer of funds by non-controlling interest less dividend distributed, net | **5** | - | 8 |
| Proceeds from exercise of employee options | **36** | - | - |
| **Net cash from (used for) financing activities** | **94** | (309) | (2,609) |
| **Net increase (decrease) in cash and cash equivalents** | **915** | 85 | (407) |
| Cash and cash equivalents at the beginning of the period | **786** | 1,203 | 1,203 |
| Effect of fluctuations in the rate of exchange on cash balances | **1** | (5) | (10) |
| **Cash and cash equivalents at the end of the period** | **1,702** | 1,283 | 786 |

The attached notes are an integral part of the condensed consolidated interim 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 condensed consolidated financial statements of the Company include those of the Company and of its subsidiaries (together – "the Group"), as well as the rights of the Group in associates. The Group is a principal provider of communications services in Israel (see also Note 10 – Segment Reporting).

**B.** The controlling shareholder of the Company is Ap.Sb.Ar Holdings Ltd., which held 40.44% of the Company's shares as at March 31, 2009. The Company was declared a monopoly in the main areas in which it operates. All the segments of operation of the Group are subject to competition. The activities of the Group are subject, as a rule, to official regulation and oversight.

**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 Sections 15 to 17 of the Communications Law. The Company's service tariffs which are prescribed in regulations are automatically updated in accordance with a linkage formula, as provided in the regulations and relying on the recommendations of public committees which have a mandate to review the Company's tariffs. The intensifying competition and the entirety of the changes in the communications market could have an adverse effect on the business results of the Group.

## NOTE 2 – BASIS OF PREPARATION

**A.** The condensed interim consolidated financial statements have been prepared in accordance with IAS 34 – *Interim Financial Reporting*, and in accordance with Chapter D of the Securities (Periodic and Immediate Reports) Regulations, 5730-1970.

**B.** The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries at December 31, 2008 and the year then ended, and their accompanying notes ("the annual financial statements"). The Group states in the notes to the interim financial statements only the material changes that have occurred from the date of the most recent annual financial statements until the date of these interim financial statements.

**C.** The condensed consolidated interim financial statements were approved by the Board of Directors on May 19, 2009.

**D.** **Use of estimates and judgment**

The preparation of condensed interim financial statements in accordance with IFRS requires Management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The judgment of Management when applying the Group's accounting policy and the principal assumptions used in assessments that involve uncertainty are consistent with those applied in the annual financial statements.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

The significant accounting policies applied in these condensed financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2008, except for application of new standards and amendments to standards, as mentioned in section A below.

### A. Initial application of new Accounting Standards

(1) 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 in two statements - a separate income statement and a statement of comprehensive income). The Group opted to present income and expenses and other comprehensive income in two separate statements. The Group also presents a statement of changes in equity instead of disclosure in the notes, after the statement of comprehensive income. The statement includes changes in equity also arising from transactions with owners in their capacity as owners (such as dividends, transactions with controlling shareholders, and share issues). The Standard is applied retrospectively.

(2) Commencing from January 1, 2009, the Group applies IFRS 8 – *Operating Segments* (“the Standard”). The Standard states that segment reporting should be in accordance with the “management approach", namely – in accordance with the format of the internal reports to the Group’s chief operational decision-maker.

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.
2. The operational results of the segment are reviewed regularly by the decision makers of the Group, in order to make decisions regarding resources to be allocated and to assess its performance.
3. Separate financial information is available.

First-time adoption of the standard did not effect the composition of the Group’s reporting segments.

(3) Commencing from January 1, 2009, the Group applies IAS 19 – *Employee Benefits*, revised (“the Amendment”), in accordance with Improvements to International Financial Reporting Standards 2008 (Improvements to IFRSs). See section C below.

(4) IAS 28 – *Investments in Associates, revised* (the Amendment). In accordance with the Amendment, an investment in an affiliate shall be tested for impairment with respect to the overall investment. Accordingly, an impairment loss recognized on the investment shall not be specifically allocated to the goodwill included in the investment but to the overall investment, and therefore it will be possible to reverse the full amount of an impairment loss that was recognized in the past 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.

### B. New standards and interpretations not yet adopted and their adoption is not expected to affect the financial statements of the Group

(1) IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations,* revised (“the Amendment”) was amended as part of Improvements to IFRSs in 2008. In accordance with the Amendment, when the parent company decides on the disposal of part of its holdings in a subsidiary so that after the disposal the parent company is left with a non-controlling interest, for example- rights that confer significant influence, all the assets and liabilities attributed to the subsidiary are to be classified as held for sale and the relevant instructions of IFRS 5 shall apply, including presentation, as a discontinued operation. The Amendment shall be implemented prospectively as from financial statements for periods beginning on July 1, 2009. Earlier application is permitted, provided that IAS 27, revised in 2008, is applied at the same time, with disclosure (as applied by the Group). Application of the Amendment is not expected to have a material impact on the Group’s financial statements.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

**B. New standards and interpretations not yet adopted and their adoption is not expected to affect the financial statements of the Group (contd.)**

(2) In the framework of the *Improvements to IFRS* project, in April 2009 the IASB published and approved 15 amendments to various IFRSs on a wide range of accounting issues. The amendments are effective for annual periods beginning on or after January 1, 2010, with an option for early adoption, subject to the terms prescribed for each amendment.

Presented hereunder are the amendments that may be relevant to the Group and are expected to have an effect on the financial statements. The Group is assessing the effect of these amendments:

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. Under the Amendment, classification of the land lease should be based on the regular criteria for classifying a lease as a finance or operating lease. The Amendment also states that when a lease includes both land and building elements, an entity should determine the classification of each element, based on the criteria in the Amendment, taking account of the fact that land normally has an indefinite economic life. The Amendment is effective for annual financial statements commencing on or after January 1, 2010. Early application of the Amendment is permitted, with disclosure. The Amendment is effective retrospectively, meaning classification of the land lease is determined based on the information available when signing the lease. If there is a change in classification of the lease, the instructions of IAS 17 are effective prospectively from the date of the lease. If, however, information necessary to apply the Amendment retrospectively is not available, classification is determined based on the information available at the adoption date of the Amendment, and the asset and liability related to a land lease that was classified as a finance lease as a result of the Amendment are recognized at their fair values at that date. Any difference between the fair value of the asset and the fair value of the liability is recognized in retained earnings.

b. IAS 18 – *Revenue*. The Appendix to IAS 18 includes an example that lists guidelines for identifying whether an entity is acting as a principal 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. IAS 39 – *Financial Instruments: Recognition and Measurement* (revised), treating loan prepayment penalties as an embedded derivative ("the Amendment"). The Amendment provides guidance on determining whether an exercise price of an embedded prepayment option reimburses the lender for an amount not exceeding the approximate present value of the lost interest for the remaining term of the host contract, then the economic characteristics and risks of the prepayment option embedded in a host debt are closely related to the host contract and the embedded derivative is not separated from the host contract. The Amendments is to be applied for annual periods commencing on or after January 1, 2010.

**C. Retrospective application by restatement**

1. Further to Note 3(V) to the financial statements as at December 31, 2008, commencing January 1, 2008, the Group opted for early application of IFRS 3 – *Business Combinations* (revised) and IAS 27 – *Consolidated and Separate Financial Statements (2008).* The Standards were applied commencing from January 1, 2008, with restatement of equity and profit or loss as at March 31, 2008 and for the three months then ended, respectively.

2. Commencing from January 1, 2009, the Group applies IAS 19 – *Employee Benefits*, revised ("the Amendment"), in accordance with 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. Accordingly, certain benefits are accounted for as short-term benefits. The Amendment is applied retrospectively.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

### C. Retrospective application by restatement (contd.)

Below is the effect of the retroactive application on the relevant sections:

#### (1) Effect on the statement of changes in equity

| | As previously reported | Effect of retrospective application Section C(1) | Effect of retrospective application Section C(2) | Following retrospective application |
|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | NIS millions |
| **At January 1, 2008 (audited)** | | | | |
| Deficit | (2,268) | - | (8) | (2,276) |

#### (2) Effect on the statement of financial position

| | As previously reported | Effect of retrospective application Section C(1) | Effect of retrospective application Section C(2) | Following retrospective application |
|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | NIS millions |
| **At March 31, 2008 (unaudited)** | | | | |
| Deferred tax assets | 623 | - | 3 | 626 |
| Employee benefits (as part of current liabilities) | 621 | - | 11 | 632 |
| Deficit | (1,870) | 13 | (8) | (1,865) |
| Non-controlling interest | (386) | (13) | - | (399) |
| **Balance at December 31, 2008 (audited)** | | | | |
| Deferred tax assets | 547 | - | 3 | 550 |
| Employee benefits (as part of current liabilities) | 401 | - | 11 | 412 |
| Deficit | (2,157) | - | (8) | (2,165) |

#### (3) Effect on the statement of income

| | As previously reported | Effect of retrospective application Section C(1) | Effect of retrospective application Section C(2) | Following retrospective application |
|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | NIS millions |
| **Three months ended March 31, 2008 (unaudited):** | | | | |
| **Profit for the period attributed to:** | | | | |
| The shareholders of the Company | 398 | 13 | - | 411 |
| Non-controlling interests | (13) | (13) | - | (26) |
| Profit for the period | 385 | - | - | 385 |

### D. Classified amounts

The condensed consolidated interim financial statements include reclassification of certain amounts of the comparative figures of the relevant sections.

## NOTE 4 – GROUP ENTITIES

A detailed description of the Group entities appears in Note 33 to the annual financial statements of the Group at December 31, 2008. Below are details of the material changes that occurred in connection with the Group entities since publication of the last annual report

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

(1) Since commencing its operations, DBS has accumulated considerable losses. The losses of DBS in 2008 amounted to approximately NIS 265 million and the loss for the three-month period ended March 31, 2009 amounted to approximately NIS 1 million. As a result of these losses, its capital deficit and its working capital deficit at March 31, 2009 amounted to approximately NIS 2,892 million and NIS 536 million, respectively.

(2) The Company's investment in DBS (primarily through shareholders' loans) at the balance sheet date amounts to approximately NIS 1,562 million (without interest and linkage). The balance of DBS's debt to the Company and its subsidiaries amounts to approximately NIS 87 million, of which approximately NIS 67 million is owed to the Company. . The Company and DBS reached an agreement for collection of the balance of DBS's debt to the Company, which was in arrears, of approximately NIS 55.6 million. Under the arrangement, the debt is being paid in 60 equal monthly instalments plus interest at prime + 1.5%. At the balance sheet date, the balance of the debt covered by the arrangement is approximately NIS 27.8 million. The balance of the debt to the Company outside the above arrangement is a current debt. At the date of approval of the financial statements, DBS is in compliance with the terms of the arrangement for payment of the debt. The parties have not yet reached an agreement on the debt balance that is not included in the agreement, and the date of its repayment.

(3) During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements.

The terms of the loans and the credit facility that DBS received from the banks, which is NIS 960 million at March 31, 2009, impose various restrictions on DBS 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 covenants").

A. In January 2009, DBS applied to the banks requesting revision of the stipulations for 2009 so as to adapt them to the budget for 2009. On March 15, 2009, the banks agreed to amend the stipulations.

B. As at March 31, 2009, DBS is in compliance with the financial covenants set for it.

C. The management of DBS believes that the sources of financing available to it will suffice for its operational requirements in the coming year, based on the projected cash flow approved by the board of directors of DBS. If additional resources are required to meet its operational requirements during the year, DBS will adapt its operations to preclude the need for additional resources beyond those available to it.

(4) Further to Note 33(3)B to the financial statements as at December 31, 2008, on April 30, 2009, the Company's board of directors resolved to implement the merger of the Company and DBS (regarding the exercise of options for DBS's shares by the Company, which, if exercised, will increase the Company's holdings in DBS from 49.8% to 58%) under the conditions prescribed in the decision of the Antitrust Tribunal and to inform the Antitrust Tribunal and the Supreme Court of this decision, without derogating from the Company's claims in the counter petition against the amount of the bank guarantee set forth in the merger conditions. Implementation of the merger is subject to the decision of the Supreme Court regarding the counter petition that was filed against approval of the merger.

## NOTE 5 – CONTINGENT LIABILITIES

### A. Claims

During the normal course of business, legal claims were filed against the companies in the Group, including applications for certification as class action lawsuits.

In the opinion of the managements of the Group's companies, which is based, *inter alia*, on legal opinions regarding the risks related to the claims, including the application for certification of the class actions, appropriate provisions have been included in the financial statements in the amount of NIS 341 million, where warranted, to cover the exposure resulting from such claims.

In the opinion of the managements of the Group's companies, the additional exposure (in addition to the above provisions) at March 31, 2009, due to claims filed against the companies in the Group on various matters and in which the likelihood of realization is possible, amounts to approximately NIS 13.2 billion, of which approximately NIS 3.4 billion relates to salary claims filed by groups of employees or by individual claims with wide ramifications. The above amounts are before the addition of interest.

Concerning applications for certification as class actions regarding which the Group has exposure beyond the aforesaid (since the claims do not state an exact amount), see claims in Note 17A(5)a and b, (21) and (36) to the financial statements as at December 31, 2008. See section (2) below for the dismissal of the claim subsequent to the date of the financial statements.

For a detailed description of these claims, see Note 17A to the Group's annual financial statements as at December 31, 2008. Details of the significant changes to the status of the material contingent liabilities of the Group since December 31, 2008 are provided below:

(1) Further to Note 17A(6) to the financial statements as at December 31, 2008, regarding the claim for payment of monetary compensation of approximately NIS 60 million and for writs of mandamus filed by an international communications operator against the Company and Bezeq International, on January 27, 2009, the plaintiff filed a motion for amendment of the claim, so as to extend the claim period, change the method for calculating the damage and include a number of new facts, and alternately, a motion for splitting up of remedies. On May 15, 2009, the court approved, with the defendants' consent, to partially accept the plaintiff's motion, so as to include damages incurred by the plaintiff subsequent to the date of filing the statement of claim and to change the calculation method of the principle damage of diverting allocated customers and giving an advantage to Bezeq International in public telephones. Regarding other matters for which an amendment to the statement of claim was requested, the court ruled that should the plaintiff insist on amending the statement of claim for these issues as well, a motion for a hearing of the matter must be filed. If the motion for the amendment is approved in full, the scope of the claim (for the purpose of fees) will be updated to NIS 77 million.

(2) Further to Note 17A(20) to the financial statements as at December 31, 2008, regarding the claim filed in November 1997, together with an application for certification as a class action, against Bezeq International, the chairman of the board of directors of Bezeq International and the then CEO of Bezeq International, alleging that Bezeq International had abused its status in the international calls market and had implemented a deliberate policy of misleading the public on the subject of international call tariffs, on May 6, 2009, the Supreme Court dismissed the plaintiff's appeal of the ruling of the district court, which denied the application for certification of the claim as a class action.

(3) Further to Note 17A(24) to the financial statements as at December 31, 2008, regarding the claim and application for its certification as a class action against Bezeq International, an associate of Bezeq International and members of the board of directors of those two companies in the matter of sending an advertisement without the consent of the recipient, violating the provisions of Amendment 40 to the Communications Law, Bezeq International filed an application for summary dismissal of the application for certification as a class action, claiming lack of cause, as the law does not permit a claim for compensation without proof of harm, in this cause, under a class action. The plaintiff filed a response to the application for a summary dismissal and requested to amend the application for certification as a class action, such that the damage claimed will be compensation for harassing the plaintiff, wasting her time and curtailing her autonomy. The amount of damages claimed remained unchanged.

## NOTE 5 – CONTINGENT LIABILITIES (CONTD.)

### B. Claims which cannot yet be assessed or for which the exposure cannot be calculated

For a detailed description of the claims in respect of which the exposure cannot yet be assessed or calculated, see Note 17(B) to the Group's annual financial statements as at December 31, 2008. Details of material changes since December 31, 2008 are provided below:

**Claims for which exposure cannot be calculated**

Further to Note 17B(1) to the financial statements as at December 31, 2008, regarding the claim filed against the Company and against the Makefet Fund, by employees who retired under a retirement agreement signed in November 1997, which was dismissed by the court on December 11, 2008, the plaintiffs filed an appeal, which the Company received on April 5, 2009.

**Claims that cannot yet be estimated**

(1) On May 4, 2009, a claim was filed in the Jerusalem District Court against Bezeq International, together with an application for certification as a class action. The plaintiff, who is a subscriber of Bezeq International's internet services, claims that he was overcharged for the internet services he received from Bezeq International, in violation of the agreement and the law. According to the plaintiff, Bezeq International breached the contract with him, misled him and acted in bad faith in the negotiations and its relations with him. The plaintiff applied for certification as a class action under the Class Actions Law 5756-2006, on behalf of a group that includes any subscriber to Bezeq International's internet services who does not have a written agreement and/or for whom the tariffs for services were increased after the initial agreement period, beyond any reasonable or acceptable amount and/or without their agreement or without notice and/or who had a uniform agreement with Bezeq International that does not comply with the requirements of the law, allowing price increases without notice and at a rate that is beyond the normal rate, for the period between November 2005 and December 2008. The total amount of the class action is NIS 216.8 million (the personal amount of the claim is NIS 2,802).

(2) Further to Note 17B(5), (6) and (7) to the financial statements as of December 31, 2008, a risk assessment for these claims was received.

### C. Other contingencies

For a detailed description of other contingencies, see Note 17(C) to the Group's annual financial statements as at December 31, 2008. Details of material changes since December 31, 2008 are provided below.

Further to Note 17C(10) to the financial statements as at December 31, 2008, regarding the letter from the Director General of the Ministry of Communications announcing that he intends to consider the imposition of financial sanctions on the Company in the amount of NIS 15 million in respect of the alleged violation of provisions of the Company's general license relating to the structural separation, on April 26, 2009, the Company submitted its detailed argument stating that the Company did not violate the provisions of its license relating to the structural separation, and the aforesaid violation cannot be attributed to the Company, and under these circumstances and the circumstances described in the Company's document, financial sanctions cannot be imposed on the Company. The Company also requested an oral hearing.

## NOTE 6 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

**A.** Further to Note 26(B) and (I) to the financial statements as at December 31, 2008, on May 3, 2009 the general meeting of the shareholders of the Company approved the allocation of 100,000 options exercisable into 100,000 ordinary shares of NIS 1 par value each to an employee-director. The exercise price of the options is NIS 5.9703 (adjusted for distribution of a dividend in cash or in kind) and the theoretic economic value based on a weighted Black and Scholes model is approximately NIS 297,000, based, inter alia, on the share price on the grant date, which was NIS 6.5, a risk-free annual interest rate of 4.85%, an expected life of 8 years and an annual standard deviation of 26.63%.

**B.** Further to Note 29(F)(3) to the financial statements as at December 31, 2008, on May 3, 2009, the general meeting of the shareholders of the Company approved a maximum bonus for 2008 for the chairman of the Company's board of directors, under the terms of his employment agreement, as approved by the general meeting on June 1, 2008, of 18 monthly salaries, amounting to NIS 3.2 million.

## NOTE 7 – REVENUE

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| **Domestic fixed-line communications** | | | |
| Fixed-line telephony | **814** | 915 | 3,470 |
| Internet - infrastructure | **203** | 179* | 731* |
| Transmission, data communication and other | **236** | 229 | 978 |
| | **1,253** | 1,323 | 5,179 |
| **Cellular** | | | |
| Cellular services and terminal equipment | **958** | 918 * | 3,756 |
| Sale of terminal equipment | **245** | 182 * | 692 |
| | **1,203** | 1,100 | 4,448 |
| **International communications, internet services and NEP** | **310** | 294 | 1,243 |
| **Multi-channel television** | **384** | 377* | 1,506* |
| **Others** | **12** | 6 | 31 |
| | **3,162** | 3,100 | 12,407 |

* See Note 3D.

## NOTE 8 – OPERATING AND GENERAL EXPENSES

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| Cellular telephone expenses | **415** | 442 | 1,723 |
| General expenses | **273** | 276 | 1,115 |
| Materials and spare parts | **217** | 217 | 809 |
| Consumption of satellite services content | **114** | 115 | 447 |
| Services and maintenance by sub-contractors | **83** | 84 | 331 |
| Building maintenance | **74** | 78 | 364 |
| International communication expenses | **81** | 68 | 273 |
| Motor vehicle maintenance expenses | **39** | 46 | 192 |
| Royalties to the State of Israel | **27** | 32 | 134 |
| Collection fees | **12** | 12 | 49 |
| | **1,335** | 1,370 | 5,437 |

## NOTE 9 – CONDENSED DATA FROM THE SEPARATE INTERIM FINANCIAL STATEMENTS OF THE COMPANY

### A. Income statement

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| **Revenue (see B below)** | **1,326** | 1,408 | 5,498 |
| **Costs and expenses** | | | |
| Depreciation and amortization | **211** | 218 | 852 |
| Salary | **278** | 316 | 1,202 |
| General and operating expenses | **420** | 485 | 1,873 |
| Operating expenses (income), net | **(20)** | 21 | 96 |
| | **889** | 1,040 | 4,023 |
| Operating income for the period | **437** | 368 | 1,475 |

### B. Revenue segmentation

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| Telephony | **839** | 933 | 3,572 |
| Internet | **207** | 198 | 790 |
| Transmission and data communication | **207** | 192 | 811 |
| Other services | **73** | 85 | 325 |
| | **1,326** | 1,408 | 5,498 |

## NOTE 10 – SEGMENT REPORTING

The Company and its investees operate in various segments of the communications sector. Data on activities by segment are stated by the segments of operation of these companies.

### A. Reporting segments

| | For the three months ended March 31, 2009 (unaudited) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Domestic fixed–line communications | Cellular telephone | International communications, internet and NEP services | Multi-channel television | Others | Adjustments | Consolidated |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Revenue** | | | | | | | |
| Total revenue from external sources | **1,253** | **1,203** | **310** | **384** | **12** | **-** | **3,162** |
| Revenue from inter-segment sales | **73** | **62** | **14** | **-** | **5** | **(154)** | **-** |
| Total revenue | **1,326** | **1,265** | **324** | **384** | **17** | **(154)** | **3,162** |
| Segment operating profit | **437** | **302** | **60** | **66** | **1** | **-** | **866** |
| **Segment assets as at March 31, 2009** | **11,729** | **4,538** | **1,051** | **1,174** | **108** | **(3,224)** | **15,376** |

## NOTE 10 – SEGMENT REPORTING (CONTD.)

| | For the three months ended March 31, 2008 (unaudited) | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Domestic fixed–line communications** | **Cellular telephone** | **International communications, internet and NEP services** | **Multi-channel television** | **Others** | **Adjustments** | **Consolidated** |
| | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** |
| **Revenue** | | | | | | | |
| Total revenue from external sources | 1,323 | 1,100 | 294 | 377 | 6 | - | 3,100 |
| Revenue from inter-segment sales | 85 | 73 | 20 | 4 | 13 | (195) | - |
| Total revenue | 1,408 | 1,173 | 314 | 381 | 19 | (195) | 3,100 |
| Segment operating profit | 368 | 215 | 56 | 27 | (2) | - | 664 |
| **Segment assets as at March 31, 2008** | 11,523 | 4,417 | 905 | 1,151 | 123 | (2,931) | 15,188 |

## NOTE 10 – SEGMENT REPORTING (CONTD.)

| | For the year ended December 31, 2008 (audited) | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Domestic fixed–line communications** | **Cellular telephone** | **International communications, internet and NEP services** | **Multi-channel television** | **Others** | **Adjustments** | **Consolidated** |
| | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** |
| **Revenue** | | | | | | | |
| Total revenue from external sources | 5,179 | 4,448 | 1,243 | 1,506 | 31 | - | 12,407 |
| Revenue from inter-segment sales | 319 | 265 | 63 | 7 | 44 | (698) | - |
| Total revenue | 5,498 | 4,713 | 1,306 | 1,513 | 75 | (698) | 12,407 |
| Segment operating profit | 1,475 | 933 | 242 | 177 | - | (10) | 2,817 |
| **Segment assets as at December 31, 2008** | 10,752 | 4,644 | 994 | 1,132 | 100 | (3,308) | 14,314 |

## NOTE 10 – SEGMENT REPORTING (CONTD.)

### B. Adjustments for segment reporting of profit or loss and assets

| | For the three months ended March 31 | | For the year ended December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| **Profit or loss** | | | |
| Total operating profit or loss for segment reporting after finance costs | **865** | 666 | 2,827 |
| Profit or loss for other categories | **1** | (2) | - |
| Non-attributable amounts | - | - | (10) |
| Finance costs, net | **(37)** | (100) | 581 |
| Share in the profits of equity-accounted investees | **2** | 1 | 5 |
| Consolidated profit before income tax | **831** | 565 | 2,241 |

| | March 31 | | December 31 |
|---|---|---|---|
| | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** |
| **Assets** | | | |
| Total assets for segment reporting | **18,458** | 17,957 | 17,490 |
| Assets attributable to activities in other categories | **108** | 123 | 100 |
| Investment in equity-accounted investees | **34** | 39 | 32 |
| Less inter-segment assets | **(3,224)** | (2,931) | (3,308) |
| Total consolidated assets | **15,376** | 15,188 | 14,314 |

## NOTE 11 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD

### 1. Pelephone Communications Ltd.

#### A. Balance sheet

| | March 31, 2009 | March 31, 2008 | December 31, 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Current assets | **1,713** | 2,081 | 1,898 |
| Non-current assets | **2,825** | 2,336 | 2,746 |
| | **4,538** | 4,417 | 4,644 |
| Current liabilities | **1,241** | 1,058 | 1,502 |
| Long term liabilities | **972** | 1,112 | 1,050 |
| Total liabilities | **2,213** | 2,170 | 2,552 |
| Shareholders' equity | **2,325** | 2,247 | 2,092 |
| | **4,538** | 4,417 | 4,644 |

#### B. Income statement

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Revenues from services and sales | **1,265** | 1,173 | 4,713 |
| Cost of services and sales | **814** | 830 | 3,216 |
| **Gross profit** | **451** | 343 | 1,497 |
| Selling and marketing expenses | **117** | 97 | 424 |
| General and administrative expenses | **32** | 31 | 140 |
| | **149** | 128 | 564 |
| **Operating income** | **302** | 215 | 933 |
| Finance expenses | **28** | 26 | 115 |
| Finance income | **(39)** | (35) | (117) |
| **Net finance income** | **(11)** | (9) | (2) |
| **Profit before income tax** | **313** | 224 | 935 |
| Income tax | **83** | 61 | 253 |
| **Net profit for the period** | **230** | 163 | 682 |

## NOTE 11 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD. AND BEZEQ INTERNATIONAL LTD (CONTD.)

### 2. D.B.S. Satellite Services (1998) Ltd.

### A. Balance sheet

| | March 31, 2009 (Unaudited) NIS millions | March 31, 2008 (Unaudited) NIS millions | December 31, 2008 (Audited) NIS millions |
|---|---|---|---|
| Current assets | **175** | 171 * | 164 |
| Non-current assets | **999** | 980 * | 968 |
| | **1,174** | 1,151 | 1,132 |
| Current liabilities | **710** | 684 | 1,497 |
| Non-current liabilities | **3,356** | 3,161 | 2,527 |
| Total liabilities | **4,066** | 3,845 | 4,024 |
| Capital deficit | **(2,892)** | (2,694) | (2,892) |
| | **1,174** | 1,151 | 1,132 |

* See Note 3D.

### B. Income statement

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Revenue | **384** | 381 | 1,513 |
| Cost of revenue | **259** | 286 | 1,091 |
| **Gross profit** | **125** | 95 | 422 |
| Selling and marketing expenses | **28** | 39 | 128 |
| General and administrative expenses | **31** | 29 | 117 |
| | **59** | 68 | 245 |
| **Operating income** | **66** | 27 | 177 |
| Finance expenses | **45** | 60 | 230 |
| Finance income | **(20)** | (19) | (52) |
| Shareholders' finance expenses | **42** | 51 | 263 |
| **Financing expenses, net** | **67** | 92 | 441 |
| **Loss before taxes on income** | **(1)** | (65) | (264) |
| Income tax | **-** | - | 1 |
| **Net loss for the period** | **(1)** | (65) | (265) |

## NOTE 11 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD (CONTD.)

### 3. Bezeq International Ltd.

#### A. Balance sheet

| | March 31, 2009 | March 31, 2008 | December 31, 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Current assets | **545** | 428 * | 496 |
| Non-current assets | **506** | 477 * | 498 |
| | **1,051** | 905 | 994 |
| Current liabilities | **292** | 287 | 254 |
| Long term liabilities | **34** | 25 | 30 |
| Total liabilities | **326** | 312 | 284 |
| Shareholders' equity | **725** | 593 | 710 |
| | **1,051** | 905 | 994 |

* See Note 3D.

#### B. Income statement

| | For the three months ended 31 March | | For the year ended December 31 |
|---|---|---|---|
| | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Revenue | **324** | 314 | 1,306 |
| Operating expenses | **199** | 190 | 780 |
| **Gross profit** | **125** | 124 | 526 |
| Selling and marketing expenses | **41** | 42 | 181 |
| General and administrative expenses | **24** | 26 | 103 |
| | **65** | 68 | 284 |
| **Operating income** | **60** | 56 | 242 |
| Finance expenses | **2** | 5 | 8 |
| Finance income | **-** | (6) | (7) |
| **Financing expenses (income), net** | **2** | (1) | 1 |
| Share in profits in equity-accounted investees | **2** | 1 | 5 |
| **Profit before income tax** | **60** | 58 | 246 |
| Income tax | **16** | 16 | 68 |
| **Net profit for the period** | **44** | 42 | 178 |

The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRS).

## NOTE 12 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE DATE OF THE FINANCIAL STATEMENTS

**A.** Further to Note 26(B) and (I) to the financial statements as at December 31, 2008, on January 21, 2009, the Board of Directors of the Company approved the allocation of the 400,000 options to senior employees in the Group. In addition, on February 19, 2009, the Board of Directors of the Company approved the allocation of the additional 1,600,000 options to senior employees in the Group in accordance with the same plan. The exercise price of the options is NIS 5.9703-NIS 6.1837 (adjusted for distribution of a dividend in cash or in kind) and the theoretic economic value based on a weighted Black and Scholes model is approximately NIS 4.1 million, based, inter alia, on the share price on the grant date, which was NIS 6.5-NIS 6.55, a risk-free annual interest rate of 3.65%-4.28%, an expected life of 4.5-5.5 years and an annual standard deviation of 25.54%-24.56%.

**B.** Following the exercise of options by employees in accordance with the options plans described in Note 26 to the financial statements as at December 31, 2008, in March 2009 the Company issued 13,938,626 ordinary shares of NIS 1 par value each. In addition, subsequent to the date of the report and up to May 17, 2009, following the exercise of additional options by the employees, in accordance with the options plans, the Company issued another 10,062,038 ordinary shares of NIS 1 par value each.

**C.** In March 2009, the Company raised bank credit amounting to NIS 400 million and the Company created a negative pledge in favor of the creditors. The loans are repayable in 2010-2013 and bear variable interest at prime + 0.85% to 1%.

**D.** Further to Note 20(I) to the financial statements as at December 31, 2008, on May 3, 2009, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company of March 23, 2009 concerning distribution of a cash dividend to the shareholders of the Company in the amount of NIS 792 million, representing NIS 0.3013025 per share at the date of record (May 11, 2009). The dividend will be paid on May 24, 2009.