“BEZEQ” THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2008

Consolidated Financial Statements for the year ended December 31, 2008

Contents

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Auditors' Report to the Shareholders of
"Bezeq" The Israel Telecommunication Corp. Limited

We have audited the consolidated balance sheets of "Bezeq" The Israel Telecommunication Corp. Limited (the Company) as at December 31, 2008 and 2007, and the related statements of income, statements of recognised income and expense and cash flows, consolidated, for each of the three years ended on December 31, 2008. These financial statements are the responsibility of the Company's Board of Directors and its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of companies which were consolidated, whose assets included in the consolidation constitute approximately 6% of the total consolidated assets at December 31, 2006 and whose revenues included in the consolidation constitute approximately 11% of the total consolidated revenues for the years ended December 31, 2006. Furthermore, we did not audit the financial statements of associates in which the investment was approximately NIS 32 million and approximately NIS 37 million as at December 31, 2008 and 2007, respectively, and the Group's equity in their profits is approximately NIS 5 million, approximately NIS 6 million and approximately NIS 11 million, for the years ended December 31, 2008, 2007 and 2006, respectively. The financial statements of those aforementioned consolidated companies and associates were audited by other auditors whose reports thereon were furnished to us and our opinion, insofar as it relates to amounts emanating from the financial statements of those companies, is based solely on the said reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors' Regulations (Manner of Auditor's Performance), 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Group, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the abovementioned other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its consolidated subsidiaries as at December 31, 2008 and 2007 and its consolidated results of operations, consolidated recognized income and expense and its consolidated cash flows, for each of the three years, the last of which ended on December 31, 2008, in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Securities Regulations (Preparation of Annual Financial Statements) - 1993.

Without qualifying our opinion, we draw attention to the uncertainties relating to the following matters, the maximum possible exposure of which is significant:

1. Contingent claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 17B and 17C.

2. The financial position of a subsidiary, as mentioned in Notes 13C(3) and 33(3), as at December 31, 2008, the subsidiary is not in compliance with the financial criteria determined, and this was subsequent to receiving revised stipulations in respect of 2008 from the banks on March 5, 2008. Subsequent to the balance sheet date the subsidiary received a relief from the banks in respect of the financial criteria as at December 31, 2008. Accordingly, at the date of approval of the financial statements, the subsidiary is in compliance with the financial criteria set forth in the financing agreement. The continuation of the subsidiary's activities is dependent on, inter alia, compliance with the stipulations determined in respect of 2009 and/or further reliefs which will be received during the year. In the opinion of the management of the subsidiary, the sources of finance available to it will be sufficient for the subsidiary's operating requirements for the forthcoming year, this being in accordance with the cash flow forecast approved by the subsidiary's board of directors.

Somekh Chaikin
Certified Public Accountants

March 23, 2009

Consolidated Balance Sheets at December 31

	Note	2008 NIS millions	2007 NIS millions
Assets			
Cash and cash equivalents	5	**786**	1,203
Investments, including derivatives	6	**33**	389
Trade receivables	7	**2,373**	2,403
Other receivables	7	**211**	247
Inventory		**158**	203
Current tax assets	8	**-**	11
Assets classified as held for sale		**34**	17
Total current assets		**3,595**	4,473
Trade receivables	7	**576**	535
Investments, including derivatives	6	**187**	233
Broadcasting rights, net of rights exercised		**253**	243
Property, plant and equipment	9	**6,036**	6,064
Intangible assets	10	**2,674**	2,526
Deferred and other expenses	11	**411**	367
Investments in associates accounted by the equity method	12	**32**	37
Deferred tax assets	8	**547**	678
Total non-current assets		**10,716**	10,683
Total assets		**14,311**	15,156

	Note	2008 NIS millions	2007 NIS millions
Liabilities			
Debentures, loans and borrowings	13	**1,780**	1,913
Trade payables	14	**1,381**	1,533
Other payables, including derivatives	14	**850**	745
Current tax liabilities		**45**	57
Deferred income		**62**	47
Provisions	15	**355**	392
Employee benefits	16	**401**	705
Total current liabilities		**4,874**	5,392
Debentures	13	**3,943**	4,420
Obligations to banks	13	**214**	307
Loans from institutions	13	**109**	105*
Loans provided by non-controlling interest in a subsidiary	13	**449**	375
Employee benefits	16	**265**	261
Deferred income and others		**76**	67*
Provisions	15	**64**	57
Deferred tax liabilities	8	**65**	-
Total non-current liabilities		**5,185**	5,592
Total liabilities		**10,059**	10,984
Equity	20		
Share capital		**6,132**	6,132
Reserves		**748**	681
Deficit balance		**(2,157)**	(2,268)
Total equity attributable to shareholders of the Company		**4,723**	4,545
Non-controlling interest		**(471)**	(373)
Total equity		**4,252**	4,172
Total equity and liabilities		**14,311**	15,156

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Shlomo Rodav	**Avi Gabbay**	**Alan Gelman**
Chairman of the Board	CEO	Deputy CEO and CFO

* See Note 3U

Date of approval of the financial statements: March 23, 2009

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

Consolidated Statements of Income for the Year Ended December 31

	Note	2008 NIS millions	2007 NIS millions	2006 NIS millions
Revenue	21	**12,407**	12,400	12,232
Costs and expenses				
Depreciation and amortisation	9,10,11	**1,703**	1,769	1,864
Salaries	22	**2,354**	2,375	2,586
Operating and general expenses	23	**5,437**	5,841	5,967
Other operating expenses, net	24	**96**	39*	231*
		9,590	10,024	10,648
Operating income	28	**2,817**	2,376	1,584
Financing expenses	25			
Financing expenses		**747**	836*	713*
Financing income		**(166)**	(487)	(356)
Financing expenses, net		**581**	349	357
Profit after finance expenses, net		**2,236**	2,027	1,227
Equity in profits of associates accounted by the equity method	12	**5**	6	11
Profit before income tax		**2,241**	2,033	1,238
Income tax	8	**720**	672	488
Profit for the year		**1,521**	1,361	750
Attributable to:				
The shareholders of the Company		**1,627**	1,330	809
Non-controlling interest		**(106)**	31	(59)
Profit for the year		**1,521**	1,361	750
Earnings per share	27			
Basic earnings per share (in NIS)		**0.62**	0.51	0.31
Diluted earnings per share (in NIS)		**0.61**	0.50	0.31

* See Note 3U.

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

Consolidated Statements of Recognised Income and Expense for the Year Ended December 31

	Note	2008 NIS millions	2007 NIS millions	2006 NIS millions
Net change in fair value of available-for-sale financial assets	6,25	**-**	4	(1)
Net change in fair value of available-for-sale financial assets transferred to profit and loss	6,25	**(5)**	-	(5)
Actuarial gains (losses) from a defined benefit plan	16	**(2)**	14	3
Foreign currency translation differences		**(4)**	-	-
Taxes in respect of revenue and expenses charged directly to equity	8	**1**	(4)	2
Income and expense recognised directly in equity		**(10)**	14	(1)
Profit for the year		**1,521**	1,361	750
Total recognised income and expense		**1,511**	1,375	749
Attributable to:				
Shareholders of the Company		**1,617**	1,344	808
Non-controlling interest		**(106)**	31	(59)
Total recognised income and expenses		**1,511**	1,375	749

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

Consolidated Statements of Cash Flows for the Year Ended December 31

	Note	2008 NIS millions	2007 NIS millions	2006 NIS millions
Cash flows from operating activities				
Profit for the year		**1,521**	1,361	750
Adjustments:				
Depreciation	9	**1,394**	1,482	1,591
Amortisation of intangible assets	10	**289**	270	248
Amortisation of deferred and other charges	11	**20**	17	25
Loss (gain) from decrease in holdings in associates accounted by the equity method	12	**-**	1	(1)
Share in profits of associates accounted by the equity method	12	**(5)**	(6)	(11)
Financing costs, net	25	**561**	372	512
Capital gain, net	24	**(68)**	(88)	(159)
Share-based payment transactions	26	**75**	-	287
Payments to a former senior officer		**-**	6	-
Income tax expenses	8	**720**	672	488
Payment for settlement of derivative financial instruments, net		**(38)**	(9)	(27)
Change in inventory		**42**	(6)	23
Change in trade receivables	7	**(10)**	(437)	109
Change in other receivables	7	**(44)**	4	(108)
Change in other payables	14	**15**	(18)	(14)
Change in trade payables	14	**(225)**	36	(79)
Change in provisions	15	**(34)**	105	27
Change in broadcasting rights net of rights utilized		**(11)**	(74)	(15)
Change in employee benefits	16	**(302)**	(300)	169
Change in deferred income and others		**50**	(11)	1
Income tax paid		**(535)**	(430)	(277)
Net cash from operating activities		**3,415**	2,947*	3,539*
Cash flows from investment activities				
Investment in intangible assets and in deferred expenses	10	**(469)**	(273)	(210)
Proceeds from sale of property, plant and equipment and deferred expenses		**147**	177	48
Current investments, net		**321**	647	1,491
Purchase of property, plant and equipment	9	**(1,300)**	(973)	(953)
Proceeds from realisation of investments and long-term loans		**19**	66	63
Purchase of investments and long-term loans		**(8)**	(8)	(20)
Dividend received		**13**	3*	26*
Interest received		**64**	116*	220*
Net cash from (used for) investment activities		**(1,213)**	(245)	665

* See Note 3U.

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (contd.)

	Note	2008 NIS millions	2007 NIS millions	2006 NIS millions
Cash flows from financing activities				
Issuance of debentures	13	**-**	1,814	-
Receipt of loans from institutional entities	13	**-**	50	50
Repayment of debentures	13	**(714)**	(1,927)	(280)
Repayment of loans	13	**(148)**	(840)	(1,269)
Short-term borrowing, net	13	**(50)**	(37)	43
Dividend paid	20	**(1,514)**	(2,860)	(1,600)
Interest paid		**(243)**	(389)	(602)
Receipt (payment) for settlement of derivative financial instruments, net		**52**	77	(76)
Transfer of funds by non-controlling interest less dividend distributed, net		**8**	-	-
Net cash used for financing activities		**(2,609)**	(4,112)	(3,734)
Increase (decrease), net, in cash and cash equivalents		**(407)**	(1,410)	470
Cash and cash equivalents at January 1		**1,203**	2,632	2,159
Effect of fluctuations in the rate of exchange on cash balances		**(10)**	(19)	3
Cash and cash equivalents at the end of the year	5	**786**	1,203	2,632

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The consolidated financial statements of the Company at December 31, 2008 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 28 – Segment Reporting).

B. On October 11, 2005, core control in the Company was transferred from the State to Ap.Sb.Ar. Holdings Ltd. and the Company ceased to be a government company. In September 2008, Ap.Sb.Ar. Holdings Ltd. exercised an option to increase its holdings by 10.66% and the percentage of its holding in the Company increased to 40.66%, as a result of which the State's holding decreased to 4.95% and from that date the State ceased to be an interested party in the Company by virtue of its holdings. The Company was declared a monopoly in the main areas in which it operates. All the main segments of operation of the Group are in 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. Arrangements pursuant to Sections 15 – 17 of the Communications Law apply to the Company's service tariffs, which are prescribed in regulations which are automatically updated in accordance with a linkage formula, all 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 PRESENTATION

A. Definitions

In these financial statements –

(1) International Financial Reporting Standards ("IFRSs") – Standards and interpretations adopted by the International Accounting Standards Board (IASB), which include International Financial Reporting Standards (IFRSs) and International Accounting Standards (IAS), including interpretations for those standards as determined by the International Financial Reporting Interpretations Committee (IFRIC) or interpretations determined by the Standing Interpretations Committee (SIC), respectively.

(2) the Company – Bezeq – The Israel Telecommunication Corp. Limited.

(3) the Group - Bezeq – The Israel Telecommunication Corp. Limited and its subsidiaries, as listed in Note 33 –Group Entities.

(4) Subsidiaries – Companies whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Group.

(5) Associates – Companies, including a partnership, in which the Group's investment is included, directly or indirectly, in the consolidated financial statements on the equity basis.

(6) Investees – Subsidiaries or associates.

(7) Related party – As defined in International Accounting Standard 24 – Related Party Disclosures.

NOTE 2 – BASIS OF PRESENTATION (CONTD.)

A. Definitions (contd.)

(8) Interested parties – As defined in Paragraph (1) of the definition of "Interested Party" in a corporation, in Section 1 of the Securities Law, 5728-1968.

(9) CPI – The Consumer Price Index as published by the Central Bureau of Statistics.

B. Statement of compliance with International Financial Reporting Standards

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, and in accordance with the Securities (Preparation of annual financial statements) Regulations, 5753-1993.

The Group first adopted IFRSs in 2006, with a transition date of January 1, 2005. The last annual financial statements prepared in accordance with generally accepted accounting standards in Israel ("Israeli GAAP") were for the year ended December 31, 2005.

The consolidated financial statements were approved by the Board of Directors on March 23, 2009.

C. Functional currency and presentation currency

The consolidated financial statements are stated in New Israel Shekels ("NIS"), which is the functional currency of the Group and rounded to the nearest million. The shekel is the currency representing the principal economic environment in which the Group operates.

D. Basis of measurement

The consolidated financial statements were prepared on the basis of historical cost except for the following items:

* Derivative financial instruments are measured at fair value.
* Financial instruments at fair value through profit and loss are measured at fair value.
* Available-for-sale financial assets are measured at fair value.
* Assets stated at deemed cost – as described in Note 9.
* Liabilities in respect of employee benefits – as described in Note 16.

The methods by which the fair value is measured are explained in Note 4. The value of non-monetary assets and equity items measured on the basis of historical cost was adjusted for changes in the CPI up to 31 December, 2003, since until that date Israel was considered a hyperinflationary economy.

E. Addition of very significant valuations

Pursuant to Section 8B of the Securities (Periodic and immediate reports) Regulations, 5730-1970, valuations which are very significant for the Group must be attached to the financial statements. For this purpose, the Group applied a quantitative test whereby an asset is deemed to be very material if its fair value exceeds 10% of the total consolidated balance sheet assets. For assets whose reassessment to fair value is charged to profit and loss, the extent of materiality was tested, *inter alia*, according to the part of the reassessment charged to the profits of the Group for the reporting period.

NOTE 2 – BASIS OF PRESENTATION (CONTD.)

F. Use of estimates and judgment

When preparing the financial statements in accordance with IFRSs, Management is required to make judgments and to avail itself of assessments, estimates and assumptions that affect application of the accounting policies and the amounts of assets, liabilities, income and expenses. It is clarified that actual results might differ from these estimates.

When formulating accounting estimates use in preparing the Company’s financial statements, the Company’s Management is required to make assumptions as to circumstances and events that involve considerable uncertainty. In exercising its judgment when making the estimates, Management relies on past experience, various facts, external factors and reasonable assumptions appropriate to the circumstances of each estimate.

The estimates and underlying assumptions are reviewed on an ongoing basis. Changes in the accounting estimates are recognised in the period in which the estimates are revised and in each future period affected by them.

Information concerning critical estimates when applying accounting policy that have the most significant effect on the financial statements is included in the following notes:

Note 3J	Inventory
Note 7	Provision for doubtful debts.
Note 8	Utilisation of losses for tax purposes and deferred tax assets and liabilities recognised.
Note 9	Estimated useful life and residual value of items of property, plant and equipment, and determining deemed cost.
Note 10	Measurement of recoverable amounts of cash-generating units.
Notes 15 and 17	Provisions and contingent liabilities.
Note 16	Measurement of a defined benefit obligation and employee benefits.
Note 26	Measurement of share-based payments.
Note 31	Financial instruments.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements were prepared according to IFRSs and their interpretations as published and in force adopted early at the date of the annual report – 31 December, 2008, on the basis of which the accounting policy of the Group was decided. The accounting policy has been applied consistently by the Group entities.

A. Basis of Consolidation

(1) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the ability to control the financial and operating policy of an entity in order to achieve benefits from its operations. In assessing control, potential voting rights that are exercisable immediately are taken into account (see also Note 33(3)(b)). The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control is acquired until the date that control ceases.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (C0NTD.)

(2) Special-purpose entity

The Company set up a special-purpose entity ("SPE") for investment purposes. SPEs are included in consolidation if, based on an assessment of the substance of its relationship with the Group and the SPEs' risks and rewards, the Group concludes that it controls the SPE. Such an entity controlled by the Group, was established under terms that impose strict limitations on the decision-making powers of the SPE's management and that result in the Group receiving the majority of the benefits related to the SPEs' operations and its net assets. The Group is exposed to risks in the activities of the SPE, and owns most of the residual rights and ownership risks relating to the SPE's assets.

(3) Associates (accounted by the equity method)

Associates are those entities in which the Group has significant influence, but not control, over financial and operating policy. Associates are accounted for using the equity method, and are first recognised at their cost. The consolidated financial statements include the Group's share in the income and expenses of investee entities, on an equity-accounted basis, after adjustments required to align the accounting policy with that of the Group from the date that significant influence commences until the date that significant influence no longer exists.

(4) Transactions eliminated upon consolidation

Intra-group balances and any unrealised income and expenses arising from intra-group transactions were eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates were eliminated against the investment to the extent of the Group's rights in those investments. Unrealised losses were eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

B. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the amortized cost in the functional currency at the beginning of the period, adjusted for the effective interest and the payments during the period, and the amortized cost in the foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies and measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising from the retranslation are recognised in profit or loss, except for differences arising from retranslation of equity investments classified as available for sale and recognised in equity.

C. Financial Instruments

(1) Non-derivative financial instruments

Non-derivative financial instruments comprise investments in shares and debentures, trade and other receivables, cash and cash equivalents, loans and credit received, trade and other payables, and also debt securities issued by the Group and loans taken out by the Group.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any attributable direct costs of the transaction. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

A financial instrument is recognised when the Group takes upon itself the contractual terms of the instrument. Financial assets are disposed of when the Group's contractual rights to the cash flows deriving from the financial assets expire, or when the Group transfers the financial assets to others without retaining control of the asset or all the risks and rewards arising from the asset.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (C0NTD.)

C. Financial Instruments (contd.)

(1) Non-derivative financial instruments (contd.)

Regular way purchases and sales of financial assets are recognised on the trade date, i.e. on the date on which the Group undertook to acquire or sell the asset. Financial liabilities are disposed of when the Group's obligation, as detailed in the agreement, expires, or when it is discharged or cancelled.

Cash and cash equivalents
Cash comprise cash balances and deposits are usable on demand. Cash value includes high-liquidity short-term investments which are easily convertible to known amounts of cash and which are exposed to minor risks of changes in value.

Available-for-sale financial assets
The Group's investments in shares, certain equity securities and a venture capital fund are classified as available-for-sale financial assets. Subsequent to initial recognition, these investments are measured at fair value, and changes therein, other than accrual of interest, deductions, impairment losses (see Note 3K1) and exchange gains and losses on available-for-sale monetary items (see Note 3B), are charged directly to equity. A dividend received in respect of available-for-sale financial assets is charged to profit and loss on the date of eligibility for payment. When the investment is derecognised, cumulative gains or losses in equity are transferred to profit or loss.

Investments stated at fair value through profit and loss
A financial instrument is classified as measured at fair value through profit and loss (mainly the Group's investments in marketable securities) if it is held for trading or if it is designated as such at the time of initial recognition. The Group manages investments of this kind and makes buy and sell decisions based on their fair value according to the manner in which the Group manages its investment strategy.

Loans and receivables
Loans and debit balances are financial assets with fixed or fixable payments which are not derivatives and are not traded on an active market. Loans and debit balances are measured at amortized cost by the effective interest method, net of losses from impairment.

Non-derivative financial liabilities
Non-derivative financial liabilities are measured at amortized cost by the effective interest method (the liability value) after attribution of transaction costs.

(2) Derivative financial instruments

The Group holds derivative financial instruments to hedge its exposure to foreign currency and the CPI. Embedded derivatives are separated from the host contract and accounted for separately if: (a) the economic characteristics and the risks of the host contract and the embedded derivative are not closely related; (b) a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative, and (c) the combined instrument is not measured at fair value through profit and loss.

Derivatives are recognised initially at fair value: the attributable transaction costs are recognised in profit and loss when incurred. Subsequent to their initial recognition, derivative financial instruments are measured at fair value, and changes therein are recognised through profit and loss.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

C. Financial Instruments (contd.)

(2) Derivative financial instruments (contd.)

Economic hedging

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities. Changes in the fair value of such derivatives are recognised in profit and loss.

Separable embedded derivatives

Changes in the fair value of separable embedded derivatives are charged immediately in profit and loss.

(3) CPI-linked assets and liabilities not measured at fair value

The value of CPI-linked financial assets and liabilities which are not measured at fair value is revalued in each period according to the rate of actual rise in the CPI.

(4) Share capital – Ordinary shares

Incremental costs directly attributable to the issue of ordinary shares and share options are stated as a deduction from equity.

D. Property, plant and equipment

(1) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and losses from impairment. Certain items of property, plant and equipment that were revalued to fair value on the date of transition to IFRSs, are measured on the basis of their deemed cost, which is the revalued amount at the transition date (January 1, 2005), in accordance with the Group's assessments based on an external appraisal.

Cost includes costs that are directly attributable to acquisition of the asset. The cost of self-constructed assets includes the cost of the materials, direct labour and financing costs, as well as any other costs directly attributable to bringing the asset to the condition for its use as intended by Management, and the costs of dismantling and removing the items and restoring the site on which they are located in cases where the Group has an obligation to vacate and restore the site. Purchased software that is an integral to the functionality of the related asset, is recognised as part of the cost of that asset.

Where significant parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment.

Changes necessitated for asset dismantling and site restoration, except for changes caused by the passage of time, are added to or deducted from the cost of the asset in the period in which they occur. The amount deducted from the cost of the asset does not exceed its carrying amount, and the balance, if any, is recognised immediately in the profit and loss statement.

Profit or loss from disposal of an item of property, plant and equipment is determined by comparing the proceeds its disposal to its carrying amount, and is recognised net in the Other income line of the statement of profit and loss.

(2) Subsequent costs

The cost of replacing part of an item of property, plant and equipment item is recognised as part of the carrying amount of the item if it is likely that the future economic benefit embodied in the item will flow to the Group and that the cost of the item can be reliably measured. The costs of day-to-day servicing are recognised in profit and loss as incurred.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

D. Property, plant and equipment (contd.)

(3) Capitalisation of borrowing costs

Costs of non-specific borrowing are capitalised as qualifying assets as defined in IAS 23 – Borrowing Costs, during the period required for completion and construction through the date on which they are ready for their intended use. Non-specific borrowing costs are capitalised for investment in qualifying assets, using a rate which is the weighted average of the rates of cost for those borrowing sources. Other borrowing costs are recognised in profit and loss as incurred.

(4) Depreciation

Depreciation is charged to profit and loss on a straight-line basis over the estimated useful life of each part an item of property, plant and equipment. Leased assets are depreciated over the shorter of the term of the lease and the period of use of the asset. Real estate is not depreciated.

Improvements made to leased premises are depreciated over the term of the lease, which includes any option for the extension of the lease held by the Group and which it intends to exercise.

The estimated useful lives for the current and comparative periods are as follows:

	Years	Main depreciation %
Digital switching equipment	4-20	10
Transmission and power equipment	5-10	20
Network equipment	5-25	4
Terminal equipment (cellular)	2-3	33
Subscriber equipment and public telephones	5	20
Vehicles	7	15
Internet equipment	4-7	20
Office equipment	5-15	10
Electronic equipment, computers and internal communication systems	3-7	33
Cellular infrastructure equipment	5-10	10
Digital satellite decoders	4-8	17
Broadcasting and reception equipment (satellite)	7	15
Buildings	25	4

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

E. Non-current assets held for sale

Non-current assets which are expected to be realised by way of sale rather than ongoing use, are classified as assets held for sale. These assets are presented at the lower of book value and fair value, less selling costs. Losses from impairment in value at the time of initial classification of an asset held for sale, and subsequent gains or losses resulting from remeasurement, are recognised in profit and loss. Gains are recognised up to the cumulative amount of loss from impairment of value recorded in the past.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

F. Broadcasting rights

Broadcasting rights are stated at cost, net of rights exercised.

Costs of purchased broadcasting rights for screening films and television programmes include the amounts paid to suppliers of rights. The broadcasting rights are depreciated in accordance with the terms of the agreement for their purchase, on the basis of actual screenings out of the total number of screenings permitted under the agreement (where the undepreciated portion at the end of the term of the agreement is depreciated in full upon its termination), or according to the term of the rights agreement. The net change in the broadcasting rights is stated as adjustments to profit as part of current operations in the statement of cash flows.

G. Intangible assets

(1) Goodwill

Goodwill is created as a result of the acquisition of subsidiaries and associates.

Acquisitions prior to January 1, 2005
As part of the transition to reporting in accordance with IFRSs, the Group chose to account for only those business combinations which occurred after January 1, 2005 in accordance with IFRS 3. Regarding acquisitions prior to January 1, 2005, the goodwill reflects the amount recognised by the Group according to Israeli GAAP. For these acquisitions, the accounting treatment was not adjusted to IFRS 3 in preparing the opening balance sheet of the Group.

For acquisitions after January 1, 2005, the goodwill reflects the excess cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity.

Subsequent measurement
Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investments, goodwill is included in the carrying amount of the investment. For assessment of impairment of value, see K(2) below.

(2) Software development costs

Software development costs are capitalised only if the development costs can be measured reliably; the software is technically and commercially applicable; a future economic benefit is expected from the development, and the Group has sufficient resources to complete the development and intends to use the software. A capitalised expense includes the cost of the materials, direct labour and overhead expenses directly attributable to preparation of the asset for its intended use. Other development expenses are recognised in profit and loss as incurred.
Capitalised development costs are measured at cost less amortisation and accumulated losses from impairment.

(3) Subscriber acquisition

Direct sale commissions paid to dealers and salespersons in respect of sales and upgrades to subscribers who have signed a commitment to remain customers for long periods, are recognised as an intangible asset. Subscriber acquisition Amortisation expenses are recognised in profit and loss over the period of the subscribers' commitments (between 18 and 36 months).

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

G. Intangible assets (contd.)

(4) Software

The Group's assets include computer systems consisting of hardware and software. Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, the licenses for the software, which are a separate item and add functionality to the hardware, are classified (mostly) as intangible assets. The depreciation in respect of software is charged to profit and loss by the straight-line method, over the estimated useful life of the asset.

(5) Frequency usage rights

Frequency usage rights relate to cellular communication frequencies for which the Group won a tender published by the Ministry of Communications (see Note 18(H) below).

(6) Other intangible assets

Other intangible assets acquired by the Group, which have a defined useful life, are measured at cost less amortisation and accumulated losses from impairment.

(7) Subsequent costs

Subsequent expenses are capitalised only when it increases the future economic benefit embodied in the asset for which they were incurred. All other expenditure, including expenditure relating to amortised goodwill and brands, is charged to profit and loss as incurred.

(8) Amortisation

Amortisation, except for goodwill, is charged to profit and loss on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use. Goodwill is not systematically amortized but is reviewed for impairment.
Estimated useful lives for the current and comparative periods are as follows:

* Capitalised development expenses	4 - 7 years
* Other rights	3 - 10 years, depending on the useful life
* Subscriber acquisition costs	Depending on the estimated contractual commitment with the subscriber
* Computer programs and licenses for software use	Over the term of the license or the estimated time of use of the program

H. Leased properties

Leases in which the Group assumes most of the risks and rewards from the property are classified as finance leases. Upon initial recognition, the leased properties are measured at the lower of the fair value and the present value of the minimum future lease payments. Subsequent to the initial recognition, the asset is treated according to the accounting policy applicable to that asset.

Other leases are classified as operating leases, where the leased properties are not recognised on the balance sheet of the Group. Leases of land from Israel Lands Administration ("the Administration") are operating leases. Lease payments made in advance to the Administration are stated in the balance sheet and charged to profit and loss over the term of the lease.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

H. Leased properties (contd.)

The Group applies IFRIC 4 – *Determining Whether an Arrangement Contains a Lease*, which defines criteria for determining, at the start of the arrangement, whether a right to use the property constitutes a lease arrangement. In addition, it defines when thereafter the arrangement should be reviewed. The Group applied the relief laid down in IFRS1, whereby the examination of whether an arrangement contains a lease was made on the basis of the facts and circumstances prevailing on January 1, 2005 (the date of transition to IFRSs).

I. Prepaid expenses in respect of a right to use capacities

In accordance with IFRIC 4, as mentioned above, transactions for acquiring an indefeasible right of use ("IRU") of undersea cable capacities are accounted for as receipt of service transactions. The prepaid expense is amortized on a straight-line basis up to 2022 as stated in the agreement and no more than the expected estimated useful life of those capacities.

J. Inventory

Inventory is measured at the lower of the cost and net realisable value. The cost of inventory is determined by the moving weighted average method. Slow-moving inventory of terminal equipment, accessorise and spare parts are stated net of the provision for impairment of value.

The inventory of a subsidiary includes terminal equipment and accessories intended for sale, as well as spare parts used for repairs in the repair service it provides to its customers. As part of its normal operations, the subsidiary upgrades the terminal equipment for its customers, and therefore inventory also includes used handsets and accessories returned by customers.

K. Impairment

(1) Financial assets

The Group reviews a financial asset for impairment when there is objective evidence that one or more events have impacted negatively on the estimated future cash flows of the asset.

The Group's review of impairment of available-for-sale financial assets that are equity instruments also includes the difference between the fair value of the asset and its original cost, for the time at which the fair value of the asset is lower than its original cost, and changes in the technological, economic or legal environment or the market environment in which the company that issued the instrument operates.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed for impairment collectively, in groups that share similar credit risk characteristics. In addition, the financial statements include specific provisions and specific Group provisions for doubtful debts, which properly reflect, according to Management's assessment, the loss inherent in debts whose collection is in doubt.

All the impairment losses are charged to profit and loss. Any cumulative loss in respect of an available-for-sale financial asset, which was formerly charged to capital, was transferred to profit and loss when the asset value became impaired.

An impairment loss is reversed if the reversal can be related objectively to an event that occurred after the impairment loss was recognised. For financial assets measured at amortized cost and available-for-sale financial assets that are debt securities, the reversal is charged to profit and loss. For available-for-sale financial assets that are equity securities, the reversal is charged directly to equity.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

K. Impairment (contd.)

(2) Non-financial assets

The carrying amounts of the Group's non-financial assets which are not inventory or deferred tax assets, are reviewed at each reporting date to determine whether there are any indications of impairment. If any such indication exists, then the assets recoverable amount is estimated. On January 1, 2005, the date of transition to IFRSs, the Group reviewed goodwill for impairment. In subsequent periods, the Group makes an assessment every year of the recoverable amount of goodwill and of assets which are not available for use, or more frequently if there are indications of impairment.

The recoverable amount of an asset or cash-generating unit is the greater of the value in use and the net selling price (fair value less selling costs). In assessing value in use, the Group capitalises the estimated future cash flows at a discount rate, which reflects the market assessments of the time value of the money and the specific risks related to the asset. For assessing impairment, the assets are grouped together into the smallest group of assets that generate cash from ongoing use, which are mainly independent of other assets and groups ("cash-generating unit"). Goodwill acquired as part of business combinations is allocated to the review of impairment for cash-generating units which are expected to generate benefits from the synergy of the combination.

Impairment losses are recognised whenever the carrying amount of the asset or its cash-generating unit exceeds its recoverable amount, and are charged to profit and loss. Impairment losses recognised for cash-generating units are allocated initially to reduce the carrying amount of the goodwill attributed to those units, and thereafter, to reduce the carrying amount of the other assets in the unit on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. For other assets, impairment losses which were recognised in prior periods are assessed at each reporting date to determine whether there are any indications that the losses have decreased or no longer exist. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, only to the extent that the asset's carrying amount after reversal of the impairment loss does not exceed the carrying amount, net of depreciation or Amortisation, that would have been determined had the loss from impairment not been recognised.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits

(1) Post-employment benefits

The Group has a number of post-employment benefit plans. The plans are usually financed by contributions to insurance companies, and are classified as defined contribution plans and as defined benefit plans.

a. Defined contribution plans

The Group's obligation to make contributions to a defined contribution plan, are recognised as an expense in profit and loss on the date on which the obligation to contribute is assumed. (See Note 16D below.)

b. Defined benefit plans

The Group's net obligation in respect of a defined benefit plan for post-retirement benefits is calculated separately for each plan by estimating the future amount of the benefit payable to the employee in return for his service in the current and prior periods. That benefit is stated at present value less the fair value of the plan's assets and less the cost of past service not yet recognised. The discount rate is the yield at the reporting date on government bonds whose currency and maturity dates are similar to the terms of the Group's obligation. The calculations are made by a qualified actuary using the projected unit credit method (see Note 16E below.)

Where the calculation creates an asset for the Group, the asset is recognised up to the net amount of the present value of the available economic benefits in the form of a refund from the plan or a reduction of future contributions to the plan. An economic benefit in the form of refunds or reduction of future contributions will be seen as available if it can be realised during the life of the plan or after settlement of the obligation.

Where the minimum contribution requirement includes an obligation to pay additional amounts relating to past services, the Company recognises an additional obligation (increase of the net obligation or reduction the net asset), to the extent to which such amounts were not available as an economic benefit in the form of a refund from the plan or a reduction of future contributions.

When the benefits of a plan are improved, the portion of the increased benefits relating to past service of employees is charged to profit and loss on a straight-line basis over the average period until the benefits mature. If the benefits mature immediately, the expense is recognised immediately in profit and loss.
The Group charges immediately, directly to reserves, all the actuarial gains and losses derived from a defined benefit plan.

(2) Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits which are not post-employment benefit plans, is the amount of future benefit payable to employees in return for their service in the current and prior periods. The amount of these benefits is discounted to its present value, net of the fair value of the assets related to the obligation. The discount rate is determined according to the yield at the reporting date on government bonds whose currency and maturity date are similar to the terms of the Group's obligation. The calculation is made using the projected credit unit method. Actuarial gains and losses are charged to profit and loss in the period in which they arise (see Note 16F below.)

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits (contd.)

(3) Severance pay benefits and voluntary retirement benefits

Benefits in respect of severance pay are recognised as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Employee benefits upon voluntary retirement are recognised when the Group proposes a plan encouraging employees to retire voluntarily, the plan is expected to be accepted, and the number of those who will benefit from the plan can be estimated reliably (see Note 16G and H below.)

(4) Short-term benefits

Obligations in respect of short-term employee benefits are measured on a non-discounted basis, and the expense is charged at the time the relevant service is rendered. A provision for short-term employee benefits in respect of a cash bonus or a profit-sharing plan is recognised when the Group has a legal or constructive obligation to pay that amount for a service rendered by the employee in the past, and that amount can be reliably estimated.

(5) Share-based payment transactions

The fair value on the grant date of options granted to employees is recognised as a salary expense with a corresponding increase in equity over the period during which the employee becomes entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options expected to vest.

The fair value of the options granted to Company employees by the State in the period when the State was the controlling shareholder of the Company, was recorded as an expense at the time the employees were entitled to the options.

M. Provisions

A provision is recognised if as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. The provisions are measured by discounting future cash flows at a pre-tax interest rate that reflects current market assessments of the time value of the money and the risks specific to the liability.

(1) Contingent liabilities

The financial statements include appropriate provisions in respect of claims against the Group companies which, in the opinion of those companies, will not be dismissed or abated even though the claims are denied by the Group companies. In addition, there are also a small number of legal proceedings, received recently, in which the risks cannot be assessed at this stage, therefore no provisions have been made.

The treatment of contingent legal claims is according to IAS 37 and its related provisions.

Accordingly, the claims are classified by likelihood of realisation of the exposure to risk, as follows:

a. More likely than not – more than 50% probability.
b. Possible – probability higher than unlikely and less than 50%
c. Unlikely – probability of 10% or less.

For claims which are more likely than not, the financial statements include provisions which in the opinion of the Group's managements, based, *inter alia*, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case.

Note 17A includes details of the amount of the additional exposure due to contingent claims whose amounts are significant, and in which the likelihood of realisation is possible.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

M. Provisions (contd.)

(2) Reorganisation

A provision for reorganisation is recognised when the Group has approved a detailed and formal reorganisation plan, and the reorganisation has either commenced or has been announced to the employees. The provision includes direct expenses necessarily arising from the reorganisation and which are not attributed to the ongoing activities of the Group.

(3) Onerous contracts

A provision for onerous contracts is recognised when the benefits expected to be derived by the Group from the contracts are lower than the unavoidable cost of meeting its obligations under the contracts. The provision is measured at the lower of the present value of the expected cost of terminating the contract and the present value of the expected net cost of continuing the contract.

(4) Site dismantling and clearing costs

A provision in respect of an obligation to dismantle and clear sites is accrued in accordance with IAS 37. The provision is accrued for those rental agreements in which the Group has undertaken to restore the rental property to its original state at the end of the rental period, after dismantling and transferring the site, and restoring it as necessary.

(5) Warranty

A subsidiary recognised a provision for warranty in respect of first-year insurances for cellular handsets. The warranty is limited to technical malfunctions defined by the subsidiary, and does not include warranty as a result of customer damages. However, an asset exists in respect of the manufacturer's warranty for those handsets, which is limited to technical malfunctions defined by the manufacturer.

N. Revenue

The Group's revenue consists mainly of revenue from fixed-line communication services, cellular services, international communication services, satellite television services, customer centre services, provision of communication services to other communications providers, sale and installation of communications equipment, and internet services. Revenue is measured at the fair value of the consideration received or about to be received, less returns, commercial discounts and quantity discounts.

(1) Equipment sales

Revenue from sales of terminal equipment is charged to profit and loss when the significant risks and rewards of ownership of the goods transfers to the buyer, receipt of the consideration is probable, the possibility that the goods will be returned and the costs generated in respect of the transaction can be reliably estimated and when the Company has no ongoing involvement with the goods.

Revenue from the sale of terminal equipment to subscribers in long-term credit arrangements are charged upon delivery to the customer at the present value of the future cash flow expected from them, at the market interest rate for transactions of this kind. Financing income in respect of these transactions is charged to income statements over the period of the instalments by the interest method.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

N. Revenue (contd.)

(2) Service revenue

Revenue from services rendered is charged to profit and loss proportionately over the term of the agreement or upon providing the service if the flow of the economic benefits associated with providing the service is certain. Revenue from calls, including revenue from prepaid call cards, is recognised when the call is made by the customer.

(3) Sales on credit

Revenue from credit sales transactions that include a financing transaction are recorded at their present value, so that the difference between the fair value of the transaction on the transaction date and the stated amount of the consideration will be recognised in the income statement as interest income, using the effective interest rate.

(4) Multi-component sale agreements

The Group recognises revenue in accordance with IAS 18. For multi-component transactions in which the terminal equipment is sold together with the customer's undertaking to receive services, the Group applies the relative fair value method. Allocation of the revenue to a component supplies is limited to the amount of the consideration that is not contingent upon the supply of additional components.

(5) Gross or net-based revenue reporting

When the Group acts in the capacity of an agent or broker without bearing the risks and rewards deriving from the transaction, its revenue is stated net. Conversely, where the Group acts as a main supplier and bears the risks and rewards deriving from the transaction, its revenue is stated gross.

(6) Lease of satellite decoders

A subsidiary collects deposits for digital satellite decoders held by its customers. At the end of the agreement, the customers are entitled to the remaining portion of the deposit in accordance with their agreement. Revenues from deduction of the deposits are charged to profit and loss, in accordance with the terms of the agreement with the customers.

O. Finance income and expenses

Finance income includes interest income in respect of amounts invested (including financial assets available for sale), income from dividends, interest income accrued by the effective interest rate method in respect of the sale of terminal equipment in instalments, gains from the sale of available-for-sale financial assets, changes in the fair value of financial assets stated at fair value through profit and loss, gains from foreign currency and gains from hedging instruments that are recognised in profit and loss. Interest income is recognised as it accrues, using the effective interest method. Dividend income is recognised on the date on which the Company’s right to receive payment is established, which in the case of quoted securities is usually the ex-dividend date.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

O. Finance income and expenses (contd.)

Financing expenses comprise interest expense on loans received, debentures issued, commissions paid, changes in the time value in respect of provisions, changes in the fair value of financial assets stated at fair value through profit and loss, losses from impairment of financial assets (except for a provision for doubtful debts, which is stated in operating and general expenses), and losses from hedging instruments recognised in profit and loss. Non-discounted borrowing costs are charged to profit and loss using the effective interest rate.

Gains and losses from exchange rate differences are reported net.

P. Income tax expense

Income tax expense comprises current and deferred taxes and is charged to profit and loss unless the tax arises from a transaction or event recognised directly in equity, in which case it is charged to equity.
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and including changes in the tax payments relating to prior years.

Recognition of deferred taxes is by the equity method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for tax purposes. The Group does not recognise deferred taxes for the following temporary differences: initial recognition of goodwill, initial recognition of assets and liabilities in a transaction which is not a business combination and which does not affect accounting profit or taxable profit, losses carried forward which are not expected to be utilised in the foreseeable future, and differences arising from investment in subsidiaries if they are not expected to be reversed in the foreseeable future. The deferred taxes are measured using the tax rates expected to be applicable to the temporary differences on the date of their realisation, based on the laws enacted or substantively enacted at the balance sheet date. The Group sets off deferred tax assets and liabilities if there is an enforceable legal right to set off current tax assets and liabilities and they are attributed to the same taxable income as is taxed by the same tax authority in the same assessed company or in different companies which intend to settle current tax assets and liabilities on a net basis or the tax assets and liabilities are settled simultaneously.

A deferred tax asset is recognised if it is probable that future taxable profits will be available against which the temporary differences can be utilised. The deferred tax assets are reviewed at each reporting date and are reduced if the related tax benefits are not expected to be realised.

Q. Earnings per share

The Group states basic and diluted earnings per share data in respect of its ordinary share capital. The basic earning per share is calculated by dividing the profit or loss attributable to the equity holders of the Company by the weighted average number of ordinary shares outstanding during the period. The diluted earning per share is determined by adjusting the loss or gain attributable to equity holders of the Company and adjustment of the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which includes share options granted to employees.

R. Segment reporting

A segment is a distinguishable component of the Group that provides services likely to be interrelated (business segment), and which is exposed to risks and rewards that differ from those of the other segments. The Group's primary format for segment reporting is based on business segments, and is determined on the basis of the Group's structure and internal reporting.

Inter-segment pricing is determined on the basis of transaction prices in the normal course of business.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

R. Segment reporting (contd.)

The results, assets and liabilities of the segment include items attributable directly to the segment and items that can be attributed on a reasonable basis. Unallocated items consist mainly of investments and the revenue from them, loans and borrowings and their expenses, and tax assets and liabilities on tax income and expenses.

The capital expenditures of the segment are total costs incurred during the period for the purchase of property, plant and equipment and intangible assets.

S. Transactions with a controlling shareholder

Assets and liabilities regarding which a transaction was made with a controlling shareholder are measured at fair value on the date of the transaction. Since such a transaction is on the equity level, the Company charges the difference between the fair value and the consideration from the transaction to equity.

T. Dividend declared subsequent to the balance sheet date

An obligation relating to a dividend proposed or declared after the balance sheet date is recognised only in the period in which the declaration was made.

U. Reclassified amounts

The financial statements include reclassification of certain amounts of the comparative figures for the relevant sections.

V. Early application of accounting standards

(1) Commencing January 1, 2008, the Group opted for early application of IFRS 3 – Business Combinations (Amended) and IAS 27 – Consolidated and Separate Financial Statements (2008).

a. IAS 27 – Consolidated and Separate Financial Statements (2008) relates to the accounting treatment of rights that do not grant control (non-controlling interest) and deals mainly with the accounting treatment of changes in the non-controlling interest after acquiring control, the accounting treatment of loss of control in a subsidiary, and allocations of profit or loss to the equity holders of the parent and to the non-controlling interest.

b. IFRS 3 – Business Combinations (Amended) relates also to business combinations made by contract only. The definition of a business combination focuses on the acquisition of control, including contingent consideration. The acquirer can choose to measure the non-controlling interest at its fair value on the acquisition date, or proportionately to the fair value of the identified assets and identified liabilities of the acquiree. Where acquisition is achieved by consecutive purchases of shares (acquisition stages), the identified assets and identified liabilities of the acquiree are recognized at their fair value when control is obtained (against profit or loss).

Application of the standards influenced the part of the Company's equity holders and of the non-controlling interest in the losses of DBS commencing January 1, 2008, 58% of which were included in the part of the equity holders compared with the accounting treatment prior to application of the standards, whereby 100% of DBS's losses, net of the financing expense to the non-controlling interest, were included in the part of the Company's equity holders. Following early application of the standards, the profits of the equity holders and the equity attributable to them, increased in 2008 by NIS 38 million. The profit and the equity attributable to the non-controlling interest decreased accordingly.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

V. Early application of accounting standards (contd.)

(2) IFRIC 13 – Customer Loyalty Programmes ("the Interpretation"). Under the Interpretation, when products and services are sold in combination with sale incentives (such as a points plan or free products), the agreement is deemed to be a multi-component agreement and the proceeds received for it must be allocated among the various components using fair value. The Group adopted the Interpretation early and retrospectively, commencing from the financial statements for 2008. In the wake of the early adoption, in 2008 the Group deferred revenue of approximately NIS 11 million. Early adoption of the Interpretation has not materially affected the Group's financial statements for periods prior to January 1, 2008.

(3) The Group opted for early adoption of IFRS 2 – Share-Based Payment – Terms of Vesting and Cancellation. The standard states that the vesting terms are the terms determining whether the Group receives the services that entitle the other party to share-based payment, and they are limited to terms of service and performance. Terms which are not vesting terms will be reflected in the fair value of the grant on the grant date, while after the grant date the Group will not update the fair value in respect of those terms. Furthermore, the standard determines the treatment of non-compliance with terms that are not vesting terms. The early application of the standard has not materially affected the results of the Group's operations and its financial position.

W. New standards and interpretations not yet adopted and whose adoption is not expected to affect the financial statements of the Group

(1) 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 internal reporting format to the decision-makers in the entity. The Standard will apply to annual periods commencing January 1, 2009 or thereafter.

(2) IAS 1 – Presentation of Financial Statements, amended ("the Standard"). The Standard requires that information in the financial statements be grouped on the basis of shared characteristics and presentation of a total income statement. The Standard permits the presentation of income and expense items and other total income items in a single income statement that includes intermediate amounts, or alternatively, the presentation of two separate statements (profit and loss followed by income). The names of some of the financial statements have been changed to clarify their purpose (e.g. the balance sheet is to be called 'Statement of financial position'). The Standard will apply to annual periods commencing January 1, 2009 or thereafter. The Standard is expected to affect the presentation of the financial statements of the Group.

(3) IAS 27 – Consolidated and Separate Financial Statements. A dividend received from subsidiaries, companies under joint control and associates will be recognised as income in separate statements of the investor company. The Standards also state that receipt of a dividend constitutes, in certain cases, an indication of impairment of the value of the held investment. The new amendment will apply to annual periods commencing January 1, 2009 or thereafter. The changes attributed to IAS 27 will be applied prospectively.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

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

(4) IFRS 7 – Financial Instruments: Disclosures ("the Standard"). The amendment expands the disclosures required concerning the fair value measurement of financial instruments, particularly for financial instruments whose fair value is measured using an assessment technique. The amendment improves the disclosures required concerning the liquidity risk. The amendment to the Standard will be applied from now onwards, for annual period commencing January 1, 2009 or thereafter. Early application is possible, with disclosure.

X. New standards and interpretations not yet adopted

(1) IAS 28 – Investments in Associates, amended ("the Standard"). Under the amendment to IAS 28, impairment of an investment in an associate will be tested for the investment as a whole. Accordingly, a recognised loss from impairment of the investment is not allocated specifically to the goodwill included in the investment bit to the investment as a whole, and therefore the entire loss from impairment recognised in the past will be reversible upon fulfilment of the terms required for reversal under IAS 36. The amendment to the Standard can be applied retrospectively or from now onwards, starting from the financial statements for periods commencing January 1, 2009. The Group is studying the implications of applying the Standard.

(2) In May 2008, as part of the Improvements to IFRSs project, the IASB published 35 amendments to various international standards covering a wide range of accounting questions. The amendments are divided into two: (1) amendments on subjects of presentation, recognition and measurement which have accounting implications, and (2) amendments relating to terminology and to the preparation of international standards.
Most of the amendments will apply to periods commencing January 1, 2009 and thereafter, with early adoption permitted, subject to conditions described for each amendment and subject to the transition terms relating to first-time adoption of IFRSs. The Group is studying the effects of the amendments on the financial statements.

NOTE 4 – DETERMINING FAIR VALUE

Accounting policies and disclosure requirements require the Group to determine the fair value of monetary and non-monetary assets and liabilities. The fair values were determined for the purposes of measurement and/or disclosure using the methods described below. Additional information regarding the assumptions used in determining the fair values can be found in the Notes relevant to the particular asset or liability.

A. Property, plant and equipment

Certain items of property, plant and equipment were revalued on the date of transition to IFRSs. Determination of the deemed cost of the items is based on an assessment of the value made by an external appraiser using the depreciated replacement cost method.

B. Investments in shares and debentures

The fair value of monetary assets measured at fair value through profit and loss and monetary assets classified as available for sale, is determined using their proposed selling price in the market or according to a model for non-negotiable assets at the balance sheet date.

C. Customers and other trade receivables

The fair value of customers and other long-term trade receivables, for disclosure purposes only, was determined using the present value of the future cash flows, discounted at the market interest rate at the balance sheet date.

NOTE 4 – DETERMINING FAIR VALUE (CONTD.)

D. Derivatives

The fair value of forward contracts on foreign currency or the CPI is based on their quoted market prices, if available, and if unavailable, on the basis of capitalization between the price stated in the forward contact and the price of the present forward contact in respect of the balance of the term of the contract until redemption at an appropriate interest rate.

E. Non-derivative financial liabilities

The fair value, which is determined for disclosure, is calculated at the present value of the future cash flows in respect of the principal component and the interest, discounted at the market interest rate at the balance sheet date.

F. Share-based payment transactions

The fair value of stock options for employees is measured using the Black and Scholes model. The assumptions of the model include the share price at the date of measurement, the exercise price of the instrument, expected volatility (based on the weighted average of historical volatility, adjusted for changes expected from information available to the public), the weighted average of the projected useful life of the instruments (based on past experience and the general behaviour of the option-holders), expected dividends, and the risk-free interest rate (based on government bonds). Conditions of service and performance which are not market conditions, are not taken into account when determining the fair value. Conditions which are not vesting conditions are taken into account in calculating the fair value. See also Note 26.

NOTE 5 – CASH AND CASH EQUIVALENTS

	December 31 2008	**December 31 2007**
	NIS millions	**NIS millions**
Bank balances	**30**	55
Demand deposits	**756**	1,148
	786	1,203

The effective interest rate on the demand deposits in 2008 was 3.9% - 4.01% (2007 – 3.3% - 5.0%). For deposits, the average maturity period was 6-7 days (2007 – 6-8 days). See also Note 31.

NOTE 6 – INVESTMENTS, INCLUDING DERIVATIVES

A. Segmentation by investment classification

	December 31 2008	December 31 2007
	NIS millions	NIS millions
Current investments		
Financial assets measured at fair value through profit and loss(1)	**6**	294
Financial assets available for sale	**-**	47
Derivatives	**24**	45
Other investments	**3**	3
	33	389
Non-current investments		
Bank deposit for providing loans to employees(3)	**130**	149
Financial assets available for sale	**57**	68
Derivatives	**-**	16
	187	233
	220	622

(1) **Sensitivity analysis – negotiable financial assets price risk**
A rise of 10% in the market value of assets measured at fair value through profit and loss at the reporting date would increase the profit and the equity by NIS 0.4 million after tax (2007 – an increase of NIS 2.1 million after tax, assuming a rise of 1% in the market value). The sensitivity test rate was determined by assessments based on the position of the capital market in the reporting year. A similar change downwards would decrease the profit and the equity by the same amounts.

(2) The deposit serves as a security for providing bank loans to Company employees. The deposit is unlinked, and the effective interest rate of the deposit at December 31, 2008 is 2.85% (2007 – 2.8%). The Company is liable for the loans to employees. The deposit is stated at its present value, taking into account the loan repayment schedule, based on a weighted average discount rate of 3.87% (2007 – 5.15%). Sensitivity analysis – price risk of assets available for sale.

(3) The strengthening of the shekel compared to the dollar by 10% would increase the value of the financial assets available for sale and increase the equity by NIS 4.1 million after tax (2007 – an increase of NIS 4.9 million). A similar change in the opposite direction would decrease equity by the same amount.

B. Segmentation by types of securities

	December 31, 2008			December 31, 2007		
	Marketable	Others	Total	Marketable	Others	Total
	Equity value	Equity value	Equity value	Equity value	Equity value	Equity value
		NIS millions			NIS millions	
Government bonds –						
CPI-linked	**-**	**-**	**-**	86	-	86
Unlinked	**3**	**-**	**3**	71	-	71
Corporate debentures	**3**	**-**	**3**	74	-	74
Foreign securities	**-**	**-**	**-**	12	-	12
Short-term loan	**-**	**-**	**-**	8	-	8
Investments in shares and options	**-**	**57**	**57**	31	68	99
Participation in mutual funds	**-**	**-**	**-**	15	-	15
Bank deposit for providing loans to employees	**-**	**130**	**130**	-	149	149
Investment in hedge fund	**-**	**-**	**-**	-	43	43
Derivatives	**-**	**24**	**24**	-	61	61
Other investments	**-**	**3**	**3**	1	3	4
	6	**214**	**220**	298	324	622

NOTE 7 – TRADE AND OTHER RECEIVABLES

	December 31 2008	December 31 2007
	NIS millions	NIS millions
Trade receivables		
Trade receivables that are related parties and interested parties	**-**	113
Outstanding debts	**747**	893
Credit vouchers and checks receivable	**554**	460
Revenue receivable	**388**	361
Current maturities of long-term trade receivables	**684**	576
	2,373	2,403
Receivables		
Prepaid expenses	**90**	80
Other receivables	**121**	167
	211	247
Long-term trade receivables[(1)]	**576**	535
	3,160	3,185

Trade and other receivables denominated in a currency which is not the functional currency include NIS 85 million of trade and other receivables denominated in US dollars (2007 – NIS 84 million), and NIS 200,000 of trade and other receivables denominated in euro (2007 – NIS 391,000).

(1) For the discounted interest rates, see Note 31.

Following is the customer debt aging at the reporting date:

	December 31 2008	December 31 2007
	NIS millions	NIS millions
Not in arrears	**2,634**	2,566
Arrears up to one year	**341**	385
Arrears between one and two years	**147**	128
Arrears of over two years	**138**	187
	3,260	3,266
Less provision for doubtful debts	**311**	328
	2,949	2,938

Movement in provision for doubtful debts during the year:

	December 31 2008	December 31 2007
	NIS millions	NIS millions
Balance at January 1	**328**	339
Change during the year, net	**(17)**	(11)
Balance at December 31	**311**	328

NOTE 8 – INCOME TAX

A. General

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Current tax expense			
In respect of the current period	**527**	365	397
Adjustments in respect of prior years, net	**(4)**	(5)	5
	523	360	402
Deferred tax expense			
Creation and reversal of temporary differences	**197**	312	91
Changes in the value of unrecognised temporary differences	**-**	-	(5)
	197	312	86
Income tax expense	**720**	672	488

B. Reconciliation of effective tax rate

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Profit	**1,521**	1,361	750
Income tax	**720**	672	488
Profit before tax	**2,241**	2,033	1,238
Statutory tax rate	**27%**	29%	31%
Income tax at the local tax rate applicable to the Group	**605**	590	384
Differences in the tax rate	**13**	34	8
Differences in definition of capital and assets	**-**	(39)	(6)
Expenses not recognised for tax purposes	**23**	52	15
Deferred taxes in respect of temporary differences not recognised in the past	**-**	-	(5)
Losses generated in the period, for which a deferred tax asset was not recognised	**71**	28	88
Change in temporary provisions not recognised	**(1)**	(1)	(4)
Taxes in respect of prior years	**(4)**	(5)	5
Others	**13**	13	3
	720	672	488

C. Income tax attributable directly to equity

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Available-for-sale financial assets	**(5)**	4	(6)
Actuarial gains and losses	**(2)**	14	3
Expenses recognised directly in equity	**(7)**	18	(3)
Total tax recognised directly in equity	**1**	(4)	2

NOTE 8 – INCOME TAX (CONTD.)

D. Deferred tax assets which were not recognised

The calculation of deferred taxes does not take into account the taxes that would be applicable in case of realisation of the investment in subsidiaries and associates, since the Group intends to retain the investment. Deferred taxes in respect of a distribution of profit in subsidiaries and associates were also not taken into account, since the dividends are not taxable.

Deferred tax assets not recognised
Deferred tax assets were not recognised in respect of the following items

	2008	2007
	NIS millions	NIS millions
Deductible temporary differences	**7**	3
Losses for tax purposes	**262**	96
	269	99

Deferred tax assets in respect of losses carried forward and tax benefits carried forward and not yet utilised, were not recognised in cases where future taxable income against which they can be utilised is not foreseen. Under existing tax laws, there is no time limit on utilising tax losses or on utilising deductible temporary differences. Deferred tax assets were not recognised in respect of these items since it is not anticipated that there will be taxable income in the future against which the tax benefits can be utilised. The balance of unrecognised deferred tax assets in respect of losses for tax purposes is approximately NIS 968 million.

E. Recognised tax assets and deferred tax liabilities

Tax assets and deferred tax liabilities are attributed to the following items

	Assets		Liabilities		Net	
	2008	2007	2008	2007	2008	2007
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Property, plant and equipment	**25**	58	**125**	116	**(100)**	(58)
Doubtful debts	**47**	50	**-**	-	**47**	50
Intangible assets	**2**	-	**13**	13	**(11)**	(13)
Monetary assets measured at fair value through profit and loss	**3**	3	**-**	-	**3**	3
Available-for-sale financial assets	**3**	3	**-**	2	**3**	1
Employee benefit plans	**363**	418	**-**	-	**363**	418
Share-based payments	**122**	136	**-**	-	**122**	136
Provisions	**48**	51	**-**	-	**48**	51
Other assets	**1**	2	**-**	-	**1**	2
Deferred expenses in connection with agreed assessments	**2**	4	**-**	-	**2**	4
Tax losses carried forward	**4**	84	**-**	-	**4**	84
	620	809	**138**	131	**482**	678

NOTE 8 – INCOME TAX (CONTD.)

F. Changes in temporary differences during the year

	Balance at January 1, 2007	Charged to profit and loss	Charged to equity	Balance at December 31, 2007	Charged to profit and loss	Charged to equity	Balance at December 31, 2008
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Property, plant and equipment	(13)	(45)	-	(58)	**(42)**	**-**	**(100)**
Doubtful debts	51	(1)	-	50	**(3)**	**-**	**47**
Intangible assets	(10)	(3)	-	(13)	**2**	**-**	**(11)**
Financial assets measured at fair value through profit and loss	2	1	-	3	**-**	**-**	**3**
Financial assets available for sale	2	-	(1)	1	**-**	**2**	**3**
Employee benefits	547	(126)	(3)	418	**(54)**	**(1)**	**363**
Share-based payments	136	-	-	136	**(14)**	**-**	**122**
Provisions	5	46	-	51	**(3)**	**-**	**48**
Deferred expenses in connection with other items	11	(9)	-	2	**(1)**	**-**	**1**
Assessment agreement	9	(5)		4	**(2)**		**2**
Losses from partnerships	3	(3)	-	-	**-**	**-**	**-**
Losses for tax purposes carried forward	251	(167)	-	84	**(80)**	**-**	**4**
	994	(312)	(4)	678	**(197)**	**1**	**482**

NOTE 8 – INCOME TAX (CONTD.)

G. Amendments to the Income Tax Ordinance

On July 25, 2005, the Knesset passed the Amendment to the Income Tax Ordinance (Number 147 and temporary order) Law, 5765-2005 (“Amendment 147”). Amendment 147 provided for a gradual reduction in the corporate tax rate, setting those rates as follows:

In the 2006 tax year, the corporate tax rate was 31%, in 2007 the rate was 29%, in 2008 – 27%, in 2009 – 26% and from 2010 and thereafter, the corporate tax rate will be 25%. In addition, commencing in 2010 and with the reduction in the company tax rate to 25%, any real capital gain will be taxed at 25%.

Current taxes and deferred tax balances at December 31, 2007 and at December 31, 2008 are calculated at the tax rates set as aforesaid.

H. Adjustments Law

Under the Income Tax (Adjustments for inflation) Law, 5745-1985 (“the Adjustments Law”), taxable results up to and including 2007 were measured on a real basis, taking into account the rate of change in the CPI. The Group is assessed on the basis of this law.

In February 2008, the Knesset enacted the Income Tax (Adjustments for inflation) (Amendment No. 20) (Restriction of effective period) Law, 5768-2008 (“the Amendment”). Under the Amendment, the effective period of the Adjustments Law ended in the 2007 tax year, and from the 2008 tax year the provisions of the law no longer applied, other than the transitional provisions intended to prevent distortions in the tax calculations.

Under the Amendment, from the 2008 tax year onwards, income for tax purposes will no longer be adjusted to a real measurement basis. Furthermore, the depreciation of inflation-immune assets and carried forward tax losses will no longer be linked to the CPI, so that these amounts will be adjusted until the end of the 2007 tax year after which they will cease to be linked to the CPI.

The effects of the amendment to the Adjustments Law were reflected in the calculation of current taxes and deferred taxes commencing 2008.

I. Final tax assessments

(1) The Company has final tax assessments up to and including 2003.

(2) Pelephone, DBS, Bezeq International and Bezeq On Line have final assessments up to and including 2004.

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT

A. Composition and movement

	Land and buildings	Switching, transmission and power equipment	Network equipment	Subscriber equipment	Motor Vehicles	Office equipment and computers	Total
				NIS millions			
Cost or deemed cost							
Balance at January 1, 2007	1,950	3,942	12,220	3,015	111	1,226	22,464
Additions	79	477	108	325	1	112	1,102
Disposals (D. below)	(85)	(268)	(45)	(57)	(32)	(53)	(540)
Transfer to assets held for sale	(54)	-	-	-	-	-	(54)
Balance at December 31, 2007	1,890	4,151	12,283	3,283	80	1,285	22,972
Balance at January 1, 2008	1,890	4,151	12,283	3,283	80	1,285	22,972
Additions	**75**	**765**	**168**	**283**	**22**	**87**	**1,400**
Disposals (D. below)	**(12)**	**(146)**	**(1)**	**(22)**	**(18)**	**(19)**	**(218)**
Transfer to assets held for sale	**(53)**	**-**	**-**	**-**	**-**	**-**	**(53)**
Balance at December 31, 2008	**1,900**	**4,770**	**12,450**	**3,544**	**84**	**1,353**	**24,101**
Depreciation and losses from impairment							
Balance at January 1, 2007	1,425	1,701	9,725	2,131	94	896	15,972
Depreciation for the year	98	621	261	359	6	137	1,482
Disposals (D. below)	(73)	(266)	(45)	(43)	(29)	(50)	(506)
Transfer to assets held for sale	(40)	-	-	-	-	-	(40)
Balance at December 31, 2007	1,410	2,056	9,941	2,447	71	983	16,908
Balance at January 1, 2008	1,410	2,056	9,941	2,447	71	983	16,908
Depreciation for the year	**85**	**605**	**286**	**310**	**5**	**103**	**1,394**
Disposals (D. below)	**(11)**	**(146)**	**(1)**	**(5)**	**(16)**	**(20)**	**(199)**
Transfer to assets held for sale	**(38)**	**-**	**-**	**-**	**-**	**-**	**(38)**
Balance at December 31, 2008	**1,446**	**2,515**	**10,226**	**2,752**	**60**	**1,066**	**18,065**
Carrying amount							
At January 1, 2007	525	2,241	2,495	884	17	330	6,492
At December 31, 2007	480	2,095	2,342	836	9	302	6,064
At December 31, 2008	**454**	**2,255**	**2,224**	**792**	**24**	**287**	**6,036**

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT (CONTD.)

A. Composition and movement (contd.)

a. Determination of fair value as deemed cost – Certain items of property, plant and equipment from the switching, transmission and power group of equipment, principally switching equipment, which were revalued to fair value on the date of transition to the IFRSs, were measured on the basis of their deemed cost, which was determined according to their fair value on the transition date (January 1, 2005), as assessed by the Group based on the valuation of an external appraiser. (The assessments were attached to the financial statements of the Group at December 31, 2006.)

b. Residual value – The residual value of the Group's copper cables was assessed at the end of the reporting year. The residual value is approximately NIS 226 million, and was NIS 591 million at December 31, 2008 and December 31, 2007, respectively. This decline in residual value will increase the depreciation expense of the Company by approximately NIS 35 million in 2009.

c. Cost of dismantling and removal of assets – The cost of items of property, plant and equipment includes dismantling and removal costs, as well as site restoration costs where the Group has an obligation. These costs are depreciated according to the expected useful life of the sites. During 2008, the Group recognised, as part of the cost of property, plant and equipment, costs of approximately NIS 4 million for dismantling and removal of assets (2007 – NIS 4 million).

d. Property, plant and equipment in the Group is removed at the year end upon reaching full depreciation, except for land, buildings and vehicles, which are removed upon their sale. In 2008, the Group removed fully depreciated property at a cost of approximately NIS 116 million (2007 – NIS 385 million).

e. The cost includes approximately NIS 35 million in the Group, representing real financing expenses which were capitalised in the reporting period in respect of loans and credit in the construction period and calculated at an average real interest rate of approximately 9.1% per year (prior year – 6.78%).

f. In November 2007, the general meeting of Pelephone adopted the resolution of Pelephone's board of directors in September 2007 concerning the installation of an HSPA/UMTS network for one billion shekels. In 2008, Pelephone invested approximately NIS 616 million in setting up the network, and the balance of the investment is expected to be spread over the next three years. Depreciation commenced during January 2009, as the network was readied and became available for use.

g. On June 26, 2008, the Board of Directors of the Company resolved to approve the Company's proceeding with the NGN project. On that date, the preparation of detailed planning of the project was approved, the set-up of two operational pilot areas and the purchase of software switches. The project will be implemented in modular form, and the Company will conduct regular reviews after each stage, of the viability of continuing the project and accordingly – the need to update the project outline. The content, pace of performance and the amounts to be invested in the project will be determined each year as part of the Company's annual budget. In July 2008 an additional investment budget was approved for performance in 2008, and in November 2008 the 2009 budget was approved.

h. The companies of the Group reviewed the useful life of the property, plant and equipment through the Depreciation Committee, in order to determine the estimated useful life of their equipment.

The principal findings of the review are these:
For infrastructure and landline communication equipment (including in respect of section g. above) a change was made in estimated useful life. As a result of the change in the estimate, depreciation expenses of the landline communication infrastructure increased in 2008 by NIS 10 million. In 2009 depreciation expenses are expected to decrease by approximately NIS 22 million, in 2010 by approximately NIS 50 million, and in 2011 expenses are expected to increase by approximately NIS 7 million.

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT (CONTD.)

A. Composition and movement (contd.)

h. (contd.)

For Pelephone network equipment (see section f. above), the estimated useful life was changed. As a result, depreciation expenses increased by approximately NIS 19 million.

The effect of the changes for subsequent periods is not material.

i. At the balance sheet date, there are agreements to purchase property, plant and equipment totalling approximately NIS 458 million consolidated (2007 – approximately NIS 348 million).

j. Concerning liens, see Note 19.

NOTE 10 – INTANGIBLE ASSETS

	Goodwill	Computer software and licenses and discounted development costs	Subscriber acquisition	Right of use in frequencies	Others	Total
	NIS millions					
Cost						
Balance at January 1, 2007	1,793	1,247	275	220	50	3,585
Acquisitions as part of business combinations	6	-	-	-	-	6
Developed or purchased separately by the Group	-	141	84	-	11	236
Disposals (1)	-	(28)	(47)	-	-	(75)
Balance at December 31, 2007	1,799	1,360	312	220	61	3,752
Balance at January 1, 2008	1,799	1,360	312	220	61	3,752
Developed or purchased separately by the Group	-	141	92	202	2	437
Disposals (1)	-	-	(25)	-	-	(25)
Balance at December 31, 2008	**1,799**	**1,501**	**379**	**422**	**63**	**4,164**
Amortisation and losses from impairment						
Balance at January 1, 2007	6	774	226	-	25	1,031
Amortisation for the year	-	203	59	-	8	270
Disposals (1)	-	(28)	(47)	-	-	(75)
Balance at December 31, 2007	6	949	238	-	33	1,226
Balance at January 1, 2008	6	949	238	-	33	1,226
Amortisation for the year	-	194	87	-	8	289
Disposals (1)	-	-	(25)	-	-	(25)
Balance at December 31, 2008	**6**	**1,143**	**300**	**-**	**41**	**1,490**
Carrying amount						
At January 1, 2007	1,787	473	49	220	25	2,554
At December 31, 2007	1,793	411	74	220	28	2,526
At December 31, 2008	**1,793**	**358**	**79**	**422**	**22**	**2,674**

(1) Fully depreciated intangible assets.

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

Total value of the goodwill allocated to each unit is as follows:

	2008	2007
	NIS millions	NIS millions
Cellular telephone – Pelephone Communications Ltd.[(1)]	**1,027**	1,027
Multi-channel television – D.B.S. Satellite Services (1998) Ltd.[(2)]	**760**	760
Others	**6**	6
	1,793	1,793

(1) The value of the use of cellular telephone – Pelephone, was calculated by the Discount Cash Flow (DCF) method, and was based on the following assumptions:

A detailed cash-flow projection was prepared for 5 years, which is a reasonable assessment range for which a detailed cash flow can be prepared.

- The cash flow forecast is based on Pelephone's strategic plan to operate a third generation network (3.75) in HSPA/UMTS technology at the beginning of 2009. The new network will mean that Pelephone will operate in GSM technology, which will help it to achieve a higher market positioning, broaden the range of handsets it sells, and lead to overall improvement in Pelephone's customer mix and ARPU. In addition, it will increase Pelephone's revenue from roaming services, even taking into account the effects of the economic crisis. On the expense side, it will increase fees for transmission, frequencies and engineering, as well as marketing expenses for penetration of the new handsets.
- The revenue forecast was constructed on the basis of a forecast for the number of subscribers and average revenue per user (ARPU) according to the structure of revenues from customers in addition to revenues from sales of handsets. The subscriber forecast is based on a cellular company market model, taking into account the possible influence of MVNO, market saturation and population growth, and assuming an increase of 1.5% in Pelephone's market share in the forecast period.
- The assumptions for call time and call prices lead to erosion of approximately 3.0% in ARPU in 2009, and growth thereafter as a result of the effects of the strategic plan.
- The operating, sales and marketing expenses were adjusted for Pelephone's volume of operations, with adjustment for operation of the HSPA network. Tax was deducted from the profit at the statutory tax rate.
- Investments were assessed according to Pelephone's investment plan, which consists of the balance of the investment in the HSPA network over three years, investment in IT and other ongoing investments in subscriber acquisition.
- The capitalisation rate taken, 10.00% (nominal), was calculated by the WACC model and based on a capital price of 12.4% and a debt price of approximately 6.6%.
- Beyond the fifth year, growth of approximately 1.25% was assumed, taking into account that in the years of the forecast, Pelephone has not exhausted the advantages from transition to the HSPA network, population growth, the stability of the market among the cellular companies, and the competition and possible future alternatives.

The value obtained from these assumptions is highly sensitive to the following:

- An increase of one half of one percent in the capitalisation rate reduces the value by approximately 6%.
- A decrease of one percent in ARPU in the first year decreases the value by 3%.

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

(2) The value of the use of multi-channel television – DBS, was calculated by the discounted cash flow method (DCF), and was based on the following assumptions:

- A detailed projected cash flow was prepared for 5 years. Beyond the fifth year, growth of approximately 1.5% was assumed, taking into account the growth in population, the balance between DBS and the cable companies which merged into one company (HOT), DTT market alternatives (digital terrestrial television broadcasts) and IPTV (Internet Protocol Television), as well as competition.
- The revenue forecast was prepared on the basis of projected number of subscribers and average revenue per user (ARPU) which provides the revenue from the services. The subscriber forecast is based on the business plan of DBS for the coming year and on continued growth based on the growth forecasts for households in Israel, the customer churn rate based on past data, global trends, the penetration of alternatives such as DTT and IPTV, and a forecast of the stabilization of competition and lower churn rates. It was assumed that the market share of DBS would increase over the years at the expense of HOT, to about 40% (compared with 38% today) – in relation to HOT only.
- The ARPU forecast is based on a price rise derived, *inter alia*, from DBS's strategy of selling YesMax sets and HD-PVR converters (which have a high ARPU), the penetration of VOD service and the addition of premium and value added services, while taking into consideration competition and the weight of the expense in the total household expense.
- Operating, selling and marketing expenses were adjusted to the projected volume of activity, assuming a gradual decrease in content expenses (the main expense) to approximately 30% of revenue.
- DBS has considerable losses for tax purposes. Accordingly, tax was not taken in the forecast period. After the forecast period, tax was taken at 25%, in respect of the part of the profit exceeding the cumulative loss at that date.
- Investments are mainly in installations, and in decoders which are a function of new subscribers, gross, and the accepted level of decoder replacement, based on past data. In addition, engineering investments for preserving what is and developing new areas were taken into account.
- The capitalisation rate taken, 13.5%, took into account DBS's dependence on external financing, limitations and dependence on changes in regulation, and the equity structure of DBS.
- The calculated value was attributed initially to the new shareholder loans (which were provided after July 2002) of about NIS 1.29 billion, since under the agreement they will be paid before the old loans. The Company's part in these loans is approximately 85%.

The value calculated with the above assumptions is highly sensitive to the following:

- An increase of one half of one percent in the capitalisation rate taken reduces the value by 9%.
- A decrease of one percent in the ARPU in the first year reduces the value by 6%.

The aforementioned valuations were made by an external appraiser. Based on these value assessments, the Group was not required to make deductions for impairment of these goodwill balances.

NOTE 11 – DEFERRED AND OTHER EXPENSES

	2008	2007
	NIS millions	**NIS millions**
Land lease rights[(1)]	**172**	185
Long-term prepaid expenses in respect of use of capacities[(2)]	**234**	177
Long-term prepaid expenses in respect of lease agreement	**5**	5
	411	367

The deductions charged to profit and loss are approximately NIS 20 million (2007 – approximately NIS 17 million, 2006 – approximately NIS 25 million).

(1) Most of the real estate assets used by the Company were transferred to it by the State of Israel pursuant to and at the consideration stated in the asset transfer agreement signed between the Company and the State on January 31, 1984. Some of these assets were leased for 49 years, with an option to extend for another 49 years, and some were rented for two years, renewable each time for another two years.

On May 15, 2003, the Company signed a settlement agreement with the Government of Israel on behalf of the State, and Israel Lands Administration, which regulated the dispute between them in the matter of the Company's rights in the various real estate assets which were transferred to the Company when it commenced operation in 1984, under the asset transfer agreement.
The rights are amortized over the course of the lease period.

(2) See Note 3I.

NOTE 12 – ASSOCIATES ACCOUNTED BY THE EQUITY METHOD

A. Below is condensed financial data regarding a principal associate accounted by the equity method, without adjustment for ownership percentage held by the Group.

	For the year ended December 31								
	Rate of ownership	Current assets	Non-current assets	Total assets	Current liabilities	Non-current liabilities	Total liabilities	Revenue	Profit/loss
		NIS millions							
2008									
Walla! Communications Ltd.	34.25%	**134**	**23**	**157**	**66**	**2**	**68**	**112**	**17**
2007									
Walla! Communications Ltd.	34.41%	134	22	156	55	3	58	99	15

NOTE 12 – ASSOCIATES ACCOUNTED BY THE EQUITY METHOD (CONTD.)

B. The investment in associates comprises the investment of Bezeq International in Walla! Communications Ltd. ("Walla") (an associate), an Israeli company whose shares are listed on the Tel Aviv Stock Exchange and which provides internet services and operates internet portals, in Bezecom Ltd. and B-Zone partnership.

Composition of the investment

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Cost of shares(1)	**80**	80
Dividend received	**(10)**	-
Share in capital reserve in respect of financial assets available for sale	**1**	1
Share in accumulated losses, net	**(19)**	(24)
	52	57
Loans and capital notes	**1**	1
	53	58
Reductions for impairment(1)	**(21)**	(21)
	32	37

(1) The balance at December 31, 2008 and 2007 includes unamortized goodwill, the cost of which at those dates amounts to NIS 3.9 million.

C. Movement in investments is as follows:

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Balance at the beginning of the year	**37**	32
Movement during the year:		
Group's equity in profits	**5**	6
Dividend received	**(10)**	-
Loans and capital notes	**-**	(1)
Balance at the end of the year	**32**	37

D. Holding percentage and market value

At December 31, 2008, Bezeq International held 34.25% of the rights in Walla (at full dilution – 32.42%).
The market value of Bezeq International's holdings in Walla shares at December 31, 2008 is approximately NIS 46.7 million (2007 – approximately NIS 83.3 million).

E. Stock options plan for Walla employees

On March 3, 2008, Walla published an immediate report on a resolution of its board of directors to grant options to the employees of Walla in a remuneration plan.

The remuneration plan is expected to consist of approximately 1.8 million options, comprising 3.71% of the equity of Walla at full dilution, convertible to approximately 1.8 million ordinary shares of Walla.

In addition, the board of directors of Walla is entitled to cancel 0.4 million options granted to the CEO of Walla in the past, and to grant them anew in accordance with the new plan.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS

This Note provides information about the contractual terms of the interest-bearing loans and borrowings. For more information about the Group's exposure to interest rate and foreign currency risks, see Note 31.

A. Composition

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current liabilities		
Short-term borrowings	**31**	81
Current maturities of debentures	**795**	841
Current maturities of bank loans	**954**	991
	1,780	1,913
Non-current liabilities		
Debentures	**3,943**	4,420
Bank loans	**214**	307
Loans from institutions	**109**	105*
	4,266	4,832
	6,046	6,745
Loans provided by the non-controlling interest in a subsidiary	**449**	375

* See Note 3U.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

B. Terms and debt repayment schedule

	Currency	Nominal interest rate %	Redemption year	December 31, 2008 Par value	December 31, 2008 Carrying amount	December 31, 2007 Par value	December 31, 2007 Carrying amount
				NIS millions			
Short-term borrowings	Shekel	Prime + (1.05-1.5)	2009	**31**	**31**	81	81
Loans from banks and others:							
Linked to the CPI*	Shekel	4.45-11	2009-2015	**391**	**431**	532	557
Unlinked(1)	Shekel	5.36-5.6	2010-2013	**846**	**846**	846	846
					1,308		1,484
Debentures issued to the public:							
Linked to the CPI – series 4 and 5(3)	Shekel	4.8-5.3	2009-2016	**2,407**	**2,737**	2,707	2,959
Debentures issued to financial and other institutions:							
Linked to the CPI**	Shekel	4.4-8.4	2009-2017	**1,829**	**2,001**	2,160	2,271
Linked to the euro		-	-	**-**	**-**	22	31
					2,001		2,302
Total interest-bearing liabilities					**6,046**		6,745
Loans provided by the non-controlling interest in a subsidiary (see E. below)	Shekel (CPI-linked)	0-11	2017	**1,012**	**449**	1,012	375

* For long-term loans of DBS from institutional bodies, the balance of which at December 31, 2008 is approximately NIS 109 million, see B(2) below.
** For an issue of debentures by DBS in July 2007, see B(4) below, and for debentures of Pelephone, see B(5) below.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

B. Terms and debt repayment schedule (contd.)

Debt payable in future years based on repayment schedules:

	December 31, 2008
	NIS millions
2009	**903**
2010	**929**
2011	**1,151**
2012	**813**
2013	**684**
2014 onwards	**1,535**
	6,015

(1) a. DBS's bank loans of approximately NIS 846 million were originally long-term loans, but since at December 13, 2008 and December 31, 2007 DBS failed to meet the financial criteria set by the banks, the loans were stated as short term. After the balance sheet date, DBS was granted a relief in connection with the financial criteria, and since that time it has been in compliance with the financial covenants set for it.

b. The loans are repaid according to a schedule over a period of 8 years commencing December 31, 2005. Under the loan agreements, DBS can change the loan tracks once every year or two years commencing December 31, 2005. On December 31, 2008, DBS changed the loans track to fixed interest loan track at an average rate of 5.52% for two years. The loans are repayable in 2010-2013.

(2) a. In March and April 2005, DBS signed agreements with three institutions, whereby those entities would provide loans to DBS in a total amount of NIS 50 million.

These loans are CPI-linked and bear 11% interest. They are repayable together with the interest and linkage differentials on December 31, 2013, but can be repaid earlier, subject to repayment of part of the bank loans under the terms laid down in the loan agreement.

The three institutions were granted an option to provide additional loans in the same amount as the loan they had provided. During 2005, the three institutions exercised that option and provided DBS with additional loans of NIS 50 million.

The Company undertook, in connection with the aforementioned loans, that if by December 31, 2013 the loans (all or some of them) are not repaid or upon fulfilment of certain other conditions, the lenders could demand that it repay the lower of the balance of the loans (principal, interest and linkage) and an amount computed according to a formula which was determined, which takes into account the value of DBS at that date. In view of the Company's undertaking, on June 22, 2005 the Company received a letter from the then Director General of the Ministry of Communications, giving notice of the decision of the Ministry to call in a guarantee in the amount of NIS 10 million out of the bank guarantee the Company had provided in accordance with the provisions of its general license. According to the Director General's notice, the decision to call in the guarantee was made in view of the fact that the Company had made a commitment to the institutions in a manner which contravenes the directive of the then Minister of Communications. The Company's position is that there are no legal or other grounds for forfeiture of the guarantee. An appeal against the decision was submitted to the then Minister of Communications, due to which the forfeiture was stayed until receipt of the ruling of the High Court of Justice in September 2007, which denied the petitions filed by the Company. In February 2008, a hearing of the Company's appeal was held before the Minister of Communications, and the guarantee was subsequently forfeited on April 3, 2008.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

B. Terms and debt repayment schedule (contd.)

(2) (contd.)

b. In December 2006, DBS signed an agreement with another institution for receipt of a loan of NIS 50 million. The loan is linked to the CPI and bears interest at an annual rate of 8%. DBS was granted an option for an additional loan in the same amount. DBS exercised the option in June 2007. Following the issue of the debentures (described in section (4) below), the loan agreement was amended and the parties agreed that DBS would repay the principal – NIS 100 million, upon receipt of the funds raised in the issue, since the institutional investor purchased debentures in the framework of the issue. The loan was repaid in 2007 as described above.

c. The balance of the loans from institutional entities at December 31, 2008 includes accrued interest of NIS 48 million (2007 – NIS 3.1 million).

(3) The balance of the par value of the Debentures (Series 4) is NIS 3,286,967,000, of which NIS 2,406,867,000 par value was issued to the public.

a. The balance of the par value of the Debentures (Series 4) is 900,000,000 of NIS 1 par value each, repayable in 3 equal annual instalments in each of the years 2009 – 2011. The interest rate for these debentures is 4.8% p.a.

b. The balance of the par value of the Debentures (series 5) is 2,386,967,000 of NIS 1 par value each, of which 1,506,867,000 debentures (some through Bezeq Zahav Holdings Ltd., a wholly-owned subsidiary of the Company) were issued to the public and to institutional investors, and the balance of 880,100,000 to Bezeq Zahav Holdings Ltd.). The debentures are payable in 6 equal annual instalments in each of the years 2011-2016. The interest rate for these debentures is 5.3% p.a.

The debentures were listed for trading on the stock exchange.

(4) On July 31, 2007, DBS issued approximately NIS 620 million par value of debentures in a private placement to institutional investors. The debentures are registered in a continuous institutional system on the Tel Aviv Stock Exchange. For the issuance, the debentures were rated by Maalot Israel Securities Rating Co. Ltd. ("the Rating Company") at BBB-/stable. In August 2008, the Rating Agency validated that rating. The proceeds from the issuance net of the costs of raising the capital amounted to approximately NIS 614 million.

The debentures are repayable in 8 annual payments of principal and interest on July 5th of each of the years 2010 – 2017, where the payments of the principal in each of the years 2010 – 2013 will be at 8% of the par value of the debentures and the payments of the principal in each of the years 2014 – 2017 will be at 17% of the par value of the debentures. The debentures are linked to the CPI commencing June 2007, and bear annual linked interest at 7.9% per year (subject to various possible adjustments pursuant to the terms of the debentures), which are paid in half-yearly instalments in January and July of each of the years 2009 – 2017.

DBS did not undertake to list the debentures for trading on the stock exchange; however, if they are listed, the annual interest paid on them from that date will be reduced to 7.4%. Pursuant to the terms set at the time of issuance of the debentures, since the debentures were not listed by July 31, 2008, the annual interest rate they bear increased to 8.4% from that date. If the debentures are listed for trading at a later date, then the annual interest on them will be reduced to 7.4% from that date.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

B. Terms and debt repayment schedule (contd.)

(4) (contd.)
If the rating of the debentures is lowered by two rating levels without the debentures having been listed, then the annual interest rate will be increased to 8% until the original rating is restored or until the debentures are listed (in which case, the above-mentioned lowering of the interest rate will apply additionally). Furthermore, if DBS does not comply with the terms set out in the financing agreement between it and the banks, and as a condition for the banks waiving such violation, DBS undertook to pay the banks, in respect of the bank credit, an additional margin on the bank interest, and if at that time the debentures are not listed for trading, then as long as the banks are paid such an additional margin and the debentures are not listed, DBS will pay the debenture- holders additional annual interest at the same rate.

(5) Pelephone issued three series of debentures in a private placement to institutional investors. The debentures, which were issued at par value, are linked to the CPI, bear annual interest of 4.4% - 5.2%, and are repayable in 20 equal semi-annual payments. The interest is paid on the unpaid balance of the principal. The balance of the debentures at December 31, 2008, is approximately NIS 811 million.

C. Charges and collateral

(1) The private debentures of the Company, whose carrying amount at December 31, 2008 is approximately NIS 535 million, are secured by a symbolic charge. In addition, the Company created a negative pledge in favour of the holders of those debentures and in favour of a bank that includes exceptions, *inter alia*, for the matter of a charge on assets that are purchased or expanded by the Company, if the undertakings for which the charge serves as security is created for the purchase or expansion of those assets and for the matter of a symbolic charge. After the balance sheet date, the Company raised bank debt of NIS 400 million, in respect of which the Company created a negative pledge in favour of the lenders.

The lenders have a right to call for immediate payment of the debentures in cases where the Company does not repay the debentures or violates their terms, if a significant attachment is imposed on its assets, if a receiver is appointed for the Company's assets or a liquidation order is given against the Company, if the Company ceases to run its business, or if the holder of another charge realises the charge it has on the assets of the Company.

In addition, some of the lenders from whom the balance of the debentures at December 31, 2008 is approximately NIS 116 million, may call for immediate payment of the debentures due to the State's holdings in the share capital of the Company having fallen below 26% (a condition which was met commencing October 11, 2005). For this reason, the balance in the financial statements is stated as a short-term liability.

The Company's position is that at the reporting date, it is in compliance with all the aforementioned terms, except for the term of the decrease of the State's holdings in the Company.

(2) a. The bank loans and debentures ("credit providers") of Pelephone, the carrying amount of which at December 31, 2008 is NIS 1,132 million, are secured by an irrevocable undertaking of Pelephone to the credit providers, not to encumber its assets without their consent, i.e. a negative pledge.

The undertaking includes, *inter alia*:

(1) A declaration that Pelephone will not encumber its assets (as may be from time to time), in whole or in part, in any manner including by means of a floating lien or a fixed lien of any type or rank, in favour of any third party, without the prior written consent of the credit providers.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

C. Charges and collateral (contd.)

(2) a (contd.)

(2) Compliance with the following financial stipulations:
   a. An undertaking that Pelephone's debt will not exceed three times its equity and an undertaking that as long as that ratio exceeds 2.5, dividends will not be distributed and management fees will not be paid to the shareholders.
   b. Pelephone undertook that the amount of its debts will not exceed NIS 3.8 billion (linked to the CPI known in January 2002).
   c. An undertaking towards a certain bank that its total debt to it will not exceed 40% of its total debts to all the financial entities.

At the date of the financial statements, Pelephone is in compliance with its undertakings and the financial stipulations to the banks with which it undertook to comply. Non-compliance with these undertakings would allow the banks and the debenture holders to call for immediate repayment of the loans it received from the banks and the debentures.

b. Under its general license for cellular services, Pelephone is not permitted to sell, lease or pledge any of its assets used for performance of the license, without the consent of the Minister of Communications, except –

(1) a charge of one of the license assets in favour of a bank operating lawfully in Israel, for receipt of bank credit, provided that it submitted notice to the Ministry of Communications concerning the charge it intends to register, noting that the charge agreement includes a clause ensuring that in any case, exercise of the rights by the bank will not harm in any way the provision of the services pursuant to the license;

(2) the sale of items of equipment when implementing an upgrade proceeding, including sale of equipment by the trade-in method.

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

b. The terms of loans and credit facility that DBS received from banks, the balance of which at December 31, 2008 is NIS 960 million, impose restrictions with regard to the lien or sale of certain assets, a restriction on receipt of credit from other banks (without the prior approval of the lending bank), a restriction on distribution of a dividend, a restriction with regard to repayment of shareholder loans, and restrictions on transactions with interested parties, a restriction on changes in the ratio of the holdings of shareholders, restrictions relating to DBS's compliance with various licenses granted to it, restrictions relating to the purchase of securities by DBS and the establishment of a subsidiary, and restrictions relating to the issuance of shares or other securities of DBS.

In addition, the terms of the loans impose various restrictions, including a demand to comply with the following financial covenants:

(1) Minimum total revenue.
(2) Minimum operating surplus (as defined in the financing agreement).
(3) Minimum operating surplus less investment in decoders (as defined in the financing agreement).
(4) Maximum churn rate.
(5) Total financing needs (as defined in the financing agreement).
(6) Maximum supplier credit.
(7) Minimum cover of bank debt and debt balances (as defined in the financing agreement).

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

C. Charges and collateral (contd.)

(3) (contd.)

The values for compliance with the financial covenants vary, and are measured each quarter. Non-compliance with the financial covenants grants the banks a right to demand early repayment of the loans DBS received.

c. On July 22, 2007, DBS and the banks signed an eighth addendum ("the Addendum") to the financing agreement, which determines, *inter alia*, the following matters:

(1) The terms laid down in the financing agreement were updated.

(2) A designation was given for the proceeds from the debentures issued by DBS in July 2007 as noted in B(5) above. Under the Addendum, the issue of debentures will serve DBS for making a partial repayment of the bank credit, for repayment of the loan it took from an institutional body in 2006 (including a bridge loan provide by that entity in June 2007), in the amount of NIS 100 million, and for its day-to-day operations.

DBS applied to the banks for adaptation of the stipulations for 2008 to DBS's budget. On March 5, 2008, the banks agreed to amend the stipulations. In addition, DBS requested that the banks make a further revision of a particular operating stipulation, and on June 25, 2008 the banks' consent to amendment of that stipulation was received at June 30, 2008.

At December 31, 2008, DBS is not in compliance with certain operational stipulations. After the balance sheet date, DBS was granted a relief in connection with the financial covenants at December 31, 2008, and accordingly, at the date of approval of these financial statements, DBS is in compliance with the financial covenants set in the updated financing agreement.
Since DBS prepares its financial statements in accordance with IFRSs, which require review of DBS's compliance with the terms at the date of the financial statements, the loans at December 31, 2008 are classified under short-term liabilities.

According to the assessments of DBS's management, the financing resources available to it will be sufficient for its operational requirements for the coming year, based on the cash flow projections approved by DBS's board of directors, and if additional resources are needed for those requirements in the coming year, DBS will adapt its activities so that additional resources beyond those at its disposal will not be required.

d. In January 2009, DBS requested of the banks that they revise the stipulations for 2009 to match them to its 2009 budget. In March 2009, the banks confirmed the revision.

e. To secure these liabilities and guarantees, DBS registered a charge on all its assets, including share capital and goodwill.

(4) The debentures issued by DBS as described above in Section B(5), are secured by a senior floating charge on all the assets of DBS (except for those excluded pursuant to the Communications Law) in an unlimited amount, as well as a senior fixed charge of unlimited amount on the rights and assets of DBS which it encumbered in favour of banks (except for those excluded pursuant to the Communications Law). These securities are of senior rank and *pari passu* to the floating charges and fixed charge created by DBS in favour of the banks to secure the bank credit.

(5) For the matter of a charge provided by the shareholders of DBS, see Note 19H below.

NOTE 13 – DEBENTURES, LOANS AND BORROWINGS, INCLUDING OBLIGATIONS TO BANKS (CONTD.)

D. Debenture issue expenses

The Group's expenses for issuing the debentures amounted to approximately NIS 10 million for 2008 (2007 – NIS 11 million).

E. Loans provided by the non-controlling interest in a consolidated company

Loans provided by the shareholders of DBS were included in the financial statements of DBS at their fair value when received. The fair value of the loans was determined according to the present value of the cash flows anticipated in respect of loan repayment, taking into account the dates on which the shareholders would first be able to demand repayment of the loans (in accordance with the restrictions to which the shareholders consented in agreements with the banks and financial institutions), and the interest rates applicable to loans carrying a similar risk on the dates of receipt of the loans. The interest rate in respect of the loans is 12%.

When a change occurs in the terms of the loans which gives rise to a difference of more than 10% in the discounted cash flows, the difference between the cash flows expected before the change when they are discounted at the interest rate on the date of provision of the loan, and their discounted value at the interest rate on the date of the change, is charged to finance income. The difference between the present value of the new cash flows when discounted at the interest rate on the date of the change, and the old cash flows when discounted at the interest rate on the date of the change, is charged to a capital fund under equity.

During 2007, as part of the rating process of the debentures with the Rating Company, DBS undertook towards the Rating Agency (and towards it alone) that it would not make repayment on account of the shareholder loans until the end of the life of the debentures.

The interest rate on the date of the change was determined in accordance with a professional opinion received by the Company from an external consultant, stating that the interest rate for capitalisation of the interest-free shareholder loans is 15.63%, and the interest rate for capitalisation of the shareholder loans bearing 5.5% interest is 15.58%. At these rates, the difference between the cash flows anticipated before the change when discounted at the interest rate on the date of providing the loan – 12%, and their discounted value at the interest rate on the date of the change – 15.63% or 15.58%, as the case may be, which amounted to approximately NIS 213 million, was charged to finance income in the financial statements of DBS, and approximately NIS 96 million in the consolidated statement. Income of NIS 96 million in the consolidated statement was attributed to the non-controlling interest, and did not impact the share of the equity holders of the Company.

The difference between the present value of the anticipated cash flows according to the new repayment dates and the present value of the cash flows that were anticipated according to the repayment dates before the change, discounted at the interest rate on the date of the change – 15.63% or 15.58%, which amounted to NIS 348 million, was charged to a capital reserve in the financial statements of DBS, of which approximately NIS 160 million was recognised as the non-controlling interest in the consolidated statement. These differences, which relate to loans provided by the non-controlling interest in DBS, are expected to impact the finance expense in the consolidated statement.

NOTE 14 – TRADE AND OTHER PAYABLES, INCLUDING DERIVATIVES

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Trade payables		
Outstanding debts	**1,262**	1,477
Notes payable	**119**	56
Total trade payables	**1,381**	1,533
Other payables, including derivatives		
State of Israel in respect of royalties	**66**	54
Liabilities to employees and other liabilities for salary and wages	**296**	271
Institutions	**200**	196
Accrued interest	**185**	120
Derivatives	**7**	12
Payables and other credit balances	**96**	92
Total other payables, including derivatives	**850**	745
	2,231	2,278

Amounts payable denominated in a currency other than the functional currency include approximately NIS 251 million in respect of suppliers denominated in US dollars (2007 – NIS 313 million), and approximately NIS 6 million in respect of suppliers denominated in euro (2007 – NIS 8 million).

NOTE 15 – PROVISIONS

	Legal claims and other disputes	Employee claims	Dismantling and clearing of sites	Onerous contracts	Warranty and others	Total
	NIS millions					
Balance at January 1, 2008	206	165	46	19	13	449
Provisions created during the period	**28**	**5**	**4**	**-**	**-**	**37**
Provisions used during the period	**(11)**	**-**	**-**	**(8)**	**(1)**	**(20)**
Provisions cancelled during the period	**(31)**	**(21)**	**-**	**(1)**	**2**	**(51)**
Effect of the elapse of time in respect of capitalisation	**-**	**-**	**4**	**-**	**-**	**4**
Balance at December 31, 2008	**192**	**149**	**54**	**10**	**14**	**419**
Current	**192**	**149**	**-**	**2**	**12**	**355**
Non-current	**-**	**-**	**54**	**8**	**2**	**64**

* See Note 3U.

Legal claims
For salary claims of employees filed against the Group and legal claims and other disputes, see also Note 17.

Dismantling and clearing of sites
The provision is in respect of an obligation of some of the Group's companies to clear sites they lease.

Onerous contracts
This item stems mainly from agreements of a subsidiary granting it usage rights in transmission equipment (an old generation of sea-bed cables), for periods ending between 2016 and 2024. Under those agreements, the subsidiary is obligated to pay fixed monthly amounts, irrespective of the extent of the use it makes of the cables. The management of the subsidiary believes that the unavoidable costs of compliance with these agreements exceed the economic benefits expected to accrue from use of the cables. This assessment, together with management's decision not to operate the sea-bed cables, was the rationale for making a provision in the financial statements. The balance of the provision reflects the discounted value of all the unavoidable costs which the subsidiary must pay to the owner of the cables until the end of the term of the agreements.

NOTE 16 – EMPLOYEE BENEFITS

A. Composition

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Present value of unfunded obligations	**258**	287
Present value of funded obligations	**171**	152*
Total present value of obligations	**429**	439*
Fair value of plan assets	**(95)**	(95)*
	334	344
Cost of past service – benefit not yet vested	**(45)**	(49)
Liability recognised in respect of a defined benefit plan	**289**	295
Liability for holiday pay	**86**	84
Liability for sick leave	**81**	70
Liability for voluntary early retirement	**210**	517
Total employee benefits	**666**	966
Stated in the balance sheet as follows:		
Short-term	**401**	705
Long-term	**265**	261
	666	966

* See Note 3U.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

A. Composition (contd.)

	2008	2007
	NIS millions	NIS millions
Movement in an obligation in respect of a defined benefit plan		
Obligation in respect of a defined benefit plan at January 1	**439**	441
Benefits paid according to the plans	**(60)**	(81)
Costs of current service and interest (see below)	**66**	128
Cutbacks	**(1)**	(21)
Exchange rate differences in respect of a foreign currency plan	**-**	(4)
Actuarial gains charged to equity (see below)	**(15)**	(24)*
Liability in respect of defined benefit plans at December 31	**429**	439
Movement in the plan's assets		
Fair value of the plan's assets at January 1	**95**	130
Amounts deposited in the plan	**21**	32
Benefits paid	**(8)**	(62)
Expected return on the plan's assets	**4**	5
Actuarial losses charged to equity (see below)	**(17)**	(10)*
Fair value of the plan's assets at December 31	**95**	95
Movement in the cost of past service – unvested benefit		
Cost of past service – unvested benefit at January 1	**49**	73
Cutbacks	**(1)**	(21)
Amortisation of cost of past service	**(3)**	(3)
Cost of past service – unvested benefit at December 31	**45**	49
Expense charged to profit and loss		
Costs of current service	**42**	107
Interest on the obligation	**24**	21
Return expected on the plan's assets	**(4)**	(5)
Exchange rate differences in respect of a foreign currency plan	**-**	(4)
Amortisation of cost of past service	**3**	3
	65	122
The expense was included in the following items in the income statement		
Salary expenses	**39**	68
Other operating expenses	**6**	42
Financing expenses	**20**	12
	65	122
Actual return on the plan's assets	**(7)**	6
Actuarial gains and losses charged directly to equity		
Amount accrued at January 1	**(2)**	12
Amounts recognised during the period	**2**	(14)
Amount accrued at December 31	**-**	(2)

* See Note 3U.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions

The principle actuarial assumptions at the date of the report:

(1) Mortality rates are based on the rates published in Insurance Circulars 6-3-2007 of the Ministry of Finance, except for early retirement, which was calculated according to the agreement with Harel, and including future changes in the mortality rate.

(2) Turnover rates were determined on the basis of the past experience of the Company and the subsidiaries, distinguishing between employees entitled to supplementary compensation and those who are not, depending on the number of years of employment in addition to the above distinction made. In the Company – the turnover rate is determined, additionally, with a distinction made between permanent employees (between 3.5% in the first year to 0.5% over 10 years), personal contract employees (5.5% per year), senior employees (20% per year), and temporary employees (between 34% in the first year and 25% for more than 7 years).

Bezeq International – The turnover rates include a distinction made between headquarters employees with full compensation rights (between 2.2% and 12.3%, depending of the length of service of the employee), headquarters employees without rights to full compensation (between 2% and 17.6%, depending of the length of service of the employee), non-headquarters employees with compensation rights (between 3.3% and 26.3%, depending of the length of service of the employee), headquarters employees without compensation rights (between 3% and 48.1%, depending of the length of service of the employee). For senior employees it was assumed that the turnover rate granting a right to full compensation is 20% for any length of service and there are no departures that do not grant a rights to payment of compensation,.

Pelephone – The turnover rate includes a distinction made between managers with compensation (8% per year), managers without compensation (between 12% and 2.5%, depending of the length of service of the employee), non-managers with compensation (between 5% and 25%, depending of the length of service of the employee), non-managers without compensation (between 45% and 7%, depending of the length of service of the employee), and senior managers with compensation (20% per year).

DBS – The turnover rate includes a distinction between employees with compensation (between 20.66% to 2% depending of the length of service of the employee) and employees without compensation (between 27% to 2% depending of the length of service of the employee).

(3) The discounted rate is based on yield on government bonds at a fixed interest rate which have a lifetime equal to that of the gross liability.

	December 31, 2008	December 31, 2007
	Main discounted rate	Main Discounted rate
Sick leave	**3.4%**	3.6%
Vacation	**3.3%**	3.4%
Compensation	**3.3%**	3.4%
Retirement benefit – holiday gift*	**4.4%**	5.3%
Retirement benefit – clubs and activities	**3.6%**	3.6%
Early notice to senior employees	**3.1%**	3.3%

* At a discount rate based on American corporate debentures.

(4) Assumptions regarding salary increments were made on the basis of experience and Management's assessments, distinguishing between the groups of employees as explained below, over the period of their service to retirement.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions (contd.)

(4) (contd.)
The Company – For permanent employees, the average salary increment is 3% for young employees, with a linear decrease to 1.5% per year up to age 60. For employees in a monthly collective agreement, salary increments average between 6% and 4% depending on the age of the employee. For employees with a personal employment agreement, salary increments average between 4% and 0.5%, depending on the age of the employee, and for senior employees, an average salary increment is 6% per year.

Bezeq International – For headquarters employees, salary increments of 7% per year to age 34 and from that age, a linear decrease of 1% until stabilisation at an increment of 1% per year from age 40. For workers who are not headquarters employees, the rate of the increment is 1%. For senior employees, the average increment is 6% per year.

Pelephone – The rate of the salary increment includes both a distinction between senior managers, managers and employees, and between different ages. The salary increment rates range between 16% and 2.5%.

DBS – For senior employees the average salary increment in 3% per year, and for all other employees the salary increment rate averages 5% per year throughout the period of service.

(5) The forecast growth rate of the assets accumulated in all the companies in the Group is 2% in real terms for old pension funds per year in the administration. For new, subsidized pension funds, a guarantee of 4.86% is assumed for 30% of the assets. For senior employee insurance where the severance interest is not transferred to compensation and their start date is prior to 1989, guaranteed interest is 4.25% in real terms. Growth rates in other plans are the discount interest plus 1% and less 1% in respect of administration fees.

(6) An obligation in respect of voluntary early retirement includes an obligation for pension and grants. The obligation for pension is calculated according to the terms of the agreement of December 5, 2006 (see section H) and in accordance with the terms with Harel (see section G). The obligation is influenced by changes in the interest rate of the debentures up to the date of purchase of the policies and their payment to Harel.

C.

	December 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005
	NIS millions	NIS millions	NIS millions	NIS millions
Present value of the defined benefit plan obligation	**429**	439*	441	314
Fair value of plan assets	**(95)**	(95)*	(130)	(114)
Deficit in the plan	**334**	344	311	200
Adjustments for liabilities arising from past experience	**(21)**	15	4	-
Adjustments for assets arising from past experience	**(13)**	(1)	(4)	-

* See Note 3U.

In 2009, the Group expects to pay NIS 14.4 million as a contribution to a defined benefit plan.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

D. Defined contribution plans

(1) The pension rights of Company employees in respect of the period of their employment in the civil service through January 31, 1985, are covered by a pension fund ("the Makefet Fund"), which took upon itself the State's obligation following an agreement between the Government of Israel, the Company, the Histadrut and the Makefet Fund.

(2) Liabilities for employee benefits at retirement age in respect of the period of their service in the Company and in the investee companies, are covered in full by regular payments to pension funds and insurance companies.

(3) The severance obligation to those who leave their employment on terms entitling them to compensation is covered, for the period from February 1, 1985, by regular contributions to such pension funds and insurance companies (in accordance with Section 14 of the Severance Pay Law). Severance pay in respect of the period of employment in the Civil Service through January 31, 1985, is actually paid by the Company, and the monies accumulated in the Makefet Fund in respect of that period are preserved in a fund that will be used for the employees' rights.

In respect of a small number of the employees (employed under special contracts), the Company has an obligation to pay severance in excess of the amount accumulated in the compensation fund which is in the employees' names.

E. Defined benefit plan

(1) The severance obligation included in the balance sheet represents the balance of the obligation not covered by contributions and/or insurance policies in accordance with the existing labour agreements, the Severance Pay Law, and the salary components which the managements of the companies believe entitle the employees to receipt of compensation. In respect of this part of the obligation, there is a reserve deposited in the Company's name in a recognised compensation fund. The reserves in compensation funds include accrued linkage differentials and interest deposited in compensation funds, in banks and in insurance companies. Withdrawal of the reserve monies is contingent upon fulfilment of detailed provisions in the Severance Pay Law.

(2) The collective agreement dated December 5, 2006 (see Section H(1) below), provides, among others, that employees who transferred from the civil service to the Company, who will end their employment due to retirement after December 31, 2013, are entitled to a supplement to close the gap between the Civil Service Law and the regulations governing the Makefet Fund. As a result of this clause in the agreement, the benefit to these employees is enhanced. The Company includes in its financial statements the liability net of the cost of prior service not yet vested. This benefit will be spread on a straight line basis over a period of 18.75 years (the average period to vesting of the benefit).

(3) Under some personal employment agreements, a number of senior employees are entitled to early retirement terms (pension and retirement grants) which are not dependent on retirement agreements for all employees. Accordingly, a liability is included in the financial statements.

(4) Benefits in respect of notice are paid at end of service. Accordingly, a liability is included in the financial statements in accordance with an employment agreement and an actuarial calculation. The increase in the benefit in respect of notice is treated as cost of prior service vested immediately, and is therefore charged immediately to profit and loss.

(5) Company retirees receive, in addition to the pension payments, benefits which consist mainly of a holiday gift, financing the upkeep of retiree clubs, and social activities. The Company's liability in respect of these costs accumulates during the service period. The Company includes in its financial statements the expected costs in respect of the post-employment period, based on an actuarial calculation for existing retirees and for the serving employees entitled to this benefit according to retirement age. The actuarial assumptions include those noted in section B above, and another assumption relating to this section – that there is no real increase in the benefits in accordance with Company policy. (The holiday gift benefit is linked to the dollar exchange rate.)

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

F. Other long-term employee benefits

Provision for sick leave

The financial statements include a provision in respect of redemption and utilisation of sick leave for all Group employees and redemption of sick leave only for employees eligible under the terms of the employment agreement and the collective agreement dated December 5, 2006. The provision was computed on the basis of an actuarial calculation. The actuarial assumptions include those noted in section B above, as well as assumptions in connection with this section based on the Company's experience according to positive accumulation of days by most of the employees and utilisation of days by the LIFO method.

Provision for vacation

The financial statements include a provision for redemption and utilisation of vacation on the basis of an actuarial calculation. The actuarial assumptions include those noted in section B above, as well as assumptions in connection with this section – positive accumulation of days by most of the employees, utilisation of days by the LIFO method, and statistical tests for the amount of utilisation and the amount of redemption.

G. Benefits in respect of layoffs and early retirement

A number of collective agreements concerning early retirement were signed in recent years. Below are details of the relevant agreements:

In September 2000, the Company reached an agreement with the employees' representatives to extend the early retirement collective agreement of 1997 ("the Retirement Agreement"). Under the Retirement Agreement, commencing April 1, 2001 and through December 31, 2006 (with an option to extend the date of final retirement for certain employees through December 31, 2008), another 1,770 employees will take early retirement, of whom 300 are not transferred employees.

On April 17, 2005, a special collective agreement was signed between the Company and the employees' representatives and the Histadrut, enabling early retirement of employees through a substitute for the Makefet Fund. On June 28, 2005, an agreement between the Company and Harel Insurance Co, Ltd. ("Harel") was completed and signed. The agreement regulates pension payments in respect of early retirement, as well as old age and survivor pension payment differences arising from legislative amendments to the Israel Economic Recovery Plan (Legislative amendments for attaining budget targets and the economic policy for the 2003 and 2004 financial years) Law, 5763-2003, for employees who retired commencing at the end of 2003 and until the beginning of 2004, and/or who will retire from the Company in accordance with the special collective agreement for retirement signed in September 2000, as amended on March 18, 2004 ("the Retirement Agreement"). Following execution of the agreement with Harel, the aforementioned special collective agreement between the Company, the employees' representatives and the Histadrut was revised and amended on the same date (June 28, 2005). On February 14, 2008, an amendment to the June 2005 agreement was signed by the Company and Harel, which contains the following main points:

(1) the June 2005 agreement will apply also to Company employees who retire from their employment in the Company by December 31, 2013 in the early pension track in accordance in accordance with the option granted to the Company in the special collective agreement of December 5, 2006, if and insofar as the Company chooses to exercise that option;

(2) reduction of the contribution paid by the Company to Harel in respect of each retiree who is insured under the June 2005 agreement, for whom a policy had not yet been issued by Harel on the date of the signature of the amendment to the June 2005 agreement.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other

(1) On December 5, 2006, the Board of Directors of the Company approved a new collective agreement between the Company and the union and the New Histadrut. The agreement regulates the labour relations in the Company following the transfer of control in the Company from the State of Israel, and delineates a new organisational structure for the Company. Below are the main points of the agreement:

a. All the agreements, arrangements and customs existing in the Company prior to execution of the agreement, including a mechanism for linking salaries to the public sector, will continue to apply only to the veteran permanent employees in the Company to whom the agreement applies, subject to changes inserted specifically in the present agreement. The hiring of existing and new temporary employees will be on the basis of monthly or hourly pay agreements based on a market salary model by occupation, with a high degree of managerial flexibility.

b. An organisational change was agreed upon, including, *inter alia*, on the basis of transition from a geographical structure to a functional structure, which will be implemented gradually over two years.

c. In 2006-2008, 975 permanent employees will retire from the Company in early pension or increased compensation tracks. The quota of retirees includes the employees who were scheduled to retire in accordance with the previous early retirement agreements but have not yet done so. In addition, the Company may, at its discretion, terminate the service of another 1,225 permanent employees (245 permanent employees in one or more of the years 2009-2013). The terms of retirement that will be granted to retirees will be largely the same as the terms of retirement prevailing in the Company today.

d. On the subject of managerial flexibility and changes in existing agreements and arrangements, the Company may determine procedures and change them from time to time at its discretion (without derogating from the rights of employees under the collective agreements applicable to them). The Company has authority in all management matters, the organization, work arrangements, work processes, etc.

e. The union declared that it would agree to and support the distribution of a dividend of NIS 1.8 billion to the shareholders which does not comply with the earnings test, which the Company intends to distribute with the approval of the court. The Company undertook that within 45 days of the date of completing the aforementioned distribution, it would issue stock options to employees amounting to 3% of the Company's issued share capital (subject to increasing its registered capital and the approval of the competent organs of the Company), at an exercise price of 50% of the share price on the date of issue of the options. If it is not possible to issue the options, the benefit will be awarded to the employees in cash (see Note 26).

f. In addition, the Company will pay the employees a special bonus for the period through December 31, 2006, in a total amount of NIS 44 million. Commencing 2007, the bonus system which had been customary in the Company (as a State-controlled company) would be changed in the manner described in the agreement.

g. The term of the agreement is from the date of its execution through December 31, 2011. The Company has an option to extend it for two additional years, through December 31, 2013. The term of the retirement section in the agreement (see section C above), will in any case be through December 31, 2013.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other (contd.)

(1) (contd.)

In May 2008, execution of an amendment to the new collective agreement as completed, in the matter of bringing forward the implementation of the organizational structure and in the matter of bringing forward retirements dates and changing the mix of those scheduled under the new collective agreement to retire by the end of 2008. On October 2, 2008 and on December 18, 2008, the Board of Directors of the Company resolved to approve the retirement of 245 employees at a cost of NIS 177 million under the collective agreement of December 2006 (as described above). The retirement will take place during 2009. The financial statements include a provision in respect of this resolution.

(2) Under the collective agreements applicable to labour relations in the Company, and in accordance with agreements with the Makefet Fund, an option is reserved for Company employees who are transferred employees, to retire under one of two retirement tracks. The method of calculation of the cost of the early retirement of the transferred employees was laid down in the provisions of a number of agreements and documents drawn up between the Company and the Makefet Fund between 1990 and 1996, including a letter of understanding prepared and signed by them in 1996. The Company contends that the Makafet Fund violated the provisions of the agreements in general, and those in the letter of understanding in particular, in that when making the calculations of early retirement costs for transferred employees, it determined those data on the basis of the assumption that those employees had chosen the track in which the cost of acquisition is higher, while disregarding the track which those employees had actually chosen. According to an actuarial opinion prepared for the Company, the difference between the payments collected by the Makefet Fund from the Company according to its calculation, and the rate of those costs if made as contended by the Company, based on the retirement track actually chosen by the employees, is a cumulative nominal amount of more than NIS 128 million, the restitution of which the Company is claiming in a claim it filed against the Makefet Fund. On November 20, 2003, the Company filed another claim against the Makefet Fund for additional amounts, in respect of other components, amounting to approximately NIS 80 million. The Makefet Fund transferred data on the earlier retirees. Based on these data and on the previous file, a revised actuarial opinion was prepared, which quantified the total amount of the claim at the date of its filing at approximately NIS 280 million. The Makefet Fund filed defence documents in the court, in which it rejects the allegations of the Company and contends that it acted in accordance with the agreements between it and the Company. With the consent of the parties, the striking out of the claim (for failure to filed affidavits on time) was cancelled, and the hearing in the Regional Court was resumed.

NOTE 17 – CONTINGENT LIABILITIES

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

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 applications for certification of the class actions, appropriate provisions have been included in the financial statements (Note 15), where warranted, to cover the exposure resulting from such claims.

In the opinion of the managements of the Group's companies, the additional exposure at December 31, 2008 due to claims filed against the companies in the Group on various matters and in which the likelihood of realisation is possible, amounts to approximately NIS 12.3 billion, of which approximately NIS 3.4 billion relates to salary claims filed by groups of employees or individual claims with wide ramifications. The above amounts are before the addition of interest.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

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 sections A (5) a. and b. and (36) below.

Below are details of the status of the significant contingent liabilities of the Group at December 31, 2008.

A. Claims

(1) In September 2004, a claim and an application for certification as a class action were filed in the Jerusalem District Court against the Company and several other defendants (including Telrad and Tadiran) and against the State of Israel – Ministry of Communications as a formal defendant. The claim and application allege that public switching cartels gave rise to unnecessary expenditure for the Company and an unjustified increase in its tariffs, in a cumulative amount of approximately NIS 1.750 billion. In this matter, the Antitrust Court approved issue of an agreed order whereby the Company will pay NIS 2 million to the State Treasury without admitting violation of the provisions of the Antitrust Law, and the Antitrust Authority will refrain from instituting proceedings in connection with the matter. On December 8, 2008, the court allowed the agreed application of the parties to the plaintiff's abandonment of the application for certification and denial of the personal claim, with payment of costs in a non-material amount to the plaintiff. The Attorney General filed an application to vacate this decision, and expressed opposition to the arrangement. The court denied the Attorney General's application and the proceeding ended.

(2) A number of claims are pending against the Company concerning recognition of various salary components as pension components and recognition of various components in the determining salary for severance pay, as follows:

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(2) (contd.)

b. In February 2002, a notice of a party to a collective dispute ("the Party Notice") was filed in the Jerusalem Regional Labour Court by the New General Federation of Workers ("the Histadrut") in the name of all Company employees. The applicant alleges that payments for grossing up of tax, the administrative on-call duty component and clothing allowances which were and are paid to Company employees, are regular pay which form part of the determining salary of each employee, including with respect to the calculation of payments upon retirement, redemption of holiday pay, grants, acclimatisation payments, percentage increments and hourly pay value, and that various payments and provisions should be made in respect thereof, including for pension purposes. The Attorney General joined the claim. In April 2006, the court gave its decision, denying all parts of the Party Notice. An appeal was filed against the decision, in which it was alleged that the decision is procedurally void, and the hearing was returned, with the consent of the parties and the Attorney General, to the Regional Labour Court. Subsequently, the Party Notice was struck out in view of the fact that the plaintiffs' position on the need to file a new party notice was not filed in time. It was agreed that a new party notice would be filed, and that the question of the limitation date would be decided when the party notice was being heard. No such party notice has been filed.

c. In November 1995, a group of employees filed a claim against the Company in the Tel Aviv Regional Labour Court, concerning the inclusion of a number of components as part of the determining pay for pension. In August 2006, a decision was given in the case, denying the claim and all its component parts, and the Court ruled that the salary increments are not fictitious increments but true and conditional increments, and accordingly, are not part of the basic salary for the purpose of calculating the pension or severance pay, holiday pay and sick pay, retirement bonus and acclimatisation bonus. An appeal was filed against this decision.

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

The maximum total exposure in respect of the above claims is approximately NIS 3.4 billion.

(3) In September 2000, an action and an application for certification as a class action were filed against the Company in the Tel Aviv District Court. The amount of the claim is estimated at approximately NIS 117 million. According to the plaintiff, the Company unlawfully collected "collection fees" from its subscribers for bills which were not paid by their due date, since in fact the Company took no collection action until 14 days after the last date for payment as written in the telephone bill. The Court certified the claim as a class action lawsuit. The Company filed an application for leave to appeal in the Supreme Court, which returned the case to the District Court for reconsideration of the application for certification in the accordance with the Class Action Law. Subsequently, the Court allowed an agreed notice of the parties whereby the definition of the group represented in the application would be changed and would apply to whoever was charged collection fees collected by the Company from March 11, 1999 to December 7, 2006, and the Court would not be obliged in any way to the decision on the matter of certification of the claim as a class action in the past.

In October 2001, an additional class action was filed in the Tel Aviv District Court on the same matter, in the amount of NIS 21 million. On July 2, 2008, the Court decided, following the application of the plaintiff's legal representative (after the death of the plaintiff) and with the consent of the Company, to strike out the claim and the application for certification as a class action lawsuit.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(4) In September 2000, three plaintiffs filed a claim in the Tel Aviv District Court, together with an application for certification as a class action, against the Company, Bezeq International and the other international call operators, concerning the charge of VAT on international calls originating from abroad. The plaintiffs estimated the total value of the claim in millions of shekels per year. The application for certification was denied, and the plaintiffs filed an appeal against the decision. Following a procedural hearing in the case (which was validated as a decision on April 10, 2007), a new claim was filed on September 4, 2008 against the State of Israel only, and the Company ad Bezeq International were deleted from the proceedings.

(5) a. In March 2003, a claim was filed in the Tel Aviv District Court against the Company, the Broadcasting Authority and the State of Israel, by various plaintiffs from Moshav Porath in the Sharon region, including the estates of deceased persons, for compensation due to physical harm allegedly caused by prohibited radiation from the Hillel broadcasting station. The amount of the claim stated by the plaintiffs is "more than NIS 15 million", and the same claim notes that the plaintiffs will also petition to split the reliefs so that they will reserve the right to sue later for other financial damages which are not bodily harm, such as damage to crops and loss of value of land.

It is noted that following an application for dismissal *in limine* filed by the Company, a partial decision was given in favour of the Company, denying the claim of five of the plaintiffs, who died before the Company started operating the station.

b. In June 2004, another claim was filed in the Tel Aviv District Court by 25 plaintiffs from Moshav Porath and Moshav Ein Vered, including 11 heirs to the estates of deceased persons, against the Company, the Broadcasting Authority and the State of Israel, for compensation in respect of bodily harm. The claim alleges violation of legislated duties, and/or acts of omission by the defendants in connection with the operation of the Hillel station. The amount of compensation claimed is not estimated (although the claim is in the jurisdiction of the District Court, i.e. more than NIS 2.5 million), and the compensation is based on financial and non-financial damages items which are listed in respect of each plaintiff, together with punitive compensation.

c. In May 2005, the Company received a claim for NIS 49 million in damages, which was filed in the Tel Aviv District Court by 14 plaintiffs who were and/or are residents of the moshavim Porath, Ein Vered, Ein Sarid and community of Kadima, against the Company, the Broadcasting Authority and the State of Israel. The claim alleges the violation of legislated duties in connection with the Hillel station, which resulted in bodily harm to the plaintiffs due to prohibited radiation.

The plaintiffs in the three claims described in sub-sections a.- c. above filed an application for consolidation of the hearings. In 2007, the three cases were transferred the Central District Court. In June 2008, the Court decided to suspend the proceedings in the three claims and to resume them, if necessary, only after the plaintiffs comply with the decision of the Court in the manner of filing documents and affidavits.

d. In May 2005, the Company received a claim in the amount (originally) of approximately NIS 141 million in damages, which was filed in the Tel Aviv District Court against the Company, the Broadcasting Authority and the State of Israel. The claim alleges the violation of legislated duties in connection with the Hillel station, which resulted in property and financial damage. An application to split reliefs was also filed, which would enable future claims for damages. Due to non-payment of court fees by some of the plaintiffs and denial of their application to exempt them from the fees, some of the plaintiffs were struck from the claim so that the number of plaintiffs is now 24, and the amount of the claim is approximately NIS 5.3 million.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(5) d. (contd.)

It is noted that on December 31, 2003, the Company ceased all broadcasts from the station, at the behest of the State and the Broadcasting Authority. Since that date, the Hillel station has not served as a broadcasting site.

(6) In January 2002 a claim for payment of monetary compensation of approximately NIS 60 million and for writs of mandamus were filed in the Tel Aviv District Court (in 2007, the case was transferred to the new Central District Court), by an international communications operator against the Company and Bezeq International. The claim is for damages allegedly sustained by that operator due to acts of commission and omission in connection with customer allocation to the international call operators. Alternatively, the operator is suing for restitution of the access fees that it paid to the Company.

(7) In July 2002, the Company received a statement of claim for monetary and declaratory relief, together with an application for certification as a class action. The claim alleges unlawful excess collection of interest in respect of arrears, also in respect of a debt which the Company collects for other communications providers. The total amount of the claim, if certified as a class action, is estimated by the plaintiffs in the tens of millions of shekels. The plaintiffs petitioned for declaratory relief that the Company abused its monopolistic status and enriched itself unjustly. A court decision denied the application for certification, and that decision was appealed in the Supreme Court. On December 1, 2008 the appeal was struck out by consent, without an order to pay costs.

(8) On December 25, 2005, a claim was filed against the Company in the Tel Aviv District Court, together with an application for certification as a class action, under the Consumer Protection Law, 5741-1981, alleging that the Company unlawfully collects payment for surfing the internet with WOW's high-speed internet service, even though is technically unable to provide the service in certain areas at the promised speed. The plaintiffs estimate the amount of the class action at approximately NIS 100 million for all subscribers. On March 6, 2008, the application for certification of the claim as a class action was allowed for a group of subscribers defined in the court's decision. On April 7, 2008, the Company filed an application for leave to appeal the decision of the District Court.

(9) In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification as a class action under the Consumer Protection Law and the Class Action Law, alleging deception in advertising in the matter of a charge for calls from a Bezeq line to a cellular line. According to the plaintiff, the Company deceived the public in its advertisements, which stated that the price of such a call would be "approximately 44 agorot per minute", whereas the exact price per call minute was 44.57 agorot, nor did it disclose that the charge for interconnect was made according to segments of 12 seconds, which means that the actual average charge was 49 agorot per minute. The plaintiff estimates the amount of the claim at approximately NIS 68.5 million (the amount of the individual's claim is NIS 11).

(10) Various municipalities and local councils submitted demands for retroactive payments of municipal property taxes for the increased area of buildings and a change of the classification for municipal tax purposes. The demands together total approximately NIS 152 million.

(11) In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification as a class action, against HOT and against the Company. According to the plaintiff, on May 17, 2006, a fault occurred in his telephone line in the HOT network and it is possible that Company employees played some part in the malfunction. The plaintiff alleges that as a result of the malfunction, he incurred financial loss, harm to his goodwill, and distress. The amount of the claim is estimated by the plaintiff at approximately NIS 102 million (the amount of the personal claim is assessed at approximately NIS 1,000).

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(11) (contd.)
It is noted that on December 24, 2007, the Company received a ruling of the Antitrust Commissioner stating that the Company abused its status in the market, in contravention of Section 29A of the Antitrust Law, in that it did not respond, as required and promptly, to steps taken in a labour dispute. The ruling also states that pursuant to Section 43(e) of the Antitrust Law, the ruling would serve as *prima facie* evidence of its contents in any legal proceeding. The Company filed an appeal against the ruling. On this matter, see also Section C(1) below.

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

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

(14) In August 2006, a claim was filed in the District Court against Pelephone, Cellcom and Partner, together with an application for certification as a class action ("the First Claim"). The amount of the action (consolidated against the three companies) is NIS 100 million. The claim relates to the time of termination of calls made from the cellular network to the fixed line network, and alleges that in such a call, where a customer initiates its termination, there is an excess charge until the time the call is actually disconnected. In November 2006, a claim and application for certification as a class action were filed in the Tel Aviv District Court against the Company, Pelephone, HOT, Cellcom and Partner, amounting to approximately NIS 159 million ("the Second Claim"). In the Second Claim, the plaintiffs allege that when terminating a call made from a cellular line to a fixed line, if the call is ended by the fixed line call recipient (and not by the cellular line call initiator), the Company and HOT delay sending the disconnection signal for about 60 seconds. As a result, they incur a loss which is reflected in air-time costs and interconnect fees. In a procedural arrangement reached between the parties, it was determined that the First Claim would be conducted against Pelephone and against Cellcom and Partner, and the Second Claim would be conducted against the Company and HOT.

(15) The Company has received a demand for the forfeiture of a guarantee in the amount of approximately USD 6.5 million related to a project (HBTL) in a basic telephony tender in 1995 in India, in which the Company participated together with others. An appeal against an order given at the request of the venture and preventing forfeiture of the guarantees, is being heard in the Appeals department of the High Court in Delhi. The Company has applied to the court in India for release of the bank guarantees it provided. The court has not yet heard the application.

(16) In May 2007, the Company received a claim, together with an application for its certification as a class action,that was filed with the Tel Aviv District Court by a plaintiff claiming to have purchased shares of the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors who served or are serving in the Company during the relevant period, and against Ap.Sb.Ar. Holdings Ltd., which holds 30% of the Company's shares.

The claim alleges that the Company's financial statements for the years 2004 and 2005 contained false and misleading material information, including with regard to the annual profit, the property, plant and equipment and the equity, in light of a retroactive deduction of approximately NIS 320 million in respect of property, plant and equipment that was not in use by the subsidiary Pelephone Communications Ltd.

The amount of the personal claim is NIS 194, and the total amount of the claim for the group is NIS 61 million.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(17) In August 2007, the Company received a claim together with an application for certification as a class action, which was filed against the Company in the Tel Aviv District Court by a plaintiff alleging to be a customer of the Company, who signed a contract with the subsidiary DBS for receipt of high-speed internet infrastructure services (ADSL). The plaintiff is seeking reimbursement of all the fixed monthly payments he made for maintaining a landline for which he no longer has any use. He contends that these payments were collected unlawfully since from the technological aspect, high-speed internet can be provided without the landline being used. According to the plaintiff, all the customers of the Company and/or of DBS who subscribed to the Company's high-speed internet service during the past two years and who requested that the Company's landline be disconnected and/or who ceased to use it but continued making the fixed monthly payments for it have the right of such a claim. The plaintiff is seeking certification of the claim as a class action in the name of the customers referred to above, and he estimates the amount of the class action at approximately NIS 113 million. On June 27, 2008, a decision was given as agreed to by the parties, in which the application for certification and the claim were struck out without an order to pay costs.

(18) In September 2007, a claim was filed against the Company in the Tel Aviv District Court, with an application for certification as a class action, concerning the collection of VAT on arrearage interest and on collection expenses and the debiting of collection expenses and commissions. The amount of the class action is estimated at approximately NIS 114 million (the amount of the personal claim is approximately NIS 127)..

(19) On March 10, 2008, the Company received a counter-claim filed in the Tel Aviv District Court by HOT Telecom Limited Partnership, against the Company and its subsidiary Bezeq International. The counter-claim, which was filed together with a statement of defence of HOT in the claim filed against it by Bezeq International (alleging discrimination against Bezeq International in contravention of the license of HOT Telecom). In the counter-claim, HOT sues for financial damages it allegedly incurred in respect of Bezeq International's marketing of fixed-line telephony by means of PRI channels; deliberate disruptions in interconnect between the Company's network and the HOT network; failure by the Company to provide naked ADSL service, and receipt of confidential information by Bezeq International about HOT's customers by illegal means. HOT is also petitioning for a permanent injunction against the defendants taking illegal action to obtain information of HOT or using confidential information obtained. For the purpose of calculating the court fees, the amount of the claim was estimated at NIS 30 million.

(20) In November 1997 a claim was filed in the District Court, together with an application for certification as a class action, against the Company, Bezeq International, the Chairman of the Board of Directors of Bezeq International and the then CEO of Bezeq International. The claim alleges, *inter alia*, that the Antitrust Commissioner had ruled 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 overseas call tariffs in that it refrained from clarifying to the public that only those who registered as Bezeq International subscribers would enjoy the reduced tariffs. The amount of the class action is estimated by the plaintiffs at approximately NIS 50 million. In December 1997 the Company was struck from the claim. On June 19, 2001, the District Court decided to deny the application for certification. In September 2001, the decision of the District Court on this matter was appealed in the Supreme Court. On September 20, 2001, an appeal was filed in the Supreme Court against the decision of the District Court. On November 22, 2005 the Court denied the application for certification of the claim as a class action.

On January 15, 2006, the applicant filed notice of appeal in the Supreme Court.

At the date of this report, Bezeq International is awaiting the decision of the Supreme Court on the appeal – i.e. whether the decision of the District Court to deny the application for certification of the claim as a class action should or should not be reversed.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(21) In September 2001, a revised statement of claim and an application for certification as a class action were filed against Bezeq International and the State of Israel. The plaintiff alleges that the tariffs for international telecommunication services during the period from May 10, 1996, through July 8, 1997, were exorbitant and unreasonable, and abused the status of Bezeq International as a monopoly, against a backdrop of falling prices as the international calls market was opening up to competition. In December 2003, the court allowed the application by virtue of the Antitrust Law and not on the basis of the cause arising from the Unjust Enrichment Law, and certified the claim as a class action. In February 2004, the plaintiff filed an appeal in the Supreme Court against the decision of the District Court relating to the cause prescribed in the Unjust Enrichment Law. In January 2004, the State and Bezeq International filed applications for leave to appeal in the Supreme Court in this matter. The Supreme Court consolidated the hearings in these three cases (the appeal of the plaintiff and the applications for leave to appeal of Bezeq International and the State), and the parties filed their summations.

(22) In July 2008, Bezeq International received two claims that were filed in the Tel Aviv District Court together with an application for their certification as class actions, concerning the debiting of customers at a dollar exchange rate higher than the representative exchange rate. According to the plaintiffs, customers of Bezeq International, Bezeq International debited customers who, under the agreements with them, pay the consideration for the services at a dollar rate, at a high exchange rate than the representative rate, which they allege is counter to the agreements with them. The plaintiffs are seeking certification of their claims as class actions in the name of any person or corporation that entered into a contract with Bezeq International in which the price of the service is denominated in dollars and Bezeq International collected monies from them at an exchange rate higher than the representative rate. The amount of the first claim is not stated, and is estimated by the plaintiff in the tens of millions of shekels, while the amount of the second claim is estimated at approximately NIS 93 million. Since the facts and legal allegations in the two actions are similar, it was agreed that the second action would be struck out and only the claim filed first would be heard. At the date of this report, Bezeq International has not yet filed its response.

(23) During the second quarter of 2008, four claims were filed against Bezeq International in the Tel Aviv and Central District Courts, concerning the use of international phone cards for calling destinations in the Philippines, Thailand and Nepal, together with applications for their certification as class actions. According to the plaintiffs, who are foreign workers, the amount of time the phone cards can actually be used averages about 50% of the time stated to the buyers of the cards. The plaintiffs also allege that Bezeq International reduces call time also for the time that elapses in a failed dial attempt, collects – contrary to its declaration – not according to units of one full minute, is misleading in the matter of the number of "units" stated on the cards, and maintains a cartel with other international communication companies in the matter of raising the prices of the phone cards.

The plaintiffs have applied for their claims to be certified as class actions by virtue of the Class Actions Law, 5766-2006, in the name of a group that includes every person who, during the seven years prior to filing the claim and during the claim's proceeding, purchased phone cards of the type referred to in the claims. The plaintiffs estimate the loss sustained by all the members of the group at approximately NIS 2,202 million, which is claimed from all three communications companies together. Of this sum, the plaintiffs attribute 50% to Bezeq International, so that the amount claimed from it is NIS 1,101 million. The plaintiffs are also requesting that the courts direct the defendants to cease the behaviour described above.

In a hearing held in the Tel Aviv District Court, it was ruled that the actions filed in the Central District Court would be transferred to the Tel Aviv Court and would be heard in consolidation, under a single and uniform statement of pleadings. At the date of this report, the pre-trial hearing has not yet taken place.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(24) In February 2009, a claim was received which was filed in the Central District Court together with an application for its certification as a class action, against Bezeq International, an associate of Bezeq International and members of the boards of directors of those two companies. According to the plaintiff, a subscriber to Bezeq International's internet services, an advertisement was sent to her e-mail inbox on two different dates in January 2009, which contained a link to a commercial website – where the name of Bezeq International and the associate appear. This was done without the plaintiff having given consent for an advertisement to be sent to it. In this, the plaintiff alleges, the defendants violated the provisions of Amendment 40 to the Communications (Telecommunications and broadcasts) Law, 5742-1982.

The plaintiff is seeking certification of the claim as a class action by virtue of the Class Action Law, 5766-2006, in the name of a group that includes any person and/or corporation who entered into an agreement with the Company for receipt of internet access services and who received from Bezeq International, commencing December 1, 2008, an advertisement, without having given their prior written consent for its receipt. The total amount of the class action is NIS 840 million.

(25) In December 2000, a claim was filed in the Tel Aviv District Court against Pelephone by the State of Israel, in respect of royalties allegedly payable for the period from January 1994 to February 1996. The amount of the claim is approximately NIS 260 million (including principal, linkage differentials and interest).

An examination conducted as part of a mediation proceeding found that the maximum amount of royalties on the revenues of Pelephone from January 1, 1994 to February 7, 1996 is only approximately NIS 118 million (before interest, linkage, and the amount paid).

On February 16, 2004, the Company provided an undertaking to Pelephone, as approved by the Board of Directors on February 12, 2004, that if the mediation proceeding fails, the Company will pay Pelephone any sum it is ordered to pay to the State, if charged in a peremptory decision in respect of royalties on revenues from the provision of cellular services during the period from January 1, 1994 to October 10, 1994. According to the Company, it paid the State for that period under the settlement agreement between it and the State dated November 29, 1995. The undertaking to indemnify is subject to the presentation of the Company's arguments in the proceeding, and the consent of Pelephone for the Company to join the action as a third party should the Company request to do so.

(26) In September 2001, a claim was filed in the Ramallah District Court by the General Public Palestinian Communications Company ("Paltel"), against Pelephone and another company.

The plaintiff alleges that its license grants it, *inter alia*, the full right and authority to set up, operate, supply, sell and manage services and stations for landline and cellular telephone communication, for providing fixed-line and cellular communications services in the territory of the Palestinian Authority for an extended period, for part of which it was granted exclusivity. According to the plaintiff, it commenced providing cellular communications services in September 1999, and despite its requests to the defendants, they are continuing to provide cellular communications services to the inhabitants of the West Bank and the Gaza Strip, without restraint and without a license from the Palestinian Communications Authority, thereby violating various provisions of law, prejudicing the exclusive rights of the plaintiff and causing it losses and damages. The reliefs requested are a permanent judicial injunction preventing the defendants from providing communications services in the areas of the Palestinian National Authority and a financial action for approximately NIS 676 million from Pelephone alone.

The process of serving the claim was halted by the Attorney General and alternative service by registered mail was returned through the Ministry of Justice. It should also be noted that Pelephone does not recognize the jurisdiction of the court in Ramallah.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

(27) In December 2002, a claim was filed together with an application for certification as a class action, in the Tel Aviv District Court against Pelephone and another cellular company, for the amount of approximately NIS 4 billion, of which approximately NIS 2.4 billion is against Pelephone.

The claim relates to amounts collected by Pelephone and the other cellular company for interconnect fees on incoming calls, from May 10, 1996 to October 2, 2000. The applicants, through their lawyers, base their claim on the allegation that every cellular operator is a monopoly in the incoming call service to its network. Pelephone and the other cellular operator abused their monopoly status in that they set high and unfair prices for the incoming call service to their networks. The correct and fair tariff for the incoming call service is 25 agorot per minute, and not as collected in the past by Pelephone and the other cellular company or as set today in the Telecommunications (Payments for interconnect) Regulations, 5760-2000. In December 2008, the claim was denied, and in January 2009 the plaintiffs filed an appeal.

(28) In April 2003, an application was filed in the Tel Aviv District Court for certification of a claim as a class action, in a total amount of approximately NIS 90 million, against all the cellular companies (Pelephone among them). The applicants allege that the three cellular companies formed a cartel among themselves for the collection of a tariff of 38 agorot plus VAT for SMS messages coming into each of their networks. The plaintiffs allege that this is a uniform, inflated, unreasonable and unfair tariff. The period to which the claim relates is from March-June 2002 through the date of filing the claim.

(29) In February 2007, a claim and an application for its certification as a class action were filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, in a total amount of NIS 449 million. The amount attributed to Pelephone is NIS 167 million. The plaintiffs are suing for restitution of excess amounts which they allege were collected from the subscribers of the defendants, claiming that the defendants charged their subscribers for a service which was provided and/or received while they were abroad, according to an increased charge (time) segment than the defendants were ostensibly permitted to charge, thereby seemingly violating the license, which prohibits them from charging their customers according to time units of one minute for roaming services.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(30) In June 2007, a financial claim and application for its certification as a class action were filed in the Tel Aviv District Court against Pelephone. The aggregate amount of the claim is approximately NIS 239 million, and it relates to a group of customers from the Russian sector of the population and the tariff tracks that were offered to them.

According to the plaintiffs, Pelephone deceived the subscribers of the "New Immigrants Plan" into believing that they would be charged on the basis of 12-second units, while in practice, they were debited on the basis of one-minute units.

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

(31) In November 2007, a claim was filed against Pelephone in the Tel Aviv District Court, together with an application for its certification as a class action in the amount of approximately NIS 368 million. The application alleges that Pelephone failed to fulfill its obligation to ascertain that the content services from external content providers were provided only to those of its customers who requested them.

According to the plaintiffs, Pelephone violated Section 58.6 of its cellular operator license and therefore also Section 11(a) of the Telecommunications Law, and is therefore in beach of a legislated duty towards its customers. The application was denied with the consent of the parties.

(32) In December 2007, a claim and an application for its certification as a class action were filed against Pelephone in the Tel Aviv District Court, in the amount of approximately NIS 37 million. The claim alleges that Pelephone decided unilaterally, commencing June 2007, to add all its telephone lines which pay only for call minutes without a commitment to a plan called the "Basic Diminishing Tariff", and to charge those who subscribe to it a monthly fee of NIS 12.90.

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

(34) In January 2008, a claim was filed in the Tel Aviv District Court against Pelephone and another company, for physical injury due to exposure to radiation during the plaintiff's work with fire extinguishing systems in its relay stations.

(35) In April 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in a total amount of approximately NIS 60 million. The claim is for the restitution of amounts which the plaintiffs allege were over-collected from Pelephone's subscribers, and is divided into three causes and three separate groups of plaintiffs. The first alleges that Pelephone does not enable free calls to be made from any telephone (in any network) to its service centre, in ostensible contravention of the provisions of the law. The amount claimed for this cause is NIS 30 million.

The second alleges that when making a "dial on" call from the voice mail box (i.e. continuation of the call from the voice mail directly to the caller who left the message without disconnecting the call), Pelephone debits for airtime also during the time until the called party (who left the message) answers, which ostensibly contravenes Pelephone's license. The amount claimed for this cause is approximately NIS 10 million.

The third alleges that when a subscriber who has signed up for a plan that includes a minutes package, dials within that plan to 1-800 destinations, the full duration of that call is deducted from the minutes package, despite the fact that calls to 1-800 destinations are supposed to be at a lower tariff. The claim relates to those subscribers who exceeded the minutes package and were debited for calls in excess of the package. The amount claimed for this cause is NIS 20 million.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(36) In May 2008, a claim was filed in the Tel Aviv District Court against Pelephone in the amount of NIS 479.5 (the statement of claim is headed "Class Action" but gives no amount claimed on behalf of the group and does not include separate processes of court – "Statement of Claim" and "Application for Certification as a Class Action" – as required).
As mentioned the total amount is not defined in the claim.
Pelephone is Defendant No. 2, while Defendant No. 1 is Only 5 Lottoclub Israel Ltd.
The claim is for restitution of amounts by Defendant 1, which the plaintiff alleges it collected, through Pelephone, from its customer club, for services it provided to those customers.
According to the plaintiff, the engagement between Defendant 1 and the members of the customer club, on the basis of which they became members of the club and monies were collected from them, was flawed, and therefore the aforementioned amounts should be refunded.
The specific allegation against Pelephone is that the debit for the services of Defendant 1 is not clearly differentiated in the phone bill that is sent by Pelephone to its customers, ostensibly in contravention of Pelephone's license.

(37) In May 2008, a claim was filed in the Tel Aviv District Court against Pelephone and others, together with an application for its certification as a class action, in the amount of NIS 50 million.
The claim is for restitution of excess amounts which the plaintiffs allege were collected from Pelephone's subscribers for "callback" service (calls made from abroad to Israel through a service known at Pelephone as "saver service").

(38) In June 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in the amount of NIS 64 million.
The claim is for the restitution of amounts which the plaintiff alleges were collected unlawfully by Pelephone, in contravention of its license, as a payment commission by means of a voucher (a commission collected from a customer who does not pay the monthly debit by standing order but by individual payment each month).

(39) In July 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in the amount of approximately NIS 240 million.
The claim is for the restitution of excess amounts which the plaintiff alleges were collected from Pelephone's subscribers, and is divided into three causes and three separate groups of plaintiffs.
The first: an allegation that in "dial on" from the 144 information service (i.e. continuation of the call to the subscriber whose number was requested, without disconnecting the call to 144), Pelephone debits for airtime also during the time until the called party answers, in ostensible contravention of Pelephone's license. The amount claimed for this cause is approximately NIS 24 million.
The second: an allegation that Pelephone collects arrearage interest from a subscriber who is late in paying Pelephone, as well as "rescheduling interest" where payments are rescheduled, in ostensible contravention of its license. The amount claimed for this cause is approximately NIS 48 million.
The third: an allegation that Pelephone collects payment for a standing order, handling fees for the voucher and commission for payment of a voucher at a service centre, ostensibly in contravention of its license. The amount claimed for this cause is approximately NIS 168 million.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(40) In October 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in the amount of approximately NIS 716 million.

The claim is for restitution of amounts collected by Pelephone from its subscribers for a Third Generation surfing package. According to the plaintiff, Pelephone obliges customers to sign up for the 3G surfing package when they buy a handset, which violates its license and the law.

(41) In June 2006, an application was filed in the Tel Aviv District Court for certification of a claim as a class action against DBS and against the cable companies, in connection with the broadcasting of commercials during broadcasts of the World Cup Games.

According to the applicants, the broadcasting of commercials, which they allege were integrated into the first three days of broadcasts of the World Cup channel as part of the games and the World Cup studio, was against the law, contrary to the contract between DBS and its customers, and contrary to the terms laid down in the decision of the Council for Cable and Satellite Broadcasts ("the Council") to approve the broadcasting of the 2006 World Cup Games.

The applicants estimated the amount of the claim at NIS 106 million for all the members of the group (based on 200,000 World Cup subscribers of the cable companies and DBS together, calculated at NIS 530 per subscriber who purchased the World Cup package).

On March 17, 2008, the applicant filed an application in court for agreed abandonment without an order to pay costs. On March 18, 2008, the court gave its decision, allowing the plaintiff's application.

(42) In April 2007, an application was filed with the District Court for certification of a class action against DBS and against The Sports Channel Ltd. (the producer of Channel 5, Channel 5+, Channel 5 live and Channel 5 gold) and its managers, in connection with the broadcasts of Channel 5 live, in which it was alleged that the broadcasting of Channel 5 live involves the transfer of content from Channel 5+ to Channel 5 live, which contravenes “the basic promise of DBS as ratified in earlier legal proceedings”. The applicant, whose cause of claim against DBS is violation of a contractual obligation, breach of the duty of good faith in a contractual engagement and unjust enrichment, estimates the amount of the action at approximately NIS 63 million.

DBS filed its response on July 1, 2007. On April 1, 2008, the reply of the applicant to the responses of the respondents was filed. On July 9, 2008, the Council for Cable and Satellite Broadcasts announced that it does not intend to present itself for the hearing.

On February 3, 2009, an evidentiary hearing was held, and dates were set for filing the summations of the parties.

(43) In July 2007, a statement of defence was filed on behalf of an entity that had been sued by DBS, and concurrently it filed a counter-claim against DBS and another company for approximately NIS 42.6 million. In the statements of defence and counter-claim, it was alleged that the liability for the failures in the decoders supplied to DBS is not that of the entity but devolves on DBS and/or the other company since the entity alleged, *inter alia*, that the decoders were not properly characterised by the defendants and were not tested as required, and in at least some of the cases were not properly installed in the homes of the DBS subscribers. In view of these allegations, the counter-plaintiff alleged various losses related to repair of the decoders even beyond the contractual warranty period, to the supply of spare parts, to providing manpower services and to various payments it made to the other company. Alternatively, the counter-plaintiff is suing for lost expenses and loss of profits, which it allegedly incurred, in the amount of USD15 million. For court fee purposes, the amount of the claim was stated at NIS 42.6 million.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(43) (contd.)
On October 2, 2008, the defendant filed a statement of reply to the statements of defence in the counter-claim, and in December 2008 the parties exchanged interrogatories, demands for additional details, disclosure of documents affidavits, and they also submitted documents for review. In a pre-trial hearing on December 16, 2008, the honourable Registrar decided, at the request of the parties, to allocate 60 days for completion of the preliminary proceedings, and ruled that applications to the court on these matters should be filed no later than April 1, 2009 and replies to responses to them should be filed by June 1, 2009. Another pre-trial hearing (defined by the Registrar as the last), is scheduled for July 14, 2009. After the defendant's application to oblige DBS to deposit a guarantee in the amount of approximately NIS 1.5 million was dismissed by the District Court Registrar, the defendant filed an appeal against the decision (a hearing of the appeal is scheduled for May 2009).

(44) In October 2007, an application for certification of a claim as a class action was filed, in connection with reception disturbances in the broadcasts of DBS and with problems in the functioning of DBS's service array during those disturbances in September 2007.

According to the applicant, during September 2007, DBS subscribers endured daily disruptions and long breaks in the transmission of television broadcasts, which were reflected, *inter alia*, in severe distortion of the picture and sound, and that the service centre of DBS did not function and no service or assistance could be obtained from it.

On January 16, 2008, the applicant file a notice in the court, stating that he had reached agreement with another plaintiff who had filed a claim and application for certification as a class action against DBS, on the same subject as the first claim, whereby the action would be heard in this claim only while the other claim would be struck out. On April 27, 2008, the additional claim was struck out.The applicants estimated their claim in the amount of NIS 121 million.

On April 13, 2008, DBS filed its response, in which it rejected the allegations of the applicant and noted that in view of the actions DBS took to identify the disturbances and to provide benefits for its customers in connection with the disturbances, and in view of the source of the disturbances which was an external source beyond the control of DBS, the purpose and rationale for use of the tool of a class action by consumers are not established against a service provider.

On November 20, 2008, the reply of the applicant was filed, alleging that in view of the fact that the frequencies used by DBS are a secondary allocation, DBS should have anticipated the disruptions and made preparation for them.

On January 14, 2009, DBS filed an application to strike out sections in the applicant's reply since they include new causes, new allegations and new evidence which are not mentioned in the application for certification. On February 11, 2009, the respondent filed its response to the application. The pre-trial hearing in the case is scheduled for March 2009.

(45) In August 2008, an application for certification as a class action in the amount of NIS 19 million was filed against DBS, concerning termination of the "Discovery Science" and "Adventure One" channels. According to the applicant, DBS should have reduced the subscription fees in view of termination of broadcasting the channels, and contends that continuing to debit full subscription fees is tantamount to robbery, behaving in bad faith, breach of agreement and unjust enrichment at subscribers' expense. The applicant further alleges that DBS deceived and misled the applicant and violated the duty of disclosure to the consumer.

On December 22, 2008, DBS filed its response, in which it rejected the allegations of the applicant. On January 4, 2009, the applicant filed his reply.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(46) In November 2007, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in the amount of NIS 12 billion. The action was dismissed without an order to pay costs.

(47) Miscellaneous claims – Various claims are pending against the Company and the Group companies arising from the normal course of business. It is the opinion of the companies' managements that the latent risk in each of these claims will not cause material financial losses beyond the amounts included in the financial statements.

B. Claims which cannot yet be assessed or in respect of which the exposure cannot be calculated

Claims in respect of which the exposure cannot be calculated

(1) In January 2004, a claim was filed in the Tel Aviv Regional Labour Court against the Company and against the Makefet Fund, by employees who retired under a retirement agreement signed in November 1997 (about 320 employees, including those who joined the claim). The plaintiffs allege that they chose the Pension Track B after having been promised an increment pursuant to the "Yellow Note" agreement, and that this promise was not kept. On December 11, 2008, the decision denied the claim, subject to a right to appeal.

In addition, in March 2008 a similar claim was filed in the Tel Aviv Regional Labour Court by another 17 retirees of the Company.

(2) In July 2004, an action for declaratory relief was filed in the Tel Aviv Regional Labour Court against the Makefet Fund, the State of Israel and the Company, by the Organization of Bezeq Retirees and six of its members, alleging that the defendants breached agreements for binding arrangements that were made upon transfer of the employees from the Civil Service to the Company. According to the plaintiffs, their rights as retirees were acquired by the State and the Company in full actuarial balance and under binding agreements, and therefore, the pension reform that followed a change in legislation on June 1, 2003, does not apply to them. On June 5, 2008, a decision was given in which the claim was struck out.

(3) In December 2005, an application was filed in the District Court for certification of a claim against DBS as a class action. The reliefs applied for are as follows:

a. Monetary compensation for every customer who entered into an agreement with DBS by telephone and not in writing (leaving the amount to the discretion of the court. In the plaintiff's personal claim, NIS 20,000 is requested in compensation).

b. Financial compensation in the amount which was overcharged, for whoever actually paid more than the amount agreed upon by telephone with DBS's service representatives.

c. A declaratory order to DBS determining that from now on, whoever enters into an agreement with it by telephone will receive the arrangement in writing within 21 days.

On March 8, 2006, DBS filed an application for dismissal of the claim as a class action. On April 11, 2006, the applicant filed its response, in which dismissal of the application was allowed without any decision having been given. A further hearing has been scheduled for September 2009.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

B. Claims which cannot yet be assessed or in respect of which the exposure cannot be calculated (contd.)

Claims which cannot yet be assessed

(4) A number of proceedings have been served on Pelephone, in which local committees are seeking to add Pelephone as a party to various appeals filed in the Appeals Committee against dismissal of impairment of value claims under Section 197 of the Planning and Construction Law, due to the erection of communications installations. Pelephone studies each application on its merits, and decides on its course of action accordingly.

(5) In January 2009, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in a total amount of approximately NIS 219 million (plus compensation for distress, to be set by the Court).

The claim is for the restitution of amount collected the Pelephone from its subscribers, according to the plaintiff, in respect of surfing in the handset by representatives of Pelephone when repairing the handset.

(6) In January 2009, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in a total amount of approximately NIS 570 million. The claim is for the restitution of amounts collected by Pelephone from its subscribers, according to the plaintiff, in respect of surfing in the handset by representatives of Pelephone for backing up the phonebook when the handset is being repaired. The cause of claim is similar and even parallels the cause of claim in section B(5) above.

(7) In February 2009, a financial claim was filed in the Petach Tikva District Court against Pelephone, together with an application for its certification as a class action in a total amount of approximately NIS 80 million. The claim is for compensation in respect of harm to the autonomy of the customer, resulting from deletion of messages from the voice mail box after a certain time (7 days).

(8) In October 2008, an application for certification as a class action was filed against DBS, concerning non-disconnection of the applicant from the HOT television services and continuing to debit her for HOT's services. According to the applicant, DBS undertook to her that she would be disconnected from HOT and would be credited if charged a "double debit" by HOT. The applicant claims breach of undertaking, deception and bad faith as causes against DBS.
The application for certification was filed in the amount of NIS 5,211.73. The applicant did not state an amount for the class action, but noted that it exceeds the competence of the Magistrate's Court (which is NIS 2.5 million).
On January 20, 2009, DBS filed its response, in which it rejects the allegations of the applicant and contends, *inter alia*, that it did not undertake to disconnect her from HOT and that her claim is a personal one which is not suited for hearing as a class action.
On February 4, 2009, the applicant filed her reply.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies

(1) On December 24, 2007, the Company received a ruling from the Antitrust Commissioner, as authorised under Section 43(a)(5) of the Antitrust Law ("the Law"), which was given following an investigation conducted by the Antitrust Authority on suspicion of abuse of monopoly status. The ruling states that the Company abused its status in the market, contrary to the provisions of Section 29A of the Law, in that it did not respond as required and promptly to steps taken during a labour dispute by its employees, in connection with the activities of other communications operators, and in that it was not prepared, according to the ruling, to apply immediately to the Labour Court in the matter of the disconnection between its network and the HOT network. It is noted that the Company filed its application for an injunction in the Labour Court towards midday on May 18, 2006, the day after the malfunction commenced in the HOT network (during the afternoon of May 17, 2006).

The ruling also stated that pursuant to Section 43(e) of the Law, this ruling would serve as *prima facie* evidence of its contents in any legal proceeding, and that pursuant to Section 43(f) of the Law, the exercise or non-exercise of the Commissioner's authority according to Section 43 is no impediment to bringing suit against a person who committed an offence against the provisions of the Law.

On March 16, 2008, the Company filed an appeal against the Commissioner's ruling.

It is noted that in May 2006, a claim and application for certification as a class action were filed against the Company and against HOT, in the matter of a malfunction in the telephone line in the HOT network on May 17, 2006. On this matter, see Section A(11) above.

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

(3) In August 2005 a claim was filed against the Government of Israel, the National Council, the Ministry of the Interior, the head of the Noise and Radiation Abatement Division (at the Ministry for Protection of the Environment), the cellular companies, including Pelephone, and a company named Elidav – Building & Investments Ltd. (the owner of a house in Ramat Hasharon on the roof of which cellular antennae were installed). The claim concerns the liability for claims under Section 197 of the Planning and Construction Law in the matter of the issue of building permits for cellular antennae. The central allegation in the claim, as far as the cellular companies are concerned, is that in the proceedings for approval of National Outline Plan 36A, the cellular companies undertook to indemnify the local committees in respect of compensation those committees would be ordered to pay in claims under the aforementioned Section 197, and that the National Outline Plan was approved on the basis of that undertaking. According to the plaintiffs, the undertaking is tantamount to "a contract in favour of a third party" in their favour and in favour of the other local committees.

The plaintiffs also allege that the Government and the National Council were negligent in that they did not anchor that undertaking in the National Outline Plan, and once it transpired – after approval of the Plan – that the cellular companies were unwilling to indemnify the local committees, the Government and the National Council should have cancelled or suspended the Plan and should also have cancelled the franchises of the cellular companies.

The plaintiffs are petitioning for a large number of reliefs (about 20), all declaratory. The principal reliefs are to declare that the cellular companies and the other defendants must pay the compensation ruled against the local committees in claims under the aforementioned Section 197.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(4) In 2001, the Ministry of Communications issued administrative directives which regulate how a subscriber switches from the services of the cable companies to DBS and vice versa, and the use of infrastructures in the subscriber's home. The directives also prescribe a duty to pay monthly usage fees for infrastructure owned by another multi-channel television service provider. Since the administrative directives were issued, DBS and the cable companies have submitted mutual complaints of violation of the directives by the other party, and voluminous correspondence has been exchanged between DBS and the Ministry of Communications on the matter. On August 15, 2005, the Ministry of Communications notified DBS and the cable companies that in view of their numerous violations of the administrative directives, it had re-examined the matter and was now considering their cancellation, *inter alia*, in view of the mechanism for purchasing the wiring prescribed in the Communications Law, which enables a subscriber to purchase the wiring in his home for NIS 120.

On November 2, 2005, DBS submitted its position to the Ministry of Communications, stating that the administrative directives should remain in place, while cancelling the early notice prescribed in them, which requires that notice be given to a party whose subscribers disconnect from its services. DBS also contended that the provisions of the law granting ownership of infrastructure to the multi-channel television provider that installs it in the homes of its

subscribers, should be rescinded. At the very least, contended DBS, if the directive remains in place, its proper interpretation should not grant the cable companies ownership of the wiring they installed in private houses. DBS also stated that the amount prescribed in the law as the consideration to be paid for purchasing the wiring (NIS 120), is baseless and that if the directive is retained, the amount should be considerably reduced.

(5) In June 2005, the cable companies ("HOT") filed an *ex parte* application in the Tel Aviv District Court, in which the court was requested to grant, among others, an order for the appointment of a receiver, who would be authorised to search and seize, at all the sites held by DBS, commercial secrets of HOT as well as other information of HOT which is confidential or restricted by law, as well as other temporary reliefs, principally to prohibit DBS from using the commercial secrets of HOT.

The background to the filing of HOT's application was the publicity given in the press to the industrial espionage affair by means of Trojan horse software, where according to HOT, DBS ostensibly acted unlawfully, through the Modi'in Ezrachi investigation firm with which it had engaged, to enable it to obtain confidential information of HOT, thereby committing the tort of robbery of a commercial secret.

Simultaneously, HOT filed a statement of claim against DBS, which does not include any request for any financial relief, in which the court is requested to grant a number of declaratory reliefs, mandamuses and injunctions concerned with prohibiting DBS from making use of commercial secrets of HOT.

In its response to the application, DBS rejected HOT's allegations and gave notice that without waiving any of its arguments, it was willing to undertake to refrain from making any use of documents related to HOT's business which had come into its possession from Modi'in Ezrachi, and that should any such document or information be found, that document, as is, would be sealed in an envelope and placed in a safe. On July 7, 2005, the court, with the consent of the parties, gave a decision, which validated as an order DBS's notice not to make any use of documents and information transferred to DBS by Modi'in Ezrachi. In practical terms, this means that the court dismissed HOT's applications for appointment of a receiver and for grant of a temporary injunction of broader scope than DBS's commitment.

On July 9, 2008, the court validated as a judgment a settlement agreement reached by the parties, in which they applied for the claim to be struck out without an order to pay costs.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(6) For the provision of their services, the Company and the subsidiary Pelephone operate installations which emit electromagnetic radiation. The operation of such installations is subject to the Non-ionizing Radiation Law, 5766-2006, which regulates the erection, operation and supervision of these installations, including a requirement for permits for that purpose. Erection and operation permits are granted by the Supervisor of Radiation at the Ministry for Protection of the Environment, and grant of an operator's license necessitates presentation of a permit under the Planning and Construction Law. The Company has obtained operating licenses from the Commissioner for most of is communications and broadcasting facilities. In January 2008 drafts were published of National Outline Plan for Communications NOP/36A ("NOP/36A"), regulating the licensing proceedings by virtue of the Planning and Construction Law for small and large radiation-emitting facilities.

On April 17, 2008, the Company filed its opposition to the proposed text of NOP/36A Small Broadcasting Installations and NOP/36A Large Broadcasting Installations. Briefly, the Company's reservations are that the plans in their proposed wording, and mainly as concern the change of the definitions of small and large broadcasting installations, create practical difficulties which are liable to prevent the Company from granting the public some of the varied services it grants at present and which it is obligated to provide by law.

On July 29, 2008, the Company received notice that in June 2008, National Outline Plan 56 had come into force, regulating the manner of erection and licensing of broadcasting installations in the Administered Territories. The plan includes transition provisions for installations that were erected under permit and for existing installations. The plan includes a requirement for a communications license and the consent of the Commissioner for the government property in the Civil Administration. These officials require, as a condition for issuing the approvals, amounts which the Company disputes. The Company is examining the financial requirements in a broader litigation in which the Company is involved, and at the date of publication of this report, is unable to assess its implications.

(7) On May 24, 2007, the Company received a notice from the Director General at the Ministry of Communications, stating that he was considering imposing financial sanctions on the Company pursuant to Chapter G1 of the Communications Law, 5742-1982, in respect of violation, he alleged, of the duty to provide number portability commencing September 1, 2006, as follows:

a. For the period from September 1, 2006, to the date of the Director General's notice, a financial sanction of NIS 2,031,750.

b. For the period from May 25, 2007, to November 30, 2007 or until the date of remedy of the alleged violation (whichever is the earlier) by the Company – a rate of NIS 6,450 for each additional day of continued violation.

c. For the period from December 1, 2007 (which, according to the letter, is the reasonable date required for the relevant license-holders to remedy the alleged violation) to the date of remedy of the alleged violation – a financial sanction as set out in Sections 37B(b) and 37C(a) of the Communications Law after Amendment 36 (it is noted that under the provisions of those sections, the relevant sanction is seven times higher than the penalty prescribed in Section 61(a)(4) of the Penal Law (which is NIS 202,000), plus 0.25% of the Company's annual income, plus a financial sanction in the amount of one fiftieth of the aforementioned sanction, for each day on which the violation continues).

The Company, Pelephone and Bezeq International (which received similar notices) responded to the notices of the Ministry of Communications.

On November 20, 2008, a letter was sent to the Company from the Ministry of Communications in connection with receipt of information on the matter, for formulating the Ministry's position on the question of the extent to which the Company was in compliance with the provisions of the Communications Law and the numbering plan for the matter of number portability. The Company replied to the Ministry's letter on January 5, 2009.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

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

(9) In January 2009, Pelephone filed an action for declaratory reliefs and mandamuses in the Petach Tikva District Court. The action revolves around the demand of Israel Lands Administration ("the Administration"), which was sent to Pelephone by e-mail, to pay it the cumulative sum of more than NIS 200 million for a five-year period in respect of the Administration's continued "consent" to the presence and erection of new cellular antennae on land it manages. Pelephone's allegations in its action are briefly that the Administration is not authorised to collect any sums of money from Pelephone in respect of the placement of broadcasting installations, that the Administration's demand is fanciful and exaggerated, that the Administration is abusing its monopolistic power, and that the Administration is acting in bad faith.

The legal advisers of Pelephone estimate that Pelephone has meritorious arguments against the Administration. Nevertheless, since the proceeding is in its very early stages and the Administration has not yet filed its reply to the action, the likelihood of the action's success cannot yet be assessed.

(10) In March 2009, the Company received a letter from the Director General of the Ministry of Communications, announcing that he intends to consider the imposition of financial sanctions on the Company pursuant to Section 37B(b)(4) of the Communications Law, in the amount of NIS 15 million, in respect of alleged violation of provisions of the Company's general license relating to the structural separation. The Company was given the opportunity to argue its case before the Director General by April 8, 2009, and is studying the contents of the letter.

(11) Concerning class actions filed against DBS in respect of broadcast disruptions, see Section A(44) above.

(12) For possible demand for early repayment of bank loans, see Note 13.

D. Claims in an associate

(1) In July 2007, a claim was filed in the Jerusalem District Court against an associate of Bezeq International, Israeli Police, the State of Israel and 7 other defendants from the field of communications, in a total amount of more than NIS 65 million, for physical injury ostensibly suffered by the plaintiff following the publication of libel and slander concerning his involvement in securities crimes and conspiracy to commit murder.

After a pre-trial hearing in the case, and in view of the Court's recommendation, the plaintiff agreed to strike the communications entities from the claim, among then the associate of Bezeq International, and on November 13, 2008, the court gave its decision striking the associate of Bezeq International as a defendant from the claim.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

D. Claims in an associate (contd.)

(2) In September 2007, an application for certification as a class action was filed in the Tel Aviv District Court against 70 respondents, including operators of e-trade sites, among them an associate of Walla ShopMind, which is owned by an associate of Bezeq International ("ShopMind") and suppliers who offered products for sale through those sites. According to the applicants, the respondents operate ostensibly "fictitious offerors" who make "fictitious offers" in auctions conducted on the sites, in order to prevent participants in the auctions from winning them at prices which the respondents consider too low, and in so doing, they applicants allege, they are acting in breach of contract and deceitfully under the Consumer Protection Law. The reliefs applied for by the applicants include orders prohibiting the respondents from interfering in auctions, and unquantifiable financial reliefs.

On October 15, 2007, the Court gave an interlocutory order that includes the prohibition of the deletion and/or change of sale data.

On December 13, 2007, ShopMind filed its response to the application for certification as a class action.

After the Supreme Court handed down its ruling on the appeal filed by ShopMind, vacating the decision of the District Court on splitting the hearing in the action, the District Court decided, on February 3, 2009, in view of the retirement of the judge appointed to the case, that the case would be transferred to his substitute. At the date of this report, no decision has been given in connection with the transfer of the case.

NOTE 18 – COMMITMENTS

A. Engagements in lease agreements and rentals

Contractual rental payments during the next 5 years, are calculated according to the rent in effect at December 31, 2008 are as follows:

For the year ended December 31,	NIS millions
2009	**192**
2010	**197**
2011	**128**
2012	**89**
2013 onwards	**139**
	745

B. Some of the sites that Pelephone leases are on lands of Israel Lands Administration ("the Administration"). Pelephone has an agreement for payments to which the Administration is entitled for the period through December 31, 2008. See Note 17.C(9) for the matter of a demand for payment received by Pelephone from the Administration after the balance sheet date.

C. At December 31, 2008, DBS is bound by agreements to purchase broadcasting rights amounting to approximately NIS 83 million.

D. At December 31, 2008, DBS is bound by agreements to purchase channels. In the year ended December 31, 2008, expenses in respect of consumption of purchased channels amounted to approximately NIS 242 million.

NOTE 18 – COMMITMENTS (CONTD.)

E. Lease of space segments

(1) DBS has an agreement for leasing space segments of the Amos 2 satellite with HLL Spacecom Satellite Communications Ltd**.** ("HLL"). The term of the lease will end 12 years after the satellite is positioned in space or at the end of the life of the satellite, whichever is earlier. The satellite was positioned in space in April 2004.

(2) In addition, DBS entered into an agreement with HLL on July 15, 2008, whereby it will lease 13 space segments in the Amos 2 and Amos 3 satellites, stating that by December 31, 2009 only 12 segments will be leased, and lease of the 13th segment will be by notice by either party of its wish to do so.

The projected annual lease fees in the coming years under these agreements are as follows:

	NIS millions
2009	**91**
2010 - 2013	**395**
2014 onwards	**222**

In May 2003, an agreement was signed with Israel Aircraft Industries ("IAI"), regulating the debts of DBS in respect of leasing the space segments for the period up to May 2002. At December 31, 2008, partial payment has been made on account of the lease fee debt for the prior periods which are overdue. In view of DBS's arrears in the payments prescribed in the above agreement, in March 2006 IAI demanded settlement of the entire debt and the interest on it. Since IAI's demand, DBS and IAI have been negotiating settlement of the debt. DBS is continuing to repay the debt on a regular basis.

In addition, DBS and HLL are in dispute in respect of the amount of the annual payments, and DBS's entitlement to a certain discount on the lease fees. In February 2008, a settlement agreement was signed between DBS and HLL for cessation of the arbitration proceeding between the parties concerning the amount of the monthly payment due to HLL for the lease of space segments in the Amos 2 satellite.

F. The Group has a number of operating lease agreements for periods of up to 4 years in respect of vehicles it uses. The contractual annual lease fees, calculated according to the fees in effect at December 31, 2008, are approximately NIS 240 million.

G. In accordance with the requirements of the license and the principles laid down by the Council for Cable and Satellite Broadcasts, in 2006-2009 DBS must invest in content broadcasts not less than 8% of its revenues from subscriber fees in local productions in the same year.

H. Rights to frequencies

Pelephone uses frequencies in the 850 MHz range, granted pursuant to its license. In addition, during 2008 Pelephone approached the Ministry of Communications, requesting to exercise its rights to a band of frequencies in the MHz 2100 range. To exercise this right, Pelephone is required to pay an additional sum of approximately NIS 181 million for license fees and retroactive frequency fees from the date on which it won a tender for these frequencies to the date of exercise of the right to receive them. In September 2008, Pelephone paid the aforesaid amount for receipt of the frequencies from the Ministry of Communications and for their use. In January 2009, the Ministry of Communications confirmed to Pelephone the return of the 5 MHz frequency range, known as TDD, from the aforementioned band of frequencies.

NOTE 18 – COMMITMENTS (CONTD.)

I. Purchase of capacity

In October 2006, Bezeq International entered into an agreement with Mediterranean Nautilus Limited ("Med-Nautilus"), for an additional purchase of an irrevocable right is use of sea-bed cable capacity in 2007, in a total amount of approximately NIS 74 million. The agreement granted an option for additional purchases, which was exercised during 2008.
In March 2008, another agreement was signed with Med-Nautilus for additional purchases in a total amount of approximately NIS 35 million, and an option to purchase additional rights of use was also exercised during 2008.

J. For engagements for the purchase of property, plant and equipment, see Note 9I above**.**

NOTE 19 – SECURITIES, LIENS AND GUARANTEES

A. In May 2003, the Company provided, at the behest of the Ministry of Communications, a bank guarantee of USD 10 million in connection with its general license for implementing telecommunications operations and for providing telecommunication services.

B. The Company provided a guarantee in favour of banks in connection with credit of up to NIS 70 million granted to a subsidiary.

C. For guarantees provided by the Company for its past investments in India, see Note 17A(15).

D. The Company provided a guarantee of approximately NIS 10 million for DBS in respect of a bank guarantee of approximately NIS 36 million which DBS had provided in favour of the State of Israel. The guarantee is valid until December 31, 2010.

E. In February 2002 and May 2005, at the demand of the Ministry of Communications, Bezeq International provided bank guarantees of approximately NIS 9.4 million and NIS 1.5 million respectively, for fulfilment of all the terms of the license to provide international telecommunication services. In addition, at the behest of the Ministry of Communications and after the balance sheet date, Bezeq International topped up a bank guarantee of approximately NIS 1.1 million for the provision of VOB services. At the balance sheet date, Bezeq International had provided additional bank guarantees in a total amount of approximately NIS 8 million.

F. Pelephone provided guarantees of approximately NIS 73 million in favour of third parties, of which approximately NIS 38 million in favour of the Ministry of Communications, in connection with a guarantee for fulfilment of the terms of its license.

G. To secure its liabilities, DBS provided documentary credit and guarantees amounting to approximately NIS 38 million (including a bank guarantee of NIS 36 million in favour of the State of Israel).

H. The shareholders in DBS (except for one of them) have pledged their shares in favour of the banks. In view of a negative pledge of the Company (see Note 13), the Company provided the banks with a perpetual guarantee for payment of the debts of DBS. The guarantee is up to a maximum amount equal to the percentage of the Company's holding in DBS, multiplied by the value of DBS as derives from realisation of the pledged shares of the other shareholders. If the Company joins the sale in the framework of realisation of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the amount of the proceeds the Company will receive from realisation of its shares in DBS. The note of guarantee includes numerous restrictions on the Company in realising the shares it holds, and lists events of violation which, if committed, will enable the banks to call in the guarantee. Furthermore, the Company undertook to put its shares up for sale if the shares pledged to the bank are sold, and agreed that in the event of realisation of collateral provided by the other shareholders, the Company would forgo repayment of shareholder loans provided for DBS and that the guarantee would apply, *mutatis mutandis*, also to stock options which the Company would receive from DBS and to the right to receive them.

NOTE 19 – SECURITIES, LIENS AND GUARANTEES (CONTD.)

H. (contd,)

Except for one, the shareholders in DBS, have made a commitment to the banks not to oppose the sale or other realisation of their shares in DBS, which were pledged or for which a guarantee was provided (by the Company), in a way that will enable the banks to accomplish a friendly liquidation.

I. For securities, charges and stipulations given by the Company and subsidiaries in connection with loan covenants and borrowings, see Note 13.

NOTE 20 – EQUITY

A. Details of movements in equity

	Share capital	Translation fund	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of options for employees	Deficit balance	Total	Non-controlling interest	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Refers to equity holders of the Company								
Balance at January 1, 2008	**6,132**	**-**	**390**	**4**	**287**	**(2,268)**	**4,545**	**(373)**	**4,172**
Total revenues and expenses recognised	**-**	**(4)**	**-**	**(4)**	**-**	**1,625**	**1,617**	**(106)**	**1,511**
Dividends to Company shareholders	**-**	**-**	**-**	**-**	**-**	**(1,514)**	**(1,514)**	**-**	**(1,514)**
Share-based payments	**-**	**-**	**-**	**-**	**75**	**-**	**75**	**-**	**75**
Transfers by non-controlling interest	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**8**	**8**
Balance at December 31, 2008	**6,132**	**(4)**	**390**	**-**	**362**	**(2,157)**	**4,723**	**(471)**	**4,252**

NOTE 20 – EQUITY (CONTD.)

A. Details of movements in equity (contd.)

	Equity capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of options for employees	Deficit balance	Total	Non-controlling interest	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Refers to equity holders of the company								
Balance at January 1, 2007	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191
Total revenues and expenses recognised	-	-	-	3	-	1,341	1,344	31	1,375
Dividends to Company shareholders	-	-	-	-	-	(760)	(760)	-	(760)
Dividends to Company shareholders – distribution that does not pass the earnings test	(177)	(1,623)	-	-	-	-	(1,800)	-	(1,800)
Change in the repayment date of a loan extended by the non-controlling interest in a subsidiary	-	-	-	-	-	-	-	160	160
Payments to a former senior officer	-	-	6	-	-	-	6	-	6
Balance at December 31, 2007	6,132	-	390	4	287	(2,268)	4,545	(373)	4,172

NOTE 20 – EQUITY (CONTD.)

A. Movements in equity (contd.)

	Equity capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of options for employees	Deficit balance	Total	Non-controlling interest	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Refers to equity holders of the company								
Balance at January 1, 2006	6,309	1,623	384	6	-	(1,762)	6,560	(505)	6,055
Total revenues and expenses recognised	-	-	-	(5)	-	813	808	(59)	749
Dividends to Company shareholders	-	-	-	-	-	(1,900)	(1,900)	-	(1,900)
Share-based payments made by the company	-	-	-	-	287	-	287	-	287
Balance at December 31, 2006	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191

NOTE 20 – EQUITY (CONTD.)

B. Share capital

	Registered		Issued and paid in	
	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007
	No. of shares	No. of shares	No. of shares	No. of shares
Ordinary shares of NIS 1 par value	**2,749,000,000**	2,749,000,000	**2,605,045,611**	2,605,045,611

C. Following completion of the sale of 30% of the State's shares in the Company to Ap.Sb.Ar. on October 11, 2005 and Ap.Sb.Ar.'s exercise of the option to increase its holdings in the Company by another 10.66% in September 2008 (see also Note 1), the State's holdings in the Company decreased at that date to approximately 4.95%.

D. The Board of Directors of the Company, at its meeting on March 1, 2006, decided that resolutions concerning distribution of a dividend would be passed on a specific basis, in accordance with the financial results of the Company, its financial position and other relevant circumstances and data. This resolution superseded earlier resolutions in the matter of dividend policy.

E. On July 31, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to increase the registered capital of the Company by 251,000,000 shares of NIS 1 par value each. A general meeting has not yet been called to discuss the matter.

F. The Company also issued stock options to employees, managers and senior employees in the Group (see Note 26).

G. Description of the funds

Translation fund
A translation fund includes all the foreign currency differences arising from translation of financial statements of a consolidated partnership whose functional currency is a foreign currency.

Capital reserve for assets available for sale
A fair value reserve includes the net cumulative change in the fair value of financial assets available for sale which were not recognised in profit and loss, until the assets are disposed of.

Capital reserve for activities between the Company and a controlling shareholder
This reserve relates to benefits granted by the State as controlling shareholder in the Company, to employees, in cash and in equity instruments of the Company.

Capital reserve for employee stock options
This reserve relates to a benefit granted to employees by means of share-based payments.

NOTE 20 – EQUITY (CONTD.)

H. Dividends

The following dividends were announced and paid by the Company:

	For the year ended December 31	
	2008	2007
	NIS millions	NIS millions
In April 2008, a cash dividend was distributed (NIS 0.26 per share)	**679**	-
In October 2008 a cash dividend was distributed (NIS 0.32 per share)	**835**	-
In February 2007, a cash dividend was distributed (NIS 0.69 per share)(1)	**-**	1,800
In October 2007 a cash dividend was distributed (NIS 0.29 per share)	**-**	760
	1,514	2,560

(1) On December 28, 2006, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company concerning distribution of a cash dividend of NIS 1,800,000,030 (comprising NIS 0.69 per share), as a distribution not in compliance with the earnings test. The distribution was subject to the approval of the court. On February 4, 2007, the court approved the distribution, and the distribution was made on February 26, 2007.

(2) In November 2006, a dividend was declared in the amount of NIS 300 million (NIS 0.12 per share). The dividend was paid in January 2007.

I. On March 23, 2009, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to distribute a cash dividend to the shareholders of in the approximate amount of NIS 792 million, which at the distribution date equates to NIS 0.3 per share. The rate of the dividend that will actually be paid will be determined on the basis of the issued and paid up share capital of the Company at the end of the business day on May 11, 2009.

NOTE 21 – REVENUE

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Fixed-line domestic communications			
Landline telephony	**3,470**	3,798	4,068
Internet – infrastructure	**790**	711	606
Transmission, data communication and others	**978**	935	895
	5,238	5,444	5,569
Cellular telephone			
Cellular services and terminal equipment			
Sale of terminal equipment	**3,756**	3,669	3,524
	692	711	617
	4,448	4,380	4,141
International communications, internet and network end point services	**1,243**	1,226	1,219
Multi-channel television	**1,447**	1,331	1,284
Others	**31**	19	19
	12,407	12,400	12,232

NOTE 22 – SALARIES

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Salaries and related expenses –			
Operating	**1,787**	1,833	1,784
General and administrative	**725**	733	727
Share-based payments	**75**	-	287
Total salaries and related expenses	**2,587**	2,566	2,798
Less – Salaries charged to investments in property, plant and equipment and in intangible assets	**233**	191	212
	2,354	2,375	2,586

NOTE 23 – OPERATING AND GENERAL EXPENSES

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**1,723**	1,828	1,854
General expenses	**1,115**	1,187	1,169
Materials and spare parts	**809**	924	923
Consumption of satellite services content	**447**	426	441
Building maintenance	**331**	332	348
Services and maintenance by sub-contractors	**364**	381	428
International communication expenses	**273**	338	384
Motor vehicle maintenance expenses	**192**	183	190
Royalties to the State of Israel	**134**	194	180
Collection fees	**49**	48	50
	5,437	5,841	5,967

NOTE 24 – OTHER OPERATING EXPENSES, NET

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Provision in respect of severance pay in early retirement	**165**	51*	290*
Capital gains from realisation of property, plant and equipment (mainly real estate)	**(18)**	(105)	(159)
Capital gain from sale of satellite communication operation	**(50)**	-	97
Provision in respect of contingent liabilities	**(5)**	80	-
Provision for impairment of long-term loans	**4**	17	-
Others	**-**	(4)	3
	96	39	231

* See Note 3U and Note 25.

NOTE 25 – FINANCING EXPENSES, NET

	For the year ended December 31,		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Interest income from bank deposits, investments and others	**61**	116	195
Net change in the fair value of financial assets measured at fair value through profit and loss (mainly for forward transactions)	**-**	168	-
Income in respect of borrowing grossed up in sales, net of discount commission	**69**	63	49
Interest income and dividend from financial assets available for sale	**-**	6	30
Net profit from realisation of financial assets available for sale transferred from equity	**-**	-	5
Income from financial liabilities provided by the non-controlling interest in a subsidiary	**-**	96	-
Other financing income	**36**	38	77
Total financing income	**166**	487	356
Interest expenses in respect of financial liabilities	**337**	420	477
Linkage differentials, net	**272**	193	6
Exchange rate differences, net	**1**	114	12
Net change in the fair value of financial assets measured at fair value through profit and loss	**32**	-	103
Expenses in respect of capitalisation of loans provided by the non-controlling interest in a subsidiary	**6**	23	50
Impairment in respect of available-for-sale financial assets	**13**	10	-
Other financing expenses	**86**	76*	65*
Total financing expenses (1)	**747**	836	713
Financing expenses, net	**581**	349	357
(1) Net of amounts capitalised in the amount of	**35**	2	1
Stated directly in equity			
Net change in fair value of financial assets classified as available for sale	**-**	4	(1)
Net change in the fair value of financial assets classified as available for sale and transferred to profit and loss	**(5)**	-	(5)

* See Note 3U. Reclassification of approximately NIS 40 million in respect of financing expenses for a provision for severance upon early retirement, which was stated in the past under Other Operating Expenses, net.

NOTE 26 – SHARE-BASED PAYMENTS

A. (1) Following public offering under a prospectus of the Company and the State on May 24, 2004, and closing the sale of core control in the Company from the State to Ap.Sb.Ar. on October 11, 2005, Company employees are entitled to payment in respect of those sales by means of grant of 4.71% of the shares of the Company held by the State. Allocation of the shares will be by means of a stock options plan as described in the outline published by the Company on November 15, 2005.

(2) Following an agreement signed with the employees (see Note 16H) in the matter of an employee stock options plan for 3% of the issued and paid up capital of the Company, on February 22, 2007, the Board of Directors approved the plan. On March 25, 2007, 78,092,000 options were allocated, and on January 2, 2008 another approximately 59,000 options were allocated to two employee-directors. The expenses in respect of this grant were recorded in 2006, since in that year a promise was made to the employees, with the terms of the grant. The value of the grant was determined at February 22, 2007, which is the grant date.

B. On November 20, 2007, the Board of Directors of the Company resolved to adopt a stock options plan for managers and senior employees in the Company and/or in associates, allocating up to 65,000,000 non-marketable options exercisable for up to 65,000,000 shares of the Company and comprising approximately 2.5% of the issued share capital of the Company, and at full dilution – approximately 2.37% of the share capital.

On December 25, 2007, the Company published an outline for the allocation of up to 65,000,000 options in accordance with the Securities (Details of an outline offering of securities to employees) Regulations, 5760-2000, in which it described, *inter alia*, the terms of the plan, and also a private placement report in accordance with the Securities (Private placement of securities in a listed company) Regulations, 5760-2000.

The stock options plan and the allocation of the options under it, were approved by the general meeting of the Company on January 31, 2008, in accordance with the Company's Articles of Association (in certain cases, there is a statutory requirement to obtain additional approval from the general meeting).

Exercise of the options under the plan was contingent upon obtaining the appropriate approvals as set forth in the provisions of the Communications (Telecommunications and broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunication Corp. Ltd.) Order, 5757-1997 ("the Telecommunications Order"). Subsequent to exercise of the option to purchase shares by the controlling shareholder in the Company, Ap.Sb.Ar. Holdings Ltd. and the resulting increase in the percentage of its holding in the Company's shares to 40.66%, exercise of the options under the plan will be permitted also without need for amendment of the Telecommunications Order.

The options will vest in three equal annual portions. The vesting dates of each portion will fall at the end of each of the first, second and third years after the grant date, and the expense for each portion will be spread over its vesting period. In addition, the plan sets forth conditions which, if met, bring forward the vesting date.

Exercise of the options for shares will be by means of a cashless exercise mechanism, unless the Board of Directors decides otherwise.

The exercise price set for the grant of 49,500,000 options is NIS 5.50 (adjusted for distribution of a dividend in cash or in kind). On June 26, 2008, the Board of Directors resolved that the exercise price for future grants of options, as would be approved by the Board of Directors from time to time, will be the same as the average stock exchange closing price of the Company's share in the 30 trading days prior to the date of the Board of Directors' decision to grant options to those offerees.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

C. Of the options, at the date of the financial statements 61,550,000 options have actually been allocated, as follows:

(1) 52,550,000 options, with a theoretical economic value of approximately NIS 147 million (of which 17,750,000 options to the CEO of the Company and senior officers who are key personnel in the Group and the theoretical economic value of which is approximately NIS 45 million), based, *inter alia*, on the share price on the grant date, a risk-free annual interest rate of between 5.09% and 5.68%, a weighted average life expectancy of between 4.5 and 5.5 years, an exercise price between NIS 5.5 and NIS 6.35 , as described above, an annual standard deviation between 22.7% and 24.3%. The grant date was determined as the later of the date of the general meeting and the date of the notice to the employees. The restriction described above by virtue of the Telecommunications Order was taken into account in calculating the theoretical economic value of the options, assuming that the restriction can be resolved.

(2) On April 17, 2008, the Board of Directors of the Company resolved to allocate 9,000,000 options to the Chairman of the Board in accordance with the plan described in Section A above, subject to a number of changes relating to the terms of his options. The allocation to the Chairman was approved by the general meeting of the shareholders of the Company on June 1, 2008.
The options will vest in 12 equal quarterly portions. The vesting dates of each portion will fall at the end of each quarter from the grant date, and the expense will be spread for each portion in accordance with its vesting period. In addition, the plan sets terms which, if met, will bring the vesting date forward.

The exercise price of each option is NIS 6.4405 per share. The price was set according to the share price on the date on which the Chairman took up his post – September 4, 2007 (which was NIS 6.649 per share) and after adjustment for distribution of a net dividend in the amount of NIS 0.26 per share, for which the X-day was April 14, 2008. The closing price of the Company's share on June 1, 2008, the date of approval by the general meeting, was NIS 6.494 per share.

The theoretical economic value of the options granted to the Chairman as described above, according to a weighted Black and Scholes model, is approximately NIS 16 million, based, *inter alia*, on the share price on the grant date, a risk-free annual interest rate of 5.1%, a weighted average life expectancy of 4 years, the exercise price noted above, an annual standard deviation of 23.11%, and a solution to the restriction described in B. above as imposed by the Telecommunications Order.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

D. The terms of the options

Grant date / Eligible employees	No. of instruments in thousands	Vesting terms	Contractual duration of the options
A. Grant of options from the State to employees on October 11, 2005	122,698	Immediate (subject to lock-up – commencing at the end of two years, for three years – one third each year)	4 years
B. Grant of options to employees on February 22, 2007[(1)]	78,151	Immediate (subject to lock-up for two years)	5 years
C. Grant to Chairman of the Board on April 17, 2008	9,000	12 quarterly portions	4 years
D Approval and/or grant of options to managers, senior employees and officers up to December 31, 2008	52,550	Three equal annual portions	8 years
Total options for shares	262,399		

(1) The expenses for this grant were recorded in 2006, since in that year a promise was made to the employees, with the terns of the grant.
(2) The options referred to in Sections A and B are delivered by physical delivery of the shares.
The options referred to in Section C and D are delivered by way of cashless exercise.

See Section I below on the matter of the approval or grant of options after the balance sheet date.

E. Number of options and weighted average of the exercise price

	No. of options	No. of options
	For the year ended December 31,	
	2008	2007
	(In thousands)	(In thousands)
Balance at January 1	**200,849**	200,849
Options granted during the year	**61,550**	-
Options forfeited during the year	**(4,000)**	-
Options exercised during the year	**(35,000)**	-
Balance in circulation at the end of the period	**223,399**	200,849
Exercisable at the end of the period subject to lock-up terms	**119,050**	200,849
Exercisable at the end of the period not subject to lock-up	**48,299**	-

After the balance sheet date, approximately 12,376,000 of the options granted by the State to employees on October 11, 2005, were exercised

The average share price in 2008 and 2007 was NIS 6.409 per share and NIS 6.82 per share, respectively.

For the balance of the options issued at December 31, 2008, the exercise price is in the range of NIS 1.94 to NIS 6.12, and the weighted average of the remaining contractual life is 3.18 years.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

F. Additional details concerning share-based payments settled in derivatives:

The fair value of the services received in consideration of the stock options granted, is based on the fair value of the granted options, measured on the Black and Scholes model, based on the following parameters:

	For the year ended December 31,	
	2008	**2007**
Weighted average of the fair value at the grant date	**NIS 2.65**	–
Share price	**NIS 6.18 – 7.049**	–
Exercise price	**NIS 5.5 – 6.44**	–
Expected volatility	**22.7% - 24.3%**	–
Duration of the option	**4 – 5.5 years**	–
Risk-free interest rate (based on government bonds)	**5.09% - 5.68%**	–

Due to the mechanism for adjustment to distribution of a dividend, the expected dividend rate assumed in the calculation of fair value is 0%.

G. Salary expense in respect of share-based payments

	For the year ended December 31,		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Options for shares granted in 2008 (1)	**75**	-	-
Options for shares granted in 2006	**-**	-	287
	75	-	287

(1) Calculation of the salary expense assumed approximately 5% in respect of forfeiture, for each year.

H. (1) The employment agreement of DBS with a number of senior employees states that if DBS adopts a stock options plan for its employees, in which employees will be granted a right to purchase shares of DBS, such a plan will include those employees. The exact percentage of options each employee will receive under the plan will be determined at the exclusive discretion of the management of DBS. At the date of signing the financial statements, DBS has not adopted an employee stock options plan and accordingly, no options have been allocated.

(2) Under the employment agreement of DBS with a number of senior employees, DBS undertook to grant each such employee options entitling each of them to purchase from DBS, by way of allocation, ordinary shares of NIS 1 par value each, in consideration of their par value. In addition, the employment agreements with the employees stated the number of options and the terms of their exercise. In November 2008, DBS signed agreements cancelling the above undertaking in consideration of payment of a onetime bonus, and included in the financial statements expenses reflecting the bonus. At the balance sheet date, DBS remains with an undertaking to grant options of DBS to the CEO alone. The allocation requires the approval of the board of directors and of the banks. The options have not yet been granted to the CEO, and accordingly, the provisions of IAS 2 on the subject of capital grants to employees have not been applied.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

I. On January 21, 2009, the Board of Directors of the Company approved the grant of the 400,000 options to senior employees in the Group and 100,000 options to an employee-director, in accordance with the plan described in section B. above. The grant to the employee-director is subject to the approval of the general meeting. On February 19, 2009, the Board of Directors of the Company approved the grant of the additional 1,600,000 options to senior employees in the Group in accordance with the same plan. The theoretical economic value of the options granted after the balance sheet date, which was calculated at the date of approval of the grant by the Board of Directors, relying on a weighted Black and Scholes model, is approximately NIS 4.2 million.

NOTE 27 – EARNINGS PER SHARE

Basic earnings per share

Calculation of the basic earnings per share at December 31, 2008 was based on the profit relating to the ordinary shareholders, and on a weighted average number of ordinary shares in circulation, calculated as follows:

	2008	2007	2006
	NIS millions	**NIS millions**	**NIS millions**
Profit attributable to the ordinary shareholders			
Profit attributable to the ordinary shares	**1,627**	1,330	809
Weighted average of the number of ordinary shares			
Weighted average of the number of ordinary shares	**2,605**	2,605	2,605

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Diluted earnings per share

Calculation of the diluted earnings per share at December 31, 2008 was based on the earnings relating to the ordinary shareholders, and on a weighted average number of ordinary shares (diluted), as follows:

	2008	2007	2006
	NIS millions	**NIS millions**	**NIS millions**
Profit attributable to the ordinary shareholders (diluted)			
Profit attributable to the ordinary shares (basic and diluted)	**1,627**	1,330	809
Weighted average of the number of ordinary shares			
Weighted average of the number of ordinary shares (basic)	**2,605**	2,605	2,065
Effect of the options on the shares	**44**	36	-
Weighted average of the number of ordinary shares (diluted)	**2,649**	2,641	2,605

The average market value of the Company's shares, for calculating the diluting effect of the options on the shares, was based on the market prices in the period during which the options were in circulation.

NOTE 28 – SEGMENT REPORTING

The Group operates in various segments in the communications sector, so that every company in the Group operates in one separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and the infrastructure it owns. The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly in the matter of the technology and the competition in the segment in which it operates.

Accordingly, the separable component in the Bezeq Group which provides a service or a group of related services, and which is exposed to different risks and yield expectations than those of other segments, is every company in the Group.

Based on the above, the business segments of the Group are as follows:

- Bezeq, The Israel Telecommunication Corp. Ltd. – fixed line domestic communications.
- Pelephone Communications Ltd. – cellular communications.
- Bezeq International Ltd. – international communications, internet services and network end point.
- D.B.S. Satellite Services (1998) Ltd. – multi-channel television.

The other companies in the Group are presented under the "Others" item.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

The results, assets and liabilities of a segment include items directly attributable to that segment, as well as those that can be allocated on a reasonable basis. Unallocated items include mainly investments and the revenue from them, loans and borrowings and their related expenses, and assets and liabilities in respect of taxes.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment and intangible assets.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation

	Year ended December 31, 2008						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,179	4,448	1,243	1,506	31	-	12,407
Inter-segment revenues	319	265	63	7	44	(698)	-
Total revenue	5,498	4,713	1,306	1,513	75	(698)	12,407
Segment results	1,475	933	242	177	-	(10)	2,817
Financing costs, net							(581)
Profit after financing expenses							2,236
Equity in profits of associates accounted by the equity method							5
Profit before income tax							2,241
Income tax							720
Profit							1,521
Attributable to:							
Shareholders of the Company							1,627
Non-controlling interest							(106)
Profit for the year							1,521

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2008						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	7,325	4,641	947	1,129	51	(181)	13,912
Investments in associates accounted by the equity method							32
Unallocated assets							367
Total assets							14,311
Segment liabilities	1,570	834	268	592	28	(181)	3,111
Unallocated liabilities							6,948
Total liabilities							10,059
Capital expenses	608	911	113	262	2		
Depreciation	709	424	41	219	1		
Amortisation of intangible assets	143	99	34	310	3		
Share-based payments	38	25	10	2	-		

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,373	4,380	1,226	1,403	18	-	12,400
Inter-segment revenues	340	304	78	12	46	(780)	-
Total revenue	5,713	4,684	1,304	1,415	64	(780)	12,400
Segment results	1,319*	805	**204**	48	-	-	2,376*
Financing costs, net							(349)*
Profit after financing expenses							2,027
Equity in profits of associates accounted by the equity method							6
Profit before income tax							2,033
Income tax							672
Profit							1,361
Attributable to:							
Shareholders of the Company							1,330
Non-controlling interest							31
Profit for the year							1,361

* See Note 3U.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	7,756*	4,290	837*	1,097	59	(229)*	13,810*
Investments in associates accounted by the equity method							37
Unallocated assets							1,309*
Total assets							15,156
Segment liabilities	1,969*	798	330*	592*	37	(229)*	3,497*
Unallocated liabilities							7,487*
Total liabilities							10,984
Capital expenses	520	440	108*	299	3		
Depreciation	789	398	46	244	3		
Amortisation of intangible assets	152*	80	29	26	2		

* See Note 3U.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,514	4,141	1,219	1,339	19	-	12,232
Inter-segment revenues	285	337	82	23	37	(764)	-
Total revenue	5,799	4,478	1,301	1,362	56	(764)	12,232
Segment results	765*	692	**119**	8	-	-	1,584*
Financing costs, net							(357)*
Profit after financing expenses							1,227
Equity in profits of associates accounted by the equity method							11
Profit before income tax							1,238
Income tax							488
Profit							750
Attributable to:							
Shareholders of the Company							809
Non-controlling interest							(59)
Profit for the year							750

* See Note 3U.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	9,837	3,717	784*	1,008	47	(214)*	15,179*
Investments in associates accounted by the equity method							32
Unallocated assets							2,334*
Total assets							17,545
Segment liabilities	2,320	756	346	584	33	(209)*	3,830*
Unallocated liabilities							8,524*
Total liabilities							12,354
Capital expenses	511	337	47	208	2		
Depreciation	875	407	38	268	3		
Amortisation of intangible assets	151*	63	31*	25	3		
Losses from impairment of intangible assets and property, plant and equipment	5	-	-	-	1		
Share-based payments	287	-	-	-	-		

* See Note 3U

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. The Company and its subsidiaries provide a range of communication services, such as telephony, access, information and data communication, transmission, satellite and video, infrastructure, international communications and internet, multi-channel television, cellular, network end point, and others ("the Services").

Among the entities for which the Company and its subsidiaries provide the Services, there are also interested parties in the Company, including Ap.Sb.Ar. which until September 25, 2008 held 30% of the Company's shares, the State of Israel, which until such date held approximately 16% of the Company's shares (after the exercise of the option by Ap.Sb.Ar. for the purchase of 10.66% of the Company's shares from the State, Ap.Sb.Ar.'s holding in the Company increased to 40.66% and the State ceased to be an interested party), and the Zeevi group, which holds 17.75% of the Company's shares through a receiver appointed for those shares on behalf of certain banks.

In view of the above, as far as interested parties in the Company are concerned, which are not the State of Israel, the Services provided to them by the Company and its subsidiaries are negligible transactions, and accordingly, in accordance with Article 64(3)(d)(1) of the Securities (Preparing annual financial statements) Regulations, 5753-1993 ("the Regulations"), they are not described in these financial statements.

With regard to the State of Israel as an interested party in the Company until September 25, 2008, below are the characteristics and scope of the transactions with the State pursuant to Article 64(3)(d)(2) of the Regulations:

(1) The provision of diverse services to the State and its many branches, including Government ministries, Companies, and Authorities ("State Authorities").

(2) The consideration for most of the transactions which the Company has with State Authorities are paid at tariffs set in the Regulations. The other transactions carried out by the Company with the State, (i.e. those for which the consideration is not paid at those tariffs), such as for services for which the regulations do not set a tariff, custom-ordered work, contract work, excavation and installation, and maintenance of transmitters, as well as transactions carried out by the Company's subsidiaries with the State authorities – all these are transactions are conducted in the normal course of business at market prices, and where each individual transaction or service, of itself, is not material for the Company.

(3) For details of the transactions with government ministries until September 25, 2008, see section E below.

Arrangements which are not in compliance with these terms are disclosed separately in the financial statements.

B. Most of the Companies in the Group are required to pay royalties to the Government of Israel. Commencing January 2001, the revenue base requiring the payment of royalties was broadened, concurrently with a gradual reduction in the rate of the royalties, until a uniform rate was arrived at for all communications operators. In August 2006, an amendment to the royalties regulations was published, which regulates the reduction of 0.5% per year in their rate for all the licensees required to pay them, commencing January 1, 2006, until a rate of 1% per year is reached in 2010. The Ministry of Communications also gave notice that it will work for amendment of the regulations so that the Company will be exempted retroactively, from January 2004, from the duty to pay royalties in respect of revenues from services which have been opened to competition. On December 31, 2007, the Ministers of Finance and Communications submitted a draft amendment of the regulations to the Knesset Finance Committee. The regulations have not yet been promulgated.

C. On May 8, 2005, a new commercial agreement was signed between the Company and the Ministry of Defence on behalf of the State of Israel, for the provision of communication services by the Company. The agreement was approved beforehand by the Audit Committee of the Board of Directors and by the Board of Directors on May 3, 2005, and required, since the Company was at that time under government control, the approval of the general meeting of the shareholders of the Company (by a special majority), as required by the Security (Transactions between a company and its controlling shareholder) Regulations, 5761-2001. Approval of the agreement was delayed at the request of the

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

Ministry of Communications and the Antitrust Commissioner, to enable receipt of the Company's remarks on questions they had raised. On August 23, 2006, the Company received a copy of a letter from the Antitrust Authority to the legal representative of the Ministry of Defence and the IDF, in which the Authority gave notice that the agreement does not contravene the provisions of the Antitrust Law, 5748-1988, and that the Authority sees no justification, at the present time, for insisting on cancellation of the agreement.

The Company forwarded a copy of the letter to the Ministry of Communications. The financial statements include the income according to the new agreement. However, the Ministry of Communications believes that the agreement includes discounts which the Company is not authorised to grant, and that it was signed for too long a term. On March 27, 2007, the Ministry demanded (following an earlier request on December 4, 2006), that the agreement be amended so as not to violate the provisions of the law and of the Company's license. The Company notified the Ministry of Defence of cancellation of the discount arrangements and is charging the IDF at the tariffs stated in the Agreement from July 2002, which preceded the current agreement, although the Ministry of Defence pays the Company according to the tariffs in the present agreement. At this stage the Company is unable to assess the developments and therefore the financial statements include the income from the Ministry of Defence according to the tariffs in the agreement dated May 8, 2005, which are lower than the tariffs. Subsequently, the Company approached the Attorney General for a decision between the Ministry of Defence and the Ministry of Communications on the question of the 2005 agreement. It is noted that in any event, the term of the 2005 agreement ended in May 2008 and the parties are negotiating terms for continuation of the engagement.

D. On July 29, 2007, an agreement was signed (after being approved by the general meeting of the shareholders of the Company on March 23, 2006) with a corporation owned and controlled by the shareholders of Ap.Sb.Ar., whereby the Company will be granted regular management and consultation services, including by means of currently-serving and future directors of the Company and/or its subsidiaries, all for a consideration of USD 1.2 million per year. The term of the agreement is from October 11, 2005 (the date on which Ap.Sb.Ar. purchased 30% of the shares of the Company), and ends on December 31, 2008. On September 28, 2008, the general meeting of shareholders of the Company approved an extension of the management agreement for an additional period of three years, under the same terms as the original agreement.

E. Transactions and balances with interested parties and related parties

	For the year ended December 31		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Sales of products and services			
To the State of Israel*	**273**	365	370
Others	**1**	-	3
Expenses			
State of Israel *			
Royalties	**102**	194	181
Frequencies	**21**	25	29
Investments			
Rights to frequencies*	**181**	-	-

* Until September 25, 2008, when the State ceased to be an interested party in the Company.
For other balances with related parties, see relevant notes.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

F. Benefits to key managerial personnel

	For the year ended December 31, 2008	
	Number of persons	**NIS thousands**
Salary [2]	5	**10,355**
Bonuses[3]	5	**8,959**
Share-base payments (see Note 26)	5	**30,024**
		49,338

(1) Key managerial personnel in the Group in 2008 include the Chairman of the Board and the CEO of the Company, as well as the three CEOs of Pelephone, Bezeq International and DBS.

(2) Changes in other provisions (which are included in total salary) are not material, except for a decrease in the provision for notice for the CEO of the Company, in the amount of NIS 746,000, in accordance with his employment agreement.

(3) The bonus to the Chairman of the Board, NIS 3,245 million, requires the approval of the general meeting of the shareholders of the Company.

	For the year ended December 31,			
	2007		2006	
	No. of persons	**NIS thousands**	**No. of persons**	**NIS thousands**
Total cost of salary	3	10,479[2]	2	13,386[3]

(1) Key managerial personnel in 2007 and 2006 include the Chairman of the Board and the CEO of the Company.

(2) Including salary and bonuses to former CEO and Chairman and to the present CEO in respect of his term of office as former CEO of Bezeq International. The salary of the Chairman includes approximately NIS 4.6 million, based on the estimated cost of salary and future payments. This cost does not include this provision, nor the salary and payments to whoever served as Acting CEO in the period from April 1, 2007 to June 26, 2007, nor special compensation to the former CEO of the Company, Mr. Amnon Dick, as described in section H below.

(3) Includes a bonus in the amount of NIS 2.4 million to the retiring CEO. Following a request of the Securities Authority regarding senior officer bonuses, the aforementioned bonus to the CEO was cancelled. The Company decided that if this bonus is not returned to the Company, it will institute legal proceedings to collect the debt. However, the former CEO has made allegations which are denied by the Company.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to Directors

	For the year ended December 31		
	2008	2007	2006
	NIS thousands	NIS thousands	NIS thousands
Remuneration to directors who are not employed by the Company (1)	**619**	372	167
Number of directors receiving the remuneration	**3**	4	2
Pay of employee-directors (2)	**1,120**	996	1,010
Number of directors receiving the pay	**2**	2	2
Management fees to a controlling company	**4,238**	5,127	5,000

(1) From the date of transfer of control in the Company to Ap.Sb.Ar., the directors serving on the Board of Directors of the Company, except for the external directors, do not receive compensation from the Company.

(2) This is the salary paid to employee-directors in respect of their work in the Company; they do not receive any additional pay in respect of their service as directors in the Company. For the matter of stock options allocated to them in 2006 and the resolution of the Board of Directors of the Company concerning an additional allocation to an employee-director on January 21, 209, see Note 26.

(3) On December 3, 2003, the general meeting of the shareholders of the Company approved an obligation to indemnify officers of the Company in the matter of the framework agreement signed between the Company and the State, including in connection with an allotment of shares to the State pursuant to the framework agreement. The obligation was limited to NIS 890 million (the amount of capital raised), linked to the CPI published after completion of raising the capital for the Company in accordance with the framework agreement.

(4) On May 13, 2004, the general meeting of the shareholders of the Company approved a commitment to officers in the matter of indemnity and insurance, as follows:

a. An obligation of the Company regarding the provision of a loan to officers to financing reasonable litigation expenses in legal proceedings, and an undertaking of the Company to purchase insurance policies for officers at reasonable cost.

b. Grant of notes of indemnity in advance to officers of the Company in the following matters:

(1) A claim of a shareholder who held 15% or more of the share capital of the Company. The total amount of indemnity will not exceed USD 150 million, plus USD 30 million for legal expenses (a claim of this kind was excluded under the officers' insurance policies of the Company).

(2) In all matters relating to a prospectus for an offer for sale of securities of the Company by the State of Israel and an offering by the Company, which was published at the end of May 2004. The total amount of the indemnity (including undertakings to indemnify in advance which were given until publication of the prospectus and for undertakings to indemnify in advance which will be given, if given, immediately prior to the transfer of control in the Company by the State), will not exceed 25% of the equity of the Company (according to the 2003 financial statements, linked to the CPI of November 2003).

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to Directors (contd.)

(5) On April 20, 2004, the Board of Directors of the Company resolved that the Company will indemnify the employees of the Group who participated in the preparation of the prospectus published in May 2004, and who are not officers of the Company, for a financial liability which would be imposed upon them and for reasonable litigation expenses they would incur, regarding all matters relating to the prospectus, in the format of the indemnification letter which was given to the officers.

(6) On April 6, 2005, the general meeting of the shareholders approved an indemnification commitment in respect of a financial liability that would be imposed on officers of the Company and in respect of reasonable litigation expenses which they would incur, relating directly or indirectly to a proceeding for the sale of the State's holdings in the Company.
The indemnification commitment will be provided to officers who served and/or were appointed and/or will be appointed by the Company, commencing from the start of the Company's preparations for the sale proceeding and until the date of the closing of the sale proceeding.

The total amount of the indemnification will not exceed 25% of the equity of the Company (according to the 2004 financial statements, linked to the CPI of November 2004), including in respect of undertakings to indemnify in advance which were provided through the date of issuance of the indemnity note, together with an undertaking to indemnify in advance in accordance with the letter of the Minister of Finance dated April 21, 2004, which will be given, if given, immediately prior to transfer of the controlling interest in the Company by the State.

(7) On May 16, 2005, the general meeting of the shareholders approved the insurance of the officers of the Company, as follows:

Approval of the exercise of an option to purchase a run-off policy for the officers' liability to the Company, with the terms of the current policy, with the following changes:

a. For a period of seven years from the date of the closing of the transfer of the State's shares in the Company which are being sold pursuant to the decision of the Ministerial Committee for Privatisation Affairs on July 19, 2004 ("the Sale Closing Date").

b. The total amount of the insurance cover will not exceed USD 150 million, plus USD 30 million in respect of legal expenses in Israel only.

c. Limits of liability:

   (1) Cover for the first 3 years at a limit of liability of USD 150 million, plus USD 30 million in respect of legal expenses in Israel only.

   (2) Cover for an additional 3 years at a limit of liability of USD 75 million, plus USD 15 million in respect of legal expenses in Israel only.

   (3) Cover for the seventh year at a limit of liability of USD 25 million, plus USD 5 million in respect of legal expenses in Israel only.

   It should be noted that there is one limit of liability for each run-off policy.

d. The premium for the entire period of insurance – USD 3 million (in a one-time advance payment).

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to Directors (contd.)

(8) The same general meeting on May 16, 2005 approved grant of an undertaking in advance to indemnify the officers of the Company who were serving with the Company at the time the indemnification commitment was provided, which will apply on the Sale Closing Date, or who served during the seven years prior to that date, for a financial liability that would be imposed upon that person in each of the events listed in the documents of indemnification and on the terms set out in them, where the officer acted in good faith and had reasonable grounds for assuming that the action is in the best interests of the Company. The indemnification commitment will not apply regarding an event for which an insurer acknowledged liability under an insurance policy, but if the officer was charged, due to an indemnifiable event, with a sum exceeding the amount paid to him by the insurer, the Company will indemnify him with the difference, and subject to the amount of the indemnity for all the officers in the Company not exceeding USD 150 million plus USD 30 million in respect of legal expenses in Israel only per claim, and in total for a year of insurance in the period of insurance. Upon closing the transaction of sale of the State's shares to Ap.Sb.Ar (October 11, 2005), this undertaking came into force.

The resolutions referred to in sections 6, 7 and 8 above will be applied from the Sale Closing Date (October 11, 2005).

(9) On August 3, 2005, the special general meeting of the shareholders of the Company approved the extension of the term of the officers' insurance policy, including a run-off option, for a period of up to 4 months, at a cost of USD 112,500 per month, commencing July 31, 2005 (the date of expiry of the prior insurance policy). Upon closing the transaction for the sale of the State's shares to Ap.Sb.Ar. (October 11, 2005), the run-off option was exercised and that policy expired.

(10) On December 26, 2007, the general meeting of the shareholders of the Company approved a "framework transaction" for the Company's engagement, during the normal course of business, in future insurance policies (after expiry of the policy approved at the same general meeting) to cover the liability of directors and officers as may be from time to time, including directors and officers who are or who are likely to be considered controlling shareholders in the Company, all the officers in companies in which the Company holds 50% or more, officers representing the Company in companies in which the Company holds 20% or more, and senior employees who are not officer, for managerial actions taken by them, and all by way of a "framework transaction" as defined in the Companies (Reliefs in transactions with an interested party Regulations, 5760-2000, at an annual premium of up to USD 510,000 plus a sum constituting up to 20% of that premium respect of the insurance cover existing today.

On October 30, 2008, the Board of Directors of the Company approved purchase of an insurance policy to cover the liability of directors and officers for a period of one year commencing October 11, 2008, with a limit of liability of USD 100 million per claim and in total for the period, and in addition, a limit of liability of USD 30 million per claim and for all the claims for the period of insurance, in respect of legal expenses in Israel only, as well as a limit of liability of USD 50 million or subsidiaries (as part of the aforementioned limit of liability), in a "framework transaction" which was approved by the general meeting of the shareholders of the Company on December 26, 2007. The annual premium for the policy is approximately USD 369.000.

(11) On January 17, 2007, the general meeting of the Company approved a commitment to indemnify the officers in the Company in accordance with the indemnity note, for any liability or expense imposed on the officer due to his actions in his capacity as an officer in the Company (including his actions in subsidiaries), within the limitations provided in the Companies Law. The total amount of the indemnity was limited to a ceiling of 25% of the equity of the Company as may be at the time of actually paying the indemnity. The indemnity note will apply to types of events listed in an addendum to the note. Subsequently, approval was given for grant of indemnity for new officers who joined the Company.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

F. Benefits to directors and the CEO (contd.)

(12) On June 1, 2008, the general meeting of the shareholders of the Company approved the terms of employment of the Chairman of the Board of the Company. Below are the main points of the agreement with the Chairman:

a. The Chairman is employed under a personal employment agreement as acting Chairman of the Board of Directors of the Company, in a full-time position, effective from September 4, 2007, the date on which the Chairman actually started working in the Company.

b. The salary of the Chairman is NIS 175,000 per month, linked to the CPI. In addition, Chairman in entitled to contributions to senior employees insurance, study fund and loss of earning capacity insurance. The Company will provide the Chairman with a company car, and will bear all the car maintenance expenses.

c. The Chairman will be granted 9,000,000 options, as described in Section 26.C(2) below.

d. A decision on the award of an annual bonus will be made at the discretion of the Board of Directors and subject to the approval of the Audit Committee of the Board of Directors and the general meeting. The amount of the annual bonus, if awarded, will be between six and eighteen monthly salaries.

e. Immediately after approval of the agreement by the general meeting, the Company will pay the Chairman a special "signature bonus" of NIS 1.2 million.

f. The Company will insure the Chairman with directors and officers insurance, and will indemnify him as is customary from time to time with regard to other directors in the Company.

g. The engagement between the Company and the Chairman is for an unlimited period, where each party is entitled to bring it to an end at any time and for any reason by giving 12 months' notice (the Company) or 6 months' notice (the Chairman).

H. On June 28, 2007, Ap.Sb.Ar., which holds 30% of the shares of the Company, notified the Company that it had signed an agreement with the former CEO of the Company, Mr. Amnon Dick, whereby Ap.Sb.Ar. would pay him special compensation of NIS 5.750 million, as a gesture for his contribution to the Company. The compensation was recorded in the Company's books as a salary expense, and concurrently – in a capital reserve operated between a corporation and a controlling shareholder.

I. Concerning guarantees to related parties, see Note 19.

NOTE 30 – FINANCIAL RISK MANAGEMENT

General

The Group is exposed to the following risks, arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (which includes currency, interest and other price risks).

This Note provides information about the Group's exposure to each of the above risks, an explanation as to how the risks are managed, and the measurement processes. Other quantitative disclosure is included in the other Notes to the financial statements.

The Board of Directors is charged with overall responsibility for risk management and supervision in the Group. The purpose of risk management in the Group is to define and monitor those risks constantly, and to minimise their possible effects arising from the exposure on the basis of assessments and expectations for parameters that affect the risks. The Group's policy is to partially hedge exposure from fluctuations in foreign exchange rates, the CPI and interest rates.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or the other party to a financial instrument fails to meet its contractual obligations, and it is derived mainly from debit balances of customers and other receivables and from investments in deposits and in securities.

Management has a credit policy in place and the Group's exposure to credit risks is monitored on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks. Credit assessments are made on material customer balances, and collateral is required for financial assets.

<u>Trade and other receivables</u>

The Group's Management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in Management's estimation, the loss inherent in debts whose collection is in question. In addition, the balances of the trade receivables are widely spread.

<u>Investments</u>

The Group has investments in securities of the Government and of investment-grade companies, which are liquid and negotiable. Transactions involving derivatives are made with entities that have a high credit rating.

<u>Guarantees</u>

The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking obligations of subsidiaries. At December 31, 2008, the Group has the guarantees described in Note 19.

At the reporting date, there is no significant concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the balance sheet.

Liquidity risk

Liquidity risk is the risk that the Group will be unable to honour its financial obligations on time. The Group's policy for liquidity management is to ensure, as far as possible, that it will always have sufficient liquidity to honour those obligations promptly, in normal conditions and in conditions of distress, without incurring undesirable losses. In addition, for the matter of the debentures held by a subsidiary, see Note 13(b)(3).

NOTE 30 – FINANCIAL RISK MANAGEMENT (CONTD.)

Market risks

Market risk is the risk that changes in market prices, such as foreign currency exchange rates, interest rates and the prices of securities, raw materials and other items, will influence the Group's revenues or the value of its holdings in financial instruments. The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters to prevent significant cash flow exposures to market risks that will influence the Group's results, liabilities and cash flow in the short term (up to one year), while maximising the return on the risk.

During the normal course of its business, the Group takes full or partial hedging action and takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in managing its investment portfolio.

CPI risk

Changes in the rate of inflation affect the Group's profitability and its future cash flows, mainly due to its CPI-linked liabilities. The Group has surplus liabilities over assets linked to the CPI. In applying a policy of minimising the exposure, the Group makes forward transactions against the CPI. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposure. A considerable part of the cash balances is invested in deposits which are exposed to changes in their real value as a result of a change in the rate of the CPI.

Foreign currency risk

The Group is exposed to foreign currency risks mainly due to dollar-linked and euro-linked payments for purchases of terminal equipment and property, plant and equipment. In addition, it provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the dollar. The Group has surplus liabilities over assets in foreign currency. In applying a policy of minimising the exposure, the Group makes forward transactions against the dollar and the euro, and purchases options against the dollar. The duration of the hedging transactions is the same as or shorter than the duration of the hedged exposures.

Interest risk

The Group is exposed to changes in the fair value as a result of investments in debentures bearing fixed interest and of borrowings at fixed interest. The Group is also exposed to changes in its cash flows as a result of borrowings at variable interest. The Group's liabilities at variable interest are mainly short term, and do not expose it to interest rate risk.

NOTE 31 – FINANCIAL INSTRUMENTS

Exposure to credit risk

The carrying amount of financial assets represents the maximum exposure to credit risk. The maximum exposure to credit risk as at the reporting date is:

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
	Carrying amount	Carrying amount
Cash and cash equivalents	**786**	1,203
Financial assets available for sale	**57**	115
Financial assets measured at fair value through profit and loss	**6**	294
Trade and other receivables	**3,070**	3,105
Bank deposit for provision of loans to employees	**130**	149
Other investments	**3**	3
Derivatives	**24**	61
	4,076	4,930

See Note 7 for the matter of maximum exposure to credit risk in respect of trade receivables.

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Liquidity risk

Below are the contractual repayment dates of monetary liabilities, including interest payments:

	At December 31, 2008						
	Carrying amount	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	More than 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives:							
Trade payables	1,381	1,381	1,381	-	-	-	-
Other payables	658	658	653	5	-	-	-
Short-term borrowings	31	31	31	-	-	-	-
Bank loans (1)	1,168	1,207	915	52	54	131	55
Debentures issued to the public	2,737	3,229	466	-	450	1,396	917
Debentures issued to financial institutions and other (2)	2,001	2,734	390	123	491	849	881
Loans from institutional entities	109	266	-	-	-	266	-
	8,085	9,506	3,836	180	995	2,642	1,853
Derivative financial liabilities							
Forward contracts on currencies	1	2	1	-	1	-	-
Options on the rate of exchange	1	1	1	-		-	-
Forward contracts on the CPI	15	4	-	7	(3)	-	-
	17	7	2	7	(2)	-	-
Loans provided by the non-controlling interest in a subsidiary	449	1,329	-	-	-	-	1,329

(1) Including loans of a subsidiary amounting of approximately NIS 846 million, stated in the financial statements as short term due to non-compliance with financial covenants as set at December 31, 2008 (see Note 13B(1)).

(2) Including approximately NIS 116 million of debentures of the Company, stated in the financial statements as short term due to non-compliance with financial covenants (see Note 13C(1)).

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Liquidity risk (contd.)

	At December 31, 2007						
	Carrying amount	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	More than 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives:							
Trade payables	1,533	1,533	1,533	-	-	-	-
Other payables	613	613	608	5	-	-	-
Short-term borrowings	81	81	-	81	-	-	-
Bank loans (1)	1,298	1,579	120	102	174	1,037	146
Debentures issued to the public	2,959	3,551	461	-	446	1,445	1,199
Debentures issued to financial and other institutions (2)	2,302	2,920	348	117	489	1,007	959
Institutional loans	105	254	-	-	-	-	254
	8,891	10,531	3,070	305	1,109	3,489	2,558
Derivative financial liabilities							
Forward contracts on currencies	11	11	11	-	-	-	-
Forward contracts on the CPI	-	1	-	1	-	-	-
	11	12	11	1	-	-	-
Loans provided by the non-controlling interest in a subsidiary	375	1,384	-	-	-	-	1,384

(1) Including loans of a subsidiary amounting to approximately NIS 846 million, stated in the financial statements as short term due to non-compliance with financial covenants as set at December 31, 2008 (see Note 13C(3)).

(2) Including approximately NIS 112 million of debentures of the Company, stated in the financial statements as short term due to non-compliance with financial stipulations (see Note 13C(1)).

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Currency and CPI risks

The Group's currency risk based on denominated values is as follows:

	December 31, 2008				
	Unlinked	CPI-linked	In dollars or dollar-linked	In euro or euro-linked	Total financial balances
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets					
Cash and cash equivalents	771	-	12	3	786
Trade receivables	2,279	24	70	-	2,373
Other receivables	115	-	-	-	115
Other investments including derivatives	8	18	7	-	33
Long-term trade receivables	526	35	15	-	576
Long-term investments and loans including derivatives	131	1	50	-	182
Total assets	3,830	78	154	3	4,065
Liabilities					
Loans and borrowings	877	903	-	-	1,780
Trade payables	1,123	-	251	7	1,381
Other current liabilities and provisions	897	345	-	-	1,242
Long-term liabilities to banks and debentures	-	4,162	-	-	4,162
Loans provided by the non-controlling interest and others	-	558	-	-	558
Other long-term current liabilities and provisions	60	66	-	-	126
Total liabilities	2,957	6,034	251	7	9,249
Details of currency futures transactions					
Dollar/shekel forward transactions	(216)	-	216	-	-
CPI-linked shekel / shekel forward transactions	(1,720)	1,720	-	-	-
Euro/shekel forward transactions	(5)	-	-	5	-
Dollar/shekel Put options	-	-	(110)		(110)
Dollar/shekel Call options	-	-	110	-	100
	(1,941)	1,720	216	5	-

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Currency and CPI risks (contd.)

	December 31, 2007					
	Unlinked	CPI-linked	In dollars or dollar-linked	In euro or euro-linked	Other foreign currency or linked to other foreign currency	Total financial balances
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets						
Cash and cash equivalents	1,115	-	83	4	1	1,203
Trade receivables	2,330	15	58	-	-	2,403
Other receivables	166	-	1	-	-	167
Other investments including derivatives	116	192	35	56	1	400
Long-term trade and other receivables	486	24	25	-	-	535
Long-term investments and loans including derivatives	149	16	60	-	-	225
Total assets	4,362	247	262	60	2	4,933
Liabilities						
Loans and borrowings	927	955	-	31	-	1,913
Trade payables	1,212	-	313	8	-	1,533
Other current liabilities and provisions	937	244	12	1	-	1,194
Long-term liabilities to banks and debentures	-	4,733	-	-	-	4,733
Loans provided by the non-controlling interest and others	-	480*	-	-	-	480
Other long-term current liabilities and provisions	57	59*	1	-	-	117
Total liabilities	3,133	6,471	326	40	-	9,970
Details of currency futures transactions						
Dollar/shekel forward transactions	(389)	-	389	-	-	-
CPI/shekel-linked forward transactions	(2,600)	2,600	-	-	-	-
	(2,989)	2,600	389	-	-	-

* See Note 3U.

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Data in NIS for exchange rates and the CPI:

	December 31 2008	December 31 2007	December 31 2006	% of change December 31 2008	% of change December 31 2007
CPI in points(*)	**125.5**	120.9	116.9	**3.8**	3.40
1 US dollar	**3.802**	3.846	4.225	**(1.14)**	(8.97)
1 euro	**5.297**	5.659	5.564	**(6.39)**	1.71

(*) CPI for the month at average base of 100=1998.

Sensitivity analysis for changes in the CPI and foreign currency

Strengthening of the NIS against the following currencies at December 31, 2008 and 2007 would increase (decrease) the equity and the profit or loss by the amounts shown below. The analysis is made on the assumption that all other variables, and in particular the interest rates, would remain fixed.

	Equity NIS millions	Profit or loss NIS millions
December 31, 2008		
USD1 – 10% strengthening of the shekel vis-à-vis the dollar	**5**	**4**
Euro 1 – 5% strengthening of the shekel vis-à-vis the euro	**-**	**-**
CPI – 10% strengthening beyond the inflation forecast (inflation forecast of 2% per year)*	**(6)**	**(6)**
December 31, 2007		
USD1 – 10% strengthening of the shekel vis-à-vis the dollar	4	17
Euro 1 – 5% strengthening of the shekel vis-à-vis the euro	1	(1)
CPI – 5% strengthening beyond the inflation forecast (inflation forecast of 2% per year)	(2)	(2)

* Sensitivity rates are determined according to assessments based on variable conditions in the economy.

Weakening of the NIS against the above currencies at December 31, 2008 and 2007 would have the same effect in the opposite direction and in the same amounts, assuming all other variables remain fixed.

Interest rate risks

Profile of the Group's interest-bearing financial instruments at the reporting date is as follows:

	Carrying amount 2008 NIS millions	Carrying amount 2007 NIS millions
Fixed-interest instruments		
Financial assets	**2,162**	2,517*
Financial liabilities	**(6,015)**	(5,787)*
Loans provided by the non-controlling interest in a subsidiary	**(449)**	(375)
	(4,302)	(3,645)
Variable-interest instruments		
Financial assets	**-**	20*
Financial liabilities	**(31)**	(958)
	(31)	(938)

* See Note 3U.

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Sensitivity analysis of the fair value for instruments at fixed interest
The Group's assets and liabilities at fixed interest are not measured at fair value through profit and loss, nor does the Group designate derivatives (interest swap contracts) as hedging instruments according to a hedge accounting model of fair value. Therefore, a change in interest rates at the reporting date will not affect profit and loss.

Sensitivity analysis of cash flow for instruments at variable interest
An increase of 100 basis points in the interest rate at the reporting date would decrease shareholders' equity and profit or loss by approximately NIS 0.23 million (2007-approximately NIS 7 million). This analysis assumes that all other variables, especially foreign currency rates, remain stable.

Fair value
The table below shows the differences between the carrying amount and the fair value of groups of financial instruments, where material differences exist among them. The carrying amount of financial assets does not differ significantly from their fair value. The fair value of long-term loans provided by the non-controlling interest in a subsidiary is similar to their carrying amount.

	December 31, 2008		December 31, 2007	
	Carrying amount	Fair value	Carrying amount	Fair value
	NIS millions	NIS millions	NIS millions	NIS millions
Short-term borrowing	**31**	**31**	81	81
Secured loans from banks and others				
CPI-linked	**481**	**473**	591	598
Unlinked	**846**	**808**	846	846
Debentures issued to the public				
CPI-linked	**2,816**	**2,841**	3,043	3,046
Debentures issued to financial institutions and others				
CPI-linked	**2,106**	**2,098**	2,302	2,354
Euro-linked	**-**	**-**	32	31
	6,280	**6,251**	6,895	6,956

Estimation of fair values
The methods used to estimate the fair values of financial instruments are described in Note 4.

Interest rates applied in the determination of fair value

	2008	2007
	%	%
Long-term trade receivables	**7.4**	7.3
Loans and receivables	**7.5**	5.5
Loans	**6.2**	5.3

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

A. Statement of financial position

	Note	2008 NIS millions	2007 NIS millions
Assets			
Cash and cash equivalents		**93**	451
Investments, including derivatives		**23**	366
Trade receivables		**902**	1,059
Other receivables		**531**	181
Inventory		**11**	19
Assets classified as held for sale		**34**	17
Total current assets		**1,594**	2,093
Trade and other payables		**54**	51
Investments, including derivatives		**137**	174
Property, plant and equipment	32E	**3,647**	3,873
Intangible assets		**138**	176
Deferred and other expenses		**171**	185
Investments in associates accounted by the cost method		**4,961**	5,033
Deferred tax assets		**537**	643
Total non-current assets		**9,645**	10,135
Total assets		**11,239**	12,228

	Note	2008 NIS millions	2007 NIS millions
Liabilities			
Debentures	32F	**671**	722
Trade payables		**330**	448
Other payables, including derivatives		**530**	490
Current tax liabilities		**19**	57
Deferred income		**25**	21
Provisions		**253**	287
Employee benefits		**355**	663
Total current liabilities		**2,183**	2,688
Debentures	32F	**3,605**	3,974
Other long-term liabilities		**19**	7
Employee benefits		**219**	219
Total non-current liabilities		**3,843**	4,200
Total liabilities		**6,026**	6,888
Equity			
Share capital		**6,132**	6,132
Reserves		**752**	680
Capital deficit		**(1,671)**	(1,472)
Total equity		**5,213**	5,340
Total equity and liabilities		**11,239**	12,228

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. Income statement

		For the year ended December 31		
		2008	2007	2006
	Note	NIS millions	NIS millions	NIS millions
Revenue	32G	**5,498**	5,713	5,799
Costs and expenses				
Depreciation and amortisation		**852**	941	1,026
Salaries		**1,202**	1,293	1,557
Operating and general expenses	32H	**1,873**	2,121	2,233
Other operating expenses, net		**96**	39*	210*
		4,023	4,394	5,026
Operating profit		**1,475**	1,319	773
Financing expenses (income), net		**(244)**	43*	(669)*
Profit before income tax		**1,719**	1,276	1,442
Income tax		**400**	394	254
Profit for the year		**1,319**	882	1,188

* See Note 3U.

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

C. Statement of recognised income and expense for the year ended December 31

	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Net change in fair value of available-for-sale financial assets	-	5	(1)
Net change in fair value of available-for-sale financial assets transferred to profit and loss	**(5)**	-	(5)
Actuarial gains (losses) from a defined benefit plan	**(2)**	13	(3)
Taxes on income and expense charged directly to equity	**1**	(4)	2
Income and expenses charged directly to equity	**(6)**	14	(7)
Profit for the year	**1,319**	882	1,188
Total recognised income and expense	**1,313**	896	1,181

D. Statement of cash flows

	Note	2008	2007
		NIS millions	NIS millions
Cash flows from operating activities			
Profit for the year		**1,319**	882
Adjustments:			
Depreciation	32E	**709**	789
Amortisation of intangible assets		**114**	146
Amortisation of deferred and other expenses		**29**	6
Financing costs, net		**(426)**	189
Capital gain, net		**(68)**	(87)
Share-based payment transactions		**38**	-
Payments to former senior officer		**-**	6
Income tax expense		**400**	394
Impairment (appreciation) of loan to a related party		**143**	(183)
Change in inventory		**9**	(6)
Change in trade receivables		**154**	(201)
Change in other receivables		**(17)**	33
Change in other payables		**49**	(56)
Change in trade payables		**(88)**	27
Change in provisions		**(34)**	79
Change in employee benefits		**(306)**	(304)
Change in deferred income and others		**1**	(8)
Income tax paid		**(335)**	(324)
Net cash from operating activities		**1,691**	1,382*

* See Note 3U

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

D. Statement of cash flows (contd.)

	Note	2008 NIS millions	2007 NIS millions
Cash flows from investment activities			
Investment in intangible assets and in deferred expenses		**(98)**	**(93)**
Proceeds from sale of property, plant and equipment and deferred expenses		**144**	**169**
Realisation of current investments, net		**319**	**647**
Purchase of property, plant and equipment	32E	**(518)**	**(412)**
Proceeds from realisation of investments and long-term loans		**19**	54
Investments in associates accounted at cost		**(2)**	**(3)**
Dividend received		**302**	4*
Interest received		**34**	91*
Net cash generated by (used for) investment activities		**200**	457*
Cash flows from financing activities			
Issuance of debentures	32F	**-**	**1,200**
Repayment of debentures	32F	**(593)**	**(1,811)**
Dividend paid		**(1,514)**	**(2,860)**
Interest paid		**(183)**	**(238)**
Receipt (payment) in respect of settlement of derivative financial instruments, net		**52**	77
Net cash used for financing activities		**(2,238)**	**(3,632)**
Net increase (decrease) in cash and cash equivalents		**(347)**	(1,793)
Cash and cash equivalents at January 1		**451**	2,262
Effects of exchange rate fluctuations on cash and cash equivalent balances		**(11)**	(18)
Cash and cash equivalents at year end		**93**	451

	For the year ended December 31, 2006 NIS millions
Cash flows from operating activities	
Profit	1,188
Adjustment to profit	817
Net cash derived from operating activities	2,005
Cash flows derived from investment activities	1,349*
Cash flows used for financing activities	(2,776)
Net increase (decrease) in cash and cash equivalents	578
Cash and cash equivalents at January 1	1,679
Effects of exchange rate fluctuations on cash balances	5
Cash and cash equivalents at December 31	2,262

* See Note 3U.

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

E. Property, plant and equipment in the Company

Movement in property, plant and equipment	2008	2007
	NIS millions	NIS millions
Cost or deemed cost		
Balance at January 1	**16,385**	16,448
Additions	**504**	442
Disposals	**(184)**	(451)
Transfer to assets held for sale	**(53)**	(54)
Balance as at December 31	**16,652**	16,385
Depreciation and loss from depreciation of assets		
Balance at January 1	**12,512**	12,203
Depreciation for the year	**709**	789
Disposals	**(178)**	(440)
Transfer to assets held for sale	**(38)**	(40)
Balance at December 31	**13,005**	12,512
Carrying amount		
At January 1	**3,873**	4,245
At December 31	**3,647**	3,873

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

F. Debentures

Debt repayment terms and schedule

	Currency	Nominal interest rate %	Redemption year	December 31, 2008 Par value NIS millions	December 31, 2008 Carrying amount NIS millions	December 31, 2007 Par value NIS millions	December 31, 2007 Carrying amount NIS millions
Debentures issued to the public							
CPI-linked							
Series 4 and 5	Shekel	4.8-5.3	2009-2016	**3,287**	**3,740**	3,587	3,915
Debentures issued to banks and others							
CPI-linked	Shekel	4.8-6.35	2009-2014	**471**	**536**	689	750
Linked to the euro					**-**	22	31
					536		781
Total interest-bearing liabilities					**4,276**		4,696

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

F. Debentures (contd.)

Debentures to be redeemed in future years based on repayment schedules:

	December 31, 2008
	NIS millions
2009	**671**
2010	**481**
2011	**834**
2012	**477**
2013	**474**
2014 onwards	**1,339**
	4,276

G. Segmentation of Company revenues

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Telephony	**3,572**	3,905	4,148
Internet	**790**	712	608
Transmission and data communications	**811**	754	711
Other services	**325**	342	332
	5,498	5,713	5,799

H. Operating and general expenses in the Company

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**894**	1,033	1,135
General expenses	**259**	268	258
Materials and spare parts	**99**	83	80
Building maintenance	**293**	297	312
Services and maintenance by subcontractors	**113**	156	179
International communication expenses	**1**	26	30
Vehicle maintenance expenses	**126**	127	137
Royalties to the State of Israel	**57**	98	66
Collection commissions	**31**	33	36
	1,873	2,121	2,233

NOTE 33 – GROUP ENTITIES

	Country of registration	Rate of ownership For the year ended December 31, 2008	2007
Pelephone Communications Ltd. (1)	Israel	**100**	100
Bezeq International Ltd. (2)	Israel	**100**	100
D.B.S. Satellite Services (1998) Ltd. (3)	Israel	**49.8**	49.8
Bezeq On Line Ltd. (4)	Israel	**100**	100
Bezeq Zahav (Holdings) Ltd. (5)	Israel	**100**	100
Stage One (6)	Israel	**71.8**	83

(1) Pelephone Communications Ltd.

Pelephone Communications Ltd. ("Pelephone") is a wholly-owned subsidiary of the Company. It provides cellular services and value added services, and sells and repairs terminal equipment.

Pelephone operates under an operating license from the Ministry of Communications – a general license for cellular services ("the License"). The License was received on February 7, 1996.

In the framework of winning an additional band of frequencies in December 2001, the term of the License was extended to 2022 with an option for extension, subject to the terms of the License, for an additional period of six years ("the Additional Period") and for renewal for one or more additional periods of six years after the Additional Period.

(2) Bezeq International Ltd.

Bezeq International Ltd. ("Bezeq International") is wholly-owned by the Company, and was incorporated on April 5, 1995 to engage in international communications in accordance with a Government decision on December 28, 1994 and following a change in the general license of the Company. Since 1999, Bezeq International has also been providing internet access services. Bezeq International has holdings in the Walla! Communications Group Ltd. (see Note 12). Following the merger with BezeqCall Communications Ltd. ("BezeqCall"), BezeqCall's network end point license was assigned to Bezeq International.

On February 8, 2009, the Minister of Communications granted a special general license for the provision of domestic telecommunications services to B.I.P. Communications Solutions (a registered partnership), a company owned by Bezeq International.
The grant of this license was made possible by the VOB policy paper which states, *inter alia*, that after the Company's market share in domestic telephony decreases to 85%, Bezeq International will be able to receive a VOB license.

The license will allow Bezeq International to provide domestic telephony services over broadband (VOB) to private customers only. However, when the Company's market share in the business segment falls below 85%, Bezeq International will be able to provide these services to business customers as well.

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

D.B.S. Satellite Services (1998) Ltd. ("DBS") was incorporated in Israel on December 2, 1998. In January 1999, DBS received a license from the Ministry of Communications to transmit satellite television broadcasts in Israel ("the License"). The term of the License when granted to the consolidated company is through January 2014, and can be extended for a period of six additional years on certain terms. In its operations, DBS is subject to the Communications (Telecommunications and broadcasts) Law, 5742-1982 ("the Communications Law'), its concomitant regulations and rules, and the terms of the License.

NOTE 33 – GROUP ENTITIES (CONTD.)

(3) D.B.S. Satellite Services (1998) Ltd. (contd.)

In July 2000, DBS ended its preparation stage and began to provide its customers with multi-channel television broadcasts in accordance with the License granted, in accordance with the Communications Law.

Pursuant to the Company's license, which includes a provision whereby the Company is obliged to maintain complete structural separation between it and its subsidiaries, including DBS, on March 31, 2004 the Minister of Communications published a document prohibiting certain cooperative business ventures between the Company and the subsidiaries, including DBS, unless, *inter alia*, the competitive status of DBS deteriorates materially.

Regarding the financial position of DBS, see below.

A. (1) Since commencing operations, DBS has accumulated considerable losses. DBS's losses in 2008 and 2007 amounted to approximately NIS 265 million and NIS 118 million, respectively. As a result of these losses, its capital deficit and its working capital deficit at December 31, 2008 amount to approximately NIS 2,892 million and NIS 1,333 million respectively.

The Company's investment in DBS (primarily in shareholder loans) at the balance sheet date amounts to approximately NIS 1,562 million (without interest and linkage). The balance of the current debt of DBS to the Company and its subsidiaries amounts to approximately NIS 99 million, of which approximately NIS 73 million is to the Company. The Company and DBS put together an arrangement for collection of the balance of DBS's debt to the Company which was in arrears, 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 31 million.
The balance of the debt to the Company outside the above arrangement, is current debt for which the agreed terms of payment are the usual credit terms between the Company and its customers. At the date of approval of the financial statements, DBS is not in compliance with the terms of the arrangement and these credit terms; however, the parties reached agreement on this matter.

(2) During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements. See Note 13C(3).

(3) On July 31, 2007, in a private placement, DBS issued approximately NIS 620 million par value of Debentures (Series A) to institutional investors, to be registered in a continuous institutional system on the Tel Aviv Stock Exchange. The net proceeds from the issuance amounted to approximately NIS 614 million. The terms of the debentures are explained in Note 13B and C above).

B. On August 2, 2006, the Company and DBS filed notices of a merger to the Antitrust Commissioner ("the Commissioner") regarding exercise of options for shares in DBS by the Company which, if exercised, would increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. Following notice from the Antitrust Authority on December 31, 2006 of the Commissioner's opposition to the merger, the Company filed an appeal against that decision on May 15, 2007.

NOTE 33 – GROUP ENTITIES (CONTD.)

(3) D.B.S. Satellite Services (1998) Ltd. (contd.)

(B) (contd.)

On February 3, 2009, the Antitrust Court decided to approve the merger on terms that require approval by the Company within three months. The Antitrust Authority and Eurocom D.B.S. Ltd. (a shareholder in DBS) filed an appeal against the decision. In addition, after the Antitrust Authority application for a stay of execution of the decision was denied by the Antitrust Court and it filed an additional application for a stay of execution in the Supreme Court, the parties arrived at an arrangement as recommended by the court, which was validated as a decision, whereby execution of the merger is delayed for the time being, and the hearing of the appeals will be scheduled for the first week of June 2009.

(4) Bezeq On Line Ltd.

Bezeq On Line Ltd. ("Bezeq On Line") was established in December 2000 and commenced operation in 2001, providing call centre outsourcing services.

(5) Bezeq Zahav (Holdings) Ltd.

Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") is wholly-owned and controlled by the Company. Bezeq Zahav was established in September 1995 and commenced operations in May 2004. Bezeq Zahav holds debentures issued by the Company.

(6) Stage One Venture Capital Fund (Israel L.P.

This is a venture capital fund in which the management rights are held by the SOCI, and the Company has rights in the profits – see Note 3A(2).

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Statement of financial position

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current assets	**1,898**	**1,976**
Non-current assets	**2,746**	**2,363**
	4,644	**4,339**
Current liabilities	**1,502**	**1,106**
Long-term liabilities	**1,050**	**1,154**
Total liabilities	**2,552**	**2,260**
Shareholders' equity	**2,092**	**2,079**
	4,644	**4,339**

B. Income statement

	For the year ended December 31,		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Revenue from services and sales	**4,713**	4,684	4,478
Cost of services and sales	**3,216**	3,347	3,250
Gross profit	**1,497**	1,337	1,228
Sales and marketing expenses	**424**	430	417
General and administrative expenses	**140**	102	110
	564	532	527
Operating income	**933**	805	701
Financing expenses	**115**	114	107
Financing income	**(117)**	(109)	(89)
Financing expenses (income), net	**(2)**	5	18
Profit before income tax	**935**	800	683
Income tax	**253**	215	197
Profit for the year	**682**	585	486

NOTE 34 – SELECTED CONDENSED DATA FROM THE 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. Statement of financial position

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current assets	**164**	157*
Non-current assets	**968**	943*
	1,132	1,100
Current liabilities	**1,497**	1,483
Long-term liabilities	**2,527**	2,246*
Total liabilities	**4,024**	3,729
Equity deficit	**(2,892)**	(2,629)
	1,132	1,100

B. Income statement

	For the year ended December 31,		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Revenue	**1,513**	1,415	1,355
Cost of revenue	**1,091**	1,117	1,139
Gross profit	**422**	298	216
Sales and marketing expenses	**128**	138	123
General and administrative expenses	**117**	104	92
	245	242	215
Operating income	**177**	56	1
Financing expenses	**493**	394	328
Financing income	**(52)**	(226)**	(9)
Financing costs, net	**441**	168	319
Loss before income tax	**(264)**	(112)	(318)
Income tax	**1**	6	2
Loss for the year	**(265)**	(118)	(320)

* See Note 3U.
** See Note 13E

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.

A. Statement of financial position

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current assets	**496**	415*
Non-current assets	**498**	472*
	994	887
Current liabilities	**254**	312
Long-term liabilities	**30**	26
Total liabilities	**284**	338
Shareholders' equity	**710**	549
	994	887

B. Income statement

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Revenue	**1,306**	1,304	1,021
Operating expenses	**780**	859	662
Gross profit	**526**	445	359
Sales and marketing expenses	**181**	147	148
General and administrative expenses	**103**	94	72
Other expenses, net	**-**	-	7
Operating income	**242**	204	132
Financing costs, net			
Financing expenses	**8**	13	20
Financing income	**(7)**	(14)	(13)
Financing expenses (income), net	**1**	(1)	7
Equity in earnings of an associate accounted by the equity method	**5**	6	11
Profit before income tax	**246**	211	136
Income tax	**68**	58	40
Profit for the year	**178**	153	96

* See Note 3U.

** The above financial statements are presented in accordance with IFRSs only, Furthermore, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.