November 9, 2011

Quarterly Report for the Period ending September 30, 2011

- Update of Chapter A (Description of Company Operations) of the Periodic Report for 2010
- Directors' Report on the State of the Company's Affairs for the period ended September 30, 2011
- Interim Consolidated Financial Statements as at September 30, 2011

bezeq

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2010

Update of chapter A (Description of Company Operations)[1] of the periodic report for 2010 (the "periodic report") of Bezeq – the Israel Telecommunications Corporation Limited ("the Company")

1. Description of general development of the Bezeq Group's business

Section 1.1 – Bezeq Group activities and business development

Section 1.1.1 – General

Following are details of the current holdings in the Company including the fully diluted holdings, assuming exercise of all the options allotted to the Group's employees and managers at September 30, 2011 and November 8, 2011 (the calculation is, inter alia, subsequent to the acquisition of Company shares by B Communications as described in the update to Section 1.3.1):

Shareholders	Percentage of holdings		
	At September 30, 2011	At November 8, 2011	Fully diluted at November 8, 2011[2]
B Communications (through B Tikshoret)	31.15%	31.15%	30.18%
The public	68.85%	68.85%	69.82%

Section 1.3 – Investments in equity and share transactions

On June 1, 2011 the Company published a shelf prospectus for the issuance of shares, debentures, convertible debentures, stock options, debenture options and marketable securities, in the scope and according to the terms set out in the shelf offering memorandums, insofar as these will be issued by the Company in the future ("the Shelf Prospectus"). Subsequently, on June 22, 2011, the Company published an amendment to the shelf prospectus in which various changes were made to the conditions of the debentures and the deed of trust. On this subject, see also the Company's reports from June 1, 2011 and June 22, 2011 that include (respectively) the shelf prospectus and the amendment to the shelf prospectus.

On June 29, 2011, the Company published a shelf offering memorandum in which context debentures (Series 6-8) were offered to the public. Concerning this memorandum and the issue of the said debentures, see the update to Section 2.13.

Section 1.3.1 – Transactions in Bezeq shares

On March 10, 2011 the Company's controlling shareholder, B Communications, acquired (through B Tikshoret) 15,072,168 of Bezeq's shares at a transaction rate of NIS 10.055 per share so that immediately after this acquisition, the balance of its holdings rose to 829,283,713 Company shares and its holdings in the Company rose to 30.84% (29.62% in full dilution).

On March 14, 2011 the Company's controlling shareholder, B Communications, acquired (through B Tikshoret) 14,590,000 of Bezeq's outstanding shares at a transaction rate of NIS 10.1716 per share so that immediately after this acquisition, the balance of its holdings increased to 843,873,713 Company shares and its holdings in the Company rose to 31.37% (30.14% in full dilution).

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[1] The update is pursuant to Article 39A of the Securities Regulations (Periodic and Immediate Reports, 5730-1970), and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the periodic report. The update relates to the Company's periodic report for the year 2010 and relates to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

[2] The calculation of full dilution assumes that all the allotted options will be exercised into shares. In view of the mechanism of net exercise of stock appreciation rights in the plan for managers and senior employees of the Group from November 2007 and the employee stock option plan (2010), this assumption is theoretical only, since in practice, under the terms of the plan and according to the outlines, offerees who exercise the options will not be allocated the full number of shares underlying them, but only the number of shares that reflects the amount of the financial benefit embodied in the options.

Section 1.4 - Distribution of dividends

Section 1.4.2 – Distribution of dividends

On April 13, 2011, the general meeting of the Company's shareholders (further to a recommendation of the board of directors from March 7, 2011) approved the distribution of a cash dividend to the Company's shareholders in the total sum of NIS 1,163 million, which on the determining date for the distribution (May 4, 2011) represented NIS 0.4305716 per share and 43.05716% of the Company's issued and paid-up capital. The dividend was paid on May 19, 2011 (together with the first portion of the special dividend, as described in the update to section 1.4.3).

On September 7, 2011, the General Meeting of the Company's shareholders (further to a recommendation of the board of directors from August 1, 2011), approved the distribution of a cash dividend to the Company's shareholders in the total sum of NIS 992 million, which on the determining date for the distribution (September 18, 2011) is NIS 0.3662451 per share and 36.62451% of the Company's issued and paid-up share capital. The dividend was paid on October 5, 2011 (together with the second portion of the special distribution, as specified in the update to Section 1.4.3).

The outstanding, distributable profits at the reporting date are NIS 550 million.[3]

Section 1.4.3 – Distribution that does not pass the profit test

On March 31, 2011 the Tel Aviv District Court (Economic Department) approved a distribution which does not pass the profit test, in a total amount of NIS 3 billion which will be distributed to the Company's shareholders in six equal semi-annual payments from 2011 until 2013 (the "Special Distribution"). Pursuant thereto, on May 19, 2011 the first portion of this distribution was distributed in a total amount of NIS 500 million (which on the record date for the distribution (May 4, 2011) represented NIS 0.1851125 per share and 18.51125% of its issued and paid-up capital), together with the distribution of the regular dividend as described in the update to section 1.4.2, and on October 5, 2010 the second portion of this special distribution was distributed in the amount of NIS 500 million, which at the determining date for the distribution (September 18, 2011) was NIS 0.1845993 per share and 18.45993% of the Company's issued and paid-up capital), together with the current dividend, as specified in the update to Section 1.4.2.

The Company recorded a liability in its financial statements at March 31, 2011 for the whole sum of the special distribution. In this instance, see also Note 6.5 to the Company's Consolidated Financial Statements for the period ended September 30, 2011.

On July 3, 2011, the bearer of a Company debenture (Series 5) applied to the Tel Aviv District Court (Economic Department) to instruct the Company to submit an up-to-date opinion and to allow responses to be submitted in view of the revised opinion, including the filing of objections, and this given that in the applicant's opinion circumstances have changed that justify a re-examination of the Company's solvency: an immediate raising of debt by the Company in the amount of NIS 3 billion (instead of from 2011-2013, pursuant to the assumption in the economic opinion that was attached to the Company's request), and a change in Midroog's rating outlook for the Company to negative. On July 10, 2011, the Company filed its response to the application stating that the application should be rejected as circumstances have not changed as alleged by the applicant and/or that justify a re-examination of the resolution pertaining to the special distribution and due to the fact that this resolution is final and absolute. On July 25, 2011, pursuant to the court's ruling, the Company received a response to the application and the Company's response from the ISA, in which context the ISA did not discuss the subject of the application – whether or not circumstances had changed since the date of the court ruling. Nevertheless, the ISA is of the opinion that should there be a significant deterioration of the Company's financial position between the date of giving the obligation and receiving approval for the distribution, and the payment date of the dividend, the Company's board of directors would be well advised to reassess the Company's compliance with the distribution tests, and if there are insufficient distributable profits, it should re-apply for the court's approval, unless the court ruling prescribes instructions that also take into account future changes in the Company's circumstances. On August 18, 2011, an application was submitted to the same court by another bearer of Company debentures (Series 5) for inclusion in the above-mentioned proceeding, given that in his view the Company should not be allowed to continue with the special distribution. During a hearing of these applications held on September 19, 2011, the parties agreed to accept the Court's position whereby the Court's approval of the distribution under Section 303 of the Companies Law will not derogate in any way from the obligations of the Company's directors and officers under any law.

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[3] Subject to meeting the distribution tests.

The Court validated this agreement and ruled that in view of this agreement, a discussion of the other issues raised in the applications filed with the Court is rendered superfluous. The Court stipulated that the foregoing is not intended to prevent a creditor from applying to the court if s/he is able to demonstrate that the Company's solvency has significantly deteriorated. Pursuant to this decision, the Company stipulated that the ruling does not change continuation of payments of the special distribution and the Company's on-going dividend policy, and that no further application to the Court is necessary before each payment is made.

In September 2011, two shareholders of the Company wrote to the board of directors alleging that the Company must take legal action against its senior officers in connection with loans taken by the Company that were (allegedly) used for distributing dividends to the shareholders and caused the Company losses and costs. According to these shareholders, the Company's senior officers violated their duty of care and trust towards the Company in this context. On October 11, 2011, the board of directors discussed these applications and resolved to reject them after concluding that there are no grounds for taking legal action as requested.

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

Section 1.5.4 – Principal results and operational data

A. Bezeq Fixed-Line (the Company’s activity as domestic operator)

(NIS millions unless stated otherwise)

	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Revenues	1,186	1,170	1,178	1,329	1,323	1,307	40З, 1
Operating profit	546	517	211	494	556	503	19,
Depreciation and amortization	180	171	162	178	171	171	47,
EBITDA	726	688	373	672	727	674	66,
Net profit	311	330	123	340	377	349	36,
Cash flow from operating activities	641	496	419	540	684	523	393
Payments for investment in property, plant & equipment and intangible assets	268	319	319	302	245	247	838
Proceeds from sale of property, plant & equipment	68	48	187	43	48	26	41
Free cash flow [1]	441	225	287	281	487	302	47,
Number of active subscriber lines at end of period (in thousands) [2]	2,341	2,336	2,342	2,352	2,382	2,412	80111
Average monthly revenue per line (NIS) (ARPL) [3]	78	78	80	83	83	81	8,
No. of outgoing minutes (in millions)	2,481	2,415	2,521	2,621	2,629	2,717	80738
No. of incoming minutes (in millions)	1,607	1,535	1,577	1,644	1,665	1,634	40683
Number of internet subscribers at the end of the period (in thousands) [2]	1,100	1,088	1,079	1,066	1,056	1,051	40, 11
% of subscribers using NGN services out of total Internet subscribers connected to the NGN network	44%	40%	37%	34%	27%	23%	47%
Average monthly revenue per Internet subscriber (NIS)	81	80	79	78	76	72	73
Average broadband speed per Internet subscriber (Mbps)	6.0	5.3	4.8	4.3	3.8	3.4	3.,
Churn rate [4]	2.6%	2.6%	3.1%	3.4%	3.1%	3.1%	3., %

(1) Cash from operating activities less purchase of property, plant and equipment and intangible assets, net.

(2) Inactive subscribers are subscribers whose Bezeq lines have been physically disconnected (except for a subscriber during (approximately) the first three months of the collection process)

(3) Excluding revenues from transmission and data communication, Internet services, services to communications operators and contractor and other works. Calculated based on average lines for the period.

(4) The number of telephony subscribers who left Bezeq Fixed-line during the period divided by the average number of registered telephony subscribers in the period.

The number of active subscriber lines, average monthly revenue per line and number of outgoing minutes were retroactively amended and were presented after elimination of the effect of card-operated public telephones.

B. Pelephone

(NIS millions unless stated otherwise)

	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Revenue from services	914	925	949	1,145	1,159	1,140	1,106
Revenues from sale of terminal equipment	507	513	501	323	283	289	287
Total revenue	1,421	1,438	1,450	1,468	1,442	1,429	1,393
Operating profit	342	357	399	343	356	362	322
Depreciation and amortization	139	143	139	154	149	149	149
EBITDA	481	500	539	497	505	511	471
Net profit	263	279	310	268	239	267	259
Cash flow from operating activities	168	101	308	91	400	378	350
Payments for investments in property, plant and equipment and intangible assets	71	86	133	92	99	114	92
Free cash flow (1)	97	15	175	(1)	301	264	258
Number of subscribers at the end of the period (thousands) (2)	2,933	2,890	2,880	2,857	2,825	2,807	2,789
Average number of minutes per subscriber per month (MOU) (3)	375	365	359	364	347	348	336
Average monthly revenue per subscriber (NIS) (ARPU) (4)	105	107	110	134	137	136	133
Average monthly revenue per subscriber (NIS) (ARPU) (based on reduced interconnect tariffs) (5)	105	107	110	109	113	111	110
Number of HSPA subscribers at the end of the period (thousands) (2)	1,757	1,610	1,471	1,325	1,160	1,005	845
Revenues from value added services (included in revenues from services)	310	297	283	269	266	246	233
% revenues from value added services / revenues from cellular services(6)	36.3%	34.5%	32.1%	25.0%	24.5%	23.0%	22.6%
Churn rate (7)	5.0%	4.9%	4.3%	3.9%	3.5%	3.9%	3.9%

(1) Cash from operating activities less purchase of property, plant and equipment and intangible assets, net.

(2) Subscriber data does not include subscribers connected to Pelephone services for six months or more but who are inactive. An inactive subscriber is one who in the past six months has not received or made at least one call or who has not paid for Pelephone services.

(3) Average monthly use per subscriber (in minutes) is calculated by the average monthly total outgoing minutes and incoming minutes in the period, divided by the average number of subscribers in the same period.

(4) Average monthly revenue per subscriber is calculated by dividing the average monthly revenues from cellular services (airtime, usage fees, call completion fees, roaming fees, value added services, and other), and repair and other services in the period, by the average number of active subscribers in the same period.

(5) After interconnect tariffs were lowered on January 1, 2011 (see section 1.7.3C in Description of the Company's Operations in the periodic report for 2010), average monthly revenues per subscriber in Q1 – Q4 of 2010 were presented on the basis of the reduced interconnect charges (in addition to the regular presentation) for the sake of comparison with the data for the first, second and third quarters of 2011.

(6) The data has been calculated on the basis of the interconnect tariffs in effect at each period.

(7) The churn rate of subscribers is based on the ratio between subscribers who disconnected from the company's services and subscribers who became inactive during the period, to the average number of active subscribers during the period.

C. Bezeq International

(NIS millions unless stated otherwise)

	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Revenue	351	332	329	350	347	340	343
Operating profit	61	60	61	65	70	124	62
Depreciation and amortization	28	26	24	25	23	23	23
EBITDA	89	87	85	90	93	147	84
Net profit	46	46	46	46	53	108	46
Cash flow from operating activities	57	68	42	92	75	66	59
Payments for investments in property, plant and equipment and intangible assets (1)	92	47	46	80	30	33	37
Free cash flow (2)	(34)	21	(4)	12	45	33	23
Churn rate (3)	3.2%	2.8%	2.9%	3.5%	3.2%	2.9%	3.2%

(1) The item also includes long-term investments in assets

(2) Cash from operating activities less purchase of property, plant and equipment and intangible assets, net.

(3) The number of Internet subscribers who left Bezeq International during the period, divided by the average number of registered Internet subscribers in the period.

D. DBS

(NIS millions unless stated otherwise)

	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Revenue	405	404	406	400	396	396	394
Operating profit	63	65	61	41	72	7	19
Depreciation and amortization	74	71	69	85	68	68	61
EBITDA	137	136	130	126	140	75	488
Net profit (loss)	(76)	(88)	(73)	(84)	(78)	(143)	)8(
Cash flow from operating activities	134	119	141	132	126	110	481
Payments for investments in property, plant & equipment & intangible assets, net (1)	67	64	71	90	65	63	64
Free cash flow (2)	67	54	70	42	62	47	63
Number of subscribers at the end of the period (thousands) (3)	585	581	580	578	575	573	174
Average monthly revenue per subscriber (NIS) (ARPU) (4)	232	232	234	231	229	231	889
Churn rate (5)	2.8%	2.9%	3.3%	3.1%	3.3%	3.1%	3.1%

(1) This item also includes investments in the cost of acquiring subscribers

(2) Cash from operating activities less purchase of property, plant and equipment and intangible assets, net.

(3) Subscriber – one household or one small business customer. In the event of a business customer with multiple reception points or a large number of decoders (such as a hotel, kibbutz or gym), the number of subscribers is calculated by dividing the total payment received from the business customer by the average revenue from a small business customer.

(4) Average monthly revenue per subscriber is calculated by dividing DBS's total revenues (revenues from content and equipment, premium channels, technical service, advanced products, one-time sale of content, revenues from channels, internet and other) by the average number of customers.

(5) The number of Internet subscribers who left DBS during the period divided by the average number of registered DBS subscribers in the period.

Section 1.6 – Forecast for the Group

Gross capital expenditures in 2011 are projected to be 15% higher than in 2010, primarily due to an increase in investments in infrastructure by the Bezeq Group companies. Insofar as the Bezeq Group decides, in 2011, to exercise the possibility of purchasing real estate that will serve as the Group's headquarters, replacing leased properties, its gross capital expenditures will increase by an additional 5% to 10% in 2011.

The Company's forecasts specified in this section are forward-looking information. In this instance, see Section 1.6 (last paragraph) of the Periodic Report for 2010.

Section 1.7 - General environment and influence of external factors on the Group's activities

Section 1.7.1 – Formation of groups in the Israeli communications market and transition to inter-group competition

HOT-Mirs Group – in accordance with Hot's report, on September 20, 2011 the General Meeting of Hot approved an agreement with a company controlled by Altice VII S.A.r.l, which is the sole shareholder of HOT's controlling shareholder, and with Migad Communications (Limited Partnership), to acquire all their rights in Mirs such that upon completion of the transaction, Mirs will become wholly owned and controlled by Hot.

IDB Group – in accordance with reports by Cellcom Israel Ltd. ("Cellcom") and Netvision Ltd. ("Netvision"), on August 31, 2011 a merger was completed between Netvision and a wholly owned subsidiary of Cellcom in which all Netvision's shares were acquired.

Section 1.7.3 - Regulatory oversight and changes in the regulatory environment

Sub-section A - Policy for regulating competition – Hayek Committee

On October 4, 2010, the Hayek Committee Report was published, including its final recommendations. The full report is attached to the Company's Immediate Report from October 5, 2010, presented by way of reference. Following are the key recommendations included in the Report:

1. Development of a wholesale market – holders of a general domestic carrier license:[4]
   - Will serve and enable use of all the relevant infrastructures so as to allow other telecommunications license holders to operate and render services to end customers.
   - Broadband access services will be given immediately so as to enable operation and control by service providers who do not have infrastructures to manage the service;
   - Shall reach agreements with other license holders regarding the aforementioned services and uses, including the service specification, method of ordering them, prices, and arrangements for service level agreements (SLA). The regulating body shall be authorized to force changes in these agreements if they do not comply with the rules mentioned in the recommendations;
2. Setting prices:

   Until prices are set by the regulating body, each wholesale service will have a standard price, independent of the consumer's characteristics; retail services sold by holders of a general domestic carrier license, including internet infrastructure on all bandwidths and the sale of call minutes, will be sold to other license holders at a price of no more than 75% of the average retail price that the Company offered private customers during the period July-September 2011. This arrangement will apply for six months from the time that the Minister of Communications approves the recommendations. The Minister of Communications may extend this period by six months only. The regulating body may determine that the prices of these services will not be set in accordance with the principle of cost, if he is of the opinion that this will not affect competition in this sector.

   A maximum price will be determined for these services, and they will be costed by the regulating body based on the principle of cost, addressing incentives for making investments.

[4] Currently applies to the Company and HOT.

The rate of return on the capital will be dynamic, based on the companies' risk levels in any given year. Prices will be reviewed once in 3 years.

The regulating body's involvement may be eliminated in due course if it is convinced that a wholesale market has developed and that competition in the sector has significantly improved.

3. Structural separation:

The current obligation for structural separation with respect to fixed line and other telecommunications services will be abolished (and will be replaced by separate accounting) after six months have elapsed from the date on which these agreements are signed or from the date on which general domestic carrier license holders begin to supply the wholesale services as determined in the said agreements, the earlier of the two (except for structural separation in multi-channel TV which will be abolished after the broadcasting of internet TV is permitted. If no such agreement is achieved, the structural separation will be abolished when the tariffs are set.

To allow all companies and communications groups to offer all telecommunication services (that they do not provide today) without any structural separation restrictions. All companies will be prohibited from transferring information between the wholesale and retail sector.

If no such wholesale market becomes operational within 24 months of the publication of the committee's recommendations, the regulating body will take action to implement structural separation between the infrastructure of the general domestic carrier license holders and the services rendered to end customers.

4. Retail price control:

An immediate move (independent of any other subject in the committee's recommendations) to take control of the Company's retail prices by setting a maximum tariff. The regulating body will revise the maximum price from time to time and it will be calculated based on the cost principle; the maximum price will be deregulated by setting tariffs in the regulations, and moving over to price control under Section 17 of the Communications Law after the regulating body is persuaded that the level of competition in this branch makes this possible. After the deregulation of prices and the removal of structural separation, the regulating body will consider canceling the fixed usage fees collected by the Company.

5. Telecommunications venture over IEC infrastructures

The committee attributes considerable importance to advancing activity by a telecommunications company which is expected to operate on the infrastructure of the Israel Electric Corporation (IEC) and believes that, with respect to the supply of wholesale services, the regulations to be applied to the entity that emerges from this initiative should be similar to those applicable to the other general domestic carrier license holders.

6. Consumer perspectives

The telecommunications companies shall allow all consumers to benefit from all the price packages that they offer; obligations will apply and action shall be taken to inform customers and advertise prices, and the information must be accessible to consumers.

The Committee also recommended that general domestic carrier license holders shall regularly publish details of the layout of the existing infrastructures for other license holders, in accordance with the requirements of the regulating body (with certain exceptions to be defined by the defense establishment), they shall deposit autonomous bank guarantees in the amount of NIS 200 million to guarantee that a wholesale market is maintained (parts and portions of the guarantee may be forfeited as determined by the regulating body), that the company managers will bear personal liability for the cost of the domestic carrier license if they fail to allow competitive use of the infrastructures, and that all the recommendations will be anchored in primary legislation that also prescribes sanctions should the domestic carrier companies fail to comply with the wholesale market regulations.

The Committee's recommendations are subject to the approval of the Ministers of Communications and Finance, and to their actual adoption and implementation.

At this stage, the Company is unable to estimate the repercussions of the report on its business performance, in part due to the dependence on way in which the recommendations are adopted and implemented.

Sub-section B – Increase in the rate of royalties – in addition to the petition filed by the Company in connection with increasing the rate of royalties, additional petitions were filed in the same matter by other communications companies, including Pelephone. All the petitions will be heard as one case. At a hearing of the petitions held at the High Court of Justice ("HCJ") on June 16, 2011, HCJ's decision was accepted in which by August 1, 2011, the State will announce its position regarding HCJ's proposal for ending impasse raised in the petition by mutual agreement. According to the proposal, the rate of royalties in 2012 will be 1.75% (instead of 2.5% in the regulations), and for subsequent years, HCJ's ruling 10289/05 shall apply, in which context the State announced that it is adopting the outline recommended by the Gronau Committee, whereby the rate of royalties applicable to the petitioner (Barak) will be reduced until they are entirely eliminated in 2012. Likewise, the State's position shall apply as presented in a written announcement given by them to the court in February 2009, whereby adoption of the said outline is subject to no circumstances occurring that have negative repercussions for the economy at the relevant dates. Accordingly, on July 31, 2011, the State announced its consent to HCJ's proposal. On September 20, 2011, the State advised the HCJ that the wording of the amended Satellite Regulations included part of the compromise proposal with respect to 2011 and 2012 only, with the intention of completing the necessary amendment for 2013 at a later stage. After the Knesset recess, the respondents intend to submit the amendment of the rest of the necessary regulations for the approval of the Knesset so that the rate of royalties for 2012 will be reduced to 1.75%, and from 2013 they will be 0%. HCJ decided that the State must submit a further update notice by November 30, 2011.

Section D – limitation of the exit fee that a license-holder may collect from a subscriber: on August 8, 2011, the amended law took effect with the following key changes: Its provisions shall apply to a subscriber whose average monthly bills are less than NIS 5,000; an exit fee shall not be collected from a subscriber who entered into an agreement with the service provider after the onset date of the amendment to the law and then cancelled his subscription. From November 8, 2011, the amendment to the law will also apply to subscribers who entered into an agreement before the amended law took effect and cancelled the agreement later on, however payment for canceling the agreement, limited to 8% (of the monthly fees) may be collected from such a subscriber.

The Company, Bezeq International, and DBS are of the opinion that the amendment to the law canceling the exit fee (if it is approved) may have further repercussions on the terms of the agreements with the companies' customers. This opinion is forward-looking information, as referred to in the Securities Law, that may not materialize or may materialize in a manner materially different from anticipations, in part depending on the conditions to be determined in the amendment to the law (if and insofar as the amendment is passed).

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

Section 2.2.2 – products and services - telephony

Regarding the operation of a unified telephony center, pursuant to a petition filed with HCJ in July 2011 in an application to issue an order nisi to turn access code 144 into a network access code, the State submitted its position to the effect that the petition should be dismissed due to absence of cause, and that the issues arising from it are under review by the ministry as part of the legislative measures awaiting completion. The State further announced that as part of the bill, the Ministry of Communications is considering formulating principles, including – prohibiting the supply information services without a Ministry of Communications license, obligating the operators to transfer their databases to such a license holder for reasonable payment, canceling allocation of the number 144 to the Company and allocating a different national access code to each holder of a license for information services.

Section 2.6.1 - Telephony

On September 7, 2011, the Ministry of Communications sent the Company a letter stating that it is of the opinion that retaining the price for the Company's NDSL service (the rate of which was determined by the Ministry of Communications) while the Company offers significant discounts to customers subscribing to its telephony services, reflects unreasonable business conduct by the Company and fails to meet the requirements of Section 17 of the Communications Law. The ministry therefore expects the Company to reduce the tariff significantly, and should it fail to do so, the ministry will consider taking further action. The Company is reviewing its steps on this matter. In this instance, see also Section 2.6.6(b)(4) of the Periodic Report for 2010.

Section 2.6.4 (b) – Other potential competing infrastructures

On October 9, 2011, the Ministries of Finance, Communications and National Infrastructures announced that they were initiating a move to choose an investor for a communications venture who will be responsible for the establishment of a third communications infrastructure in Israel, and in which IEC would hold 49% of the share capital. A selection committee will conduct the public process. Registration to participate in the process will commence on October 10, 2011, and the process is expected to last 6 months. It is worth noting that on October 25, 2011, an amendment to the Communications (Bezeq and Broadcasts) (Processes and Conditions for Obtaining a General License to Render Domestic Fixed Bezeq Services) Regulations, 5772-2011, was published, stipulating the conditions for granting an infrastructure domestic carrier license.

Section 2.7.2 – Domestic fixed-line communications infrastructure

The Company is preparing for further development of the network and a further increase of bandwidths offered to customers. To this end, the Company is examining a series of technologies, based both on the existing network and on the deployment of an optical fiber network to the customer's home (FTTH/FTTB). This review requires the Company to prepare itself and deploy its systems, and the Company has begun working in this direction.

Section 2.7.4 – Land

Sub-section E – review of an investment in land as a substitute for rental – on July 13, 2011, the board of directors gave the Company permission to negotiate with Carasso Real Estate Group for the purchase of a 25-dunam plot of land defined as plot no. T-3 according to Valid Plan PT/1/2004 (block 6365, parcel numbers 106 - 109 and 38, (among others), in Petach Tikvah's Kiryat Aryeh Industrial Zone ("the Plot"). The estimated price of the Plot is NIS 125 million plus VAT. Completion of the negotiations for the acquisition of the plot is expected to take several months. The Plot is slated for the construction of offices and communications facilities to replace the existing offices that are currently rented. Completion of the construction and occupancy is scheduled for the end of 2015. According to the Company's initial estimates, the entire project will cost NIS 700 million (including the price of the Plot as specified above and the relevant levies). This cost will be spread over the period of the project (5 years, as noted above) in line with the pace of progress in the construction work.

The Company's estimates regarding the project and its cost are forward-looking information, as defined in the Securities Law. These estimates are based, in part, on purchase and construction costs, the state of the real-estate market, and the Company's plans at the date of making the decision. These estimates may not materialize or may materialize in a manner materially different from that anticipated.

Section 2.9.7 - Employee benefit plans

In Section C – employee stock options plan (2010) – on March 16, 2011 the Company published a new outline as part of this plan which is incorporated by reference.

Section 2.9.8 - Officers and senior management in the Company

On March 16, 2011 Ran Guron was appointed as the Company's Deputy CEO (in addition to his position as VP of Marketing in the Company).

Section 2.11 – Working capital

During the third quarter of 2011, the Company shifted to positive working capital (in its solo and consolidated reports), mainly as a result of the raising of loans and the issuance of long-term bonds.

Section 2.14 - Taxation

Concerning the recommendations on amending the tax rates and their possible impact, see Note 12.7 to the Company's Consolidated Financial Statements for the period ended September 30, 2011.

Section 2.13.1 – Average and effective interest rates on loans

In view of the debt raised by the Company, as noted in the update to Section 2.13.3, below are current details about the distribution of long-term loans (including current maturities) and short-term loans, at September 30, 2011:

Loan period	Source of financing	Amount (NIS millions)	Currency or linkage	Type of interest and change mechanism	Average interest rate	Effective interest rate	Interest range in 2011
Long-term loans	banks	2,400	Unlinked NIS	Variable, based on prime rate*	4.45%	4.5%	3.17%-4.95%
	banks	1,800	Unlinked NIS	Fixed	5.76%	5.85%	5%-6.85%
	Non-Bank sources**	425	Unlinked NIS	Variable, based on STGL interest per annum **	4.46%	4.54%	4.46%-4.92%
	Non-Bank sources**	1,729	Unlinked NIS	Fixed	5.92%	6.38%	5.70%-6.65%
	Non-Bank sources***	2,541	CPI-linked NIS	Fixed	4.61%	4.09%	3.70%-5.95%

* Prime interest rate in October 2011 – 4.50%.

** The STGL (makam) yield per annum (812) – 3.062% (average for the last five trading days of August 2011) for the next interest period.

*** Not including debentures (Series 5) held by a wholly owned subsidiary.

Company loans in the total amount of NIS 7.3 billion include a cross-default mechanism that under certain conditions allows immediate recall of the debt should a third party demand immediate repayment of Company debts towards it due to a breach of contract.

Section 2.13.3 – Credit received during the Reporting Period

Bank / institutional debt raised in May 2011

Between May 12, 2011 and May 18, 2011, the Company completed the raising of NIS 2 billion of debt by means of loans from Israeli banks and from a financial institution (group). NIS 1.4 billion of this amount is long-term debt (at an average duration of 6.2 years) and NIS 600 million of this amount is short-term debt for a year. It should be noted that some of debt was raised as part of the exercising of a letter of undertaking for the extension of long-term credit that the Company received on February 17, 2011 from a bank, as mentioned in Section 2.13.7 in the 2010 Periodic Report, so that the scope of the undertaking according to the letter was reduced after the debt raising from NIS 1.5 billion to NIS 700 million.

In connection with this raising of debt, the Company made the following commitments towards each of the entities that had extended the credit (in this section – "the financing entities"):

1. An undertaking not to create any other liens on its assets (negative lien) under the same conditions as those of the negative lien given in favor of the banks, and subject to exceptions defined therein (see Note 14C(1) to the Financials of 2010).
2. The financing documents include accepted grounds for recalling the credit, including violations, insolvency, liquidation procedures, receivership or the like, as well as the right to demand immediate repayment if a third-party lender demanded immediate repayment of the Company's debts towards it for an amount that is more than the defined amount.
3. Regarding the long-term credit extended to the Company, the Company undertook that should it make an undertaking towards any lending entity whatsoever ("additional lender") in connection with financial criteria, the financing entities may (under certain conditions) ask the Company to sign an identical undertaking towards them.

Subsequently, on August 2, 2011, the Company took a long-term loan of NIS 600 million (5.3 years duration) to replace the short-term debt in the same amount mentioned above. Upon taking this loan, the letter of undertaking for the aforementioned credit is deleted.

In this instance, see also Note 12.2 to the Company's consolidated financial statements for the period ended September 30, 2011.

Debentures issued to the public in June 2011

On July 3, 2011, the Company issued debentures (Series 6-8) in accordance with a shelf proposal from June 29, 2011, which was published by virtue of the shelf prospectus, as follows:

(a) NIS 958,088,000 nominal value debentures (Series 6), bearing fixed annual interest of 3.70%, as defined in the issuance offer. The debentures (principal) shall be repaid in 5 equal, annual installments, payable on December 1 every year from 2018 through 2022 (inclusive). The first interest payment will be made on December 1, 2011, and subsequently the interest will be paid twice a year on June 1 and December 1 every year from 2012 through 2022. The principal of the debentures (Series 6) and their interest shall be linked to the CPI published in June 2011 in respect of May 2011.

(b) NIS 424,955,000 nominal value debentures (Series 7), bearing variable interest at the short-term government loan ("STGL") yield per annum ("base interest"), plus a margin of 1.40% at the rate determined in the issuance tender. The debentures (principal) shall be repaid in 5 equal, annual installments, payable on December 1 every year from 2018 through 2022 (inclusive). The first interest payment was made on September 1, 2011, and subsequently the interest will be paid four times a year on March 1, June 1, September 1, and December 1 2011 through 2022 (in 2011 – on September 1, and December 1, only). The debentures (Series 7) are not linked to the CPI or to any currency.

(c) NIS 1,329,363,000 nominal value debentures (Series 8), bearing fixed annual interest of 5.70%, as defined in the issuance tender. The debentures (principal) shall be repaid in 3 equal, annual installments, payable on June 1 every year from 2015 through 2017 (inclusive). The first interest payment will be made on December 1, 2011, and subsequently the interest will be paid twice a year on June 1 and December 1 every year from 2012 through 2016. The last interest payment will take place on June 1, 2017. The debentures (Series 8) are not linked to the CPI or to any currency.

In total, the Company received consideration of NIS 2,712,406,000 in respect of the debentures (Series 6-8), allotted according to the shelf proposal.[5]

For further details on this subject, see the Company's shelf proposal report from June 29, 2011 and an announcement on the results of the issue according to the Company's shelf proposal report from June 30, 2011, which is incorporated by reference. See also Note 12.4 to the Company's consolidated financial statements for the period ended June 30, 2011.

<u>Section 2.13.6 - Credit rating</u>

On April 3, 2011 the Company was notified by Midroog Ltd. which grades the Company's debentures (Series 4 and 5), that it had been removed from its watch list for the rating of these debentures, while retaining its rating (Aa1) with negative outlook, following the planned reduction of its capital and distribution of a special dividend of NIS 3 billion as decided by the Company and approved by the district court.

On June 29, 2011, Midroog announced a rating of Aa1, negative outlook, for the NIS 3 billion debentures (Series 6-8) to be issued by the Company, and application of the same rating to the Company's debentures in circulation.

On June 29, 2011, S&P Maalot announced that it had set a rating of ilAA+ (ilAA plus)[6] for the Company's new debentures (Series 6-8) in the amount of NIS 3 billion.

<u>Section 2.13.7 - Company assessment for raising financing and possible sources in 2011</u>

On this subject, see update to Section 2.13.3.

<u>Section 2.16.2 – the Company's domestic carrier license</u>

Sub-sections (C) & (D) – marketing of joint service bundles and tariffs, on July 3, 2011, the Company received a letter from the Director General of the Ministry of Communications concerning the price of broadband internet access services – prices for subscribers and marketers. In the letter, the Ministry of Communications asserts that the Company's conduct regarding the prices offered for broadband internet access deviates from the provisions of its general license and applied practice and the Company must correct this deviation from its license.

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[5] Within the context of the issuance of the aforementioned debentures, Eurocom Capital Underwriting Ltd. (a company controlled indirectly by Eurocom Communications Ltd., the Company's indirect controlling shareholder), acquired 43,938,000 debentures (Series 6), 18,885,000 debentures (Series 7), and 48,849,000 debentures (Series 8). (For details of the remaining holdings at the date of the report, see Note 7.5 to the Company's consolidated financial statements for the period ending September 30, 2011.) Accordingly, as of the date of the acquisition of the said debentures, Eurocom must report as a principal shareholder in the Company by virtue of its holdings.

[6] The Company's rating is ilAA+ - negative outlook.

Further to the Ministry of Communications' request, the Company informed the ministry, without admitting to the contents of the letter, that it would revise the price of internet access infrastructure for new subscribers to its joint service bundles (through the Company and through ISPs) as well as for new subscribers who purchase infrastructure services separately.

Sub-section (D) – Tariffs – pursuant to the Communications Announcement (Bezeq and broadcasts) (Calculation and linkage of Bezeq payments), 5771-2011, the Company's tariffs were revised as of June 1, 2011, based on the formula prescribed in the Communications Regulations (Bezeq and Broadcasts) (Calculation and linkage of payments for Bezeq services) (Amendment), 5767-2007, so that the fixed monthly payment for a telephone line and for ISDN-BRA services rose by 2.66%, and the other services provided by the Company that are prescribed in the regulations (including interconnect fees) were reduced by 0.65%.

Section 2.16.8 – Antitrust Laws

On June 30, 2011 the Antitrust Authority asked the Company for information within the context of its investigation of the Company's activity regarding the supply of bundle services (on this subject see also the update to Section 2.16.2).

Regarding sub-section G on the subject of a review by the Antitrust Authority of the Company's conduct with respect to the supply of transmission services by the Company to competing domestic carrier companies, on October 11, 2011, the Antitrust Authority informed the Company that the Commissioner was considering issuing a ruling in accordance with his powers under Section 43(A)(5) of the Antitrust Law, that the Company had abused its position in contravention of the provisions of Section 29A of the Antitrust Law. The notice stated that the Commissioner considers determining that:

A. The Company refused to supply transmission services that provide telephony and internet services (domestic carrier) to Cellcom Israel Ltd. ("Cellcom") and Partner Communications Ltd. ("Partner");

B. The Company's refusal is based on its position that it is not obligated and is not interested in supplying these services to its competitors;

C. The Company sells these transmission services to other customers and also sells transmission services to provide mobile radio telephone (MRT) services to Cellcom and Partner.

D. By refusing to sell these services, the Company abuses its status in contravention of the provisions of Section 29A of the Law.

The Commissioner's notice further states that before making his decision, the Company is given the opportunity to present its case in writing by November 27, 2011. Given that the Company believes that it is operating lawfully, it intends to exercise its right to a hearing. It should be noted that as described in Section 2.6.3 of the Periodic Report for 2010, as of October 2010, the Company also supplies infrastructure and transmission services to competing telecommunications operators.

Section 2.16.10 – Consumer legislation

On January 1, 2012 an amendment to the Consumer Protection Law will take effect whereby the Company will not be entitled to collect a commission, as defined in the law, for payment of its bills, and in which customers will be able to pay their bills by standing order at the bank, through their credit card or in cash, as well. The Minister of Communications may restrict application of the law with respect to certain consumers of the Company.

Section 2.17.1 – Material agreements concerning debentures

Deed of trust for debentures (Series 6) from May 31, 2011 and an amendment to the deed from June 21, 2011

A deed of trust signed with Reznik Paz Nevo Trust Ltd. for a series of up to 3,000,000,000 debentures to be issued according to a shelf prospectus.

Deed of trust for debentures (Series 7) from May 31, 2011 and an amendment to the deed from June 21, 2011

A deed of trust signed with Reznik Paz Nevo Trust Ltd. for a series of up to 3,000,000,000 debentures to be issued according to a shelf prospectus.

Deed of trust for debentures (Series 8) from June 21, 2011

A deed of trust signed with Strauss Lazar Trust Company (1992) Ltd. for a series of up to 3,000,000,000 debentures to be issued according to a shelf prospectus.

For further details concerning the debentures from the aforementioned series, including details about the issue of debentures from these series according to a shelf prospectus from June 29, 2011, see update to Section 2.13.3. Sub-section (b) – Deed of Trust for debentures (Series 5) from May 24, 2004

On June 16, 2011, the Company received notice from Mizrahi-Tefahot Trust Company Ltd. ("Mizrahi-Tefahot") that its tenure as the trustee for the Company's debentures (Series 5) had expired, consistent with the provisions of Sections 35E(2) and 35N(A)(3) of the Securities Law, 5728-1968, due to a possible conflict of interests, in view of credit given to the Company and/or its controlling shareholder by Mizrahi-Tefahot Bank Ltd, which is the trust company's parent. Consequently, the Company is taking action to appoint a trustee to replace Mizrahi-Tefahot. Until another trustee is appointed, MIzrahi-Tefahot will continue to serve as trustee.

Section 2.18 – Legal proceedings

Section 2.18.1 – with respect to claims concerning the recognition of various salary components, in October 2011 a former employee of the Company filed an action against the Company at the Tel Aviv District Labor Court that includes an application for its certification as a class action. The main purpose of the action is a request to refund wage differences stemming, according to the claimant, from a failure to include two wage supplements, on-call duty fees and premium, that he alleges should have been included in the hourly rate when calculating overtime and the redemption of vacation days. The claimant applied for certification of the action as a class action in the amount of NIS 150 million in the name of some of the Company's employees and pensioners. It should be noted that there are several legal proceedings pending against the Company (including "collective" proceedings) on similar and/or identical matters to this claim, as noted in Section 2.18.1 of the Company's periodic report for 2010.

Section 2.18.6 – regarding an arbitration claim filed by one of the shareholders in DBS against the Company and against another DBS shareholder, on July 5, 2011, the parties signed an agreed announcement concerning a settlement of the case whereby the claim would be rejected and the claimant waives all its claims. The compromise settlement was certified in an arbitration ruling on August 2, 2011.

Section 2.18.8 – In the matter of a claim filed in the Tel Aviv District Court in July 2010 together with a motion for its certification as a class action, alleging that as a result of a fault in the telephone lines, Company subscribers were prevented from communicating with HOT subscribers, on April 13, 2011 the court approved the removal of the claimant from the application.

Section 2.18.11 – with regard to four claims together with applications to certify them as class actions concerning a malfunction of the Company's network on January 25, 2011, the claims that were filed at the Nazareth, Haifa and Central Region District Courts were transferred to the Tel Aviv District Court.

Section 2.18.10 – with respect to a claim including an application for its certification as a class action that was filed against the Company in October 2010 at the Tel Aviv District Court alleging that the Company does not provide a written document that includes the details required under the Consumer Protection Law – on September 20, 2011, the applicant submitted a motion for abandonment (with consent). The court has not yet issued its ruling on this matter.

Section 2.18.13 – concerning legal proceedings in connection with an application to approve a distribution that does not meet the profit test, that was filed with the Tel Aviv District Court (Economic Department), as well as two applications by shareholders of the Company in which context it is alleged that the Company must take legal measures against its senior officers in connection with loans taken by the Company that were (allegedly) used to distribute dividends to the shareholders – see the update to Section 1.4.3.

In October 2011, a motion was filed at the Tel Aviv District Court, together with an application for its certification as a class action, alleging that the Company unlawfully broadcasts self advertising on the music on hold (MOH) (music played to callers during hold time, when calling a subscriber to the service) about subscribing to the service. The claimants estimate the total amount of the claim for all members of the group at NIS 199.5 million, and it comprises a request to refund the service fees to subscribers for the service as well as a request for compensation in respect of prohibited advertising (for callers to subscribers to the service), and all from the date on which the Company commenced this service.

3. Mobile radio-telephone (cellular telephony) - Pelephone Communication Ltd. (“Pelephone”)

Sections 3.1.3 and 3.1.4 – Changes in the volume of operation in the field and in its profitability and Market developments (respectively)

Various regulatory amendments, including a restriction on exit fees, led to the removal of transfer barriers and intensified the competition between the cellular operators and as a result, to an increase in the number of transferring subscribers among the cellular operators. This caused a churn rate of approximately 14.2% for the first nine months of 2011, compared with 15.3% throughout 2010.

In addition, it should be mentioned that in recent months competition between the companies has intensified. The increased competition has resulted in an erosion of tariffs and the average revenue per subscriber for new customers as well as existing customers, in an effort to retain them.

Pelephone expects these trends to continue in forthcoming quarters as well, and possibly even to intensify with the entry of the new operators.

Pelephone's aforementioned estimates are forward-looking information, as defined in the Securities Law. These estimates may not materialize, may materialize in part or may materialize in a manner that differs significantly from forecasts.

Vigorous subscriber traffic in the cellular market and a rise in demand for handsets and for smartphones in particular, contributed to an increase in revenues from terminal equipment which for the first nine months of 2011 totaled NIS 1,521 million, representing 35.3% of total revenues, compared with revenues of NIS 1,182 million, accounting for 20.6% for the whole of 2010. Most terminal equipment is sold in 36 installments and this increase in sales led to an increase in the number of Pelephone's customers and a worsening of cash flows from on-going operations.

Section 3.7.2 A - Entry of another operator with its own infrastructure

In April 2011 a tender was held to grant frequencies and a license for cellular operators that own infrastructures. Mirs Communication Ltd. (of the HOT-Mirs Group) and another company won the tender. Due to the fact that the other company and another bidder failed to comply with the conditions of the tender, the ministry of Communications Tendering Committee awarded the right to the cellular license to Golan Telecom Ltd. Under the terms of the tender, the new operators will be able to launch their operation after deploying a cellular network which initially will cover 10% of the population of Israel. After the deployment, the new operators will be able to use the networks of the existing operators for a period of seven years (with an extension option subject to approval for up to a further three years) based on a national roaming model.

Under the tender, Mirs Communications Ltd. will pay NIS 710 million and Golan Telecom Ltd. will pay NIS 360 million in license fees (the “maximum license fees”) at the end of 5 years. The maximum license fees will be reduced by one seventh (1/7) (approximately 14.3%) for each percent (1%) of market share they accumulate in the private sector in the five years following the grant of the license, so that a new operator achieving a market share of 7% in the private sector will not pay any license fees.

To guarantee payment of the license fees, the new operators undertook to submit a bank guarantee in favor of the Ministry of Communications in the amount of the maximum license fees.

Following a hearing which took place regarding an engineering and operational national roaming arrangement, in April 2011 a decision regarding an amendment to the above-mentioned license was published.

In July 2011, the Ministry of Communications issued a press release listing the main recommendations of the inter-ministerial committee on "the sharing of infrastructures in the cellular market". Following are the key recommendations:

1. A model for the forced sharing of sites will be defined, giving preference to the possibility of involving the new operators.
2. Obtaining a permit to set up a site will be conditional on a proposal for cooperation for all operators.
3. The operators will be obligated to erect sites that facilitate sharing with up to four participants.
4. All the components and infrastructures used for broadcasting from a given facility will be shared, excluding active designated equipment (radio equipment).

5. With respect to sharing on a new site, all the costs of the site (one-time and on-going) will be divided equally among all the participants, and regarding an existing site, the on-going costs will be divided equally among the participants, and in addition one-time costs in respect of adjustment only, arising from the new participants' involvement in the site, will be divided among them.

6. All license holders will be encouraged and obligated to reduce the number of unshared sites each year.

Implementation of the recommendations requires them to be anchored in legislation. Implementation of the recommendations imposes significant restrictions on Pelephone's ability to spread its network.

Pelephone has contacted the Attorney General, submitting its reservations to the aforesaid recommendations. These reservations focus on the requirement to reduce the number of existing sites that are not shared and the economic model for the sharing of costs, whereby new participants in existing sites will only be required to bear their share of the "adjustment costs" and not the full costs of erecting the site.

Domestic roaming agreements

On November 8, 2011, Pelephone and Mirs Communications Ltd. ("Mirs") signed an agreement in which Mirs will purchase from Pelephone (exclusively) national domestic roaming services for its subscribers, on Pelephone's UMTS/HSPA network and the parties will also collaborate on sites. The agreement is until December 31, 2014 and is subject to the approval of the Antitrust Commissioner (should this be necessary) and the parties competent organs.

In October 2011, Cellcom announced that it had signed a domestic roaming services agreement and sharing of infrastructures with Golan Telecom Ltd.

Pelephone anticipates that the entry of the new operators will intensify competition in the cellular market.

Pelephone's assessments of the effect of the entry of the cellular operators with infrastructures into the cellular markets are forward looking information as defined in the Securities Law. These assessments are based on the competition structure in the market, the effects of past changes in it and the regulation which is expected to apply to the new operators as it is known at present. There is no certainty as to the effect these new operators will have. These assessments might not be realized or might be realized in a manner materially different from anticipations, inter alia, because of changes in the competition structure and regulatory changes applicable to the new cellular operators.

Section 3.12.1 – Suppliers of terminal equipment

In view of the rate of Pelephone's purchases from Apple Sales International ("Apple") during the first nine months of 2011, Apple is likely to be considered a principal supplier of Pelephone in 2011. Accordingly, at the end of 2011, Pelephone will examine its annual purchase rate and insofar as the supplier is considered a principal supplier, the 2011 report will be revised accordingly.

Section 3.15.2 A – Undertaking towards banks

Pursuant to legal position 104-15 of the Israel Securities Authority from October 30, 2011, following are further disclosures concerning the financial covenants for reportable credit:

Financial covenants to which Pelephone is committed	At December 31, 2010	At September 30, 2011	Maximum ratio required
Pelephone's total debts shall not exceed 3 times its equity	6600	66.1	3666
Total debts shall not exceed NIS 3.8 billion (linked to the known index for January 2002. at September 30, 2011 = NIS 4.82 billion).	16.0	16.6	26.4
Liability to a particular bank that its debts towards the bank shall not exceed 40% of the cumulative amount of all Pelephone's debts towards financial institutions, including bond holders.	1362%	1263%	26%

Section 3.17.1 – Provisions of law pertaining to the environment that apply to Pelephone's operations

As part of the Ministry of Interior's discussion of environmental matters on May 4, 2011, it was decided to ask the Minister for Protection of the Environment to delete from the proposed wording of the regulations, the instruction that makes a distinction between a balcony and a roof terrace regarding the prohibition on erecting and operating a source of radiation. By virtue of the foregoing, and due to disagreements on this subject, promulgation of the regulations was delayed, and as far as Pelephone is aware, up to the date of the report the regulations have not yet been approved. On May 31, 2011, the World Health Organization's International Agency for Research on Cancer (IARC) published an announcement to the effect that radiofrequency electromagnetic fields associated with the use of mobile phones may be carcinogenic to humans (Group 2B).

Section 3.18.1 B – Wireless Telegraph Ordinance

In July 2011, the Ministry of Communications refunded Pelephone NIS 41.4 million in frequency fees for which it had been overcharged when exercising the right to use 3-G frequencies.

As part of the exercising of this right, Pelephone must pay the frequencies fee for the period from 2003 until the date on which it exercised its right – i.e. 2008. The Ministry of Communications based the charge on the maximum frequency tariff prescribed in the regulations, as of 2003. During the course of the legal action taken by Cellcom and Partner, it was stipulated that the Ministry of Communications must charge the companies a reduced tariff, gradually increasing from year to year, and charge the maximum tariff only from the fifth year (2008). This amount includes interest and linkage differences in the amount of NIS 5.4 million that were credited to the Income Statement as financing income, and the remainder, deducted from the intangible asset.

Concerning Section 3.18.3 – Royalties

Concerning a petition on the subject of the rate of royalties, see the update to Section 1.7.3.

Section 3.18.4 – Site construction licensing

On April 13, 2011, the State submitted another revised statement to HCJ whereby on April 11, 2011, the Tendering Committee announced the two winners of the tender for new cellular operators in Israel. In view of the above, and of the intention to give the new operators a license in the near future, the statement said that the Attorney General is considering applying to the HCJ to limit the temporary order that was issued regarding the possible erection of wireless access facilities by the two new operators, even without a building permit. On August 30, 2011, the State submitted a further revised notice to HCJ, according to which, inter alia, the Attorney General is of the opinion that a decision should be made that the temporary injunction should be restricted under certain conditions to a pre-defined period, until July 31, 2012, with respect to the new operators only. In view of the above, on September 6, 2011, HCJ qualified the temporary injunction it had issued consistent with the conditions put forward by the Attorney General in his response from August 30, 2011. Further to the above, it should be noted that on April 28, 2011, the Forum for Cellular Sanity filed another application for an interim injunction to prohibit progress for the supply of Fourth Generation broadcasts until a public hearing has been held or a ruling has been handed down on the petition. On July 3, 2011, HCJ rejected the application on the grounds that the requested relief was too general and far reaching. On June 5, 2011, HCJ issued a decision whereby the Attorney General must submit a further updated statement by July 19, 2011 that also addresses a limitation of the interim injunction.

Section 3.21 – Legal proceedings

A. Claims added during the period

In August 2011, a motion was filed at the Petach Tikva District Court against Pelephone, Cellcom, and Partner, together with an application for its certification as a class action. The amount of the action against the respondents is not specified. The action refers to the charge for calls made overseas when the call duration is rounded up to the nearest whole minute, and this, as alleged by the claimant, contrary to the provisions of the license and in contravention of the law.

B. Terminated claims

1. Section 3.21.1 C – concerning a motion from August 2006, and an application for its certification as a class action to refund amounts in respect of the time of disconnecting calls made from a cellular network to the Bezeq or Hot networks, in October 2011 a ruling was handed down dismissing the appeal that the claimants had filed in this action.
2. Section 3.21.1 F – concerning a motion from August 2009 and an application for its certification as a class action, alleging that Pelephone saves SMS messages sent through the Pelephone network on Pelephone's systems, in September 2011, a ruling was handed down approving the compromise agreement reached by the parties. The compromise settlement stipulates that Pelephone will supply 4 million SMSs to be used by charitable associations, and in addition, Pelephone paid lawyers fees and insignificant owners' expenses.
3. Section 3.21.1. G – concerning a motion from August 2009 and an application for its certification as a class action against Pelephone and other respondents in respect of services provided by the respondents and charged for through the cellular phone bill (information sent by SMS), in September 2011, the plaintiff filed an application to withdraw from the action and a ruling was issued approving the application for abandonment.
4. Section 3.21.1(M) – concerning a claim from October 2010 and an application to certify it as a class action for the restitution of amounts collected for services supplied by the respondents Unicell, Telemesser and Select by cellular telephone, in May 2011 the applicants withdrew their application (and undertook not to file it again) with the court's approval, which was given the validity of a court ruling.
5. Section 3.21.1(N) – concerning an action from October 2010 and an application for its certification as a class action alleging that Pelephone is acting in contravention of the Consumer Protection Law by failing to provide its customers with a written document containing the details required under the Consumer Protection law, when entering into an agreement for changing or adding to a continuing transaction, in June 2011, the court decided to allow the plaintiff to withdraw his application for certification.
6. In June 2011, a motion was filed at the Tel Aviv District Court against Pelephone, Cellcom, Partner, and Mirs, together with an application for its certification as a class action. The applicant estimates the amount of the action against Pelephone at NIS 503 million. The motion refers to the sale of accessories for carrying handsets on the body that do not comply with the instructions of the handset manufacturers and the Ministry of Health with respect to non-ionizing radiation. In addition to the financial relief, additional relief in the form of an injunction to prohibit the sale of these items, or alternatively to publish a warning, is requested. In September 2011, the application against Pelephone was dismissed outright, after the court concluded that there is no firm evidence for the filing of an action against Pelephone.

4. International communication, internet services and NEP– Bezeq International Ltd. ("Bezeq International")

Section 4.1.7 – Structure of competition and the applicable changes in the sector

On September 6, 2011, the Minister of Communications announced that it had given the Israel Telecommunications Company Ltd., a general license for providing international Bezeq services. The license will allow Bezeq to begin supplying international services within six months.

Concerning completion of the Cellcom-Netvision merger, see the update to Section 1.7.1.

Section 4.20 - Legal Proceedings

Section 4.20.2 – concerning a claim together with an application to certify it as a class action on the subject of the raising of tariffs for internet access services following the first year of operation and charging the plaintiff for services that it claims it did not order, on June 5, 2011, a ruling was handed down in which the court rejected the claim and the application for its certification as a class action. Subsequently, on September 4, 2011, an appeal against the ruling was filed with the court.

Sections 4.20.4 and 4.20.5 – The two petitions filed by Partner in the High Court of Justice (in the matter of awarding a license to provide international communications services to Partner and in the matter of determining a uniform interconnect fee for outgoing international telephone calls from a cellular phone which is the same as the interconnect fee for incoming calls) were dismissed upon an application from Partner on March 24, 2011.

5. Multi-Channel Television – D.B.S. Satellite Services (1998) Ltd. ("DBS")

Section 5.1.4 - Market developments in the field of operation

Section 5.1.4A - In March 2011 the Ministry of Communications published the Broadcasting via Digital Broadcasting Stations Bill, 2011. The bill is designed to expand the DTT setup within 24 months of the publication date of the law, so that, *inter alia,* the Knesset channel, Educational TV channel and other designated channels that request to do so will be added (in addition to the designated Russian-language channel, the designated Arabic channel, and the designated channel for Israeli and Mediterranean music), although broadcasting a designated channel over and above five designated channels is subject to available capacity for this purpose. Any of the above channels may be added upon request with payment of a distribution fee. It is also proposed that the Minister of Communications may, in consultation with the Minister of Finance, the Council and the Second Authority, add more channels to the DTT setup by their request upon payment of a distribution fee. Furthermore, under the proposed memorandum of law, beginning January 1, 2014, the DTT setup and its operation would be transferred from the Second Authority to a public body, statutory corporation or government company which are not broadcasters nor supervise TV or radio broadcasts, which shall be appointed by the Minister of Communications and Minister of Finance and approved by the government. Subsequently, in July 2011, the Carriage of the Digital Broadcast Station Transmissions Bill, 5711-2011, passed its first reading with some changes made in the legislative memorandum. Accordingly, the DTT setup will be expanded within two years of publication of the law or by December 31, 2013, whichever is earlier. As far as DBS is aware, at the date of this report, the bill is being discussed by the Knesset Finance Committee which is also discussing possible changes to the bill.

Section 5.4 – New products

Regarding the regulation of broadcasts on new platforms and using new technologies – in October 2011, the joint Ministry of Communications and Council task force submitted to the Minister of Communications, its recommendations concerning the method and process of regulating virtual-TV broadcasts (audio-visual content) over the internet. The primary recommendation is to shift from regulation based on transmission and recording methods to regulation based on output, so that internet-TV broadcasts should have the same features as the broadcasts currently offered by the broadcasting entities (the criteria for determining these features were included in the task force recommendations), they shall be subject to regulation by the Council and any other relevant regulating entity. It was also recommended that a follow-up team be established, involving all the relevant entities, including the Ministry of Communications, the Council, the Israel Broadcasting Authority (IBA) and the Second Authority for Television and Radio for the purpose of reviewing and adapting the existing regulations that apply to the present world of broadcasting to the developing world of broadcasting, in an effort to create a standard, comprehensive set of regulations for both the existing and new world of broadcasts (including a recommendation on appropriate legislative amendments). The team noted that the task force must continue to take into account possible changes in the distribution of revenues between the broadcasting entities and the new entities and the expansion of the range of broadcasting entities that will be subject to the new regulations. The team further recommended that insofar as the new broadcasting entities continue to replace the regulated broadcasting entities (the team found that the replacement rate is still low), which will have a negative economic impact on the regulated broadcasting entities even before the recommended regulations are adopted, the regulating entities should work for the adoption of urgent, temporary regulations to include temporary alleviations for the supervised entities and/or impose obligations tailored to the internet broadcasting entities. At the date of this report, the Minister of Communications has yet to make a decision regarding these recommendations.

Implementation of these conclusions by the Ministry of Communications may have repercussions for regulating VOD services provided by DBS and may also affect the development of the transfer of video content over the internet.

DBS's opinion in this instance is forward-looking information, as defined in the Securities Law, based in part on the recommendations of the task force as published at this date. There is no certainty that the Ministry of Communications will in fact implement these recommendations. This estimate may not materialize, or it may materialize in a manner that differs significantly from that anticipated, in part depending on the actual implementation of the recommendations and the content of the implemented regulations, if they are in fact implemented.

Section 5.6 – Marketing and distribution

Concerning the external marketers – in October 2011, DBS informed its external marketer on which it is partially dependent that it had violated the agreement with it and that it is canceling the agreement with it. At the date of this report, the external marketer disputes DBS's right to cancel the agreement. DBS is working to lessen any possible damage inherent in the termination of the agreement with the external marketer, stemming from the degree of dependence on it.

Section 5.12 – Human capital

Section 5.12.4 – concerning the third portion of the option warrants granted to the CEO of DBS – in September 2011, the Company's board of directors concluded that the changes in the holding structure of DBS will not affect the third portion of the options allocated to the CEO of DBS, and that they remain valid and may be exercised. For further details concerning the board of directors' decision, see an Immediate Report issued by the Company on September 12, 2011, presented by way of reference.

Section 5.15 - Financing

Section 5.15.5B – in connection with the expansion of DBS's debenture series (Series B) – in March 2011, after receiving approval from the banks and confirmation from the rating company that the rating of the expanded series would be ILA-, DBS implemented a private issue by way of an expansion of a series of debentures (Series B) in the amount of NIS 120 million, where half the proceeds of the issue will be used to repay long-term bank credit.

Further to legal position 104-15 of the Israel Securities Authority from October 30, 2011, following are stipulations and emphases, for the sake of good order, in connection with reportable credit:

Section 5.15.2 –

On the subject of a restriction on DBS in a financing agreement concerning undertaking liabilities from third parties – DBS may not undertake credit from a third party (excluding insignificant amounts under the specified conditions) without the consent of the banks.

Concerning a cross-default mechanism – it is stipulated that under the financing agreement, the violation of a significant commitment of debentures by DBS is construed as a material violation of a material agreement, and it therefore entitles the banks to immediately recall the bank credit. However, the banks may exercise this right only if the trustee has placed the debentures under immediate recall as a result of the aforementioned violation.

On the subject of the financial covenant concerning minimum debt service coverage ratio (DSCR) – the DCSR is measured between DBS's cash balances,[7] plus DBS's surplus before financing,[8] and the total principal repayments and interest payments.[9] The covenant targets rise gradually until 2013, when the covenant targets for the dates December 31, 2010 and September 30, 2011 were equal to a minimum DSCR of 1 and 1.05 respectively. At December 31, 2010 and September 30, 2011 DBS was in compliance with this covenant (DSCRs were 1.106 and 1.49 respectively).

On the subject of the financial covenants concerning maximum and minimum suppliers credit – this covenant is measured according to the balance of the liabilities to suppliers and service providers presented in DBS's financial statements for the period commencing at the beginning of that calendar year and ending at the end of the measured quarter. The covenant target is that supplier's credit shall be no less than NIS 300 million and no more than NIS 500 million.[10] At December 31, 2010 and September 30, 2011, DBS was in compliance with this covenant (suppliers' credit was NIS 410 million and NIS 432 million, respectively).

Section 5.15.5 –

Regarding the restriction that applies to DBS according to trust deed A with respect to its right to register senior liens in favor of additional bearers of securities or to include them in existing liens – DBS retains this right as long as the ratio between the comprehensive debt of DBS[11] (after the issuance of securities and taking the proceeds into account) at the end of the quarter preceding the issue and its EBITDA for the 12 months ending at the end of the last calendar quarter is no higher than 6.5.

Concerning the restriction that applies to DBS according to Trust Deed B, with respect to its right to record senior liens in favor of additional bearers of securities or to include them in existing liens – DBS retains this right as long as the ratio between the comprehensive debt of DBS[12] (after the issuance of securities and taking the proceeds into account) at the end of the quarter preceding the issue and its EBITDA for the 12 months ending at the end of the last calendar quarter is no higher than 5.7.

Concerning the financial covenant that applies to DBS according to Trust Deed B – every quarter DBS must meet a maximum debt/ EBITDA ratio[13] of 5.7. At December 31, 2010 and September 30, 2011, DBS was in compliance with this covenant (the debt / EBITDA ratios were 3.74 and 3.14, respectively).

Section 5.17 - Restrictions and supervision of the company

Section 5.17.5 – Despite the fact that in 2009 DBS's total investment in local productions exceeded 8% of its revenues from subscription fees, in February 2011 the Council informed DBS, among other things, that DBS had not complied with its obligation to invest in local production on the channels owned by external producers in 2009 or with its obligation to invest in local productions for infants, children and youth in 2009. The Council notified DBS that it had to compensate for the shortfalls of 2009 in 2011-2012 and in some categories also in 2013. DBS disputes some of the determinations of

7 Cash, deposits, and available-for-sale securities as they are at the end of the quarter according to DBS's financial statements, plus the unutilized balance of the short-term bank credit limit.

8 The total amount of net cash resulting from DBS's on-going operations over the last four quarters, net of the total amount of cash (net) used for investment activity during those four quarters according to the cash flow reports included in DBS's financial statements.

9 The total amount to be repaid in the four quarters subsequent to the quarter under review, against the long-term bank credit and against the debentures (Series A) and (Series B).

10 Concerning the maximum target, credit from suppliers who are interested parties in the amount of up to NIS 100 million shall not be taken into account as long as the credit form suppliers who are not interested parties is no more than NIS 500 million.

11 The comprehensive debt is defined in Trust Deed A: DBS's debts that are guaranteed in a senior lien, for an unlimited amount, on all DBS's assets, pari passu with the collateral that DBS created in favor of the holders of debentures (Series A).

12 The comprehensive debt is defined in Trust Deed B: DBS's debts guaranteed by a senior lien, for an unlimited amount, on all the debts of DBS, pari passu with the collateral that DBS created in favor of the holders of debentures (Series A), net of cash amounts and monetary deposits available to DBS.

13 The ratio between the comprehensive debt (as defined in footnote 12) and EBITDA of DBS (total operating profit from ordinary operations, before financing expenses and taxes, plus depreciation and amortization and plus provisions and extraordinary non-recurring expenses) for the 12 months ending in the relevant quarter.

the Council, and it has contacted the Council in an attempt to change its decision regarding the interpretation of Section 17A(b) of the Communications Regulations, stipulating that at least 50% of DBS' total investments in local productions must be in local productions that are broadcast on channels that it does not produce ("external channels"), as the Council is of the opinion that investments in productions broadcast on external channels that were produced with DBS' involvement should not be recognized.

On November 3, 2011, DBS received a Council decision from October 27, 2011, stating that to comply with the provisions of the section, DBS must ensure that there is no interest in productions broadcast on external channels; that the Council intends to instruct DBS to double its investment in external channels relative to shortfalls in this category during the period 2007-2009, and that it intends to recommend that the Minister of Communications should forfeit the guarantee deposited by DBS by virtue of its license. (DBS is unaware of the amount of the guarantee it will loose.) DBS intends to ask the Council to reconsider this decision. If the Council does not change its decision, there will be shortfalls in this category in 2010 and 2011 as well, and DBS will have to adjust the mix of its local productions and the manner in which they are ordered for coming years.

DBS's assessment of the shortfalls, the change in the said mix and the aforementioned sanctions is forward-looking information, as defined in the Securities Law. This forward-looking information is based on the Council's current decision and subject to the Council's decision after hearing DBS, and also, with the respect to the guarantee, to the Minister of Communications' decision. This estimate may materialize or may materialize in a manner that differs significantly from that anticipated, depending on the Council's decision and the decision of the Minister of Communications, if they are accepted.

In October 2011, the Council informed DBS that as of 2012 its revenues from subscription fees, which form a basis for calculating the obligation for original productions, would be considered as including any payments paid by its subscribers to receive their broadcasts and acceptance of their services, including revenues from terminal equipment and the installation of such equipment, and this despite the fact that according to the policy implemented by the Council to date with respect to the inclusion of revenues from terminal equipment for calculating the obligation to make original productions was conditional on a mechanism based on the profitability of this revenue component, and in previous years revenues from terminal equipment and its installation were not included in the basis for calculating original Israeli productions. DBS disputes this decision and has sent its response on the subject to the Council. DBS is of the opinion that should the Council implement this new policy, DBS will have to significantly increase its annual investment in locally produced programs from 2012 onwards.

These estimates by DBS regarding the size of the annual investment are forward-looking information, as defined in the Securities Regulations, based in part on the Council's current announcement which is still subject to hearing DBS. There is no certainty that the Council will in fact implement this position or that the policy implemented will be identical to the one that DBS was informed of. This estimate may not materialize, or it may materialize differently from that anticipated, in part depending on the policy that the Council actually implements, on the Company's actual revenues, and on the obligatory rates of local productions out of DBS's total revenues from subscription fees defined in respect of 2012 onwards.

Terminal equipment

In March 2011 the Ministry of National Infrastructures published draft Energy Resource Regulations (Maximum Electrical Output in an Active Standby Situation of a Digital Set-Top Box for the Receipt of Television Broadcasts), 5771-2011 designed to regulate the maximum output of digital set-top boxes in an active standby situation. To the best of DBS's knowledge, this draft has not yet been discussed by the Knesset Economics Committee and at this time, the Ministry of National Infrastructures is making changes in it prior to tabling it for discussion. Preliminary tests conducted by DBS indicate that the further the original version of the draft regulations progresses toward binding legislation, the more adverse could be its effect on DBS's ability to continue using some of the decoders which its subscribers are currently using, and on its ability to import the decoders that require greater electric output than the maximum prescribed in the draft regulations. DBS has asked the Ministry of National Infrastructures to amend the wording of the draft regulations so as to minimize these possible effects wherever possible.

DBS's estimate is forward looking information as defined in the Securities Law, based, inter alia, on the current wording of the draft regulations. There is no certainty that this draft will become binding legislation or that the wording of this legislation, if and when it is passed, will be identical to the wording of the above-mentioned published draft. This estimate might not be realized or might be realized in a manner materially different from expectations, inter alia, depending on the wording of the legislation if and when it is passed.

In July 2011, the Council chair informed DBS that he intends to recommend that the Council consider amending DBS' broadcasting license such that the deposit that subscribers are required to make for borrowing an HD or PVR decoder will be limited to the cost of the purchase of the decoder lent to the subscriber (eliminating an alleviation that was given to DBS in the past regarding these advanced decoders). In August 2011, the Council chair informed DBS, inter alia, that he intends to recommend that the Council amends the subscription agreement such that in order to borrow used terminal equipment, an amount will be deposited that is no more than its depreciated cost. DBS has been summoned to respond to these recommendations, and it intends to present its objections to the Council. DBS is of the opinion that insofar as these recommendations are implemented, its revenues will be severely reduced.

This opinion is forward-looking information, as defined in the Securities Law, based, in part, on the aforesaid announcements by the Council, that are still subject to a hearing with DBS, and there is no certainty that these announcements will in fact be adopted and implemented by the Council. This estimate may not materialize, or it may materialize in a manner that differs significantly from that anticipated, in part depending on the decisions that are actually made, if they are made, by the Council.

Section 5.18 – Significant agreements

Section 5.18.1 – on September 19, 2011, Spacecom published an Immediate Report concerning a malfunction in the accumulator of the Amos 3 satellite. According to an Immediate Report published by Spacecom, the voltage in the battery dropped during an "eclipse period" (a regular, cyclical phenomenon that occurs twice a year, for a period of 42 days each time, during which the satellite and the solar panels that supply it with electrical energy are hidden from the sun during the day), probably due to a fault in one of the battery cells. As a result, Spacecom announced that to reduce the load on the accumulator during the eclipse period, it intends not to operate up to two transponders during this period. Spacecom further noted that in its opinion and the opinion of the satellite manufacturer, this operations plan will facilitate proper function of the satellite, although it commented that there is no certainty that this plan will suffice, and Spacecom may be required to take further operational measures. Close to the date of this report, Spacecom informed DBS that the decision not to operate these transponders is unlikely to affect the service that DBS receives from Spacecom.

This opinion is forward-looking information, as defined in the Securities Law, based in part on Spacecom's publications regarding the fault and its repercussions and on the materialization of Spacecom's estimates as submitted to DBS. Consequently, this opinion may not materialize, or may materialize in a manner different from that anticipated, in part depending on technical and operating conditions relating to the satellite and the malfunction, as well as on other operational or other measures, insofar as they are taken by Spacecom.

Section 5.20 – Legal proceedings

Section 5.20.1 A – on October 6, 2011, DBS and Pace signed a compromise agreement with Eurocom Digital Communications Ltd., settling the disputes that had emerged between them, and according to which a new supply agreement took effect between DBS and Pace, in which, inter alia, Pace will supply DBS with a certain quantity of decoders free of charge. Subsequent to the motion with consent that the parties filed with the district court for certification of the compromise agreement, on October 9, 2011 the court instructed that the claim and counterclaim be dismissed, as agreed by the parties.

Section 5.20.1 B – On July 21, 2011, a motion was filed at the Tel Aviv-Jaffa District Court to approve a settlement in which DBS will give anyone who was a subscriber during the period of the service disruptions and lived in communities in the north of Israel, as specified in the agreement, the following benefits: Anyone who is currently a subscriber of DBS – 3 DVDBOX films or a package of channels of those listed in the settlement agreement, for 60 days; for anyone who is not a subscriber to DBS – to enroll in its services and be entitled to the aforesaid benefits or receive NIS 35. Under the settlement, the class action plaintiff will receive payment of NIS 200,000 and his attorneys will receive NIS 1,300,000. On October 24, 2011, a hearing took place during which the court instructed the parties to submit notice concerning an amendment to the application to certify the compromise agreement so that in addition to advertising the notice for the public concerning submittal of the application for certification as a compromise settlement as specified in the agreement, members of the first group will also receive a message through DBS' messaging system to its subscribers. In addition, the dates on which the Attorney General must present his response were specified.

Section 5.20.1.C – on November 7, 2011, the Court resolved to strike out the proceeding due for want of prosecution.

Section 5.20.1D – On March 31, 2011 DBS filed its response to the motion for certification by refuting the applicant's arguments and noted*, inter alia*, that it had adopted detailed procedures to comply with the provisions of the Consumer Protection Law; that it is in compliance with the obligation imposed on it to notify its customers when an offer ends; and that a specific fault had occurred in the private matter of the applicant which led to the fact that she was not identified by DBS's system as a customer approaching the end of her term of commitment. On April 14, 2011, the court approved an application filed by the parties for agreed withdrawal and dismissed the claim.

Section 5.20.1 F – on September 11, 2011, the parties filed an application to certify a compromise agreement they had signed on September 8, 2011, at the Tel Aviv-Jaffa District Court. Under the compromise agreement, and as defined in the agreement, during the period of the benefit, DBS will provide an additional 90 hours that are accompanied by subtitles and sign language. It was also agreed that the application for certification will be amended so that it will apply up to the day on which the court approves the compromise agreement. It was also agreed that NIS 40,000 will be paid to the representative claimant as a special bonus, and the representative claimant's attorney will receive payment of NIS 324,800 (including VAT at the lawful rate) as his fee. Subsequent to the court's decision, the parties filed an application to amend the application for certification, as defined in the compromise settlement, as well as a brief explanation of the quality of the benefit proposed in the settlement agreement, including the degree to which is corresponds with the format prescribed and approved in the compromise agreement in a separate proceeding in connection with inadequate subtitles and sign language during broadcasts by the Channel 2 concessionaires and the Channel 2 new company. On October 2, 2011, the court instructed that the application for approval be amended, and that the notices should be published in the press pursuant to the Class Action Law, 5766-2006. The court also instructed the parties to send notice of the application to certify the compromise agreement to the Attorney General, the courts administration, and the Commissioner of Equal Rights for Persons with Disabilities. The hearing for the application to certify the compromise agreement was set for January 22, 2012.

Section 5.20.1 – in March 2011 the CEO of DBS was investigated by the Consumer Protection Authority. To the best of DBS's knowledge, the investigation centers on suspicions of alleged violations by DBS of the Consumer Protection Law relating to arguments of deception and lack of disclosure in customer agreements. At the date of this report, DBS has not yet received an update regarding the results of the investigation.

November 9, 2011	
Date	Bezeq - The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shaul Elovitch, Chairman of the Board of Directors

Avi Gabbay, Chief Executive Officer

Directors' Report on the State of the Company's Affairs for the nine-month and three-month period ended September 30, 2011

We respectfully present the Directors' Report on the state of affairs of Bezeq – The Israel Telecommunication Corp. Limited ("the Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter referred to as "the Group"), for the nine-month period ended September 30, 2010 and for the three-month period then ended ("Quarter").

The Directors' Report contains a condensed review of its subject-matter, and it assumes that the Directors' Report at December 31, 2010 is also available to the reader.

Commencing April 25, 2010, the financial statements of Walla! Communications Ltd. ("Walla") are consolidated in the financial statements of the Group.

The Group reports on four main segments of operation in its financial statements:

1) **Domestic fixed-line communications**

2) **Cellular communications**

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

4) **Multi-channel television**

In addition, the Company has an "Others" segment in its financial statements, which consists mainly of Internet services and the operation of Internet portals (through Walla), and customer center services (through Bezeq On Line). The Others segment is not material at the Group level.

Profit for the reporting period amounted to NIS 1,540 million,[1] compared with a profit of NIS 1,868 million in the corresponding period, a decrease of approximately 17.6%.

Profit for the reporting Quarter amounted to NIS 549 million, compared with NIS 588 million in the corresponding quarter, a decrease of 6.6%.

The Company's EBITDA (operating profit before depreciation and amortization) decreased from NIS 3,884 million in the corresponding period and NIS 1,329 million in the corresponding quarter, to NIS 3,584 million in the current period and NIS 1,301 million in the Quarter.

The results of the reporting period and the Quarter were affected by a large number of factors as described in the following pages, including expenses in respect of early retirement which were recorded in the reporting period.

[1] In this translation of the Directors' Report, all amounts should be understood by the reader to be rounded to the nearest million or thousand, as the case may be.

1. Remarks of the Board of Directors on the state of the corporation's affairs, the results of its operations, its equity, cash flows and other subjects

1.1 Financial condition

1.1.1 Assets

The Group's assets at September 30, 2011 amount to NIS 18.49 billion, compared with NIS 15.25 billion on September 30, 2010, of which NIS 5.96 billion (32%) are fixed assets compared with NIS 5.53 billion (36%) on September 30, 2010.

The increase in the Group's assets stems mainly from the Domestic Fixed-Line Communications segment, as described below.

In the Domestic Fixed-Line Communications segment, there was an increase of NIS 2.8 billion in total assets, without investment in associates, compared with September 30, 2010. The increase stemmed mainly from the investment of most of the proceeds from an issue of debentures in the current quarter in shekel trust funds and from a rise in fixed asset balances due to deployment of the NGN system and a rise in cash and intangible asset balances.

In the Cellular segment, assets increased from NIS 4.85 billion on September 30, 2010 to NIS 5.40 billion at September 30, 2011. The increase stemmed mainly from an increase in the customer balance due to an increase in revenue from sales of terminal equipment on instalments, which was partially offset by a decrease in property, plant and equipment, in intangible assets and in investment in financial assets held for trade.

In the International Communications, Internet and NEP services segment, total assets increased by NIS 175 million. Most of the increase occurred in property, plant and equipment balances following investment in laying the undersea cable.

1.1.2 Liabilities

The Group's debt to financial institutions and debentures-holders at September 30, 2011 amounted to NIS 9.61 billion, compared with NIS 5.73 billion on September 30, 2010. The increase in debt stemmed from the Domestic Fixed-Line Communications segment, due to an issue of debentures and receipt of bank loans (see Note 12 to the financial statements). The increase was slightly moderated by repayment of debentures and loans in the segment and in the Cellular segment.

1.2 Results of operations

1.2.1 Principal results

Below are condensed data from the consolidated statements of income.

	For the nine-month period ended September 30				For the three-month period ended September 30			
	3122	3121	Increase	Change	3122	3121	Increase	Change
	NIS millions	NIS millions	(Decrease)	%	NIS millions	NIS millions	(Decrease)	%
Continuing operations								
Revenues	**92834**	82929	)206(	)2%(	**32:28**	32083	)116(	)4%(
Costs and expenses	**7228:**	62086	93	2%	**22:84**	22054	)81(	)4%(
Operating profit	**32655**	22843	)299(	)11%(	**:55**	979	)35(	)4%(
Finance expenses, net	**279**	87	81	93%	**97**	74	12	16%
Profit after finance expenses, net	**32487**	22756	)380(	)14%(	**969**	905	)47(	)5%(
Share in losses of affiliates	**314**	180	23	13%	**77**	71	)5(	)7%(
Profit before income tax	**32284**	22576	)403(	)16%(	**8:3**	834	)42(	)5%(
Income tax	**744**	708	)75(	)11%(	**354**	246	)3(	)1%(
Profit for the period	**22651**	12868	)328(	)18%(	**65:**	588	)39(	)7%(
Attributed to:								
Company owners	**22653**	12868	)326(	)17%(	**661**	588	)38(	)6%(
Non-controlling interest	**)3(**	-	)2(	-	**)2(**	-	)1(	-
Profit for the period	**22651**	12868	)328(	)18%(	**65:**	588	)39(	)7%(
Earnings per share								
Base earnings per share (NIS)	**1568**	0.70	)0.13(	)19%(	**153**	0.22	)0.02(	)9%(
Diluted earnings per share (NIS)	**1567**	0.69	(0.12)	(17%)	**153**	0.22	)0.02(	)9%(

The Group's revenues in the reporting period amounted to NIS 8.723 million, compared with NIS 8,929 million in the corresponding period, a decrease of 2.3%.
The Group's revenues in the Quarter amounted to NIS 2,917 million, compared with NIS 3,033 million in the corresponding quarter, a decrease of 3.8%.
Most of the decrease in the Group's revenues stemmed from the decrease in revenues from interconnect fees as a result of a 70% reduction in the tariff compared with the corresponding period, in the Cellular and Domestic Fixed-Line segments. The decrease was moderated mainly by a rise in revenues from sales of terminal equipment in the Cellular segment.

The Group's depreciation and amortization expenses in the reporting period amounted to NIS 1,040 million, and remained stable compared with the corresponding period.
Depreciation and amortization expenses in the Quarter amounted to NIS 357 million compared with NIS 350 million in the corresponding quarter, an increase of 2%.

The salary expense of the Group in the reporting period amounted to NIS 1,612 million, compared with NIS 1,486 million in the corresponding period, an increase of 8.5%.
The salary expense in the Quarter amounted to NIS 540 million compared with NIS 492 million in the corresponding quarter, an increase of 9.8%.
The increase in the salary expense stemmed mainly from the Domestic Fixed-Line segment, due primarily to an increase in share-based payments, and also to the consolidation of Walla during the second quarter of 2010.

Operating and general expenses of the Group in the reporting period amounted to NIS 3,445 million, compared with NIS 3,713 million in the corresponding period, a decrease of 7.2%.
Operating and general expenses in the Quarter amounted to NIS 1,182 million compared with NIS 1,271 million in the corresponding quarter, a decrease of 7%.
The decrease in operating and general expenses stemmed from the Domestic Fixed-Line segment and the Cellular segment, mainly due to the decrease in interconnect fee expenses following their reduction as noted above. The decrease was moderated by an increase in the cost of selling terminal equipment in the Cellular segment.

The Group's expenses, net, for other operations in the reporting period amounted to NIS 82 million, compared with NIS 154 million in the corresponding period. The changes stems from recording expenses of NIS 281.5 million in respect of early retirement in the Domestic Fixed-Line segment in the first quarter of 2011 (see Note 12.1 to the financial statements).
In the Quarter, the Group had revenues, net from other operations amounting to NIS 106 million, compared with revenues of NIS 59 million in the corresponding quarter, an increase of 79.7%. The increase in revenue stemmed from the Domestic Fixed-Line segment.

The net finance expenses of the Group in the reporting period amounted to NIS 168 million, compared with NIS 87 million in the corresponding period, an increase of 93.1%.
Net finance expenses in the Quarter amounted to NIS 86 million compared with NIS 74 million in the corresponding quarter, an increase of 16.2%.
The increase in net finance expenses stemmed mainly from the Domestic Fixed-Line segment, and was partially offset by the transition from finance expenses to finance income in the Cellular segment.

1.2.2 Segments of operation

A. Below are operational data for the Group's segments of operation.

	For the nine-month period ended September 30				For the three-month period ended September 30			
	3122		3121		3122		3121	
	NIS millions	% of total income	NIS millions	% of total income	NIS millions	% of total income	NIS millions	% of total income
Revenues by segment of operation								
Domestic Fixed-Line Communications	**42645**	**5156%**	32934	44.1%	**22297**	**5158%**	12323	43.6%
Cellular	**5241:**	**5: 55%**	42264	47.8%	**22532**	**5958%**	12442	47.5%
International Communications, Internet and NEP Services	**22123**	**2257%**	12030	11.5%	**461**	**2351%**	347	11.4%
Multi-Channel TV	**22326**	**245:%**	12183	13.2%	**516**	**245:%**	396	13.1%
Others and setoffs*	**)22458(**	**)2655%(**	)12482(	)16.6%(	**(446)**	**)2654%(**	)475(	)15.6%(
Total	**92834**	**211%**	82929	100%	**32:28**	**211%**	32033	100%

	For the nine-month period ended September 30				For the three-month period ended September 30			
	3122		3121		3122		3121	
	NIS millions	% of total income	NIS millions	% of total income	NIS millions	% of total income	NIS millions	% of total income
Operating profit by segment of operation								
Domestic Fixed-Line Communications	**22335**	**4752%**	12549	39.4%	**657**	**5751%**	556	42.0%
Cellular	**221 9**	**3656%**	12040	24.4%	**453**	**3552%**	356	24.7%
International communications, Internet and NEP Services	**293**	**2951%**	255	24.8%	**72**	**2855%**	70	20.2%
Multi-Channel TV	**2:1**	**2657%**	138	11.7%	**74**	**2657%**	72	18.2%
Others and setoffs*	**)311(**	**-**	)139(	-	**)79(**	**-**	)75(	-
Consolidated operating profit / % of Group's revenues	**32655**	**3: 53%**	22843	31.8%	**:55**	**4355%**	979	32.3%

* Setoffs are mainly in respect of a segment that is an affiliated company.

B. **Domestic fixed-line communications segment**

Revenues

Segment revenues in the reporting period amounted to NIS 3,534 million compared with NIS 3,934 million in the corresponding period, a decrease of 10.2%.
Segment revenues in the Quarter amounted to NIS 1,186 million compared with NIS 1,323 million in the corresponding quarter, a decrease of 10.4%.

The decrease in the segment's revenues stemmed primarily from a decrease in revenues from fees for interconnection with the cellular networks (with a corresponding decrease in expenses as described below), following the reduction in the fees commencing January 1, 2011. Review of the impact of the change in the interconnect fees on the Company's income, reveals that the lower tariffs deducted NIS 400 million from the segment's revenues in the reporting period and NIS 138 million in the Quarter.[2]

Conversely, there was a rise in revenues from high-speed Internet, mainly due to increased ARPU from surfing speed upgrades, and a rise in sales of home networks and in the number of Internet subscribers. There is also a rise in revenues from data communications. In the reporting period and Quarter, the rise in revenues compared with the corresponding period and quarter was offset mainly by a decrease in revenues from telephony as a result of a decline in traffic and in the number of lines, as well as erosion of revenue per telephone line.

Costs and expenses

Depreciation and amortization expenses in the reporting period amounted to NIS 513 million and remained stable compared with the corresponding period.
Depreciation and amortization expenses in the Quarter amounted to NIS 180 million compared with NIS 171 million in the corresponding quarter, an increase of 5.3%.
The increase in depreciation and amortization expenses, which stems from investments in the NGN project, was offset by the end of depreciation of property, plant and equipment.

The salary expense in the reporting period amounted to NIS 859 million compared with NIS 783 million in the corresponding period, an increase of 9.7%.
The salary expense in the Quarter amounted to NIS 284 million compared with NIS 256 million in the corresponding quarter, an increase of 10.9%.
The increase in the salary expense stems mainly from an increase of NIS 119 million in share-based payments in the period and NIS 39 million in the Quarter, and from a rise in salaries. The increase was partially offset by an increase in salary attributed to investments and a decrease in the number of employees.

Operating and general expenses in the period amounted to NIS 806 million compared with NIS 1,187 million in the corresponding period, a decrease of 32%.
Operating and general expenses in the Quarter amounted to NIS 282 million compared with NIS 399 million in the corresponding quarter, a decrease of 29%.
The decrease in these expenses stemmed from a decrease in fees for interconnection with the cellular networks and corresponded to a decrease of similar amount in revenues from interconnect fees, due to the reduction in tariffs noted above.

Expenses, net, for other operations in the reporting period amounted to NIS 82 million compared with income of NIS 97 million in the corresponding period.

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[2] In view of the reduction in interconnect fees commencing January 1, 2011 and for comparison purposes, revenues in the corresponding period and quarter were calculated at the reduced interconnect tariffs.

The transition from income to expenses stems from recording an expense provision of NIS 281.5 million in respect of early retirement severance (see Note 12.1 to the financial statements). In contrast, there is an increase in capital gains from the sale of copper cables and real estate properties (see Note 12.6 to the financial statements).
Income, net, from other operations in the Quarter amounted to NIS 106 million, compared with income of NIS 59 million in the corresponding quarter. The rise in income stems mainly from an increase in capital gains from the sale of copper cables and from an expense provision in respect of early retirement severance recorded in the corresponding quarter.

Profitability

Operating profit in the segment in the reporting period amounted to NIS 1,274 million compared with NIS 1,549 million in the corresponding period, a decrease of 17.8%.
Operating profit in the Quarter amounted to NIS 546 million compared with NIS 556 million in the corresponding quarter, a decrease of 1.8%.
The decrease in operating profit stems from the changes described above in the income and expense items in the reporting period, mainly the provision in respect of early retirement severance.

Finance expenses, net

Net finance expenses in the reporting period amounted to NIS 187 million compared with NIS 58 million in the corresponding period.
Net finance expenses in the Quarter amounted to NIS 88 million compared with NIS 30 million in the corresponding quarter.
The increase in net finance expenses stemmed primarily from an increase in borrowings at fixed and variable shekel interest, from finance expenses in respect of revaluation of the liability for the distribution of a dividend that does not pass the profit test, from a rise in interest expenses in respect of debentures and in the reporting period also a related rise in linkage expenses due to a rise in the known index to which they are linked, at a higher rate than in the corresponding period. The increase in finance expenses was moderated mainly by a rise in finance income in the reporting period from shareholder loans to DBS, and by gains from investment in financial funds in the Quarter.

C. Cellular segment

Revenues

Revenues in the reporting period amounted to NIS 4,309 million compared with NIS 4,264 million in the corresponding period, an increase of 1%.
Revenues in the Quarter amounted to NIS 1,421 million compared with NIS 1,442 million in the corresponding quarter, a decrease of 1.5%.
Segment revenues from services (including value added services) in the reporting period amounted to NIS 2,788 million compared with NIS 3,405 million in the corresponding period, a decrease of 18.1%.
Segment revenues from services in the Quarter amounted to NIS 914 million compared with NIS 1,159 million in the corresponding quarter, a decrease of 21.1%.

The decrease in revenues from services stemmed primarily from the reduction of interconnect fees, which reduced revenues by NIS 595 million in the period and by NIS 204 million in the Quarter. In addition, it is noted that in the past few months competition has intensified among the cellular companies, which has led to erosion of tariffs both for new customers and for existing customers, as part of the efforts to retain them. This is reflected also in a decline in ARPU.

Segment revenues from sales of terminal equipment in the reporting period amounted to NIS 1,521 million compared with NIS 859 million in the corresponding period, an increase of 77.1%.

Segment revenues from sales of terminal equipment in the Quarter amounted to NIS 507 million compared with NIS 283 million in the corresponding quarter, an increase of 79.2%.
The increase in revenues from the sale of terminal equipment stemmed mainly from a rise in the selling prices of the terminal equipment and a rise in the number of sales and upgrades, following increased sales of smartphones.

Costs and expenses

Depreciation and amortization expense in the reporting period amounted to NIS 421 million compared with NIS 447 million in the corresponding period, a decrease of 5.8%.
Depreciation and amortization expense in the Quarter amounted to NIS 139 million compared with NIS 149 million in the corresponding quarter, a decrease of 6.7%.
The decrease in depreciation and amortization expenses stems from items of property, plant and equipment for which the depreciation period ended, mainly the CDMA network, and was partially offset by an increase in depreciation in respect of new items of property, plant and equipment.

The salary expense in the reporting period amounted to NIS 452 million compared with NIS 443 million in the corresponding period, an increase of 2.0%.
The salary expense in the Quarter amounted to NIS 153 million compared with NIS 143 million in the corresponding quarter, an increase of 7.0%.
The increase in the salary expense stems mainly from a decrease in salary attributed to investments, a rise in salary and incentives as a result of a rise in the minimum wage, and a rise in the number of positions.

Operating and general expenses in the reporting period amounted to NIS 2,338 million compared with NIS 2,334 million in the corresponding period, an increase of 0.2%.
Operating and general expenses in the Quarter amounted to NIS 787 million compared with NIS 794 million in the corresponding quarter, a decrease of 0.9%.
The change in operating and general expenses stems primarily from an increase in the cost of selling terminal equipment due mainly to an increase in the quantity and cost of the handsets sold and upgraded following increased sales of smartphones, and on the other hand, a decrease in the costs of the services due to the decrease in call completion costs which stems from the reduction of interconnect fees.
The reduction of interconnect fees reduced operating and general expenses by NIS 467 million in the period and by NIS 162 million in the Quarter.

Profitability

Operating profit in the reporting period amounted to NIS 1,098 million compared with NIS 1,040 million in the corresponding period, an increase of 5.6%.
Operating profit in the Quarter amounted to NIS 342 million compared with NIS 356 million in the corresponding quarter, a decrease of 3.9%.
The change in operating profit stems from the reasons noted above.

Finance income, net

Net finance income in the reporting period amounted to NIS 23 million compared with net finance expenses of NIS 23 million in the corresponding period.
Net finance income in the Quarter amounted to NIS 4 million compared with net finance expenses of NIS 38 million in the corresponding quarter.
The increase in net finance income stems primarily from payment of interest and linkage in respect of a royalties claim in the corresponding period.

D. **International communications, internet and NEP**

Revenues

Revenues in the segment in the reporting period amounted to NIS 1,012 million compared with NIS 1,030 million in the corresponding period, a decrease of 1.7%.
The decrease in revenues in the reporting period stems from a decrease in the number of outgoing and incoming minutes, a market-wide phenomenon, as well as a decrease in call transfer activity among communications carriers around the world and in the sale of private exchanges (PBX). Conversely, revenues from Internet increased as a result of an increase in the number of customers and growth in integration operations (IT and communications solutions for businesses).
Revenues in the segment in the Quarter amounted to NIS 351 million compared with NIS 347 million in the corresponding quarter, an increase of 1.2%.
The increase in income in the Quarter stemmed from a rise in the number of outgoing minutes, an increase in revenues from Internet as a result of an increase in the number of customers and growth in integration operations, offset by a decrease in call transfer activity among communications carriers around the world and in sales of private exchanges (PBX).

Costs and expenses

Depreciation and amortization expenses in the reporting period amounted to NIS 79 million, compared with NIS 70 million in the corresponding period, an increase of 12.9%.
Depreciation and amortization expenses in the Quarter amounted to NIS 28 million, compared with NIS 23 million in the corresponding period, an increase of 21.7%.
The increase in depreciation and amortization expenses stems mainly from an increase in property, plant and equipment and intangible assets.

The salary expense in the reporting period amounted to NIS 195 million compared with NIS 187 million in the corresponding period, an increase of 4%.
The salary expense in the Quarter amounted to NIS 65 million compared with NIS 61 million in the corresponding quarter, an increase of 7%.
Most of the increase in the salary expense is in respect of an increase in outsourcing workers together with an increase in revenues from integration activities.

Operating and general expenses in the reporting period amounted to NIS 566 million, compared with NIS 581 million in the corresponding period, a decrease of 4.3%.
The decrease in these expenses stems from the reasons for the decrease in the segment's income.
Operating and general expenses in the Quarter amounted to NIS 197 million, similar to the corresponding quarter.

Revenues from other operations, net, in the corresponding period last year include recording of a profit of NIS 57.4 million from revaluation of holdings in Walla after assuming control of that company.

Profitability

Operating profit in the segment in the reporting period amounted to NIS 182 million compared with NIS 255 million in the corresponding period, a decrease of 28.6%.
Operating profit in the segment in the Quarter amounted to NIS 61 million compared with NIS 70 million in the corresponding quarter, a decrease of 12.9%.
The decrease in operating profit in the reporting period stems from the changes described above in the revenues and expenses analysis, as well as recording a profit of NIS 57.4 million in the corresponding period as a result of a revaluation of segment's holdings in Walla.

E. Multi-channel television (stated by the equity method)

Revenues

Revenues in the segment in the reporting period amounted to NIS 1,215 million compared with NIS 1,183 million in the corresponding period, an increase of 2.7%.
Revenues in the segment in the Quarter amounted to NIS 405 million compared with NIS 396 million in the corresponding period, an increase of 2.3%.
Most of the increase stems from a rise in revenues from consumption of advanced services and from an increase in the number of the segment's customers and in average monthly revenue per subscriber.

Costs and expenses

Cost of sales in the reporting period amounted to NIS 809 million compared with NIS 842 million in the corresponding period, a decrease of 3.9%.
Most of the decrease stems from a one-time provision for AKUM in respect of copyright, made in the corresponding period.
Cost of sales in the Quarter amounted to NIS 268 million compared with NIS 259 million in the corresponding period, an increase of 3.5%.

Selling, marketing, administrative and general expenses in the reporting period amounted to NIS 216 million, compared with NIS 203 million in the corresponding period, an increase of 6.4%.
Selling, marketing, administrative and general expenses in the Quarter amounted to NIS 74 million, compared with NIS 65 million in the corresponding period, an increase of 13.8%. Most of the increase stems from a rise in depreciation expenses.

Profitability

Operating profit in the reporting period amounted to NIS 190 million compared with 138 million in the corresponding period, an increase of 37.7%.
Operating profit in the Quarter amounted to NIS 63 million compared with 72 million in the corresponding period, a decrease of 12.5%.
The change in operating profit stems from the changes described above in the income and expense items, and primarily from a material provision for AKUM made in the corresponding period.

1.2.3 Income tax

The Group' tax expense in the reporting period amounted to NIS 633 million, which is 29.1% of pre-tax profit, compared with NIS 708 million and 27.5% of pre-tax profit in the corresponding period.

The Group' tax expense in the Quarter amounted to NIS 243 million, which is 30.7% of pre-tax profit, compared with NIS 246 million and 29.5% of pre-tax profit in the corresponding quarter.

The rise in the percentage of tax out of pre-tax profit stems mainly from expenses that are not recognised for tax purposes (primarily share-based payments and finance expenses in respect of revaluation of the liability for a distribution that does not pass the profit test), and from timing differences in the recognition of expenses for tax purposes (primarily early retirement), which will be recognised when tax levels are lower than the current rate.

1.3 Equity

Equity attributed to the owners of the Company at September 30, 2011 amounted to NIS 2.05 billion, which is 11.1% of the total balance sheet, compared with NIS 4.71 billion and 30.9% of the total balance sheet on September 30, 2010. The decrease in equity stems from the distribution of a dividend of NIS 2.16 billion and from distribution of a dividend of NIS 3 billion that does not pass the profit test in the reporting period, which is stated at its present value of NIS 2.81 billion (see Note 6.5 to the financial statements). The decrease was partially offset by the Group's profit in the Quarter, which has not yet been distributed.

1.4 Cash flow

Consolidated cash flow from operating activities in the reporting period amounted to NIS 2,327 million, compared with NIS 2,948 million in the corresponding period, a decrease of NIS 621 million.
Consolidated cash flow from operating activities in the Quarter amounted to NIS 882 million, compared with NIS 1,166 million in the corresponding quarter, a decrease of NIS 284 million.
Most of the decrease stems from the Cellular segment due to changes in working capital, primarily the increase in sales of terminal equipment in 36 installments.

Cash flow from operating activities is one of the sources for financing the Group's investments. In the reporting period these included NIS 1,190 million in the development of communications infrastructure compared with NIS 907 million in the corresponding period, and NIS 244 million in intangible assets and deferred expenses in the current period compared with NIS 234 million in the corresponding period.
In addition, in the Domestic Fixed-Line segment, NIS 1,998 million net out of proceeds from an issue of debentures in the Quarter was invested in shekel trust funds, and the same segment received the consideration of NIS 303 million from sales of property, plant and equipment in the reporting period, compared with NIS 89 million in the corresponding period.

In the reporting period, the Group repaid net debts and paid interest amounting to NIS 1,690 million, of which NIS 825 million of debentures, NIS 633 million of loans and NIS 232 million of interest payments, compared with net debt repayment and interest payments of NIS 1,312 million in the corresponding period. Conversely, in the Domestic Fixed-Line segment, NIS 3.09 billion of debentures were issued, of which NIS 2.69 billion in the Quarter. In addition, bank loans of NIS 2.2 billion were taken in the reporting period, compared with NIS 2.6 billion in the corresponding period (see Note 12 to the financial statements).
In addition to the above, a dividend of NIS 1.66 billion was paid in the reporting period, compared with NIS 2.45 billion in the corresponding period.

The average of long-term liabilities (including current maturities) to financial institutions and debenture-holders in the reporting period was NIS 6,763 million.

Average supplier credit in the reporting period was NIS 1,009 million, and average short-term customer credit was NIS 2,832 million. Average long-term customer credit was NIS 1,247 million.

The Group's working capital surplus at September 30, 2011 amounted to NIS 1,336 million, compared with a working capital deficit of NIS 675 million on September 30, 2010. The Company's working capital surplus at September 30, 2011 was NIS 140 million, compared with a working capital deficit of NIS 1,759 million on September 30, 2010. The transition from deficit to surplus working capital in the Company stems from an increase in its current assets, due mainly to increased investment in financial funds, and in cash balances. The surplus in working capital is moderated by an increase in the current liabilities of the Company, primarily due to an increase in the balance of dividend payable.

2. Remarks of the Board of Directors on the exposure to and management of market risks

2.1 The fair value of the asset surplus exposed to changes in fixed nominal shekel interest decreased by NIS 4,771 million over the liability surplus, as a result of a distribution that does not pass the profit test and which is stated in the financial statements at current value, raising debt in May 2011, of which NIS 900 million at fixed interest, and the issue of debentures series 8.

The fair value of the liability surplus exposed to changes in real shekel interest and the liability surplus exposed to changes in the CPI, increased by NIS 984 million as a result of the issue of debentures series 6 at fixed interest.

The Company's investment balance of NIS 2.02 billion in shekel financial trust funds at September 30, 2011 brings exposure to changes in the prices of negotiable securities (see Note 12.4 to the financial statements).

Other than the above changes, the sensitivity analyses of the fair value and the effect of the change in market prices on the fair value of the balances in and off the balance sheet, for which there is strong engagement at September 30, 2011, do not differ materially from the report at December 31, 2010.

2.2 The linkage base report at September 30, 2011 does not differ materially from the report of December 31, 2010, except for an increase of about NIS 4 billion in unlinked assets and an increase of NIS 7.2 billion in unlinked liabilities. Most of this increase is the result of an issue of debentures and receipt of loans not linked to the CPI and in respect of which receipts were invested in financial funds or in cash balances, and is additional to an increase in liabilities in respect of the distribution that does not pass the profit test, which is not linked to the CPI.

3. Aspects of corporate governance

3.1 Disclosure on the proceeding for approving the Company's financial statements

3.1.1 The committee

The Company's Financial Statements Review Committee is a separate committee that does not serve also as the Audit Committee (each committee has its own chairman). It is noted that members of the Audit Committee are also members of the Financial Statements Review Committee (Mordechai Keret – external director, Itzchak Idelman – external director, Dr. Yehoshua Rosenzweig – independent director, and Eldad Ben-Moshe – independent director).

3.1.2 The members of the committee

The committee has four members: Itzchak Idelman, Chairman (external director), Mordechai Keret (external director), Eldad Ben-Moshe (independent director), and Dr. Yehoshua Rosenzweig (independent director). All four have accounting and financial expertise. All the members of the committee provided a statement prior to their appointment. For additional details about the directors who comprise the committee, see Chapter D of the Company's 2010 Periodic Report.

3.1.3 <u>Procedure for approval of the financial statements</u>

A. The Financial Statements Review Committee discussed the financial statements at its meetings on November 1, 2011 and on November 6, 2011, and submitted its recommendations to the Board of Directors of the Company.

B. All the members of the committee participated in the above meetings.

C. In addition to the members of the committee, the meeting on November 1, 2011 was attended by the Chairman of the Board, the CFO and Deputy CEO, the VP of Economics, the Company's comptroller, the internal auditor, the General Counsel, Rami Nomkin – director, the external auditors, and other office-holders in the Company. The meeting on November 6, 2011 was attended, in addition to the committee members, by the Chairman of the Board, the CEO of the Company, the CFO and Deputy CEO, the comptroller, the internal auditor, Rami Nomkin – director, the Company Secretary, the General Counsel, the external auditors, and other office-holders in the Company.

D. Among other things, the committee reviewed the assessments and estimates made in connection with the financial statements, internal controls relating to financial reporting, the integrity and propriety of the disclosure in the financial statements, and the accounting policies adopted in the material affairs of the corporation.

E. At its meeting on May 5, 2011, the committee adopted a resolution on the identity of the regular attendees of its meetings. The committee also decided that at the end of each quarterly meeting for approval of the financial statements, there would be a discussion among the members of the committee, the internal auditor and the external auditors only.

F. The committee's recommendations were submitted in writing to the Board of Directors of the Company on November 6, 2011.

G. The Board of Directors discussed the recommendations of the Financial Statements Review Committee and the financial statements themselves, on November 9, 2011.

H. The Board of Directors believes that the recommendations of the Financial Statements Review Committee were submitted a reasonable time (about three business days) before the Board of Directors meeting, even taking into account the scope and complexity of the recommendations.

I. The Board of Directors of the Company accepted the recommendations of the Financial Statements Review Committee and resolved to approve the financial statements of the Company for the third quarter of 2011.

3.2 Commencing 2011, the Company ceased to apply the provisions of the Securities (Periodic and immediate reports) (Amendment) Regulations, 2009, in the matter of internal control, and instead it applies the provisions of the Sarbanes-Oxley Act of 2002 (SOX), as a significant subsidiary of a company that is traded in the U.S.

3.3 Details of internal auditing in the material investees of the Company

During the period, the internal auditor of Pelephone Communications Ltd., Mr. Shlomi Drori, tendered his resignation. His term of office will end on November 30, 2011.

4. Disclosure concerning the financial reporting of the corporation

4.1 Critical accounting estimates

Preparation of the financial statements in accordance with IFRSs requires management to make assessments and estimates that affect the reported values of assets, liabilities, income and expenses, as well as disclosure in connection with contingent assets and liabilities. Management bases these assessments and estimates on past experience and on valuations, expert opinions and other factors which it believes are relevant in the circumstances. Actual results might differ from these assessments with different assumptions or conditions. The financial statements provide information about primary topics of uncertainty in critical estimates and judgments in the application of the accounting policy.
We believe these assessments and estimates to be critical since any change in them and in the assumptions could potentially and materially affect the financial statements.

4.2 Details of a material valuation in accordance with Article 8B of the Securities (Periodic and immediate reports) Regulations, 1970

In the reporting period, the Company recorded expenses of NIS 124 million in respect of its 2010 employee stock options plan as described in Note 27C to the 2010 financial statements. The recording of the expenses is based on the following valuation:

Identification of assessment topic	Assessment of fair value of options granted by the Company to its employees and to two employee-directors on January 11, 2011 and January 25, 2011, respectively.
Timing of assessment	Valuation of options at the grant dates: January 11, 2011 and January 25, 2011.
Value of assessment topic prior to assessment date	Not relevant.
Value of assessment topic determined in the assessment	NIS 284,675 (without forfeiture prior to vesting).
Identification and characteristics of assessor	Ernst & Young (Israel) Ltd. The work was done by a team led by Einat Sperling, partner, manager of Valuation and Business Modeling. Einat is a partner in the Economics department and manages Valuation and Business Modeling. She has worked at E&Y for about 11 years in the Economics department and has about 13 years' experience in this area. Einat has prepared valuations and built business models for E&Y clients in Israel and abroad, as well as advising on reorganization and other financial advice. In recent years Einat has led projects of valuation for business purposes, for tax purposes and for accounting purposes, among them – examination of impairment of value, allocation of surplus purchase cost, and valuation of employee stock options according to IFRSs and US GAAP. Einat has been involved in transactions and valuations involving millions of dollars in various areas (technologies, retail, food and beverages, industrial pharma manufacturing, banking, communications, real estate and others). Einat has a B.A. in Economics and management from the Technion – Israel Institute of Technology, Haifa, and an MBA with a major in finance, accounting, strategy and development from the Recanati School of Business Administration at Tel Aviv University. Einat is also a certified CPS (Isr.). The assessor has no personal interest in or dependence on the Company. The Company undertook to compensate Ernst & Young in respect of third party claims in connection with providing the services listed below.
Assessment model	Black-Scholes-Merton model.

Assumptions on which the assessor made the valuation	• The Company's share price on the date of grant to the employees and employee-directors – NIS 10.45 and NIS 10.62 respectively. • Exercise price – NIS 7.457 per share. • Dividend return – The exercise price adjusted to dividend distribution at the gross amount and therefore the dividend rate taken for the purpose of the calculation is 0%. • Expected lifespan of the options – between 2.5 and 4 years, depending on the vesting terms. • Risk-free interest rate – between 3.17% and 3.86%, depending on the expected lifespan of the options. • Expected volatility – between 25.93% and 26.26%, depending on the expected lifespan of the options.

4.3 Given the significance of the claims filed against the Group, which cannot yet be assessed or in respect of which the exposure cannot yet be calculated, the auditors drew attention to them in their opinion on the financial statements.

5. Details of series of liability certificates

5.1 Debentures Series 4 – on June 1, 2011, NIS 300,000,000 par value was repaid. This series has been repaid in full.

5.2 Debentures Series 5 – Updated data at September 30, 2011:

		Debentures Series 5
A	Par value	NIS 1,989,139,167 (1) (2)
B	Par value revalued to the report date (linked to the CPI)	NIS 2,389,541,780 (3)
C	Accrued interest	NIS 42,215,239
D	Fair value	NIS 2,617,508,229
E	Stock exchange value	NIS 2,617,508,229

(1) On November 6, 201, NIS 397,827,833 par value was repaid.
(2) Of which, NIS 773.4 million par value is held by a wholly-owned subsidiary.
(3) Of which, NIS 881 million is held by a wholly-owned subsidiary.

On June 16, 2011, the Company received notice from Mizrachi Tefahot Trust Fund Ltd, ("Mizrachi Tefahot") that in accordance with the provisions of Sections 35E(2) and 35N(a)(3) of the Securities Law, 1968, its tenure as trustee for the Company's Debentures (Series 5) had expired for reasons of possible conflict of interests, in that credit had been provided for the Company and/or its controlling shareholder by Mizrachi Tefahot Bank Ltd., a parent of Mizrachi Tefahot. The Company is seeking another trustee, and until a new one is appointed, Mizrachi Tefahot is continuing to fulfill that role.

5.3 On July 3, 2011 the Company issued debentures from series 6, 7 and 8, as shown below, based on a self offering report dated June 29, 2011 which was published by virtue of the shelf prospectus. Below are details of those debentures:

		Debentures Series 6	Debentures Series 7	Debentures Series 8
A	Issue date	July 3, 2011	July 3, 2011	July 3, 2011
B	Total par value on issue date	NIS 958,088,000	NIS 424,955,000	NIS 1,329,363,000
C	Its par value	NIS 958,088,000	NIS 424,955,000	NIS 1,329,363,000
D	Par value revalued to the report date (linked to the CPI)	NIS 963, 636,772	NIS 424,955,000	NIS 1,329,363,000
E	Accrued interest	NIS 8,773,7271	NIS 1,510,591	NIS 18,645,128
F	Fair value	NIS 983,956,376	NIS 412, 206,350	NIS 1,404,472,210
G	Stock exchange value	NIS 983,956,376	NIS 412, 206,350	NIS 1,404,472,210
H	Type of interest	Fixed, at 3.7%	Variable – short-term loan for one year plus margin not exceeding 1.4%	Fixed, at 5.7%
I	Principal repayment dates	December 1st of each of the years 2018-2022	December 1st of each of the years 2018-2022	June 1st of each of the years 2015-2017
J	Interest payment dates	June 1st and December 1st of each year, from December 1, 2011 to December 1, 2022	March 1st, June 1st, September 1st and December 1st of each year from September 1, 2011 to December 1, 2022	June 1st and December 1st of each year, from December 1, 2011 to June 1, 2017
K	Linkage	Principal and interest linked to the CPI (base index: May 2011)	Unlinked	Unlinked
L	Corporations' right to early redemption	None	None	None
M	Ratio of liability to Company's total liabilities	Material	Not material	Material

Series 6 and 7

Trustee – Reznick Paz Nevo Trusts Ltd.
Contacts in trust company – CPA Yossi Reznick and Adv. Liat Bachar-Segal
E-mail: trust@rpn.co.il. Tel: 03-6393311. Fax: 03-6393316
Address: 14 Yad Harutzim Street, Tel Aviv

Series 8

Trustee – Strauss Lazar Trust Co. (1992) Ltd. Ltd.
Contact in trust company – CPA Uri Lazar
E-mail: slcpa@slcpa.co.il. Tel: 03-6237777. Fax: 03-5613824
Address: 17 Yitzchak Sadeh Street, Tel Aviv

With reference to the above debentures, the Company undertook not to create additional liens on its assets unless it simultaneously creates a lien in favor of the debentures-holders (negative pledge) on identical terms to the terms of the negative pledge given in favor of banks and subject to exceptions defined in it, as described in Note 14C(1) to the financial statements at December 31, 2010.

5.4 On April 3, 2011, the Company received notice from Midroog Ltd. rating company, which rates the debentures issued by the Company (series 4 and 5), of removal of the debentures from the Watch List, while leaving their rating unchanged (Aa1) with negative outlook, following the capital decrease outline and distribution of a special dividend of NIS 3 billion decided upon by the Company and approved by the District Court.

On June 29, 2011, Midroog announced a rating of Aa1 with negative outlook for the debentures (series 6-8) of up to NIS 3 billion issued by the Company, and the same rating for the Company's debentures in circulation.

On June 29, 2011, S&P Maalot announced that it has set a rating of ilAA+ for the Company's new debentures (series 6-8) of up to NIS 3 billion.

The latest rating reports are attached to this Directors' Report.

6. Miscellaneous

For information about the liabilities of the reporting corporation and the consolidated and proportionately consolidated companies in its financial statements at September 30, 2011, see the reporting form uploaded by the Company to Magna on November 9, 2011.

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

Shaul Elovitz Chairman of the Board	Avraham Gabbay CEO

Date of signature: November 9, 2011

Condensed Consolidated Interim Financial Statements September 30, 2011 (Unaudited)

bezeq

The information contained in these financial statements constitutes a translation of the financial statements published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

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

Introduction

We have reviewed the accompanying financial information of Bezeq The Israel Telecommunication Corporation Limited and its subsidiaries (hereinafter - "the Group"), comprising of the condensed consolidated interim statement of financial position as of September 30, 2011 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the nine and three month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 "*Interim Financial Reporting*", and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

We did not review the condensed interim financial information of certain consolidated subsidiaries whose assets constitute 1.94% of the total consolidated assets as of September 30, 2011, and whose revenues constitute 1.77% and 1.85% of the total consolidated revenues for the nine and three month periods then ended, respectively. The condensed interim financial information of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of such companies, is based solely on the said review reports of the other auditors.

Scope of Review

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

Conclusion

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

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

Without qualifying our above conclusion, we draw attention to the claims made against the Group of which the exposure cannot yet be assessed or calculated, as described in Note 5.

Somekh Chaikin

Certified Public Accountants (Isr.)

November 9, 2011

Condensed Consolidated Interim Statements of Financial Position

	September 30 2011 (Unaudited) NIS millions	September 30 2010 (Unaudited) NIS millions	December 31 2010 (Audited) NIS millions
Assets			
Cash and cash equivalents	**1,564**	1,346	365
Investments, including derivatives (see Note 12.4)	**2,056**	66	7
Trade receivables	**3,008**	2,737	2,701
Other receivables	**229**	191	227
Inventories	**199**	178	178
Assets classified as held for sale	**12**	30	29
Total current assets	**7,068**	4,548	3,507
Investments, including derivatives	**115**	134	129
Trade and other receivables	**1,594**	1,073	1,114
Property, plant and equipment	**5,959**	5,533	5,610
Intangible assets	**2,237**	2,221	2,248
Deferred and other expenses	**268**	300	292
Investment in equity-accounted investees (mainly loans)	**1,031**	1,111	1,084
Deferred tax assets	**218**	332	254
Total non-current assets	**11,422**	10,704	10,731
Total assets	**18,490**	15,252	14,238

	September 30 2011	September 30 2010	December 31 2010
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Liabilities			
Debentures, loans and borrowings	**776**	954	949
Trade payables	**919**	1,086	1,061
Other payables, including derivatives	**892**	848	770
Current tax liabilities	**432**	377	267
Deferred income	**52**	32	33
Provisions	**220**	295	251
Employee benefits	**467**	351	269
Dividend payable (see Note 6)	**1,974**	1,280	-
Total current liabilities	**5,732**	5,223	3,600
Debentures	**4,670**	1,958	1,967
Bank loans	**4,168**	2,815	2,801
Employee benefits	**271**	298	305
Other liabilities	**44**	44	43
Provisions	**70**	68	69
Deferred tax liabilities	**60**	88	83
Dividend payable (see Note 6)	**1,386**	-	-
Total non-current liabilities	**10,669**	5,271	5,268
Total liabilities	**16,401**	10,494	8,868
Equity			
Total equity attributable to equity holders of the Company	**2,048**	4,714	5,327
Non-controlling interests	**41**	44	43
Total equity	**2,089**	4,758	5,370
Total equity and liabilities	**18,490**	15,252	14,238

Shaul Elovitch
Chairman of the Board of Directors

Avi Gabbay
CEO

Alan Gelman
Deputy CEO and CFO

Date of approval of the financial statements: November 9, 2011

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

Condensed Consolidated Interim Statements of Income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Continuing operations					
Revenue (Note 8)	**8,723**	8,929	**2,917**	3,033	11,987
Costs and expenses					
Depreciation and amortization	**1,040**	1,041	**357**	350	1,409
Salaries	**1,612**	1,486	**540**	492	2,024
General and operating expenses (Note 9)	**3,445**	3,713	**1,182**	1,271	5,026
Other operating expenses (income), net	**82**	(154)	**(106)**	(59)	(216)
	6,179	6,086	**1,973**	2,054	8,243
Operating profit	**2,544**	2,843	**944**	979	3,744
Financing income (expenses)					
Financing expenses	**445**	287	**186**	150	391
Financing income	**(277)**	(200)	**(100)**	(76)	(282)
Financing expenses, net	**168**	87	**86**	74	109
Segment profit (loss) after financing expenses, net	**2,376**	2,756	**858**	905	3,635
Share in losses of equity-accounted investees	**203**	180	**66**	71	261
Profit before income tax	**2,173**	2,576	**792**	834	3,374
Income tax	**633**	708	**243**	246	932
Profit for the period	**1,540**	1,868	**549**	588	2,442
Attributable to:					
Owners of the Company	**1,542**	1,868	**550**	588	2,443
Non-controlling interests	**(2)**	-*	**(1)**	-*	(1)
Profit for the period	**1,540**	1,868	**549**	588	2,442
Earnings per share					
Basic earnings per share (NIS)	**0.57**	0.70	**0.20**	0.22	0.91
Diluted earnings per share (NIS)	**0.57**	0.69	**0.20**	0.22	0.90

* Less than NIS 500,000

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

Condensed Consolidated Interim Statements of Comprehensive Income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit for the period	**1,540**	1,868	**549**	588	2,442
Other comprehensive income for the period, net of tax	**2**	3	**3**	3	13
Other comprehensive income for the period	**1,542**	1,871	**552**	591	2,455
Attributable to:					
Owners of the Company	**1,544**	1,871	**553**	591	2,456
Non-controlling interests	**(2)**	-*	**(1)**	-*	(1)
Other comprehensive income for the period	**1,542**	1,871	**552**	591	2,455

* Less than NIS 500,000

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

Condensed Consolidated Interim Statements of Changes in Equity

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS millions								
	Attributable to owners of the Company								
Nine months ended September 30, 2011 (unaudited)									
Balance at January 1, 2011 (audited)	6,213	378	146	390	(10)	(1,790)	5,327	43	5,370
Profit for the period	**-**	**-**	**-**	**-**	**-**	**1,542**	**1,542**	**(2)**	**1,540**
Other comprehensive income for the period, net of tax	**-**	**-**	**-**	**-**	**2**	**-**	**2**	**-**	**2**
Total comprehensive income for the period	**-**	**-**	**-**	**-**	**2**	**1,542**	**1,544**	**(2)**	**1,542**
Transactions with owners recognized directly in equity									
Dividend to Company shareholders not in compliance with the earnings test (see Note 6)	(2,415)	(396)	-	-	-	-	(2,811)	-	(2,811)
Dividend to Company shareholders	-	-	-	-	-	(2,155)	(2,155)	-	(2,155)
Share-based payments	-	-	127	-	-	-	127	-	127
Exercise of options for shares	23	71	(78)	-	-	-	16	-	16
Balance at September 30, 2011	**3,821**	**53**	**195**	**390**	**(8)**	**(2,403)**	**2,048**	**41**	**2,089**

Condensed Consolidated Interim Statements of Changes in Equity (contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS millions								
	Attributable to owners of the Company								
Nine months ended September 30, 2010 (unaudited)									
Balance at January 1, 2010 (audited)	6,187	275	210	390	(5)	(513)	6,544	(6)	6,538
Profit for the period	-	-	-	-	-	1,868	1,868	-	1,868
Other comprehensive income for the period, net of tax	-	-	-	-	3	-	3	-	3
Total comprehensive income for the period	-	-	-	-	3	1,868	1,871	-	1,871
Transactions with owners recognized directly in equity									
Dividend to Company shareholders	-	-	-	-	-	(3,733)	(3,733)	-	(3,733)
Share-based payments	-	-	16	-	-	-	16	-	16
Exercise of options for shares	19	81	(79)	-	-	-	21		21
Transfers by non-controlling interests	-	-	-	-	-	-	-	2	2
Non-controlling interests in a business combination	-	-	-	-	-	-	-	57	57
Increase in the rate of holding in a subsidiary	-	-	-	-	(5)	-	(5)	(9)	(14)
Balance as at December 31, 2010	6,206	356	147	390	(7)	(2,378)	4,714	44	4,758

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

Condensed Consolidated Interim Statements of Changes in Equity (contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS millions								
	Attributable to owners of the Company								
Three months ended September 30, 2011 (unaudited)									
Balance at July 1, 2011	3,814	35	171	390	(11)	(1,961)	2,438	42	2,480
Profit for the period	-	-	-	-	-	550	550	(1)	549
Other comprehensive income for the period, net of tax	-	-	-	-	3	-	3	-	3
Total comprehensive income for the period	-	-	-	-	3	550	553	(1)	552
Transactions with owners recognized directly in equity									
Dividend to Company shareholders	-	-	-	-	-	(992)	(992)	-	(992)
Share-based payments	-	-	43	-	-	-	43	-	43
Exercise of options for shares	7	18	(19)	-	-	-	6	-	6
Balance at September 30, 2011	3,821	53	195	390	(8)	(2,403)	2,048	41	2,089

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

Condensed Consolidated Interim Statements of Changes in Equity (contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS millions								
	Attributable to owners of the Company								
Three months ended September 30, 2010 (unaudited)									
Balance at July 1, 2010	6,203	345	153	390	(5)	(1,686)	5,400	49	5,449
Profit for the period	-	-	-	-	-	588	588	-	588
Other comprehensive income for the period, net of tax	-	-	-	-	3	-	3	-	3
Total comprehensive income for the period	-	-	-	-	3	588	591	-	591
Transactions with owners recognized directly in equity									
Dividend to Company shareholders	-	-	-	-	-	(1,280)	(1,280)	-	(1,280)
Share-based payments	-	-	5	-	-	-	5	-	5
Exercise of options for shares	3	11	(11)	-	-	-	3	-	3
Transfers by non-controlling interests	-	-	-	-	-	-	-	2	2
Non-controlling interests in a business combination	-	-	-	-	-	-	-	2	2
Increase in the rate of holding in a subsidiary	-	-	-	-	(5)	-	(5)	(9)	(14)
Balance at September 30, 2010	6,206	356	147	390	(7)	(2,378)	4,714	44	4,758

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

Condensed Consolidated Interim Statements of Changes in Equity (contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS millions								
	Attributable to owners of the Company								
Year ended December 31, 2010 (audited)									
Balance at January 1, 2010	6,187	275	210	390	(5)	(513)	6,544	(6)	6,538
Profit for the period	-	-	-	-	-	2,443	2,443	(1)	2,442
Other comprehensive income for the period, net of tax	-	-	-	-	-	13	13	-	13
Total comprehensive income for the period	-	-	-	-	-	2,456	2,456	(1)	2,455
Transactions with owners recognized directly in equity									
Dividend to Company shareholders	-	-	-	-	-	(3,733)	(3,733)	-	(3,733)
Share-based payments	-	-	39	-	-	-	39	-	39
Exercise of options for shares	26	103	(103)	-	-	-	26	-	26
Transfers by non-controlling interests, net	-	-	-	-	-	-	-	2	2
Non-controlling interests in a business combination	-	-	-	-	-	-	-	57	57
Increase in the rate of holding in a subsidiary	-	-	-	-	(5)	-	(5)	(9)	(14)
Balance as at December 31, 2010	6,213	378	146	390	(10)	(1,790)	5,327	43	5,370

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

Condensed Interim Statements of Cash Flows

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from operating activities					
Profit for the period	**1,540**	1,868	**549**	588	2,442
Adjustments:					
Depreciation	**802**	823	**275**	277	1,114
Amortization of intangible assets	**217**	198	**74**	65	269
Amortization of deferred and other expenses	**21**	20	**8**	8	26
Profit from a controlling shareholder in an investee	**-**	(57)	**-**	-	(57)
Share in losses of equity-accounted investees	**203**	180	**66**	71	261
Financing expenses, net	**232**	77	**113**	43	113
Capital gain, net	**(167)**	(115)	**(80)**	(86)	(171)
Share-based payment	**127**	16	**43**	5	35
Income tax expenses	**633**	708	**243**	246	932
Expenses (income) for derivatives, net	**(20)**	(1)	**(20)**	-	10
Change in inventory	**(33)**	89	**71**	(4)	84
Change in trade and other receivables	**(744)**	(288)	**(237)**	(44)	(300)
Change in trade and other payables	**(137)**	85	**(68)**	248	(21)
Change in provisions	**(31)**	(91)	**(33)**	(79)	(136)
Change in employee benefits	**164**	(153)	**(18)**	(100)	(215)
Net income tax paid	**(480)**	(411)	**(104)**	(72)	(690)
Net cash from operating activities	**2,327**	2,948	**882**	1,166	3,696

Condensed Interim Statements of Cash Flows (contd.)

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flow used in investing activities					
Investment in intangible assets and deferred expenses	**(244)**	(234)	**(86)**	(76)	(343)
Refund from the Ministry of Communications for frequencies	**36**	-	**36**	-	-
Proceeds from the sale of property, plant and equipment and deferred expenses	**305**	89	**69**	48	133
Acquisition of financial assets held for trading	**(2,857)**	(110)	**(2,853)**	(50)	(113)
Proceeds from the sale of financial assets held for trading	**853**	200	**851**	30	251
Purchase of property, plant and equipment	**(1,190)**	(907)	**(393)**	(300)	(1,279)
Proceeds from disposal of investments and long-term loans	**7**	12	**1**	8	11
Investments and long-term loans	**(1)**	(4)	**2**	(1)	(6)
Proceeds (payment) of derivatives	**(8)**	-	**3**	-	(2)
Business combinations less cash acquired	**-**	(145)	**-**	(115)	(145)
Interest and dividend received	**19**	9	**7**	2	9
Net cash used for investing activities	**(3,080)**	(1,090)	**(2,363)**	(454)	(1,484)
Cash flows used in financing activities					
Bank loans received	**2,200**	2,670	**600**	770	2,670
Issue of debentures, net	**3,092**	-	**2,692**	-	-
Repayment of loans	**(633)**	(433)	**(609)**	(9)	(448)
Repayment of debentures	**(825)**	(687)	**(68)**	(65)	(697)
Short-term borrowing, net	**(3)**	(6)	**-**	(231)	(6)
Dividend paid	**(1,663)**	(2,453)	**-**	-	(3,733)
Interest paid	**(232)**	(192)	**(39)**	(17)	(237)
Proceeds from exercise of options and others	**16**	9	**6**	(9)	24
Net cash used for financing activities	**1,952**	(1,092)	**2,582**	439	(2,427)
Increase (decrease) in cash and cash equivalents	**1,199**	766	**1,101**	1,151	(215)
Cash and cash equivalents at beginning of period	**365**	580	**463**	195	580
Cash and cash equivalents at end of period	**1,564**	1,346	**1,564**	1,346	365

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

Notes to the Financial Statements

1. Reporting Entity

1.1 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 condensed consolidated financial statements of the Company include those of the Company and its subsidiaries (together referred to as "the Group"), as well as the Group's interest in associates. The Group is a principal provider of communication services in Israel (see also Note 10 – Segment Reporting).

1.2 As from April 14, 2010, the ultimate controlling shareholder in the Company is Shaul Elovitch, together with his brother, Yosef Elovitch, through their holdings in Eurocom Communications Ltd., the controlling shareholder in Internet Gold-Golden Lines Ltd., which controls B Communications Ltd. ("B Communications"). B Communications holds Company shares through a company that it controls. At September 30, 2011, this company held 31.15% of the Company's shares. Each of these companies is also considered as a controlling shareholder in the Company.

1.3 The Company is subject to various sets of laws that regulate and restrict its business activities, including its tariffs. The Company's tariffs are regulated by provisions in the Communications Law. The Company's service fees are regulated and adjusted according to a linkage formula. The Company was declared a monopoly in the main areas in which it operates. All the operating segments of the Group are subject to competition. The operations of the Group are subject, in general, to government regulation and supervision. The intensifying competition and changes in the communication market could have an adverse effect on the business results of the Group.

2. Basis of Preparation

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

2.2 The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as at December 31, 2010 and the year then ended, and their accompanying notes ("the Annual Financial Statements"). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent Annual Financial Statements until the date of these consolidated interim financial statements.

2.3 The condensed consolidated interim financial statements were approved by the Board of Directors on November 9, 2011.

2.4 Use of estimates and judgment

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

The judgments made by management, when applying the Group's accounting policies and the key assumptions used in assessments that involve uncertainty, are consistent with those applied in the Annual Financial Statements.

3. Reporting Principles and Accounting Policy

The significant accounting policies applied in these condensed consolidated interim financial statements are consistent with those applied in the Annual Financial Statements for the year ended December 31, 2010, except as described below.

3.1. Recognition of actuarial gains or losses

In the interim reporting period, the Group does not perform an updated actuarial assessment for measuring employee benefits unless there are significant changes during the interim period in the principal actuarial assumptions in a defined benefit plan: discount rate, expected return on plan assets, employee leave rate and the rate of future salary increases. As a result, actuarial gains or losses are not recognized in the reporting period.

3.2. Initial application of new accounting standards

3.2.1 Related party disclosures

As from January 1, 2011 the Group applies IAS 24 (2009) – Related Party Disclosures (“the Standard”) The Standard includes changes in the definition of a related party. The Standard is applied retrospectively.

The Group mapped related parties for initial application of the Standard. According to the new definition and following the mapping, new related parties were identified. The Group had no transactions with these related parties in the reporting period and in corresponding periods.

3.2.2 Interim financial reporting

As from January 1, 2011, the Company applies the amendment to IAS 34 – Interim Financial Reporting: significant events and transactions ("the Amendment"). The Amendment expands the list of events and transactions requiring disclosure in interim financial statements. In addition, the minimum requirement for disclosure in the current standard, prior to the Amendment, was eliminated. Application of the Amendment did not have an effect on the financial statements.

3.3. New standards and interpretations not yet adopted

A. In May 2011, the IASB published a new set of accounting standards for consolidation of financial statements and related issues. The Group is examining the effect of adopting the standards on the financial statements. The Standard is effective retrospectively for annual periods commencing on or after January 1, 2013. Early adoption is permitted, subject to the conditions that were determined. New standards published:

1. IFRS 10, Consolidated Financial Statements
2. IFRS 11, Joint Arrangements
3. IFRS12, Disclosure of Interests in other Entities

3. Reporting Principles and Accounting Policy (contd.)

B. In May 2011, IFRS 13, Fair Value Measurement ("the Standard") was published. The Standard supersedes the guidelines for fair value measurement in other IFRSs. For this purpose, the Standard defines fair value, provides guidelines for fair value measurement and determines new disclosure requirements for fair value measurement. The Standard is effective for annual periods beginning on January 1, 2013. Early adoption is permitted, subject to the conditions that were determined. The Group is examining the effect of adopting the Standard on the financial statements.

C. In June 2011, the amendment to IAS 19, Employee Benefits ("the Amendment") was published. The Amendment includes a number of revisions to accounting guidelines for employee benefits. The Amendment is effective retrospectively for annual periods commencing on or after January 1, 2013. Early application is permitted, with disclosure. The Group is examining the effect of adopting the Amendment on the financial statements.

4. Group Entities

A detailed description of the Group entities appears in Note 13 to the Group's Annual Financial Statements as at December 31, 2010. Below are details of the material changes that occurred in connection with the Group entities since publication of the Annual Financial Statements.

DBS Satellite Services (1998) Ltd. (an equity-accounted associate)

4.1 For information about the financial position of DBS, see Note 4 to the financial statements of DBS for the nine and three months ended September 30, 2011, attached to these reports.

4.2 DBS has a current debt to the Group companies of NIS 61 million, of which NIS 50 million is to the Company.

5. Contingent Liabilities

During the normal course of business, legal claims were filed against Group companies or there are pending claims (“in this section: “Legal Claims”).

In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 203 million, where provisions are required to cover the exposure resulting from such claims.

In the opinion of the managements of the Group companies, the additional exposure at September 30, 2011, due to claims filed against Group companies on various matters and which are unlikely to be realized, amounts to NIS 12.8 billion (of which NIS 1.2 billion is for claims, which at this stage cannot be assessed, as set out in sections 5.1 and 5.2 below). For updates subsequent to the reporting date, see sections 5.1 and 5.2 below. This amount and all the amounts of the additional exposure in this note are linked to the CPI and are stated net of interest.

For motions for certification of class action suits to which the Group has exposure beyond the aforesaid (since the claims do not state an exact amount), see sections 5.2 and 5.4 below.

5.1. Employee claims

In the financial statements for 2010, the Group estimated that as at December 31, 2010, the additional exposure (beyond the provisions included in these financial statements) for employee claims amounts to NIS 2 billion, relating mainly to claims filed by groups of employees or individual claims with wide ramifications. Of this amount, a total of NIS 1.8 billion is for an individual proceeding (the amount claimed is not material) and for indirect lateral effects that may arise from the grounds of the claim in this procedure. In respect of this proceeding, subsequent to the approval date of the financial statements for 2010, the Company received revised opinions according to which as at December 31, 2010 and September 30, 2011, the claim is unlikely to be accepted. Accordingly, the Company believes that the exposure for NIS 1.8 billion out of the total exposure estimated by the Company is unlikely.

At September 30, 2011, the possible exposure amounts to NIS 251 million (of which NIS 25 million is for claims, which at this stage cannot be assessed), and refers to other claims described above. In the opinion of the management of the Company, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 100 million, where provisions are required to cover the exposure resulting from such claims.

Subsequent to the reporting date, a former employee of the Company filed a claim and motion for certification of the claim as a class action amounting to NIS 150 million. There are a number of legal proceedings against the Company for matters that are similar to and/or the same as this claim. The possible exposure for this claim is included in the total possible exposure for employee claims as at September 30, 2011, as set out above.

5.2. Customer claims

At September 30, 2011, the amount of the additional exposure for customer claims amounts to NIS 6.1 billion (beyond the provisions included in these financial statements). Of these claims, there are claims amounting to NIS 1.2 billion, which, at this stage, cannot yet be estimated. There are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claim is not stated in the claims. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 31 million, where provisions are required to cover the exposure arising from such claims.

In addition, subsequent to the reporting date, customer claims amounting to NIS 257 million were filed against Group companies and customer claims with exposure of NIS 209 million came to an end.

5. Contingent Liabilities (contd.)

5.3. Supplier and communication provider claims

At September 30, 2011, the amount of the additional exposure for supplier and communication provider claims amounts to NIS 1 billion (beyond the provisions included in these financial statements). In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 9 million, where provisions are required to cover the exposure arising from such claims.

5.4. Claims for punitive damages

At September 30, 2011, the amount of the additional exposure for punitive damages amounts to NIS 5.1 billion (beyond the provisions included in these financial statements). This amount does not include claims for which the insurance coverage is not disputed. There are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claim is not stated in the claim.

In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 1 million, where provisions are required to cover the exposure resulting from such claims.

5.5. Claims by developers and companies

At September 30, 2011, the amount of the additional exposure for claims by developers and companies amounts to NIS 70 million (beyond the provisions included in these financial statements). In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 11 million, where provisions are required to cover the exposure arising from such claims.

5.6. Claims by the State and authorities

At September 30, 2011, the amount of the additional exposure for claims by the State and authorities amounts to NIS 300 million (beyond the provisions included in these financial statements), of which NIS 19 million is for a claim, which at this stage cannot be assessed. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 51 million, where provisions are required to cover the exposure resulting from such claims.

For claims against DBS, see Note 5 and 6 to the financial statements of DBS as at September 30, 2011, which are attached to these financial statements. Subsequent to the reporting date and the approval date of the financial statements of DBS as at September 30, 2011, a customer claim (and motion for certification as a class action) against DBS was struck out due to inactivity. The exposure for this claim was NIS 98 million. For details of the claim see Note 21(2)(B) to the financial statements of DBS as at December 31, 2010 attached to the financial statements of the Company as at the same date.

6. Equity and Share-based Payments

6.1 Below are details of the Company's equity:

Registered			Issued and paid up		
September 30 2011	September 30 2010	December 31 2010	September 30 2011	September 30 2010	December 31 2010
(Unaudited)	(Unaudited)	(Audited)	(Unaudited)	(Unaudited)	(Audited)
Number of shares	Number of shares	Number of shares	Number of shares	Number of shares	Number of shares
2,825,000,000	2,749,000,000	2,825,000,000	**2,708,724,551**	2,678,944,392	2,685,917,052

6.2 Following the exercise of options by employees in accordance with the options plans set out in Note 27 to the financial statements as at December 31, 2010, in the nine months ended September 30, 2011, the Company issued 22,807,499 ordinary shares of NIS 1 par value each.

6.3 Subsequent to the reporting date and through to November 8, 2011, following the exercise of options by the employees, in accordance with the options plans set out in Note 27 to the financial statements as at December 31, 2010, the Company issued 194,265 ordinary shares of NIS 1 par value each.

6.4 In March 2011, the Board of Directors of the Company approved the allotment of 1,900,000 options to Company employees, according to the 2010 employee options plan set out in Note 27(C) to the financial statements as at December 31, 2010. In practice, in April 2011, employees were allocated 1,306,374 options out of these options. The theoretical economic value of the allotted options, calculated at the allotment date and based on a weighted Black and Scholes model, is NIS 6 million.

6.5 Further to Note 21(C) to the financial statements as at December 31, 2010 regarding a planned distribution of NIS 3 billion to the Company's shareholders ("the special distribution"), which is a sum not in compliance with the earnings test, as defined in section 302 Companies Law, 1999, on March 31, 2011, the economic division of the district court approved the Company's petition to approve the distribution. The special distribution to the Company's shareholders is payable in six equal payments, during 2011-2013. Accordingly, on May 19, 2011, the first part of the special distribution, amounting to NIS 500 million, was paid (representing NIS 0.1851125 per share at the record date), together with payment of the regular dividend as described in section 6.6 below. On October 5, 2011, the second part of the special distribution, amounting to NIS 500 million was paid (representing NIS 0.1845993 per share at the record date), together with payment of the regular dividend as described in section 6.6 below.

6. Equity and Share-based Payments (contd.)

The liability for the distribution is recognized as a financial liability and was initially measured at its present value at the date approval was received from the court. Discounting is based on the expected payment dates, at a discount rate of 3.81%-5.05%.

The dividend for payment is stated as follows:

	September 30, 2011	
	Dividend to pay undiscounted	Presented in the statement of financial position *
	(Unaudited)	(Unaudited)
	NIS millions	NIS millions
Current liabilities	1,000	982
Non-current liabilities	1,500	1,386
	2,500	2,368

* Dividend payable for the special distribution presented in the statement of financial position at current value plus financing expenses accumulated from March 31, 2011 to September 30, 2011

On July 3, 2011, a holder of the Company's Debentures (Series 5) petitioned the economic division of the Tel Aviv district court to order the Company to submit a revised opinion and to permit submission of responses in view of the revised opinion, including to submit objections, alleging that there has been a change in circumstances that justifies reassessment of the Company's solvency: raising debt of NIS 3 billion by the Company (as described in Note 12.4 below), immediately, instead of between 2011-2013, according to the assumption in the economic opinion attached to the Company's application and downgrade of the Company's rating to negative. On July 10, 2011, the Company submitted its response to the petition, according to which the petition should be rejected since there have been no changes to the circumstances as alleged by the applicant and/or which justify reexamination of the decision regarding the special distribution and since this is a final and absolute decision.

On July 25, 2011, further to the court ruling, the Company received the response of the Israel Securities Authority ("the ISA") to the petition and the Company's response, which did not require the ISA to address the petition - whether circumstances had changed since the court ruling. However, according to the ISA, if there is a material deterioration in the Company's position between the date the commitment is provided and the distribution is approved, and the date the dividend is paid, the Company's Board of Directors will reassess the Company's compliance with the distribution test. If there are no appropriate profits for distribution, the Company will reapply for court approval, unless the court ruling includes instructions that also take into account future changes in the Company's circumstances.

On August 18, 2011, another holder of the Company's Debentures (Series 5) petitioned the court to add it to the aforementioned procedure, claiming that the Company should not be permitted to continue to implement the special distribution. In the hearing of these petitions held on September 19, 2011, the parties agreed to accept the position of the court, according to which the court's approval of the distribution under section 303 of the Companies Law does not derogate in any way from the obligations of the Company's officers under any law. The court validated the consent and ruled that in view of the consent, discussion of the other issues that arose in the petition is unnecessary. The court noted that the aforesaid does not prevent a creditor that is able to demonstrate a material adverse change in the Company's solvency from applying to the court. Further to this decision, the Company clarified that the decision does not affect the continuation of payment of the special distribution and the Company's regular dividend policy and does not require reapplication to the court before payment.

6. Equity and Share-based Payments (contd.)

6.6 The Company distributed the following cash dividends (in addition to the special distribution as described in section 6.5 above):

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
October 2011 (NIS 0.366 per share) *	992	-	992	-	-
April 2011 (NIS 0.43 per share)	1,163	-	-	-	-
October 2010 (NIS 0.478 per share) *	-	1,280	-	1,280	1,280
May 2010 (NIS 0.917 per share)	-	2,453	-	-	2,453
	2,155	**3,733**	**992**	**1,280**	**3,733**

On September 7, 2011, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company of August 1, 2011 to distribute a cash dividend to the shareholders of the Company in the amount of NIS 992 billion, representing NIS 0.3662451 per share and 36.62451% of the Company's issued and paid up capital on the record date (September 18, 2011). The dividend was paid on October 5, 2011 (together with the second payment of the special distribution, as described in section 6.5 above).

7. Transactions with Interested and Related Parties

7.1 Further to Note 30(E) to the financial statements as at December 31, 2010, on April 13, 2011, the general meeting of the Company's shareholders approved a maximum bonus for 2010 of 18 monthly salaries, amounting to NIS 3.507 million, for the former chairman of the Company's Board of Directors, under the terms of his employment agreement, as approved by the general meeting on June 1, 2008.

7.2 Further to Note 30(E)(2)(m) to the financial statements as at December 31, 2010, regarding a framework transaction for three years for the Company's engagement in future insurance policies to cover D&O liability, in April 2011, the general meeting of the Company's shareholders approved the framework agreement.

7.3 Further to Note 30 (E)(2)(n) to the financial statements as at December 31, 2010 regarding the Company's engagement in a D&O liability insurance policy for one year, from April 14, 2011, in April 2011, the general meeting of the Company's shareholders approved the engagement.

7. Transactions with Interested and Related Parties (contd.)

7.4 In August, 2011, the general meeting of the Company's shareholders approved the agreement between DBS with Advanced Digital Broadcast SA ("ADB") and Eurocom Digital Communications Ltd. ("Eurocom Digital Communications") (after receiving the approval of the Company's Board of Directors). The agreement is for the purchase of yesMaxHD converters and receipt of suppliers credit in USD from Eurocom Digital Communications for an additional 60 days in connection with purchase of the converters, as follows: (1) An additional order of yesMaXHD converters from Eurocom Digital Communications and ADB, further to the orders approved at the Company's general meeting on July 29, 2010 and April 13, 2011, according to the framework agreement, at a total cost of USD 20.7 million (the price is for sea shipment; for earlier delivery that requires air shipment, DBS will cover the additional shipping cost); (2) supplier credit in USD from Eurocom Digital Communication for an additional 60 days ("the Additional Credit Period") in connection with purchase of the converters. According to the framework agreement, the payment terms are EOM + 35 days. For the Additional Credit Period, DBS will pay interest at a rate of 1% (6% in nominal annual terms). The scope of the credit is estimated at an average of NIS 12 million and payment of the annual interest is estimated as NIS 724,000.

7.5 On June 28, 2011, the Board of Directors of the Company approved (after approval of the Audit Committee) preliminary commitments from Eurocom Capital Underwriting Ltd. ("Eurocom Capital Underwriting") (a company indirectly controlled by Eurocom Communications Ltd., the indirect controlling owner of the Company), in a tender for classified investors for a public offering of Debentures (Series 6-8) (as described in Note 12.4 below). In the Company's institutional tender of June 28, 2011, preliminary commitments were received from Eurocom Capital Underwriting amounting to 5% of the total debentures relevant to the preliminary commitments from classified investors for each of the Debentures Series (6 to 8).

As part of the shelf offering prospectus, Eurocom Capital Underwriting acquired 43,938,000 Debentures (Series 6), 18,885,000 Debentures (Series 7) and 48,849,000 units of Debentures (Series 8). As at September 30, 2011, Eurocom Capital Underwriting holds 4,209,970 Debentures (Series 6) and 2,826,031 Debentures (Series 7).

7.6 Further to Note 30 (E)(2)(j) to the financial statements as at December 31, 2010 regarding the undertaking to indemnify in advance directors who are controlling shareholders in the Company and/or their relatives, subsequent to the reporting date, in October 2011, the general meeting of the Company's shareholders approved (after amending the Company's articles accordingly) an amendment to the deed of indemnity granted to directors or officers who are controlling shareholders of the Company or their relatives regarding indemnification for payment to parties harmed by the violation according to section 52 BBB(a)(1)(a) of the Securities Law or for expenses in respect of a proceeding according to section H(3), H(4) or I(1) of the Securities Law or according to Article D in Chapter 4 of Part IX of the Companies Law.

In addition, further to Note 30(G)(10) regarding the undertaking to indemnify all of the Company's officers, the general meeting of the Company's shareholders approved (after the approval of the Audit Committee and the Board of Directors), the amendment to the deed of indemnity for officers currently serving in the Company (other than directors or officers who are controlling shareholders in the Company or their relatives), such that the amended deed of indemnity will also allow indemnification of the officer for payment to parties injured by the violation (according to section 52 BBB(a)(1)(a) of the Securities Law, 1968) or for an expense incurred by an officer in respect of a proceeding conducted in his affairs according to section 3H, 4H or I1 of the Securities Law or according to Article D in Chapter 4 of Part IX of the Companies Law, including reasonable litigation expenses and attorney's fees.

8. Revenue

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Domestic fixed-line communication					
Fixed-line telephony	**1,777**	2,302	**593**	765	3,074
Internet - infrastructure	**810**	719	**276**	248	977
Transmission and data communication	**563**	538	**192**	177	713
Other services	**175**	170	**55**	63	226
	3,325	3,729	**1,116**	1,253	4,990
Cellular					
Cellular services and terminal equipment	**1,831**	2,475	**580**	832	3,286
Value added services	**890**	745	**310**	266	1,014
Sale of terminal equipment	**1,521**	854	**507**	280	1,176
	4,242	4,074	**1,397**	1,378	5,476
International communications, internet and NEP services	**967**	1,004	**338**	337	1,334
Other	**189**	122	**66**	65	187
	8,723	8,929	**2,917**	3,033	11,987

9. General and Operating Expenses

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Materials and spare parts	**1,187**	765	**399**	245	1,049
General expenses	**912**	866	**321**	303	1,184
Cellular telephone expenses	**662**	1,381	**228**	469	1,866
International communication expenses	**235**	242	**83**	84	325
Building maintenance	**205**	201	**70**	80	107
Vehicle maintenance expenses	**85**	94	**37**	30	132
Services and maintenance by sub-contractors	**64**	86	**13**	26	265
Royalties to the State of Israel	**79**	61	**26**	28	74
Collection fees	**16**	17	**5**	6	24
	3,445	3,713	**1,182**	1,271	5,026

10. Segment Reporting

10.1. Operating segments

	Domestic fixed-line communi-cation	Cellular	International communica-tions and internet services	Multi-channel television	Other	Adjustments	Consoli-dated
				NIS millions			
Nine months ended September 30, 2011 (unaudited)							
Revenue from external sources	**3,322**	**4,240**	**966**	**1,215**	**185**	**(1,215)**	**8,713**
Inter-segment revenue	**212**	**69**	**46**	**-**	**26**	**(343)**	**10**
	3,534	**4,309**	**1,012**	**1,215**	**211**	**(1,558)**	**8,723**
Depreciation and amortization	**513**	**421**	**79**	**214**	**17**	**(204)**	**1,040**
Segment results – operating profit	**1,274**	**1,098**	**182**	**190**	**4**	**(204)**	**2,544**
Financing expenses	**381**	**52**	**8**	**438**	**4**	**(438)**	**445**
Financing income	**(194)**	**(75)**	**(7)**	**(11)**	**-**	**10**	**(277)**
Total financing expenses, net	**187**	**(23)**	**1**	**427**	**4**	**(428)**	**168**
Segment profit (loss) after financing expenses	**1,087**	**1,121**	**181**	**(237)**	**-**	**224**	**2,376**
Share in the losses (profits) of equity-accounted investees	**-**	**-**	**(1)**	**-**	**-**	**204**	**203**
Segment profit (loss) before income tax	**1,087**	**1,121**	**182**	**(237)**	**-**	**20**	**2,173**
Income tax	**323**	**269**	**44**	**1**	**1**	**(5)**	**633**
Segment results – net profit (loss)	**764**	**852**	**138**	**(238)**	**(1)**	**25**	**1,540**
Segment assets	**9,855**	**5,397**	**1,168**	**1,256**	**308**	**(1,708)**	**16,276**
Segment liabilities	**15,250**	**1,862**	**299**	**4,914**	**260**	**(6,184)**	**16,401**
Nine months ended September 30, 2010 (unaudited):							
Revenue from external sources	3,726	4,073	1,004	1,181	115	(1,181)	8,918
Inter-segment revenue	208	191	26	2	26	(442)	11
	3,934	4,264	1,030	1,183	141	(1,623)	8,929
Depreciation and amortization	512	447	70	200	7	(195)	1,041
Segment results – operating profit	1,549	1,040	255	138	12	(151)	2,843
Financing expenses	190	95	8	368	-	(374)	287
Financing income	(132)	(72)	(5)	(2)	-	11	(200)
Total financing expenses, net	58	23	3	366	-	(363)	87
Segment profit (loss) after financing expenses	1,491	1,017	252	(228)	12	212	2,756
Share in the losses (profits) of equity-accounted investees	-	-	(4)	-	-	184	180
Segment profit (loss) before income tax	1,491	1,017	256	(228)	12	28	2,576
Income tax	405	252	48	1	3	(1)	708
Segment results – net profit (loss)	1,086	765	208	(229)	9	29	1,868
Segment assets	7,053	4,851	995	1,260	288	(1,494)	12,953
Segment liabilities	9,224	1,945	291	4,596	245	(5,807)	10,494

10. Segment Reporting (contd.)

	Domestic fixed-line communi-cation	Cellular	Internatio-nal communi-cations and internet services	Multi-channel television	Other	Adjustments	Consoli-dated
	NIS millions						
Three months ended September 30, 2011 (unaudited)							
Revenue from external sources	**1,114**	**1,396**	**338**	**405**	**66**	**(405)**	**2,914**
Inter-segment revenue	**72**	**25**	**13**	**-**	**8**	**(115)**	**3**
	1,186	**1,421**	**351**	**405**	**74**	**(520)**	**2,917**
Depreciation and amortization	**180**	**139**	**28**	**74**	**6**	**(70)**	**357**
Segment results – operating profit (loss)	**546**	**342**	**61**	**63**	**(1)**	**(67)**	**944**
Financing expenses	**166**	**30**	**3**	**139**	**2**	**(154)**	**186**
Financing income	**(78)**	**(34)**	**(2)**	**(1)**	**-**	**15**	**(100)**
Total financing expenses (income), net	**88**	**(4)**	**1**	**138**	**2**	**(139)**	**86**
Segment profit (loss) after financing expenses	**458**	**346**	**60**	**(75)**	**(3)**	**72**	**858**
Share in the losses (profits) of equity-accounted investees	**-**	**-**	**(1)**	**-**	**-**	**67**	**66**
Segment profit (loss) before income tax	**458**	**346**	**61**	**(75)**	**(3)**	**5**	**792**
Income tax	**147**	**83**	**15**	**1**	**-**	**(3)**	**243**
Segment results – net profit (loss)	**311**	**263**	**46**	**(76)**	**(3)**	**8**	**549**
Three months ended September 30, 2010 (unaudited)							
Revenue from external sources	1,252	1,378	337	394	61	(392)	3,030
Inter-segment revenue	71	64	10	2	10	(154)	3
	1,323	1,442	347	396	71	(546)	3,033
Depreciation and amortization	171	149	23	68	2	(63)	350
Segment results – operating profit	556	356	70	72	9	(84)	979
Financing expenses	84	65	2	151	1	(153)	150
Financing income	(54)	(27)	(1)	(2)	-	8	(76)
Total financing expenses, net	30	38	1	149	1	(145)	74
Segment profit (loss) after financing expenses	526	318	69	(77)	8	61	905
Share in the losses (profits) of equity-accounted investees	-	-	-	-	-	71	71
Segment profit (loss) before income tax	526	318	69	(77)	8	(10)	834
Income tax	149	79	16	1	2	(1)	246
Segment results – net profit (loss)	377	239	53	(78)	6	(9)	588

10. Segment Reporting (contd.)

	Domestic fixed-line communi-cation	Cellular	Internatio-nal communi-cations and internet services	Multi-channel television	Other*	Adjustments	Consoli-dated
	NIS millions						
Year ended December 31, 2010 (audited)							
Revenue from external sources	4,990	5,474	1,333	1,578	178	(1,578)	11,975
Inter-segment revenue	273	258	47	5	32	(603)	12
	5,263	5,732	1,380	1,583	210	(2,181)	11,987
Depreciation and amortization	690	601	94	285	15	(276)	1,409
Segment results – operating profit	2,043	1,383	320	178	14	(194)	3,744
Financing expenses	282	111	11	500	3	(516)	391
Financing income	(192)	(100)	(6)	(9)	-	25	(282)
Total financing expenses, net	90	11	5	491	3	(491)	109
Segment profit (loss) after financing expenses	1,953	1,372	315	(313)	11	297	3,635
Share in the losses (profits) of equity-accounted investees	-	-	(3)	-	-	264	261
Segment profit (loss) before income tax from continuing operations	1,953	1,372	318	(313)	11	33	3,374
Profit from discontinued operations	-	-	1	-	-	(1)	-
Income tax	527	339	65	1	4	(4)	932
Segment results – net profit (loss)	1,426	1,033	254	(314)	7	36	2,442
Segment assets	6,352	4,892	1,032	1,243	291	(1,836)	11,974
Segment liabilities	7,964	1,930	304	4,665	241	(6,236)	8,868

* Restated following deconsolidation of a previously consolidated subsidiary of Bezeq International

10. Segment Reporting (contd.)

10.2. Adjustments for segment reporting of revenue, profit or loss

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue					
Revenue from reporting segments	**10,070**	10,411	**3,363**	3,508	13,958
Revenue from other segments	**211**	141	**74**	71	210
Cancellation of revenue from inter-segment sales except for revenue from sales to an associate reporting as a segment	**(343)**	(442)	**(115)**	(154)	(603)
Cancellation of revenue for a segment classified as an associate	**(1,215)**	(1,181)	**(405)**	(392)	(1,578)
Consolidated revenue	**8,723**	8,929	**2,917**	3,033	11,987

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit or loss					
Operating profit for reporting segments	**2,744**	2,982	**1,012**	1,047	3,924
Cancellation of results for a segment classified as an associate	**(190)**	(138)	**(63)**	(72)	(178)
Financing expenses, net	**(168)**	(87)	**(86)**	(74)	(109)
Share in losses of equity-accounted investees	**(203)**	(180)	**(66)**	(71)	(261)
Profit (loss) for other categories	**4**	4	**(1)**	9	14
Other adjustments	**(14)**	(5)	**(4)**	(5)	(16)
Consolidated profit before income tax	**2,173**	2,576	**792**	834	3,374

11. Condensed Financial Statements of Pelephone Communications Ltd. and Bezeq International Ltd.

11.1. Pelephone Communications Ltd.

Statement of financial position

	September 30 2011	September 30 2010	December 31 2010
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**2,244**	2,013	2,071
Non-current assets	**3,153**	2,838	2,821
	5,397	4,851	4,892
Current liabilities	**1,290**	1,193	1,198
Long-term liabilities	**572**	752	732
Total liabilities	1,862	1,945	1,930
Equity	**3,535**	2,906	2,962
	5,397	4,851	4,892

Statement of income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from services	**1,898**	2,660	**604**	893	3,536
Revenue from value added services	**890**	745	**310**	266	1,014
Revenue from sales of terminal equipment	**1,521**	859	**507**	283	1,182
Total revenue from services and sales	**4,309**	4,264	**1,421**	1,442	5,732
Cost of services and sales	**2,755**	2,784	**926**	941	3,754
Gross income	**1,554**	1,480	**495**	501	1,978
Selling and marketing expenses	**367**	351	**125**	115	468
General and administrative expenses	**89**	89	**28**	30	127
	456	440	**153**	145	595
Operating profit	**1,098**	1,040	**342**	356	1,383
Financing expenses	**52**	95	**30**	65	111
Financing income	**(75)**	(72)	**(34)**	(27)	(100)
Financing expenses (income), net	**(23)**	23	**(4)**	38	11
Profit before income tax	**1,121**	1,017	**346**	318	1,372
Income tax	**269**	252	**83**	79	339
Profit for the period	**852**	765	**263**	239	1,033

11. Condensed Financial Statements of Pelephone Communications Ltd. and Bezeq International Ltd.

11.2. Bezeq International Ltd.

Statement of financial position

	September 30 2011 (Unaudited) NIS millions	September 30 2010 (Unaudited) NIS millions	December 31 2010 (Audited) NIS millions
Current assets	**459**	459	447
Non-current assets	**717**	542	591
	1,176	1,001	1,038
Current liabilities	**279**	259	279
Long-term liabilities	**20**	32	25
Total liabilities	299	291	304
Equity	**877**	710	734
	1,176	1,001	1,038

Statement of income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from services	**1,012**	1,030	**351**	347	1,380
Operating expenses	**595**	616	**209**	208	822
Gross income	**417**	414	**142**	139	558
Selling, marketing and development expenses	**151**	141	**51**	48	192
General and administrative expenses	**84**	80	**30**	26	109
Other revenue, net	**-**	(62)	**-**	(5)	(63)
	235	159	**81**	69	238
Operating profit	**182**	255	**61**	70	320
Financing expenses	**8**	8	**3**	2	11
Financing income	**(7)**	(5)	**(2)**	(1)	(6)
Financing expenses (income), net	**1**	3	**1**	1	5
Share in profits of equity-accounted associates	**1**	4	**1**	-	3
Profit before income tax	**182**	256	**61**	69	318
Income tax	**44**	48	**15**	16	65
Profit for the period from continuing operations	**138**	208	**46**	53	253
Profit (loss) for the period from discontinued operations	**-**	-	**-**	-	1
Profit for the period	**138**	208	**46**	53	254

12. Material Events During the Reporting Period and Subsequent Events

12.1 On January 24, 2011, the Company's Board of Director's approved an early retirement plan for employees. According to the plan, up to 260 employees will retire from the Company at a total cost of up to NIS 281.5 million. The expense of NIS 281.5 million for the plan was recognized in the financial statements as other operating expenses.

12.2 In May 2011, the Company completed raising debt totaling NIS 2 billion, through loans from Israeli banks and an institutional organization (a group) and a private placement of debentures to an institutional organization (group).

A. A loan of NIS 600 million, which is unlinked and bears variable interest at a rate of prime minus 0.8%, repayable in one payment in May 2012. The interest for the loan is paid every three months. Subsequently, on August 2, 2011, the Board of Directors approved the repayment of this loan and approved another loan of NIS 600 million instead, bearing interest at a rate of prime plus 0.15%. The principal is payable in 12 equal annual payments during 2012-2023. The interest is payable twice a year.

B. Loans of NIS 500 million, which are unlinked and bear variable interest at a rate of prime plus 0.2%, repayable in eight equal semi-annual payments of the principal between 2017 and 2020. The interest on the loans is payable twice a year.

C. Loans of NIS 500 million, which are unlinked and bear fixed annual interest at a rate of 6.85%, repayable in eight equal semi-annual payments of the principal between 2017 and 2020. The interest on the loans is payable twice a year.

D. Unmarketable debentures in the amount of NIS 400 million, which are unlinked and bear fixed annual interest at a rate of 6.65%, repayable in eight equal semi-annual payments of the principal between 2017 and 2020. The interest on the debentures is payable twice a year.

The Company has provided the following undertakings to each of the credit providers ("the Credit Providers"):

1. The Company will not create additional pledges on its assets (a negative pledge), under the same terms as the negative pledge in favor of the banks and subject to the exceptions described in Note 14C(1) to the financial statements as at December 31, 2010.

2. The financing documents include accepted grounds for immediate repayment of the credit, including events of breach, insolvency, liquidation or receivership proceedings, as well as the right to call for immediate repayment if a third party lender calls for immediate repayment of the Company's debts in an amount exceeding the amount set.

3. In respect of the long-term credit provided to the Company, the Company undertook that if it makes a commitment to any lender (an additional lender) regarding financial covenants, the financing organizations may (under certain circumstances) require the Company to provide them with a similar undertaking.

As at September 30, 2011 and the approval date of the financial statements, the Company is in compliance with all the commitments in respect of this credit, there were no grounds to call for immediate repayment of the credit and financial covenants were not determined as set out above.

12. Material Events During the Reporting Period and Subsequent Events (Contd.)

Some of the debt was raised by exercising the letter of undertaking for long-term credit that the Company received from a bank in February 2011, as described in Note 34A to the financial statements as at December 31, 2010. After raising the debt, the amount of credit in the letter of undertaking was reduced from NIS 1.5 billion to NIS 700 million. Further to the resolution of the Board of Directors of August 1, 2011, as described in section 12.2(A) above, the letter of undertaking was canceled.

12.3 On June 1, 2011 the Company published a shelf prospectus for the issue of shares, debentures, convertible debentures, share options, debenture options and commercial papers, in the same scope and under the same conditions defined in the shelf offering memorandums, to the extent that these will be published by the Company in the future ("the Shelf Prospectus"). Subsequently, on 22 June 2011, the Company issued an amendment to the Shelf Prospectus, which included mainly amendments to the terms of the debentures and deed of trust.

12.4 On June 29, 2011, the Company issued a shelf offering memorandum for a public offering of Debentures (Series 6 to 8) according to a shelf prospectus as described in section C above. On July 3, 2011, the Company issued debentures according to the shelf offering memorandum, as follows:

A. 958,088,000 Debentures (Series 6) of record, of NIS 1 par value each for a gross consideration of NIS 958,088,000. The debentures are repayable in five equal annual payments on December 1st of each of the years 2018 to 2022 and bear fixed annual interest at a rate of 3.7%. The principal and interest of the debentures are linked to the CPI. The interest is payable twice a year as from December 1, 2011.

B. 424,955,000 Debentures (Series 7) of record, of NIS 1 par value each for a gross consideration of NIS 424,955,000. The debentures are repayable in five equal annual installments on December 1 of each of the years 2018 to 2022 and bear variable annual interest at the short-term loan (Makam) yield plus a margin of 1.4%. The interest is payable four times a year as from September 1, 2011. Debentures (Series 7) are not linked to the CPI or any currency. The interest payable for Debentures (Series 7) from September 1, 2011 to December 1, 2011 amounts to 1.1155%.

C. 1,329,363,000 debentures of NIS 1 par value each, for a gross consideration of NIS 1,329,363,000. The debentures are repayable in three equal annual payments on June 1st of each of the years 2015 to 2017 and bear fixed annual interest at a rate of 5.7%. The interest is payable twice a year as from December 1, 2011. Debentures (Series 8) are not linked to the CPI or any currency.

The total gross consideration for the debentures amounted to NIS 2,712,406,000. On July 3, 2011, the net consideration of NIS 2,694,283,579 for the issuance was received (net of issuance fees).

The Company invested most of the proceeds of the issuance in a number of shekel mutual funds (short-term mutual funds, according to the Joint Investments Law in mutual funds such as debentures, fixed deposits and cash with an average life of up to 90 days). At the date of initial recognition, the Company classified its investment in financial funds to financial assets measured at fair value through profit or loss.

12. Material Events During the Reporting Period and Subsequent Events (Contd.)

The Company undertook the following for the debentures that were issued:

1. The Company will not create additional pledges on its assets unless pledges are created at the same time in favor of the debenture holders (negative pledge), under the same terms of the negative pledge in favor of the banks and subject to the exceptions described in Note 14C (1) to the financial statements as at December 31, 2010.

2. The Company will take steps so that, to the extent under its control, debentures of the relevant series will be rated by at least one rating company, so long as there are debentures of the relevant series in circulation.

3. If the Company provides an undertaking towards any entity in respect of compliance with financial covenants, the Company will provide the same undertaking to its debenture holders (subject to certain exceptions).

4. Standard grounds were included for immediate repayment of the debentures, including breach events, insolvency, dissolution procedures or receivership. In addition, a right was determined to call for immediate repayment if a third party lender calls for immediate repayment of the Company's debts in an amount exceeding the amount determined.

As at September 30, 2011 and the approval date of the financial statements, the Company is in compliance with all the commitments in respect of the debentures, there were no grounds to call for immediate repayment of the credit and financial covenants were not determined as set out above.

12.5 In July 2011, the Board of Directors of the Company approved negotiations to acquire land covering 25 dunams for the construction of offices and communication facilities to replace the existing offices that are currently leased. The estimated price of the lot is NIS 125 million plus VAT. According to the Company's preliminary estimates, the overall project cost is expected to amount to NIS 700 million (including the price of the lot as described above and the relevant levies). This cost will be spread over the project period according to the rate of construction.

12.6 In the reporting period, the Company recognized a capital gain of NIS 119 million from the sale of real estate and NIS 48 million from the sale of copper cables. The total consideration for these sales amounts to NIS 343 million (of which a total of NIS 62 million has not yet been received).

12.7 On October 30, 2011, the Israeli government approved the recommendations for taxation in the report presented by the committee for socio-economic change. The changes in the tax rates approved by the government require legislation, which, at the approval date of the financial statements as at September 30, 2011, has not been completed. Accordingly, the approved changes in the tax rates have no effect on measurement of the deferred tax assets and liabilities in these financial statements, since the legislation has yet to be completed.

Had the new tax laws come into effect by September 30, 2011, the new tax rates would have been reflected in the financial statements as at September 30, 2011, in the amount of the deferred tax balances and recording of deferred tax revenue of NIS 40 million.

DBS SATELLITE SERVICES (1998) LTD.

CONDENSED INTERIM FINANCIAL STATEMENTS

SEPTEMBER 30, 2011

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The information contained in these financial statements constitutes a translation of the financial statements published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

Condensed Interim Financial Statements as of September 30, 2011

Contents

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Review Report to the Shareholders of DBS Satellite Services (1998) Ltd.

Introduction

We have reviewed the accompanying financial information of DBS Satellite Services (1998) Ltd (hereinafter - "the Company"), comprising of the condensed interim statement of financial position as of September 30, 2011 and the related condensed interim statements of income, comprehensive income, changes in equity and cash flows for the nine and three month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 "*Interim Financial Reporting*", and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

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

Conclusion

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

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

Without qualifying our above conclusion, we draw attention to Note 4 regarding the financial condition of the Company. The continuation of the Company's activities depends on its compliance with the stipulations as set forth in the financing agreements with the banks.

Somekh Chaikin
Certified Public Accountants (Isr.)

November 2, 2011

Condensed Interim Statements of Financial Position as of

	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Assets			
Trade receivables	**8=: ,<; ?**	1, 16111	1, 86811
Trade receivables and debit balances	**88,@8@**	869, 1	116111
Total current assets	**8><,; =>**	1116191	1196991
Broadcasting rights, net of rights exercised	**: 8>,: ; 8**	1196819	1116191
Property, plant and equipment, net	**==: ,; @:**	, 996899	, 116888
Intangible assets, net	**@@=89**	816111	8161, 9
Total non-current assets	**8,9?9,; ; ;**	1618968111	161, 16111
Total assets	**8,9<<,@88**	161, 16111	16111 16111

Condensed Interim Statements of Financial Position as of

	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Liabilities			
Borrowings from banks	**75,918**	866,511	135,438
Current maturities for debentures	**57,605**	55,698	56,062
Trade payables and service providers	**394,430**	379,281	355,771
Other payables	**159,494**	151,074*	164,951
Provisions	**95,288**	83,927*	89,266
Total current liabilities	**782,735**	1,536,491	801,488
Debentures	**1,122,953**	580,684	1,030,973
Loans from institutions	**-**	199,657	-
Bank loans	**365,819**	-	470,810
Loans from shareholders	**2,598,608**	2,213,651	2,300,387
Long-term trade payables	**37,440**	58,213*	54,264
Employee benefits	**6,570**	7,554	6,696
Total non-current liabilities	**4,131,390**	3,059,759	3,863,130
Total liabilities	**4,914,125**	4,596,250	4,664,618
Capital deficit			
Share capital	**29**	29	29
Share premium	**85,557**	85,557	85,557
Options	**48,219**	48,219	48,219
Capital reserves	**1,537,271**	1,537,271	1,537,271
Capital reserve for share-based payments	**10,278**	9,087	9,391
Accumulated deficit	**(5,339,568)**	(5,016,169)	(5,101,941)
Total capital deficit	**(3,658,214)**	(3,336,006)	(3,421,474)
Total liabilities and equity	**1,255,911**	1,260,244	1,243,144

David Efrati	Ron Eilon	Katriel Moriah
(Authorized to sign as chairman of the board) (See Note 8)	CEO	CFO

* Reclassified

Date of approval of the financial statements: November 2, 2011

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

Condensed Interim Income Statements

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue	**1,214,978**	1,182,710	**405,468**	395,347	1,582,930
Cost of revenue	**808,676**	842,188	**267,780**	258,524	1,128,848
Gross profit	**406,302**	340,522	**137,688**	136,823	454,082
Selling and marketing expenses	**111,968**	103,521	**37,171**	31,543	143,202
General and administrative expenses	**104,287**	99,283	**37,153**	33,538	132,561
	216,255	202,804	**74,324**	65,081	275,763
Operating profit	**190,047**	137,718	**63,364**	71,742	178,319
Financing expenses	**139,592**	136,959	**42,941**	56,393	181,584
Financing income	**(10,927)**	(2,354)	**(474)**	(2,427)	(9,313)
Shareholders' financing expenses	**298,221**	231,764	**96,242**	95,550	318,499
Financing expenses, net	**426,886**	366,369	**138,709**	149,516	490,770
Loss before income tax	**(236,839)**	(228,651)	**(75,345)**	(77,774)	(312,451)
Income tax	**788**	751	**540**	577	1,188
Loss for the period	**(237,627)**	(229,402)	**(75,885)**	(78,351)	(313,639)
Basic and diluted loss per share (NIS)	**7,948**	7,673	**2,538**	2,621	10,491

The attached notes are an integral part of these condensed interim financial statements

Condensed Interim Statements of Comprehensive Income

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Loss for the period	**(237,627)**	(229,402)	**(75,885)**	(78,351)	(313,639)
Other items of comprehensive income:					
Actuarial losses from a defined benefit plan	**-**	-	**-**	-	(1,535)
Other comprehensive loss for the period	**-**	-	**-**	-	(1,535)
Total comprehensive loss for the period	**(237,627)**	(229,402)	**(75,885)**	(78,351)	(315,174)

The attached notes are an integral part of these condensed interim financial statements

Condensed Interim Statements of Changes in Equity

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Accumulated deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Nine months ended September 30, 2011 (unaudited)							
Balance as of January 1, 2011 (audited)	9@	?<,<<>	; ?,98@	8,<: >,9>8	@: @8	)<,898,@8(	): ,; 98,; >; (
Total comprehensive income for the period							
Loss for the period	-	-	-	-	-	)9: >,=9>(	)9: >,=9>(
Other comprehensive loss for the period	-	-	-	-	-	-	-
Total other comprehensive loss for the period (unaudited)	9@	?<,<<>	; ?,98@	8,<: >,9>8	@: @8	)<,: : @<=?(	): ,=<@898(
Transactions with owners recognized directly in equity							
Share-based payments	-	-	-	-	??>	-	??>
Balance as of September 30, 2011 (unaudited)	9@	?<,<<>	; ?,98@	8,<: >,9>8	89,9>?	)<,: : @<=?(	): ,=<?,98; (
Nine months ended September 30, 2010 (unaudited)							
Balance as of January 1, 2010 (audited)	19	816111	186119	16111 16111	, 6911	)1618, 61, 1(	)161 1861, 1(
Total comprehensive income for the period							
Loss for the period	-	-	-	-	-	)1196111(	)1196111(
Other comprehensive loss for the period	-	-	-	-	-	-	-
Total other comprehensive loss for the period (unaudited)	19	816111	186119	16111 16111	, 6911	)1611, 61, 9(	)161186 1,1 (
Transactions with owners recognized directly in equity							
Share-based payments	-	-	-	-	1611,	-	1611,
Balance as of September 30, 2010 (unaudited)	19	816111	186119	16111 16111	96181	)1611, 61, 9(	)1611, 611, (

The attached notes are an integral part of these condensed interim financial statements

Condensed Interim Statements of Changes in Equity (Contd.)

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Accumulated deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Three months ended September 30, 2011 (unaudited)							
Balance as of July 1, 2011 (unaudited)	9@	?<,<<>	; ?,98@	8,<: >,9>8	@@@9	)<,9=: ,=?: (	): ,<?9,=8>(
Total comprehensive income for the period							
Loss for the period	-	-	-	-	-	)><,??<(	)><,??<(
Other comprehensive loss for the period	-	-	-	-	-	-	-
Total other comprehensive loss for the period (unaudited)	9@	?<,<<>	; ?,98@	8,<: >,9>8	@@@9	)<,: : @<=?(	): ,=<?,<99(
Transactions with owners recognized directly in equity							
Share-based payments	-	-	-	-	9??	-	9??
Balance as of September 30, 2011 (unaudited)	9@	?<,<<>	; ?,98@	8,<: >,9>8	89,9>?	)<,: : @<=?(	): ,=<?,98; (
Three months ended September 30, 2010 (unaudited)							
Balance as of July 1, 2010 (unaudited)	19	816111	186119	16111 16111	8611,	)169116818(	)161186, , (
Total comprehensive income for the period							
Loss for the period	-	-	-	-	-	)186111(	)186111(
Other comprehensive loss for the period	-	-	-	-	-	-	-
Total other comprehensive loss for the period (unaudited)	19	816111	186119	16111 16111	8611,	)1611, 61, 9(	)1611, 6111(
Transactions with owners recognized directly in equity							
Share-based payments	-	-	-	-	111	-	111
Balance as of September 30, 2010 (unaudited)	19	816111	186119	16111 16111	96181	)1611, 61, 9(	)1611, 611, (

The attached notes are an integral part of these condensed interim financial statements

Condensed Interim Statements of Changes in Equity (Contd.)

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Accumulated deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Year ended December 31, 2010 (audited)							
Balance as of January 1, 2010 (audited)	29	85,557	48,219	1,537,271	6,931	(4,786,767)	(3,108,760)
Total comprehensive income for the year							
Loss for the year	-	-	-	-	-	(313,639)	(313,639)
Other comprehensive loss for the year	-	-	-	-	-	(1,535)	(1,535)
Total other comprehensive loss for the year	-	-	-	-	-	(315,174)	(315,174)
Transactions with owners recognized directly in equity							
Share-based payments	-	-	-	-	2,460	-	2,460
Balance as of December 31, 2010 (audited)	29	85,557	48,219	1,537,271	9,391	(5,101,941)	(3,421,474)

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

Condensed Interim Statements of Cash Flow

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities					
Loss for the period	**(237,627)**	(229,402)	**(75,885)**	(78,351)	**(313,639)**
Adjustments					
Depreciation and amortization	**213,798**	199,710	**74,074**	67,780	**284,732**
Financing expenses, net	**417,319**	328,576	**138,718**	126,292	**465,562**
Proceeds from sale of property, plant and equipment	**(156)**	(44)	**(91)**	(15)	**(35)**
Share-based payments	**887**	2,156	**288**	711	**2,460**
Income tax expenses	**788**	751	**540**	577	**1,188**
Change in trade receivables	**5,299**	(1,279)	**(5,257)**	(1,137)	**(8,695)**
Change in accounts receivable and debit balances	**(769)**	2,514*	**(1,306)**	3,726*	**363**
Change in trade payables and service providers	**8,002**	(16,802)*	**(868)**	(21,966)*	**(2,731)**
Change in other payables and provisions	**565**	99,427*	**8,298**	31,927*	**83,659**
Change in broadcasting rights, net of rights exercised	**(12,851)**	(25,063)	**(3,563)**	(2,943)	**(19,724)**
Change in employee benefits	**(126)**	165	**(207)**	93	**(438)**
	632,756	590,111*	**210,626**	205,045*	806,341
Income tax paid	**(788)**	(751)	**(540)**	(577)	(1,188)
Net cash from current operations	**394,341**	359,958*	**134,201**	126,117	491,514
Cash flows used in investing activities					
Proceeds from the sale of property, plant and equipment	**354**	1,493	**156**	1,056	**1,589**
Acquisition of property, plant and equipment	**(156,638)**	(151,461)	**(51,634)**	(52,441)	**(226,728)**
Acquisition of intangible assets	**(17,418)**	(10,221)	**(6,428)**	(2,500)	**(14,897)**
Payments for subscriber acquisition	**(28,791)**	(27,299)	**(9,274)**	(9,771)	**(36,756)**
Net cash used in investment activities	**(202,493)**	(187,488)	**(67,180)**	(63,656)	**(276,792)**

* Reclassified

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

Condensed Interim Statements of Cash Flow (Contd.)

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows used in financing activities					
Repayment of loans from institutions	**-**	-	**-**	-	**(115,731)**
Bank loans received	**-**	255,000	**-**	-	**255,000**
Repayment of bank loans	**(84,851)**	(283,105)	**-**	(55,020)	**(580,718)**
Repayment of debentures	**(57,271)**	(55,020)	**(57,271)**	-	**(55,020)**
Short-term bank credit from banks, net	**(79,660)**	4,685	**6,076**	22,489	**41,232**
Payment for lease financing obligation	**(397)**	-	**(397)**	-	-
Interest paid	**(88,221)**	(94,030)	**(35,418)**	(29,930)	(203,444)
Issue of debentures, net	**118,553**	-		-	443,959
Net cash used for financing activities	**(191,847)**	**(172,470)**	**(87,010)**	(62,461)	**(214,722)**
Change in cash and cash equivalents	**-**	**-**	(19,990)	**-**	**-**
Cash and cash equivalents at the beginning of the period	**-**	**-**	19,990	**-**	**-**
Cash and cash equivalents at the end of the period	**-**	**-**	-	**-**	**-**

The attached notes are an integral part of these condensed interim financial statements

NOTE 1 –REPORTING ENTITY

DBS Satellite Services (1998) Ltd. ("the Company") was incorporated in Israel on December 2, 1998. The Company's head office is at 6 Hayozma St., Kfar Saba, Israel.

In January 1999, the Company received a license from the Ministry of Communications for satellite television broadcasts ("the License"). The License is valid until January 2017 and may be extended for a further six years under certain conditions. The Company's operations are subject, *inter alia,* to the Communications Law (Telecommunications and Broadcasts), 1982 ("the Communications Law") and the regulations and rules promulgated thereunder and to the license terms.

Pursuant to its license, Bezeq The Israel Telecommunication Corporation Limited ("Bezeq") is required to maintain full structural separation between it and its subsidiaries, and between it and the Company. Additionally, on March 31, 2004, the Minister of Communications published a document banning certain business alliances between Bezeq and its subsidiaries, and between Bezeq and the Company, unless, *inter alia*, there is a material deterioration in the competitive status of the Company. The Ministry is considering the approval of certain exemptions regarding the restrictions relating to the alliances while amending the license. This process has not yet been completed.

In August 2009, the Supreme Court accepted the Antitrust Commissioner's appeal of the ruling of the Antitrust Tribunal approving the merger (as defined in the Antitrust Law, 1988) between the Company and Bezeq by exercising the options held by Bezeq into Company shares, subject to certain conditions, and ruled against the merger.

NOTE 2 - BASIS OF PREPARATION

A. Statement of compliance

The condensed interim financial statements have been prepared in conformity with IAS 34, Interim Financial Reporting, and do not include all of the information required for full annual financial statements. They should be read in conjunction with the financial statements for the year ended December 31, 2010 ("the annual statements"). In addition, these statements have been prepared in conformity with the provisions of Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

The condensed interim financial statements were approved by the Company's Board of Directors on November 2, 2011.

B. Use of estimates and judgment

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

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

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in these condensed interim financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2010, except as described below:

A. Recognition of actuarial gains or losses

The Company does not produce in every interim reporting period an updated actuarial assessment for measuring employee benefits unless there are significant changes during the interim period in the principal actuarial assumptions in a defined benefit plan: discount rate, expected return on plan assets, employee leave rate and the rate of future salary increases. As a result, actuarial gains or losses are not recognized in the reporting period.

B. Initial application of new accounting standards

(1) Related party disclosures

Beginning January 1, 2011, the Company applies IAS 24 (2009) – Related Party Disclosures ("the Standard"). The Standard includes changes in the definition of a related party and modifications of disclosure requirements for government-related entities. The Standard is applied retrospectively.

For the initial application of the Standard, the Company mapped the relationships of the related parties. According to the new definition and following the mapping, new related parties were identified. The Company had no transactions with these related parties in the reporting period and in corresponding periods.

(2) Interim financial reporting

Beginning January 1, 2011, the Company applies the amendment to IAS 34 – "Interim Financial Reporting", regarding significant events and transactions ("the Amendment"), which was published as part of the improvements to IFRSs issued by the International Accounting Standards Board (IASB) for 2010. According to the Amendment, the list of events and transactions requiring disclosure in interim financial statements was expanded. In addition, the minimum requirement for disclosure in the current standard, prior to the Amendment, was eliminated. The disclosures required according to the Amendment were reflected in these condensed interim financial statements.

C. New standards which have not yet been adopted

In May 2011, IFRS 13, Fair Value Measurement ("the Standard") was published. This Standard replaces the directives in respect of the method of measuring fair value which appear in the various IFRSs and consequently it is the only source for directives on measuring fair value under IFRS. For this purpose, the Standard defines fair value, sets a directive framework for fair value measurement and establishes new disclosure requirements in respect of fair value measurement. The Standard shall be applied for annual periods commencing on January 1, 2013. Early application is possible subject to provision of disclosure. The Standard shall be applied prospectively when the disclosure requirements of the Standard do not apply to comparative information for periods prior to first-time application of the Standard. The Company is reviewing the consequences of adoption of the Standard on the financial statements.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (Contd.)

C. New standards which have not yet been adopted (contd.)

In June 2011 an amendment was published to IAS 19, Employee Benefits ("the Amendment"). The Amendment contains a number of modifications to the accounting treatment of employee benefits. The Amendment eliminates the possibility of postponing the recognition of actuarial gains and losses and costs of past service which have not yet matured. Also modified were the definitions of short-term employee benefits and of other long-term benefits, disclosure requirements were added for defined benefit plans which are designed, inter alia, to provide better information regarding the characteristics of these benefit plans and the associated risks. In addition, it was determined that termination benefits will be recognized on the earlier of the dates on which the Company recognizes, pursuant to IAS 37 – Provisions, Contingent Liabilities and Contingent Assets, restructuring costs which also include payment of termination benefits, and the date on which the entity can no longer withdraw its proposal for payment of termination benefits.

The Amendment will apply for annual periods commencing on or after January 1, 2013, and will be applied retroactively. Early application is possible subject to provision of disclosure. At this stage the Company is reviewing the consequences of adoption of the Standard on the financial statements.

NOTE 4 – FINANCIAL POSITION OF THE COMPANY

A. Since the beginning of its operations, the Company has accumulated substantial losses. The Company's losses in 2010 amounted to NIS 314 million and losses in the nine months ended September 30, 2011 amounted to NIS 238 million. As a result of these losses, the Company's capital deficit and working capital deficit at September 30, 2011 amounted to NIS 3,658 million and NIS 607 million, respectively.

B.

1. In March 2011, the Company expanded Debentures (Series B) by issuing additional debentures in the amount of NIS 117 million par value and which totaled NIS 120 million. Maalot gave the Debentures (Series B) a rating of ilA-. According to the amendment to the Company's bank finance agreement, fifty percent of the proceeds from the issuance will be used for early partial repayment of the Company's long-term bank loans.

2. At September 30, 2011, the Company is in compliance with the financial covenants set for it.

3. The Company's management believes that the financial resources at its disposal will be sufficient for the Company's operations for the coming year, based on the cash flow forecast approved by the Company's board of directors. If additional resources are required to meet its operational requirements for the coming year, the Company will adapt its operations to preclude the need for additional resources beyond those available to it.

NOTE 5 – CONTINGENT LIABILITIES

LEGAL CLAIMS

A. Employee claims

During the normal course of business, employees and former employees filed collective and individual claims against the Company. Most of these claims are for alleged non-payment of salary components and delay in salary payment. At September 30, 2011, these claims amounted to NIS 1,649,000. In the opinion of the management of the Company, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 1,640,000, where provisions are required to cover the exposure resulting from such claims.

B. Customer claims

During the normal course of business, the Company's customers filed claims against the Company. At September 30, 2011, these claims amounted to NIS 1,050,675,000. In the opinion of the management of the Company, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 3,526,000, where provisions are required to cover the exposure resulting from such claims.

Of these claims, there are claims amounting to NIS 310,000 which cannot yet be assessed.

Further to the claim for broadcasting disruptions which was included in the customer claims described in note 21B to the 2010 annual financial statements, on July 21, 2011, a motion was filed in the Tel Aviv – Jaffa District Court to certify a settlement agreement under which the Company would offer the following benefits to any subscriber living in northern towns in the disruption period, as detailed in the settlement agreement: anyone who is a current subscriber of the Company – 3 DVDBOX movies or one of the channel packages listed in the settlement agreement for 60 days; anyone who is no longer a subscriber of the Company – an option to subscribe to its services and become entitled to the above-mentioned benefits or to receive NIS 35. Under the settlement agreement, the class representative would be paid compensation of NIS 200,000 and its lawyers NIS 1,300,000. During the motion which was heard on October 24, 2011, the court ordered the parties to submit notice of an amendment to the motion for certification of the settlement agreement, so that in addition to publication of this notice of the motion for certification of the settlement arrangement as set forth in the settlement agreement, said notice would also be sent to members of the first group via the Company's subscriber notification system. Furthermore, during the hearing, dates were set for submission of a response from the Attorney-General.

Further to the claim regarding the Company's breach of duty to hearing impaired customers, which was included in the customer claims described in note 21B to the annual financial statements, on September 11, 2011, the parties filed a motion in the Tel Aviv – Jaffa District Court to certify a settlement agreement. This agreement defined a benefit period during which the Company would offer an additional 90 hours to be accompanied by subtitling and sign language, and the motion for certification would be amended so that it would apply until the date on which the court certified the settlement agreement. The agreement also stipulated that NIS 40,000 would be paid to the class representative as special compensation, and NIS 324,800 (including VAT as required by law) to its lawyer as its fee. A hearing of the motion for certification of the settlement agreement was set for January 22, 2012.

C. Supplier and communication provider claims

During the normal course of business, suppliers of goods and/or services to the Company filed various claims against the Company. The main claim was filed for alleged damage to a supplier as a result of the Company's negligence. At September 30, 2011, these claims amounted to NIS 63,064,000. In the opinion of the management of the Company, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 75,000, where provisions are required to cover the exposure resulting from such claims. See note 7 for details of events which occurred after the balance sheet date.

NOTE 5 – CONTINGENT LIABILITIES (Contd.)

D. **Investigation by the Authority**

In March 2011, the Consumer Protection Authority conducted an investigation of the CEO of DBS. To the best of DBS's knowledge, the investigation concerns suspicions of alleged violations of the Consumer Protection Law by DBS, regarding contentions of deception and lack of disclosure when contracting with customers. At the reporting date, DBS has not yet received an update regarding the investigation results.

NOTE 6 –EVENTS IN THE BALANCE SHEET PERIOD

A. An amendment to the law restricting the exit fees a licensee may charge its subscribers took effect on August 8, 2011 and its main changes are that its provisions will apply to subscribers whose average monthly bills are less than NIS 5,000 and it will be impossible to charge exit fees to a subscriber entering into an agreement after the commencement of the amendment who then cancels it. Three months later the amendment will also apply to a subscriber entering into an agreement before the amendment to the law takes effect who then cancels it. However it will be possible to charge such subscribers a fee for cancelling the agreement which is limited to 8% of the subscriber's average monthly bill prior to the cancellation date, multiplied by the number of months remaining until expiration of the contract period.

B. In July 2011 the chairman of the Council notified the Company of his intention to recommend to the Council that it amend the Company's broadcasting license so that the sum of the deposit paid by a subscriber borrowing an HD or PVR decoder will be limited to its purchase cost (with cancellation of the relief which used to be granted to the Company for these advanced decoders). In August 2011 the chairman of the Council notified the Company, inter alia, of his intention to recommend to the Council that it amend the subscriber agreement so that the sum of the deposit paid for borrowing used terminal equipment would not exceed its amortized cost. The Company was invited to comment on these recommendations and is planning to submit them to the Council.

C. In respect of note 6 to the financial statements, in the corresponding period of last year, regarding the VAT audit which took place in the Company, on September 8, 2011 the Company signed an agreement with the tax authority regarding the VAT audit assessment for the period from January 2006 until July 2010.

D. In September 2011 Bezeq's board of directors concluded that the changes which took place in its holdings structure have no consequences for the third tranche of the options allotted to its CEO and that they are valid and exercisable.

E. In respect of note 32C to the annual report regarding an amendment to the Royalties (Satellite Broadcasting) Regulations, further to appeals filed by Bezeq and other communications companies in the High Court of Justice (HCJ), and to a proposal from the HCJ for a resolution to the dispute, on September 20, 2011, the State announced that the texts of the amendment to the Satellite Regulations stipulated that the rate of royalties in 2012 would be 1.75%, and that it intended to submit an amendment to the remaining regulations for approval by the Knesset to the effect that the rate of royalties for 2012 would be reduced to 1.75%, and as of 2013 it would be 0%. The HCJ ruled that the State should submit another update notice by November 30, 2011.

NOTE 7 – MATERIAL EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. In February 2011 the Council notified the Company that it was not in compliance with its duty to invest in local productions for the channels owned by external producers and its duty to invest in local productions for infants, children and youth in 2009. The Council announced that the Company should remedy these deficiencies in 2011 and 2012, and in some of the categories, also in 2013. Since the Company disputes some of the Council’s findings, it has requested that the Council modify its position regarding the interpretation of section 17A(B) of the Broadcasting Rules which stipulates that at least 50% of the Company's total investment in local productions should be invested in local productions broadcast on channels which it does not produce (“external channels”) since the Council believes that investments in productions which have been produced with the involvement of the Company and are broadcast on external channels should not be recognized.

On October 30, 2011, the Company received a letter from the chairman of the Council stating that in order to comply with the section’s provisions, the Company had to cut itself off from the productions broadcast on the external channels; that the Council intended to order the Company to invest sums in external channels equal to double the sums of the breach recorded for the Company from 2007 to 2009 and to recommend to the Minister of Communications that he forfeit the guarantee deposited by the Company under its license (the Company does not know whether a full or partial forfeit is under consideration). It is noted that these recommendations have not yet been accepted. If the Council does not change its decision, deficiencies in this category are likely in 2010 and 2011, and the Company will have to make changes to its mix of local productions and the way in which they are commissioned.

This notice from the Council’s chairman is subject to a decision from the Council, and regarding the guarantee, to a decision from the Minister of Communications.

The Company's legal counsel believes that at this preliminary stage it is impossible to assess the consequences for the Company if the notice is implemented.

B. In October 2011 the Council notified the Company that as from 2012 it would regard its revenues from subscriber fees which constitute a basis for the calculation of its original production obligation, as including all the payments made by its subscribers to receive its broadcasts and services, including revenues from terminal equipment and its installation, whereas previously the policy adopted by the Council with regard to the inclusion of revenues from terminal equipment in the calculation of the original production obligation was conditional upon a mechanism based on the profitability of this revenue component, and in most of the previous years the component was not included as a basis for this calculation. The Company disputes this finding and intends to request that the Council change its decision in this matter.

C. On October 6, 2011, a settlement agreement was signed by the Company, Pace and Eurocom Digital Communications Ltd., in resolution and settlement of their disputes, whereby a new supply agreement between the Company and Pace takes effect under which Pace will supply the Company, at no charge, with a certain number of decoders. Following an application filed by the parties in the District Court for approval of the settlement agreement, on October 9, 2011 the District Court ordered the dismissal of the claim and counterclaim in accordance with the consent of the parties.

NOTE 8 – APPOINTMENT OF THE CHAIRMAN OF THE BOARD OF DIRECTORS FOR THE APPROVAL MEETING

At the date of approval of the financial statements, the Company’s Board of Directors does not have an incumbent chairman. Consequently, the Company’s Board of Directors authorized David Efrati, a director in the Company, to serve as chairman of the Board of Directors’ meeting convened to approve the financial statements and to sign the Company’s financial statements as of September 30, 2011.

Condensed Separate Interim Financial Information At September 30, 2011 (Unaudited)

The information contained in these financial statements constitutes a translation of the financial statements published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

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Somekh Chaikin
8 Hartom Street, P.O. Box 212
Jerusalem, 91001

Tel: 02 531 2000
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website: www.kpmg.co.il

To:
The shareholders of “Bezeq” The Israel Telecommunication Corp. Limited

Special review report on separate interim financial information according to Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970

Introduction

We have reviewed the separate interim financial information presented in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970 of “Bezeq” The Israel Telecommunication Corp. Limited (hereinafter – “the Company”), as of September 30, 2011 and for the nine and three month periods then ended. The separate interim financial information is the responsibility of the Company’s Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the separate interim financial information of investee companies the investment in which amounted to NIS 218 million as of September 30, 2011, and the Group’s share in their losses amounted to NIS 1.8 and NIS 2.2 million for the nine and three month periods then ended, respectively. The financial statements of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of such companies, is based solely on the said review reports of the other auditors.

Scope of Review

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

Conclusion

Based on our review and review report of other auditors, nothing has come to our attention that causes us to believe that the accompanying separate interim financial information was not prepared, in all material respects, in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970.

Without qualifying our above conclusion, we draw attention to the claims made against the Company of which the exposure cannot yet be assessed or calculated, as described in Note 4.

Sincerely,

Somekh Chaikin
Certified Public Accountants (Isr.)

November 9, 2011

Condensed Interim Statements of Financial Position at

	September 30, 2011	September 30, 2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Assets			
Cash and cash equivalents	**1,320**	1,104	198
Investments, including derivatives	**2,229**	188	178
Trade receivables	**758**	825	771
Other receivables	**119**	93	329
Inventories	**14**	8	15
Loans to a subsidiary (Note 5)	**283**	-	-
Assets held for sale	**12**	30	29
Total current assets	**4,735**	2,248	1,520
Investments, including derivatives	**80**	99	96
Trade and other receivables	**215**	202	206
Property, plant and equipment	**4,285**	3,936	4,006
Intangible assets	**329**	242	276
Investment in investees	**7,443**	6,885	6,939
Deferred tax assets	**211**	326	248
Total non-current assets	**12,563**	11,690	11,771
Total assets	**17,298**	13,938	13,291

	September 30, 2011 (Unaudited) NIS millions	September 30, 2010 (Unaudited) NIS millions	December 31, 2010 (Audited) NIS millions
Liabilities			
Debentures, loans and credit	**770**	946	941
Trade payables	**154**	319	306
Other payables, including derivatives	**661**	512	569
Loans from subsidiaries	**-**	91	203
Current tax liabilities	**383**	257	229
Deferred income	**23**	17	17
Provisions (Note 4)	**200**	269	230
Employee benefits	**430**	316	233
Dividend payable	**1,974**	1,280	-
Total current liabilities	**4,595**	4,007	2,728
Debentures	**5,043**	2,363	2,373
Bank loans	**3,996**	2,600	2,600
Employee benefits	**224**	251	259
Deferred and other income	**6**	3	4
Dividend payable	**1,386**	-	-
Total non-current liabilities	**10,655**	5,217	5,236
Total liabilities	**15,250**	9,224	7,964
Equity			
Share capital	**3,821**	6,206	6,213
Share premium	**53**	356	378
Reserves	**577**	530	526
Deficit	**(2,403)**	(2,378)	(1,790)
Total equity	**2,048**	4,714	5,327
Total equity and liabilities	**17,298**	13,938	13,291

Shaul Elovitch
Chairman of the Board

Avraham Gabbay
CEO

Alan Gelman
CFO and Deputy CEO

Date of approval of the financial statements: November 9, 2011

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

Condensed Interim Statements of Income

	Nine months ended September 30		Three months ended September 30		For the year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues (Note 2)	**3,534**	3,934	**1,186**	1,323	5,263
Costs and expenses					
Depreciation and amortization	**513**	512	**180**	171	690
Salaries	**859**	783	**284**	256	1,079
Operating and general expenses (Note 3)	**806**	1,187	**282**	399	1,609
Other operating expenses (income), net	**82**	(97)	**(106)**	(59)	(158)
	2,260	2,385	**640**	767	3,220
Operating profit	**1,274**	1,549	**546**	556	2,043
Net financing expenses (income)					
Financing expenses	**381**	190	**166**	84	282
Finance revenues	**(194)**	(132)	**(78)**	(54)	(192)
Finance expenses, net	**187**	58	**88**	30	90
Profit after financing expenses, net	**1,087**	1,491	**458**	526	1,953
Share in earnings of investees, net	**778**	782	**239**	211	1,017
Profit before income tax	**1,865**	2,273	**697**	737	2,970
Income tax	**323**	405	**147**	149	527
Profit for the period	**1,542**	1,868	**550**	588	2,443

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

Condensed Interim Statement of Comprehensive Income

	Nine months ended September 30		Three months ended September 30		For the year ended
	2011	2010	2011	2010	December 31, 2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit for the period	**1,542**	1,868	**550**	588	2,443
Other comprehensive income (loss) for the period, net of tax	**2**	3	**3**	3	8
Other comprehensive income (loss) for the period, net of tax, due to investees	**-**	-	**-**	-	5
Other comprehensive income for the period, net of tax	**2**	3	**3**	3	13
Total comprehensive income for the period	**1,544**	1,871	**553**	591	2,456

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

Condensed Interim Statement of Cash Flows

	Nine months ended September 30		Three months ended September 30		For the year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from operating activities					
Profit for the period	**1,542**	1,868	**550**	588	2,443
Adjustments:					
Depreciation	**456**	457	**160**	153	618
Amortization of intangible assets	**57**	55	**20**	18	72
Share in income of investees accounted by the equity value method	**(778)**	(782)	**(239)**	(211)	(1,017)
Finance expenses, net	**189**	40	**95**	28	69
Net capital gain	**(167)**	(115)	**(80)**	(86)	(171)
Share-based payment transactions	**125**	8	**42**	2	26
Income tax benefit expenses	**323**	405	**147**	149	527
Change in inventory	**-**	1	**(7)**	1	(6)
Change in trade and other receivables	**22**	(52)	**7**	(17)	29
Change in trade and other payables	**(168)**	44	**6**	119	55
Change in provisions	**(30)**	(10)	**(33)**	(1)	(45)
Change in employee benefits	**161**	(149)	**(15)**	(94)	(213)
Expenses and income for derivatives, net	**(20)**	-	**(20)**	-	11
Net cash flows from activities (used for operations) for transactions with investees		11		17	2
Income tax paid, net	**(156)**	(181)	**8**	18	(260)
Net cash flows from operating activities	**1,556**	1,600	**641**	684	2,140
Cash flows from investing activities					
Investment in intangible assets	**(110)**	(105)	**(41)**	(40)	(156)
Proceeds from sale of property, plant and equipment	**303**	89	**68**	48	132
Change in current investments, net	**(1,998)**	-	**(1,998)**	-	-
Purchase of property, plant and equipment	**(796)**	(625)	**(227)**	(205)	(876)
Proceeds from sale of investments and non-current loans	**4**	2	**1**	(2)	2
Payment for derivatives	**(8)**	-	**3**	-	(2)
Acquisition of a subsidiary from an investee	**-**	(196)	**-**	(196)	(196)
Interest and dividend received	**18**	7	**8**	1	8
Net cash generated from investment activities for transactions with investees	**435**	1,076	**(15)**	442	1,097
Net cash used for investing activities	**(2,152)**	248	**(2,201)**	48	9

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

Condensed Interim Statements of Cash Flows (cont.)

	Nine months ended September 30		Three months ended September 30		For the year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flow for financing activities					
Bank loans received	**2,200**	2,600	**600**	700	2,600
Issuance of debentures	**3,092**	-	**2,692**	-	-
Repayment of bank loans	**(600)**	(400)	**(600)**	-	(400)
Short-term borrowing, net	**-**	-	**-**	(226)	-
Repayment of debentures	**(691)**	(558)	**-**	-	(567)
Dividend paid	**(1,663)**	(2,453)	**-**	-	(3,733)
Interest paid	**(203)**	(153)	**(26)**	-	(196)
Proceeds from disposal of warrants and others	**16**	21	**6**	3	36
Net cash flows from Activities (used for operations) for transactions with investees	**(433)**	(161)	**-**	(111)	(51)
Net cash from (used for) financing activities	**1,718**	-1,104	**2,672**	366	(2,311)
Net increase (decrease) in cash and cash equivalents	**1,122**	744	**1,112**	1,098	(162)
Cash and cash equivalents at the beginning of the period	**198**	360	**208**	6	360
Cash and cash equivalents at the end of the period	**1,320**	1,104	**1,320**	1,104	198

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

Notes to Condensed Separate Interim Financial Information

1. Manner of preparing financial information

1.1. Definitions

The Company - Bezeq The Israel Telecommunication Corporation Ltd.

Subsidiary, the Group, investee, interested party - as these terms are defined in the Company's consolidated financial statements for 2010

1.2. Manner of preparing financial information

The separate interim financial statements are presented in accordance with Article 38(D) of the Securities Regulations (Periodic and Immediate Reports),1970 and do not include all the information required under Regulation 9(C) and the Tenth Addendum of the Securities Regulations (Periodic and Immediate Reports),1970 with respect to the separate financial information of the corporation. They should be read in conjunction with the separate financial statements for the year ended December 31, 2010 and in conjunction with the condensed interim consolidated financial statements as of September 30, 2011 ("the Consolidated Financial Statements").

The accounting policy for this separate condensed interim financial information is based on the accounting policy specified in the separate financial information as of December 31, 2010 and for the year then ended.

2. Revenue

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Land-line telephony	**1,836**	2,368	**612**	788	3,160
Internet - infrastructure	**810**	720	**276**	249	977
Transmission and data communication	**700**	663	**239**	219	882
Other services	**188**	183	**59**	67	244
	3,534	3,934	**1,186**	1,323	5,263

3. General and operating expenses

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2011	2010	2011	2010	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**193**	599	**65**	198	801
General expenses	**190**	181	**72**	65	250
Materials and spare parts	**62**	55	**23**	16	88
Building maintenance	**185**	183	**63**	64	240
Services and maintenance by sub-contractors	**55**	57	**17**	18	76
Motor vehicle maintenance expenses	**63**	72	**22**	24	101
Royalties to the Government of Israel	**42**	24	**14**	8	31
Collection commissions and sundries	**16**	16	**6**	6	22
	806	1,187	**282**	399	1,609

4. Contingent liabilities

During the normal course of business, various lawsuits were filed against the Company and it faces various pending proceedings (in this section: "Litigations").

The Company's financial statements include provisions for litigations in the amount of NIS 200 million. The amounts of additional exposure beyond these provisions for litigations amount to NIS 2.5 billion (of which NIS 877 million relate to proceedings which at this stage cannot be estimated). In addition, there are other proceedings for which the Company is exposed beyond the foregoing amounts due to the fact that no exact amount has been claimed.

It is noted that subsequent to the reporting date, a former employee of the Company filed a class action against the Company amounting to NIS 150 million. There are a number of legal proceedings against the Company for similar matters and the exposure for this claim is included in the exposure for legal claims as at September 30, 2011 as set out above. In addition, subsequent to the reporting date, a class action amounting to NIS 200 million was filed against the Company.

For further information concerning contingent liabilities see Note 5 to the consolidated financial statements.

5. Material agreements and transactions with investees during the reporting period and thereafter

5.1 With respect to a loan granted by the Company to Bezeq On-line Ltd. (as described in the separate financial information as of December 31, 2010 and for the year then ended), after repayment of NIS 5 million during the period, the balance of the loan principle has been paid up.

5.2 On September 1, 2011, the Company provided a loan of NIS 17 million to Bezeq Online. The loan is linked to the CPI, bears annual interest at a rate of 4% and is repayable in three equal annual payments as from September 1, 2012.

5.3 During May 2011, Pelephone Communications Ltd. ("Pelephone") paid the Company a dividend it announced in May 2011, in the amount of NIS 280 million. The entire foregoing amount was paid by offsetting a loan that the Company granted to Pelephone, so that no cash was transferred between the companies. The loan is linked to the CPI, bears interest of 4%, and is payable on May 17, 2012.